Agenda, Volume 2, Number 4, 1995

Contents

George Fane, 'APEC: Regionalism, Globalism, or Obfuscation?' 399

Alan E. Bollard and Michael Pickford, 'New Zealand's "Light-Handed" Approach to Utility Regulation' 411

Stephen P. King, 'Guaranteeing Access to Essential Infrastructure' 423

Keith Trace, '"You Couldn't Give It Away": Privatising the Australian National Line' 433

Wayne Mapp, 'New Zealand's System of Citizens Initiated Referenda' 445

Saul Fridman, 'Ontario's Equal Opportunity Legislation: An Act Not to Follow' 455

Franco Papandrea, 'Television Stations' Compliance with Australian Content Regulation' 467

REVIEW ARTICLE

Heather Smith, 'Beyond Picking Winners? Recent Writings on Australia's Industry Policy' 479

NOTES AND TOPICS

Robert Albon, 'William Baumol's Contributions to Public Utility Economics' 489

Tony Makin, 'The Wealth Cycle and Macroeconomic Policy' 494

REVIEWS

Charles Crouch reviews *Regulating Our Utilities* by Dan Corry, David Souter and Michael Waterson, and *Regulating Utilities: The Way Forward* edited by Michael Beesley 499

Michael James reviews *Labyrinths of Prosperity: Economic Follies, Democratic Remedies* by Reuven Brenner 502

Grant M. Scobie reviews *Feeding and Greening the World: The Role of International Agricultural Research* by Derek Tribe 505

Brian Crittenden reviews *Sociological Theory and Educational Reality* by Alan Barcan 508

Brian T. Trainor reviews *Fatherless America: Confronting our most urgent social problem* by David Blankenhorn 511

Mark Schubert reviews *Australia Betrayed: How Australian democracy has been undermined and our naive trust betrayed* by Graeme Campbell and Mark Uhlmann 513

CORRESPONDENCE

From John Langmore, John Quiggin and Tom Valentine 515

NON-AGENDA

Ross H. McLeod, 'Getting Value for Money from the Overseas Aid Community' 521

John Logan, 'Unpaid Work and Equal Opportunists' 525

Agenda, Volume 2, Number 4, 1995, pages 399-409

APEC: Regionalism, Globalism, or Obfuscation?

George Fane

ASIA-PACIFIC ECONOMIC COOPERATION (APEC), which now has 18 members, was set up in 1989 to promote economic cooperation and trade liberalisation. The 1994 Leaders' Meeting resulted in the Bogor Declaration, which announced a commitment to achieving free and open trade in the Asia-Pacific no later than 2020, and by 2010 for the industrialised members of APEC. However, it is argued here that the reluctance of members to make binding commitments, and APEC's consequent lack of adequate powers of enforcement, will largely nullify these attempts to liberalise trade. APEC will therefore probably end up merely as a regional version of the Organisation for Economic Cooperation and Development (OECD). Indeed, the creation of an APEC bureaucracy is well under way: a permanent secretariat and ten working groups have already been established.

It is somewhat surprising that APEC has gained widespread support from national governments, given that its promises of trade liberalisation lack credibility, that the case for an OECD for the Asia-Pacific was rejected in the 1970s, and that even the case for the OECD itself is now being questioned. The explanation suggested here is that APEC's lofty goals and high profile have allowed it to fill the vacuum created by the obsolescence of older summit gatherings, such as the Non-Aligned Movement and the Commonwealth, which likewise provided national leaders with international stages on which to be seen performing statesmanlike actions.

Regionalism vs Globalism

Despite its bureaucracy and its six years of reports, meetings and declarations, APEC has still not resolved the most basic issue facing it: whether to adopt regionalism, with members offering one another trade preferences, or globalism, with members extending the benefits of trade liberalisations to all countries equally. The Bogor Declaration left this choice open by qualifying 'the goal of free and open trade' by the clause 'in the Asia-Pacific'. The Australian Minister for Trade, Senator R. McMullan, was recently reported as saying that APEC might 'never' need to confront the potentially divisive issue of non-discrimination as it moved towards its goal of free trade by 2020 (*The Australian*, 28 June 1995).

George Fane is Senior Fellow in the Research School of Pacific and Asian Studies at The Australian National University.

The argument between globalism and regionalism was fought out, but not finally resolved, within the APEC Eminent Persons Group (EPG) during the writing of the EPG's 1994 Report. The case for regionalism, which is supported by the US and Canadian governments, was made by the US Chairman of the EPG, Professor C. Fred Bergsten; globalism, which is supported by the Japanese and Australian governments, was advocated by Australia's EPG representative, Neville Wran. In my view, both options face difficulties that may well be insurmountable; but, since globalism is unenforceable, it will achieve almost nothing, and Australia would therefore have done better to explore the feasibility of regional agreements.

The choice between regionalism and globalism now facing APEC countries can be clarified by an analogy with the trade-policy choices faced a century ago by the six future Australian States.[1] The drafters of the Australian Constitution were right to guarantee the freedom of interstate trade; and, analogously, I believe that APEC countries would gain by removing existing barriers to intra-regional trade. However, whereas I favour free trade between Australia and the rest of the world, I am opposed to the pursuit of globalism by APEC.

There are two main differences between the two cases. First, APEC is large enough to have substantial bargaining power, whereas Australia has always been a very small part of the world economy. It is therefore in APEC's interest to demand reciprocal concessions from the rest of the world rather than to liberalise unilaterally. This argument applies more strongly to the larger countries in APEC than to the smaller ones; but Australia should nevertheless use whatever influence it has to encourage the US and Japan to demand reciprocal trade liberalisations from the rest of the world.

The second difference is far more important. The central purpose of this article is to argue that the supporters of APEC globalism have grossly underestimated the problem of enforcement, and that if APEC tries to adopt globalism enforced by moral suasion it will fail to achieve any significant trade liberalisation. The Australian States achieved freedom of interstate trade by means of the High Court and a guarantee in Section 92 of the Australian Constitution; the APEC analogue would be a detailed, enforceable, regional free-trade agreement. Extending freedom of interstate trade to free trade between Australia and the rest of the world would have required an *additional* constitutional guarantee. In contrast, if the drafters of Australia's Constitution had implemented the analogue of APEC globalism, they would have inserted the following two provisions in place of the present s.92: a non-binding declaration that all States set a goal of complete free trade in the distant future; and a binding requirement that, in the meantime, each State impose the same tariffs on trade with each other State that it imposes on trade with foreign countries. In terms of the APEC analogy, dispensing with s.92 corresponds to the decision not to have an enforceable regional agreement; the non-binding declaration is the Bogor Declaration; and the binding re-

[1] I am grateful to Ted Sieper for pointing out this similarity.

quirements are obligations of APEC countries to grant most favoured nation (MFN) treatment to all members of the World Trade Organisation (WTO).[2]

The substitution of these two provisions for Australia's constitutional guarantee of freedom of interstate trade would have meant imposing on international trade any tariffs on external trade. Relative to *enforceable* regionalism, the case against *non-binding* globalism is that it would sacrifice limited regional trade liberalisation for an unachievable utopia. If, as now seems likely, it is impossible for Australia to achieve a regional free-trade treaty with even a subset of APEC countries, broader than its existing agreement with New Zealand, then it should stop pretending that APEC is more than a regional version of the OECD.

The Role of Obfuscation

The drafters of the 1994 EPG Report attempted to paper over the conflict between the regionalist and globalist options proposed by Bergsten and Wran by adopting two obfuscations. The first was to deny making any recommendation that APEC become a free-trade area (FTA) but nevertheless to recommend that it become an organisation meeting the conventional definition of an FTA, as given in Article XXIV.8(b) of the General Agreement on Tariffs and Trade (GATT).[3] Admittedly, the form of the FTA recommended by the Report is more open than that of existing FTAs. The second obfuscation was that, while unambiguously rejecting globalism, the EPG Report nevertheless accepted the label 'open regionalism', which had previously been adopted by the supporters of globalism to describe their own preferred option for APEC.

The label 'open regionalism' is itself a contradiction in terms: if a program of trade liberalisation is 'open', in the sense of not seeking to discriminate against the rest of the world, then it cannot involve 'regionalism' in the established sense of a prefer-

---

[2] The general MFN provision of Article I of GATT may be roughly paraphrased as follows: with respect to customs duties and other similar taxes and regulations applied to the imports or exports of any product, each member must treat trade with each other member in a way which is at least as favourable as that applied to trade in the same product with any other country, 'the most favoured nation'. GATT provides for various exemptions from the general MFN provision of Article I. The two most important exemptions are, first, that preferences may be granted to imports from developing countries; and second, that countries have the right under Article XXIV to set up FTAs or customs unions, in which the members remove barriers on substantially all trade between each other, provided that the formation of the bloc does not raise the average level of trade barriers between members of the bloc and non-members.

[3] The EPG Report makes a persuasive case for rejecting globalism (p.21). Proposals which would constitute an FTA are set out in the EPG's 'four-part formula' (pp.19-20). There is even a discussion (pp.30-31) of the rules of origin that APEC would need under these regionalist proposals. The Report's extraordinary assertion that it does not recommend the creation of an FTA occurs on page 35, where an attempt is made to justify this assertion by pointing out that, under its proposals, APEC would be more open than an FTA needs to be in order to conform with WTO/GATT requirements. With equal validity: 'an open box is not a box, because a box can be closed.'

ential trade agreement among a subset of nations.[4] The advantage of seeming to offer openness and regionalism simultaneously explains why the term has been used by the advocates of both globalism and regionalism to describe their conflicting recommendations. For APEC globalists, it has the major advantage of obscuring the fact that the trade policy component of their proposals does not involve any regional element at all, while the truly regionalist components of these proposals involve some discrimination against outsiders. For example, it is misleading to suggest that policies such as intergovernment cooperation in the provision of infrastructure can involve regionalism without discriminating against outsiders. If APEC governments make reciprocal agreements resulting in less strict appraisal criteria being applied to projects which primarily facilitate Asia-Pacific trade than to projects which facilitate trade with all countries, the policy clearly discriminates against outsiders. If the magnitude of this discrimination is negligible, the policy should be called 'negligible regionalism'.

Free-riding and the Need to Enforce Trade Agreements

The advocates of APEC globalism have paid little attention to the problems of enforcing trade agreements. For example, the Bureau of Industry Economics (BIE, 1995:ix-x) asserts that concern about non-APEC economies free-riding on APEC's plans to liberalise trade

> has no merit from an economic viewpoint. Import barriers typically impose a greater cost on the country using them than they do to other countries. Hence, a nation is doing itself an even greater economic favour than it is doing for its trading partners by removing its trade barriers.

Similarly, Elek (1995:6) claims that APEC does not need 'legalistic texts' or enforcement mechanisms.

Such arguments for downplaying the free-rider problem ignore two distinctions that are crucial to the positive theory of international trade policy. The first is the distinction between the weights implicitly assigned by the political process to the gains and losses of the groups affected by protection, and the weights assigned to these gains and losses in the standard economists' argument for free trade, which assumes that a dollar of gain or loss to any one citizen has the same social value as a dollar of gain or loss to any other citizen. In contrast, a government wanting to retain office will put more weight on a dollar of gain or loss to a group concentrated in marginal electorates than on a dollar of gain or loss to a widely dispersed group, or to one concentrated in safe electorates. Only by neglecting this distinction can one reach the naive conclusion that governments will not try to free-ride on trade liberalisation agreements, merely because they would not do so if they always followed the advice of economists.

The second crucial distinction is that between outcomes under cooperative arrangements and those under non-cooperative ones. To justify spending any resources

[4] This definition of regionalism is taken from Bhagwati (1993); the definition of openness is from Elek (1995).

on setting up a multilateral-trade policy institution, such as APEC, it is necessary to assume that these outcomes would *not* be the same, since otherwise there would be nothing useful for the institution to do. But if the non-cooperative and cooperative outcomes differ, mechanisms must be designed for stopping attempts by governments to adopt non-cooperative strategies, despite having promised to adopt cooperative ones. Since free-riding means following a non-cooperative strategy when others are following cooperative strategies, and since the basic purpose of a multilateral agreement is to ensure that governments adopt cooperative rather than non-cooperative strategies, it clearly makes little sense to propose a multilateral institution while ignoring or dismissing the importance of free-riding.[5]

One source of the belief that enforcement of globalism by APEC will not face serious difficulties is a series of articles by Drysdale and Garnaut (1993, 1994a, 1994b) and Garnaut (1994). These authors set out an optimistic view of trade negotiations, which they call the 'prisoners' delight'.[6] Free-riding does not occur in this model because the pay-offs that determine tariff policy are consistent with those which would be obtained if governments always acted on the advice of free-trade economists. The differences between this model and the traditional (and, I believe, more relevant 'prisoners' dilemma' model) can be illustrated by Table 1, which shows the pay-offs to two governments which result from the tariff settings of each. Although the table is only illustrative, it is argued here that it captures the stylised features of actual trade negotiations.

The prisoners' dilemma can be illustrated by deleting the row and column corresponding to high tariffs, so that the table collapses to the four cells in the top left corner. In the absence of some way of enforcing a cooperative agreement, the home government's best strategy, for either tariff setting by the foreign government, is to set a moderate tariff rather than a low one. Similarly, for either tariff setting by the home government, the best strategy for the foreign government is to set a moderate tariff rather than a low one. In the absence of an enforceable cooperative agreement, both governments would therefore set moderate tariffs, and end up worse off than if they had both set low tariffs. It would therefore be in the interest of both to establish an institution, such as the WTO, through which they could commit themselves to adopt low tariffs, in exchange for an agreement that the other government would also set low tariffs.

---

[5] If there were several possible non-cooperative equilibria, and if one of them coincided with the cooperative equilibrium, even a purely indicative trade agreement might play a useful coordinating role, since governments would have no incentive to free-ride in this situation. If this theoretical possibility were of practical relevance in setting tariff and non-tariff barriers, the experience of negotiating and enforcing multilateral trade agreements would have involved much less disagreement than it actually has. Coordination problems are relevant in the administration of safety standards and customs procedures. These issues are discussed in the section on administrative harmonisation.

[6] The models of trade negotiations set out in this section were originally illustrated by a story about two hypothetical prisoners, each faced with a choice between (a) denying a crime and (b) confessing it and implicating the other in return for a reduced sentence.

Table 1

Pay-offs to the home and foreign governments under different trade policies

		Foreign government's tariffs		
		Low	*Moderate*	*High*
Home government's tariffs	*Low*	16, 16	6, 20	4, 16
	Moderate	20, 6	10, 10	5, 5
	High	16, 4	5, 5	0, 0

Note: the first number in each cell is the pay-off to the 'home' government, while the second is the pay-off to the 'representative foreign' government.

The prisoners' delight model can also be illustrated as a special case of Table 1 by deleting the row and column corresponding to low tariffs, leaving the four cells in the bottom right corner. In these four cells, it is assumed that each government gains by setting a moderate tariff rather than a high one, whatever the tariff set by the other. This is consistent with the view that almost everyone loses from the setting of high tariffs. In choosing between moderate and high tariffs, the dominant strategy for each government is therefore to set a moderate tariff, and the result is that both achieve the best of the four available outcomes in the truncated table. The happy result that neither government has an incentive to free-ride on the other arises only because the cooperative and non-cooperative outcomes are identical. This in turn implies that a cooperative agreement between the two governments would serve no useful purpose.

Table 1 illustrates a general proposition: the prisoners' delight case is irrelevant both in non-cooperative situations and in the design of institutions for achieving international cooperation. Even if there are some tariff ranges over which the prisoners' delight case holds, these ranges are irrelevant. This can be seen as follows. If the whole range of tariffs in Table 1 is available, low tariffs are chosen if countries can enforce cooperation, whereas moderate tariffs are chosen in the absence of enforceable cooperation; but these are exactly the same outcomes as those which result when the prisoners' delight part of the table is deleted. The reason for the irrelevance of the prisoners' delight case in trade negotiations is simple: cooperative agreements can never be needed to ensure trade liberalisations across tariff ranges over which it is in a government's self-interest to liberalise, regardless of what other governments may do.

Experience under GATT: Free-riding and Unilateral Trade Liberalisations

GATT's history was largely one of difficult negotiations, involving concessions, followed by attempts by many countries to find loopholes by which to avoid making these concessions, leading eventually to further negotiations to try to close the loopholes which had been created.[7] Examples of such loopholes include: the use of waiv-

[7] See Snape (1985), particularly pages 4-8.

ers to avoid the application of GATT rules to agricultural protection; the use of quotas under the multi-fibre agreement; the negotiation of 'voluntary' export restrictions; the use of quarantine restrictions for protective purposes; and the sometimes illegitimate use of anti-dumping measures. These creative, but non-cooperative, attempts at avoiding commitments to liberalise trade necessitated a cooperative attempt, during the Uruguay Round, to strengthen the mechanisms for detecting, deterring, and otherwise limiting attempts to renege on cooperative agreements. The kinds of mechanisms needed to enforce even partial compliance with commitments to liberalise trade are indicated by the hundreds of pages, megabytes of schedules, and seven years of negotiations involved in finalising the Uruguay Round.

The GATT experience, summarised above, is entirely consistent with the prediction of the prisoners' dilemma model that countries have incentives to look for ways of reneging even on nominally binding agreements. However, to account for the unilateral trade liberalisations in excess of GATT requirements which have also occurred, particularly in the last ten to 15 years, it is necessary to assume that the countries involved have increased their estimates of the benefits obtainable from trade liberalisation. Such an assumption is very plausible, since it is merely one example of a worldwide growth in scepticism about the desirability of government attempts to regulate markets. The economic successes of the outward-oriented East Asian economies have been both cause and consequence of the worldwide changes in attitudes towards restrictions on international trade.

The prisoners' dilemma model predicts that if there is an increase in the perceived benefits from trade liberalisation, and if cooperative trade negotiations, like the Uruguay Round, involve delays and take place only infrequently, then the countries that liberalise unilaterally will be the small ones. This is because, the smaller the country, the smaller the gap between the tariffs which its government would set under cooperative and non-cooperative arrangements;[8] and, therefore, the smaller the change in the perceived benefits from trade liberalisation needed to make the tariff which would be optimal under non-cooperative arrangements smaller than the tariff which was formerly optimal under cooperative arrangements. In conformity with this prediction, most unilateral liberalisations in the last ten to 15 years have indeed been undertaken by small countries.

Administrative Harmonisation

The use of country-specific procedures for administering trade and investment regulations can itself be a form of non-tariff barrier (NTB). For example, the US has complained that Japan's use of Japanese rather than international administrative procedures of Japanese quality and safety standards is a barrier against US exports. The harmonisation of administrative procedures within a region is therefore a way of reducing NTBs on intra-regional trade without reducing NTBs on inter-regional trade.

[8] If all tariffs are set on MFN principles, and if one country is too small to affect other countries, its tariffs will be ignored by them. The outcomes for the small country and for all others will then be the same, whether or not it takes part in cooperative arrangements with them.

Just as reducing tariffs only on intra-regional trade would have trade-diverting effects as well as trade-creating effects, so too regional harmonisation would divert trade as well as create it. However, the fact that the trade-diverting effects of harmonisation are less obvious than those of regional tariff preferences has helped to generate many proposals for APEC-wide harmonisation of administrative regulations on trade and investment.[9] The possible areas for harmonisation that have been suggested include: the treatment of foreign investment, including taxation and dispute-resolution procedures; environmental regulations; customs procedures and documents; product safety and quality standards; labelling laws; and competition policies.

However, even in these areas, the scope for coordination among APEC countries which is both mutually beneficial and genuinely rational is limited by two facts. First, since institutions for harmonising trade and investment procedures on a global basis already exist, it could well be counter-productive to set up competing regional harmonisation procedures. Second, the scope for mutually beneficial harmonisation is probably far smaller than it might appear at first glance: the costs to individual countries of harmonising particular policies may often be very large, since harmonisation involves changing and relearning complex administrative procedures. If these costs were not substantial, all coordination problems would have been solved long ago. The abundance of proposals for regional harmonisation is matched by a scarcity of detailed analysis of them. For example, all the works listed in footnote 9 recommend harmonisation of customs procedures, but none explains how APEC will improve on, or even how it will relate to, global attempts at harmonisation. If the example of customs procedures is typical, it appears that regional harmonisation will not involve the setting up of regional standards to compete with globally agreed standards: rather, APEC will try to influence the setting of new global conventions, and some members will increase their efforts to comply with global harmonisation plans.[10] This may well be useful, but is unlikely to be of great importance, and contains only minor elements of regionalism.

Since it would be prohibitively expensive to amend the vast array of existing statute and case law in member countries, it would be unrealistic to expect real harmonisation of competition policies on an APEC-wide basis. Similarly, the cost of amending existing investment laws and regulations is also one of the reasons why APEC's 1994 investment code is empty. Not only is this code non-binding, it also contains numerous escape clauses, of which the most transparent is the provision that foreign investors can be denied national treatment with exceptions as provided for in domestic laws, regulations and policies.

---

[9] See, for example, EPG Report (1994:10-17, 32-3); Elek (1992); BIE (1995:29-30); Yamazawa (1993).

[10] APEC and the World Customs Organisation have each set up working groups to review the out-of-date guidelines for global customs harmonisation under the 1973 Kyoto Convention, and to make recommendations for a revised convention. When the reviews have been completed, and when a new convention has been agreed to, the individual country administrations will begin the process of accession to, and implementation of, the revised procedures. This will be a very slow process: merely finalising the preamble of the new convention is expected to take about three years.

Agreements to ensure the national treatment of foreign investors clearly involves much more than mere harmonisation of administrative procedures. In my view, investment liberalisation can probably be done best on a plurilateral rather than a fully MFN basis, by drawing up an investment code whose main provision would be that countries which signed the code would guarantee to grant national treatment, including right of establishment, to investors from all other countries that had signed the code. This element of reciprocity would limit the scope for free-riding. The arrangement should be negotiated and administered through the WTO, since no useful purpose would be served by restricting it to APEC members.

Concerted Unilateral Liberalisation

It has been widely reported that at the APEC leaders' meeting in Osaka in November 1995, the Japanese government will propose that each APEC government should set the rate at which it plans to fulfil its commitments under the Bogor Declaration, and that a review mechanism should be used to monitor each country's progress (*The Australian*, 23 March 1995). Under this proposal, APEC liberalisations would be available to all members of the WTO on a fully MFN basis. An indication of the weakness of the proposal is that a new piece of APEC double-talk, 'concerted unilateral liberalisation', has been invented to describe it.

It is often argued that one of the useful purposes served by the WTO, and before it by GATT, is to allow a government which wishes to pursue trade liberalisation to deflect opposition from previously protected domestic interest groups by pointing to its external commitments. Since the force of this argument is proportional to the severity of the sanctions which a country would incur by breaking its commitments, it has little force as a defence of concerted unilateral liberalisation. This is because of two crucial differences between WTO agreements and APEC agreements under globalism. First, the former are binding commitments, whereas the latter are not. Second, a government cannot break its commitments to the WTO with complete impunity, because of the WTO's detailed rules and sanctions; in contrast, under globalism, even expulsion from APEC would have no adverse effects on the tariffs and NTBs faced by a country's exports. Under globalism, the only sanction available to APEC would be moral suasion. Since recent history abounds with examples of promises to domestic groups which governments have broken, there is little basis for confidence in non-binding commitments to foreigners. The Australian government endorsed the utopian goal of complete free trade by 2010 less than a month after it had reneged on an apparently binding commitment to open its aviation market to competition from New Zealand the following week.

Conclusion

APEC's membership is now so large and disparate that it would probably be impossible to transform it into an FTA. Yet Australia should not take the lead in closing off regionalist options, since it could well benefit from even a limited extension of regional free trade. APEC may pretend to adopt globalism, but, with moral suasion as its only

weapon, it will have negligible effects on trade liberalisation. Besides, any trade liberalisation that can be effected on a fully MFN basis by APEC can be done better through the WTO.[11] I do not believe that the Bogor Declaration will ever be unilaterally implemented on a fully MFN basis, because it would be like a GATT round in which Europe, and any APEC countries which chose to free-ride on the others, would receive all the benefits of whatever liberalisations were made without being required to make any politically painful concessions themselves; meanwhile, those APEC governments that kept to the Bogor Declaration would have to concede very much more than they conceded in the Uruguay Round.

Given the political capital that has been invested in APEC, attempts will be made to claim major achievements on its behalf, by attributing to it all instances of regional cooperation and unilateral trade liberalisation involving APEC countries. Defenders of APEC already point to its investment code as an example of cooperation in reducing barriers between APEC economies, and to Indonesia's May 1995 deregulation package as an example of a trade reform brought about by the Bogor Declaration. The weakness of these claims is obvious: the investment code is both non-binding and full of loopholes; and deregulation packages have been a roughly annual event in Indonesia since the mid-1980s. The imagination reels at the thought of what would have been claimed on APEC's behalf if it had been set up before the widespread process of unilateral liberalisation in the Asia-Pacific region got under way.

Since the governments which have invested political capital in it need something to point to when challenged by sceptics, APEC probably will have some small liberalising effects on trade policy in the short run, even though these efforts are likely to involve mainly the timing and packaging of reforms and to fall far short both of the goals of the Bogor Declaration and of what is claimed on APEC's behalf. In drawing up a balance sheet for APEC, three costs must be set against any minor short-term benefits. First, the making of unrealistic promises has its own costs, one of which is the risk that APEC may eventually discredit more serious attempts to liberalise trade by failing to fulfil its promises. Second, APEC has probably already delayed multilateral trade negotiations: the non-APEC members of the WTO have little incentive to begin negotiating reciprocal trade liberalisation as long as APEC countries continue to make promises among themselves to concede unilaterally all that the others might demand in a new WTO round. Third, there is the cost of administering APEC. If it does eventually subside into a regional version of the OECD, it would not be the first time that the main legacy of a political gimmick has been a new bureaucracy.

---

[11] An overview of the implications for tariff policy of possible retaliation by other countries is given by Corden (1974:172-6).

References

APEC Ministerial Meeting (1994), 'Economic Leaders' Declaration of Common Resolve', Bogor.

Bhagwati, J. (1993), 'Regionalism and Multilateralism: An Overview', in J. de Melo & A. Panagariya (eds), *New Dimensions in Regional Integration*, Cambridge University Press, Cambridge.

Bureau of Industry Economics (BIE) (1995), *Potential Gains to Australia from APEC Open Regionalism and the Bogor Declaration*, AGPS, Canberra (Occasional Paper 29).

Corden, W. (1974), *Trade Policy and Economic Welfare*, Clarendon Press, Oxford.

Drysdale, P. & R. Garnaut (1993a), 'The Pacific: an Application of a General Theory of Economic Integration', in C. Bergsten & M. Noland (eds), *Pacific Dynamism and the International Economic System*, Institute for International Economics, Washington DC.

—— (1993b), 'NAFTA and the Asia-Pacific Region: Strategic Responses', in R. Cushing et al. (eds), *The Challenge of NAFTA*, Lyndon B. Johnson School of Public Affairs, Austin.

—— (1994), 'Principles of Pacific Economic Integration', in R. Garnaut & P. Drysdale (eds), *Asia-Pacific Regionalism: Readings in International Economic Relations*, Harper Educational Publishers, Sydney.

Elek, A. (1992), 'Pacific Economic Cooperation: Policy Choices for the 1990s', *Asian-Pacific Economic Literature* 6(1): 1-15.

—— (1995), 'APEC Beyond Bogor: An Open Economic Association in the Asia-Pacific Region', *Asian-Pacific Economic Literature* 9(1): 1-16.

Eminent Persons Group (EPG) (1994), *Achieving the APEC Vision: Free and Open Trade in the Asia-Pacific*, Asia-Pacific Economic Cooperation, Singapore.

Garnaut, R. (1994), 'Open Regionalism: Its Analytic Basis and Relevance to the International System', *Journal of Asian Economics* 5(2): 273-90.

Snape, R. (1985), 'International Trade – What Rules?', Mimeo of Address to the Mont Pelerin Society, Sydney.

Yamazawa, I. (1993), 'East Asian Dynamism and Pacific Cooperation', *Policy* 9(2): 2-5.

I wish to thank Anne Daly, Ross McLeod, Ray Trewin, and the referees for their helpful comments.

CLARIFICATION

A Note by James Cox titled *How Much Spending? The EPAC Survey of Public Expenditure Preferences in Australia* was published in *Agenda*, volume 2, number 2, 1995. The authors of the EPAC report *Public Expenditure in Australia* wish to make it clear that the survey of public expenditure preferences was not commissioned or funded by EPAC but was an independent study conducted by David Throsby and Glenn Withers under Australian Research Council funding.

Agenda, Volume 2, Number 4, 1995, pages 411-422

New Zealand's 'Light-Handed' Approach to Utility Regulation

Alan E. Bollard and Michael Pickford

AFTER enjoying considerable prosperity in the early post-war decades, based on high commodity prices and favourable access to the British market, New Zealand suffered major economic reversals in the 1970s. Britain's entry into the European Community, and massive increases in oil prices, undermined the country's competitive advantage. Its traditional reliance on a narrow range of commodity exports and a single overseas market cost it dearly. Rather than adjusting to these international changes, successive governments opted to continue with policies, originally conceived in the Depression years of the 1930s, designed to insulate New Zealand industry from its competitors. These interventionist policies culminated in heavy government borrowing to finance the 'Think Big' energy projects of the 1980s. During this period New Zealand's relative standard of living dropped markedly. In 1950, its GDP per capita was 26 per cent above the OECD average; 40 years later it had dropped to 27 per cent below the average.

Economic Liberalisation in the 1980s

Although hesitant and piecemeal reforms were initiated in the late 1970s, New Zealand was ripe for a more radical approach. This came with the new Labour government in July 1984 which, in the short space of three years, introduced a series of far-reaching reforms affecting commerce, government, and the relationship between the two. These reforms continued at a slower rate under subsequent governments.

Several factors influenced the economic liberalisation policies adopted and the way they were implemented. First, it was widely agreed that a change in the business environment was essential to improve economic performance, even though it was recognised that this could be costly in terms of business failures and lost jobs. Second, government economic advisers, particularly those in the Treasury, had formulated a coherent view about the way to carry out reform. This view incorporated theories relating to contestable markets, principal-agent relationships, the economic role of government, and the regulation of industry (The Treasury, 1984). Third, the cohesive political structure in New Zealand, and in particular a very strong ex-

---

Alan Bollard is Chairman of the Commerce Commission. Michael Pickford is Senior Lecturer in the School of Applied and International Economics at Massey University, and currently on secondment with the Commerce Commission.

ecutive government, allowed a relatively small number of political leaders to carry through the reform process relatively unimpeded.

As a result, the economic reforms were consistent, wide-ranging, and introduced very quickly. The majority of those reforms which impinged on the business sector were implemented in the period 1984-89 — a very short period by international standards, although some reforms, such as import liberalisation, were phased in gradually. Apart from this, little attention was paid to minimising transition costs; to sorting out sequencing issues (though reforms within some sectors reveal a sequenced series of decisions, as for example in the corporatisation and privatisation of government trading departments); or to compensating the losers from the reforms. This 'big bang' approach was seen as the only way to carry through the reforms within an acceptable time: it avoided possible constraints imposed by the three-year electoral cycle, and undercut opposition from special interest groups by introducing changes that affected all areas.

The basic thrust of the reform program was to free the market mechanism so that resource allocation would be guided by price and profit signals which were not distorted by controls and subsidies. The emphasis was on allowing the forces of enterprise and self-interest to generate efficiency and economic growth; concern about distributional equity was correspondingly reduced. Government intervention in the economy was rolled back by putting its trading activities (including utilities) on a commercial footing, exposing them to competition, and in some cases privatising them.

The pace of reform was constrained only by the rate at which officials could formulate the necessary policies. Few sectors were left untouched. An early focus was the financial sector. Interest-rate controls and nearly all regulations on banks and other financial institutions were removed, as were foreign-exchange controls. Monetary policy was to have the single aim of lowering inflation (a goal later enshrined in the Reserve Bank Act 1989), and the fiscal deficit was to be reduced, implying a redirection of stabilisation policy away from the immediate goal of full employment. The floating of the dollar in March 1985 led it to appreciate under the influence of high interest rates (caused by the budget deficit and a tight monetary policy), which initially hurt the profitability of exporting industries. The pace of import liberalisation was accelerated: licences were phased out in favour of tariffs, which were reduced according to a timetable. The faster implementation of Closer Economic Relations with Australia added to import competition. The extensive system of subsidies to the agricultural sector was abolished almost overnight in 1984, and price controls were eliminated (except for three items) by 1987. Plans were established for the deregulation of many industries, ranging from eggs to cement and real-estate services, and the lifting of controls on road and rail freight was completed.

To underpin the newly deregulated economy, a heavily amended and more strongly competition-focused Commerce Act was enacted in 1986. But significant labour market reform had to wait for a change of government. The Employment

Contracts Act 1991 introduced a more flexible, decentralised approach to labour relations and reduced the role of trade unions in wage bargaining.[1]

In addition to promoting private-sector reform, the government itself restructured the core departments of the public service. This, together with tight control of labour costs, resulted ultimately in a significant reduction in expenditure. On the revenue side, the tax base was broadened with the introduction of the goods and services tax and the closure of loopholes, allowing the top rate of income tax to be halved. When economic growth resumed in mid-1992, rising income combined with tight control of expenditure produced the first budget surpluses in many years. The Fiscal Responsibility Act 1994 now requires the government to focus on debt reduction by running surpluses (Scott, 1995).

Competition Policy

The strengthening of competition policy through the Commerce Act 1986 was seen as an integral part of these reforms. The Act is closely modelled on Australia's Trade Practices Act 1974, which draws heavily on United States anti-trust concepts and principles, and the Commerce Commission has a similar role, and similar objectives and powers, to the Australia's Trade Practices Commission. Both Acts are designed to promote competition on three fronts: by ensuring that competition is not artificially constrained through restrictive practices; by screening mergers and takeovers to prevent the acquisition or strengthening of an undesirable degree of market power; and to deter firms in a dominant position in a market from using that position to lessen competition. In New Zealand the Act was seen as necessary to deter the possible spread of restrictive practices and mergers by firms wishing to reduce competition in the newly deregulated marketplace, and to provide the basis of the 'light-handed' regulation of corporatised and privatised utilities with market power.

However, the New Zealand regulatory regime departs from the Australian in eight principal ways:

1. The Commerce Act has *wide and general application*; almost no trading activity (whether private or public) is exempted. New Zealand has no equivalent of the Australian States, and hence avoids the constitutional questions raised by State versus federal jurisdiction.

2. *All public sector activity*, whether conducted by central or local government, falls within the scope of the Commerce Act to the extent that the bodies concerned are 'in trade'. There are no significant exemptions other than the labour market and offshore activities, such as shipping.

[1] For an early appraisal of the rationale for, and the impact of, the reforms see Bollard & Buckle (1987).

3. The Commerce Act is *broad spectrum*, covering all industries in the same way. There are no major industry-specific regulators such as Austel, and only a very few remaining areas of statutory monopoly, such as New Zealand Post in letters and some of the export-marketing boards.

4. *Specific trade practices*, such as price discrimination, secondary boycotts and exclusive dealing arrangements, are not generally singled out for particular prohibition. Rather, most are dealt with on the basis of their ultimate competitive effects.

5. The Commerce Act has *a higher threshold of anti-competitiveness* in assessing mergers or takeovers, namely, whether a dominant position will be acquired or strengthened. The current Australian test is a 'substantial lessening of competition'.

6. There is a reliance (under a 1990 amendment) on voluntary notification of mergers, rather than mandatory pre-notification.

7. The Commerce Act ensures a clear separation between the Commerce Commission and the political and executive arms of government, allowing it independence in its competition-enforcement activities.

8. The Commerce Act relies on court-based dispute resolution of competition issues, and incorporates private rights of action and appeal.

As legal standards have evolved, the Act (in authorisation cases) focuses attention on efficiency issues (Pickford, 1993). In *Tru Tone Ltd v Festival Records*[2] the Court of Appeal stated that the Act 'is based on the premise that society's resources are best allocated in a competitive market where rivalry between firms ensures maximum efficiency in the use of resources'. Early concerns with distributional matters have faded. It has been accepted after much vigorous debate in court cases, Ministry of Commerce discussion papers, and elsewhere, that the Act adopts no distributional standard: it does not specifically favour the rights of any particular group of people, such as consumers disadvantaged by monopoly pricing. This stance presumably rests on the assumption that distributional goals are more effectively achieved through efficiently targeted welfare policies.

Reform of Public Sector Enterprises

In the early 1980s the Treasury estimated that public sector enterprises in New Zealand accounted for about 12 per cent of GDP, and for some 20 per cent of investment in the economy. Since they often produced inputs used by firms in the private sector, their efficiency, price-setting and investment behaviour had a major

[2] 2 NZLR [1988] 352-64.

impact on the economy. However, their performance was judged to have been poor for several reasons: a lack of clear, non-conflicting objectives; an operating environment free of competition; inadequate monitoring of performance; lack of accountability; and political interference. From 1985 government policy aimed to improve efficiency by putting the operations of state trading operations on a commercial basis through corporatisation, privatisation and the introduction of competition.

Under the State-Owned Enterprises Act 1986 the major government trading departments were corporatised on 1 April 1987, from which time they were required to operate as profitable and successful businesses, comparable with their private sector counterparts. Goods and services were to be marketed on a user-pays basis unless an explicit subsidy was provided to finance non-commercial activities. Regulatory barriers were dismantled, thereby exposing the new corporations to private sector competition, and other forms of special assistance, such as subsidised government loans, were removed. Taxes and dividends had to be paid to the government. In short, 'competitive neutrality' was to apply. Monitoring of performance was enhanced by the establishment of measurable targets based on profitability (although asset values were hard to assess) as set out in corporate plans, and backed by new information systems. Departmental organisation was replaced by a company (limited liability) structure, with the government as sole shareholder. Managers were given greater independence in decision-making, but were accountable to boards of directors appointed from the private sector, and ultimately to Parliament through the Minister of Finance and the responsible minister. Decision-making in state-owned enterprises (SOEs) was thus removed from direct political interference.

Although these reforms represented major progress, it was argued that certain problems remained with the SOE model (New Zealand Business Roundtable, 1988). Since the ownership rights in SOEs are diverse and cannot be transferred (ownership being vested in the Crown), managers lack the incentives to perform normally provided through the share market. They face no threat of takeover, and the monitoring of performance by shareholders and investment analysts is attenuated (the free-rider problem). In addition, the incentives provided by the possibility of bankruptcy are regarded as minimal because of an implicit government guarantee. By reducing risk, this may distort the cost of capital in a downwards direction. Finally, some claim that SOE decision-making is subject to residual government interference since the directors are political appointees and an annual statement of 'corporate intent' has to be approved by the government. Moreover, interest groups may pressure the government to hold inquiries into particular management decisions, as happened with the pricing of the Electricity Corporation (ECNZ) and New Zealand Post's rural mail charges in the early 1990s. Such considerations provide the justification for privatising the SOEs, as has happened in several cases, including Telecom and New Zealand Rail.[3] Competition and other concerns have

[3] However, SOEs are typically large and complex organisations, which would tend to make them more resistant to takeover and bankruptcy, and more difficult for the capital market to monitor because of

hindered moves to privatise other major utilities such as ECNZ, CoalCorp and Television New Zealand.

The radical changes in the role of the New Zealand government in trading activities in the economy are summarised in Figure 1.

Figure 1

The changing role of government in trading activities in New Zealand

	Provision of funds	Ownership	Provision of services	Regulation
Pre-1984	Direct funding by Parliamentary vote	Widespread public ownership	Widespread public provision with little or no private involvement	Many statutory monopolies; price, import, and entry controls
Post-1984	Only for public-goods areas and social obligations	Corporatisation under state ownership; some privatisation	User charges, contracting out, private sector crowd-in	Commerce Act, information disclosure, competition

A Regulatory Framework for Utilities

Regulation of utilities (primarily found in communications, energy and transport) poses more complex problems than the regulation either of non-utility SOEs or (generally) of private sector firms through competition policy. This is because utilities, particularly those in the energy sector, have intrinsic features that, by resulting in small numbers of industry participants and by raising significant barriers to entry and exit, serve to attenuate competition. These features include: substantial economies of scale, sometimes to the point of natural monopoly (e.g. high voltage electricity transmission lines, local telephone loops); economies of scope (e.g. in the provision of different telecommunication services); and large, lumpy, immobile investments in sunk assets (e.g. natural-gas production facilities and distribution pipelines; railway networks). Further regulatory problems are raised by the fact that networks and plants (e.g. hydro-electric dams) typically have low marginal costs of

---

information asymmetries and possible managerial opportunism. Thus privatisation may not be able to solve all of the incentive problems posed by large, complex SOEs. For an agency-cost analysis, see Farrar & McCabe (1995).

expanding output up to full capacity, but high fixed costs associated with that capacity; by the potential for substantial externalities, especially environmental (e.g. coal mining, power stations); and, in some cases, by inelastic demand curves (e.g. for electricity because of appliance ownership), which raise the gains from the exercise of market power.

Left to themselves, such industries may generate significant resource misallocation and inefficiency from their monopoly pricing and other behaviour. At the other extreme, direct regulation imposed by a regulatory commission is likely to bring its own inefficiencies. These include: the costs of the regulatory body; the 'paper burden' or information supply costs imposed on the regulated firm, and the scope for it to engage in 'opportunistic' behaviour; the compliance costs arising from imperfect regulation; the losses associated with the possible corruption of the system through 'regulatory capture'; and dynamic losses associated with the control by regulators of industry structure and conduct, which may inhibit new entry, competition, and innovation. The design of a regulatory regime must therefore weigh up the potential costs and benefits involved.

New Zealand's approach to utility regulation, which charts a middle course, has been more innovative than most. Dubbed 'light-handed' regulation, it comprises a mix of the following eight elements, not all of which are used in any particular industry:

1. A reduction or elimination of statutory barriers to entry, so as to encourage the entry of new competitors, as has happened in the case of telecommunications, television broadcasting, and domestic airlines. All of these industries were formerly state-owned statutory monopolies.

2. A separation of the core natural-monopoly network from the more contestable parts of the industry, and the encouragement of competition in the latter. This is happening in electricity generation, where the transmission network has been hived off as a separate business in public ownership.

3. In cases where there has been no such separation,[4] incumbents who refuse to provide access to natural-monopoly facilities on reasonable terms risk breaching s.36 of the Commerce Act (based on s.46 of Australia's Trade Practices Act), which can carry with it punitive damages.

4. The imposition of information disclosure regimes on operators of natural monopolies in telecommunications, electricity, and postal services (and soon gas) in order to facilitate private (including capital market) monitoring of behaviour, and hence action under the Commerce Act (Ministry of Commerce, 1995).

[4] Examples include the major gas and telecommunication utilities, which were sold complete with networks. While there may be efficiency reasons for this integration, it has complicated the entry conditions for potential new competitors (see below).

Such regimes could also improve the bargaining position of new entrants in contestable markets and allow public pressure to be placed on poorly performing monopolists. In the same vein, full accounting ring-fencing is required of electricity distributors who also operate as retailers (the same is soon to be required of gas distributors).

5. The encouragement of competition from substitute goods or from new technologies. Industries that historically have been the preserve of regulated monopolists, such as long-distance transport (New Zealand Rail) and parcel post (New Zealand Post), have experienced intense competition from road freight and courier services respectively. In telecommunications, technological advances in cellular, radio and satellite-based technologies are undermining the advantages of network ownership, while in electricity retailing the sharp fall in the price of metering is expected to increase the number of electricity users having the option of switching between retailers.

6. Some of the privatised companies, including Air New Zealand, Telecom, and electricity supply companies have certain, well-defined, operating obligations (e.g. safety requirements) imposed upon them. Others are required to meet social obligations agreed with the government. For example, New Zealand Post's obligations include six-day delivery and a universal service requirement, for which it is compensated by the imposition of a price floor of 80 cents on the carriage of ordinary letters (under 200 grams) by rival firms, which are not then able to compete with Post's lower price. In some cases the government has retained a 'Kiwi share' to prevent changes to the Articles of Association (e.g. to maintain a 65 per cent domestic ownership of Air New Zealand to allow the government to negotiate international bilateral access agreements).

7. A recent development (announced in June 1995) is the breaking up of the state-owned ECNZ, which is dominant in the electricity generation market, into two separate generating companies, which are expected to begin trading in February 1996. Although this should promote competition, it might threaten the savings achieved through the coordination of generation from ECNZ's 39 hydro and thermal power plants.

8. If all else fails, there is the threat of direct intervention to induce firms with natural-monopoly characteristics to act within competitive bounds. The Commerce Commission can recommend to the government that it impose price control. In addition, there have been specific warnings of direct regulation for particular industries. However, the government has shown no desire to reintroduce such controls in the newly deregulated environment.

These elements of regulation have been widely applied to utilities throughout the communications, energy and transport sectors (including the ports and airports).

Although the emphasis is on admitting and encouraging competition wherever possible, New Zealand's policy of light-handed regulation clearly does not mean zero regulation, as has sometimes been asserted.

Regulatory Issues to Date

The utilities, whether privatised or not, are subject to the same constraints on behaviour under the Commerce Act as other businesses. So far the Commerce Commission has had to resolve three main competition issues involving utilities: mergers and takeovers; the price and other terms of access to facilities; and complaints of monopoly pricing. As an example, in the local markets for the supply and distribution of electricity, the Commission has received a number of complaints alleging inability by one company to gain access to another's network, usually because of onerous terms and conditions in the 'use of system' agreements. These include: refusal to negotiate; the demanding of unreasonable reconciliation costs; and the locking in of large customers through high line charges coupled with low unit energy charges. The Commission has taken the view that such difficulties can often be resolved by negotiation and by further refinement to access agreements during the 'shakedown' period of industry adjustment to developing competition, but that persistently anti-competitive behaviour (whether by a network owner towards an entrant seeking access or by arrangements between an incumbent supplier and downstream buyers) may have to be taken to court.

The Commission's general approach has been:

- To give industries a breathing space after deregulation to sort out their own approach to appropriate industry structure and conduct, rather than to try to impose any 'optimal' arrangement upon them; and in the meantime to 'educate' participants on the reach of the Act.

- To monitor merger activity, and give clearance to those mergers that do not raise competitive concerns, in terms of s.66(3)(a) of the Commerce Act. Where dominance is acquired or strengthened in a market, the merger may be authorised under s.67(3)(b) only where the detriments from loss of competition are outweighed by public benefits (such as efficiency gains).

- To monitor closely the contractual arrangements for access being negotiated between would-be users and the owners of telecommunications, electricity and gas networks and other natural-monopoly facilities, and to consider guidelines for what might constitute predatory behaviour in this area.

- To undertake active investigations in markets where competition has been slow to emerge or where anti-competitive behaviour appears to be a problem.

- To take court action where it sees anti-competitive agreements among firms or the misuse of a dominant position.

Competition disputes arising either from the enforcement activities of the Commission or from grievances of private parties are resolved in the courts. Three types of legal approach have recently been used in New Zealand courts, depending upon whether the dominant firm faces rivals (e.g. Telecom, electricity supply companies) or not (e.g. operators of ports and airports). Recent litigation involving the latter has revolved around judicial review and the principle of prime necessity. Judicial review has also been used where the monopolist derives its power to operate a facility from statute. The doctrine of prime necessity imposes upon a monopolist who owns an essential facility a common-law duty to supply at a reasonable price. For example, New Zealand Rail used the doctrine as an argument against the Port of Marlborough company examining its revenue as a means of fixing the port's charges.

Finally, s.36 of the Commerce Act may be employed against a dominant firm, but only when there is a *purpose* to restrict competition. Section 36 prohibits dominant firms from using a dominant position for the purpose of restricting entry into a market, preventing competitive conduct in a market, or eliminating a firm from a market. However, this does not prohibit the dominant firm from using its market power for purposes other than anti-competitive ones. For instance, the charging of a 'monopoly' price in itself is not prohibited, although the inference is that monopoly profits should be competed away where entry is possible.

Access, particularly in telecommunications, has attracted the most attention, and may become the benchmark by which the light-handed policy is judged. The Baumol-Willig rule (Baumol & Sidak, 1994), which states that monopolists are entitled to provide services to new competitors at the price which they would charge themselves, has been sanctioned by the Privy Council (1994).[5] But as the rule is likely to preserve any monopoly profits that might be earned by the incumbent, pricing performance may not be immediately improved, unless there is scope for the entrant to bypass the incumbent's network. Moreover, the price that the entrant can charge for its part of the service provided is limited, because of competition, to the variable costs saved by the incumbent through not providing that element. No scope is left for the entrant to recoup its own overhead costs, unless it is more efficient. While hindering competition, this is a necessary requirement for the promotion of static production efficiency in the industry as a whole.

In other words, the encouragement of competition from new entry may itself be distortionary in circumstances where a single, natural-monopoly supplier producing efficiently would minimise the cost of producing the output. For example, efficient bypass in electricity distribution may be viable only where the incumbent sets a line charge that is inflated by over-valued assets or inefficiencies (or contains an element of monopoly rent). In some cases the exposure of incumbents to the threat of competition could make them improve their efficiency (and reduce monopoly

[5] There have been numerous reviews of the litigation between Telecom and Clear Communications (the entrant) concerning the latter's efforts to gain access to Telecom's network. See, for example, Ross (1995) and van Roy (1995).

prices), without actual entry taking place. Increasing the contestability of markets would then have served its purpose. Alternatively, the promotion of inefficient entry through the adoption of other pricing rules could conceivably still be socially beneficial overall if the resulting inefficiencies were more than offset by dynamic gains from the introduction of competition in the market.

Summary and Evaluation

In New Zealand the corporatisation of government trading activities (including utilities) into state-owned enterprises had the goal of putting their operations into a corporate framework with commercial objectives, and in the same competitive environment as that faced by companies in the private sector. Statutory entry barriers were dismantled, information disclosure was introduced, access to networks was required, competition was encouraged, and the new enterprises were subject to the prohibitions of the Commerce Act. Key features of New Zealand's competition law are the narrow focus on a single, well-defined objective — the promotion of competition as a means of increasing efficiency, with efficiency over-riding competition where the two conflict — and a broad scope, which extends to almost all 'in-trade' activities (this contrasts with the Australian predilection for special industry treatment, as noted in the CER Services Accord of 1988). Consistent application of the Act across industries is encouraged by having a single body responsible for enforcement. This also reduces the likelihood of the regulator becoming captured by a specific industry, allows policy in one industry to be informed by experience in another, and is much cheaper.

The success of light-handed regulation has to be gauged against the probability that natural monopoly is more widespread in New Zealand, where markets are typically small, than in larger countries. Nonetheless, the policy has made inroads into areas of monopoly power in a relatively short time, and from a former status quo of government ownership and heavy regulation. For example, New Zealand Rail's freight rates reportedly fell by 50 per cent in real terms between 1983 and 1991 (Duncan & Bollard, 1992:129), while over the period 1987-94 Telecom reduced the price in real terms of a basket of residential telephone services by 45 per cent (Kerr, 1994). However, three general issues continue to cause concern: monopoly pricing; discriminatory and anti-competitive pricing; and the terms and conditions of access to natural monopoly facilities. Light-handed regulation clearly has not eliminated — and is not likely to eliminate — all monopoly distortions in the economy. Time is required for the approach to show its worth, and the costs and benefits associated with it have to be compared with those of other regulatory options available, rather than with 'first-best' outcomes in an ideal world.

Critics have argued that the law is too comfortable for incumbents and too challenging for new entrants. An incumbent monopolist has an incentive to delay entry in order to preserve profits, and little to lose save the consequences of a renewal of direct regulation, which it could always circumvent by a last-minute change of heart. On the other hand, a potential entrant may have an incentive to refuse reasonable offers while continuing to play the role of disadvantaged underdog, in

the hope of securing more favourable terms through direct government intervention. A number of interests, both potential entrants and customers of incumbents, have intensified lobbying for stronger s.36 penalties and for legally binding arbitration in disputes between owners of networks and potential entrants. Arbitration proposals have been criticised as likely to distort investment decisions since investors may not know in advance whether, and under what terms, they may be required to share the use of their assets with others.

New Zealand's policy is an innovative one and has attracted much international attention. But the policy is relatively new. The reality of market entry, technical change and the development of new contractual arrangements between firms suggests dynamic markets with unpredictable long-term outcomes. Hence, the success of the policy may be judged only by a comparison with alternatives on a long-term basis.

References

Baumol, W. & J. Sidak (1994), 'The Pricing of Inputs Sold to Competitors', *Yale Journal on Regulation* 11(1): 171-202.

Bollard, A. & R. Buckle (eds) (1987), *Economic Liberalisation in New Zealand*, Allen & Unwin, Wellington.

Duncan, I. & A. Bollard (1992), *Corporatization and Privatization: Lessons from New Zealand*, Oxford University Press, Auckland.

Farrar, J. & B. McCabe (1995), 'Corporatisation, Corporate Governance and the Deregulation of the Public Sector Economy', *Public Law Review* 6(1): 24-43.

Kerr, R. (1994), 'Answering the Critics: Privatisation is Better', *The Independent*, 4 February: 7.

Ministry of Commerce (1995), *Light-handed Regulation of the New Zealand Electricity and Gas Industries*, Wellington.

New Zealand Business Roundtable (1988), *State Owned Enterprises: Issues of Ownership and Regulation*, Wellington.

Pickford, M. (1993), 'The Evaluation of Public Benefit and Detriment Under the Commerce Act 1986', *New Zealand Economic Papers* 27: 209-31.

Privy Council (1994), *Telecom v Clear, Appeal No. 21 of 1994*, London.

Ross, M. (1995), 'New Zealand's Experiment in Pricing Access to Essential Facilities', *Agenda* 2(3): 366-70.

van Roy, Y. (1995), 'The Privy Council Decision in *Telecom v Clear*: Narrowing the Application of s.36 of the Commerce Act 1986', *New Zealand Law Journal*, February: 54-60.

Scott, G. (1995), 'New Zealand's Fiscal Responsibility Act', *Agenda* 2(1): 3-16.

The Treasury (1984), *Economic Management*, Wellington.

The authors gratefully acknowledge the comments on an earlier version of the article by three referees. The views expressed are those of the authors alone, and the usual disclaimers apply.

Agenda, Volume 2, Number 4, 1995, pages 423-431

Guaranteeing Access to Essential Infrastructure

Stephen P. King

THE Australian federal government's Competition Policy Reform Act 1995 (CPRA), together with matching State legislation, represents the culmination of a reform process that began with the Hilmer Committee report.[1] At the heart of this Act are rules designed to administer third-party access to essential infrastructure facilities such as 'electricity transmission grids, telecommunications networks, rail tracks, major pipelines, ports and airports' (Hilmer et al., 1993:240). These rules aim to expand competition in upstream and downstream markets by forcing the owners of key facilities to allow potential competitors access to these facilities, which, otherwise, would give their owners unassailable monopoly power. Access is already required in telecommunications; Optus has negotiated an agreement for access to Telstra's (Telecom Australia's) network. But the aim of the CPRA is to make such agreements the norm rather than the exception.

The Act includes a number of principles that the relevant minister and regulatory authorities must observe both when declaring a facility liable for access and when determining an access agreement. A facility owner may be forced to provide access when 'access (or increased access) to the service would promote competition in at least one market', when it is not economical 'for anyone to develop another facility to provide the service', and when 'the facility is of national significance' (44G.2.a, b, c).

The Act assumes that the parties to any access agreement will, in the first instance, negotiate the specifics of such an agreement between themselves. However, if agreement cannot be reached the parties must go to arbitration before the Australian Competition and Consumer Commission. The commission will then make a determination based upon a number of guiding principles and specific limitations (44X and 44W). The aim of this process is to achieve access without infringing on the legitimate rights of facility owners and with a minimum of bureaucratic and regulatory intervention.

---

[1] Formally known as the Independent Committee of Inquiry into National Competition Policy (see Hilmer et al., 1993). This article deals only with the CPRA as, at the time of writing, details of the relevant State bills are generally not available.

Stephen King is in the Economics Program in the Research School of Social Sciences at The Australian National University.

Preliminary Issues

Why is any of this legislative framework necessary? The underlying principle, drawn from the Hilmer report, is that industries such as electricity and gas contain core infrastructure facilities which are 'natural monopolies'. The services provided by these facilities are an essential input into the production of some final good(s) or service(s), so that, in the absence of access arrangements, these facilities endow their owners with monopoly power. In Australia, many of the relevant facilities are owned by State governments and the end markets are monopolised by State-owned utilities. Access rules are designed to break down this monopoly power and to introduce competition into the end markets by making available the essential input controlled by the utilities.

Three key preliminary questions should precede any enforced access regime. What is the 'end market' that requires access to ensure competition? Is the relevant facility really essential for that competition? And what are the costs of mandated access?

Defining the end market. How is the correct end market to be determined? Consider, for example, a gas transmission pipeline that leads to Sydney. Does this pipeline service a Sydney gas market, or are gas sales merely one part of a larger Sydney market for energy sources and fuels? If the market is defined as the former and if the pipeline is the only economically feasible way to ship gas to Sydney, then access to that pipeline is clearly crucial for any firm wishing to compete in the Sydney gas market. However, if the relevant market is that for energy sources and fuels, so that gas is merely one of a number of competing fuel sources, access may not even be important, far less essential.

This question is not merely a matter of semantics, but is crucial to both the implementation and economic implications of the CPRA. Market definition and the interpretation of 'promote competition in a market' will be the first legal hurdles for any access declaration. These issues will determine whether access, with the accompanying legislative constraints, is required. Market definition will establish the future regulatory path of the relevant industry. Choosing the wrong path may have significant efficiency consequences. For example, Teece (1990) compares American and German natural gas regulation. Whereas the US has relied on significant and often misdirected regulatory intervention, Germany has relied on inter-fuel competition to control the gas industry. Teece finds that Germany has consistently outperformed the US in terms of both price and utilisation of pipeline capacity. Focusing on an incorrect or irrelevant end market can lead either to the maintenance of monopoly power or to costly intervention where none is needed.

But is it essential? The Hilmer report cites competition as the rationale for access regulation. Competition cannot be left to normal market pressures because of a natural monopoly problem. 'Like other monopolists . . . the owner of the facility is able to use its monopoly position to charge higher prices and derive monopoly profits at the expense of consumers and economic efficiency' (Hilmer et al.,

1993:241). The CPRA captures the 'natural monopoly' feature of an access facility by requiring that the National Competition Council and the relevant minister can declare a facility only if 'it would be uneconomical for anyone to develop another facility to provide the service' (44G.2.b and 44H.4.b).

The term 'natural monopoly' refers to an industry where the cost-minimising production technology requires that, at all relevant levels of demand, it is more efficient if output(s) are supplied by one producer than by more than one producer. 'All relevant levels of demand' means all quantities of the product(s) that would be purchased at a price or prices that are at least equal to marginal cost. 'More efficient' means that the total cost of production of the product(s) is minimised with a single producer for all possible combinations of the relevant quantities. It immediately follows that what is or is not a natural monopoly will change with technical progress and with changes in the nature of demand, particularly the expansion of demand over time. A facility that is a natural monopoly today need not be one tomorrow.

Little attempt seems to have been made to determine which, if any, of the facilities mentioned in the Hilmer report are natural monopolies. For example, while I am quite happy to accept that domestic gas distribution is likely to embody a natural monopoly technology (I am also quite ready for someone to show me data that proves that this is incorrect), it is far from obvious that gas transmission involves a natural monopoly technology. Ellig and Giberson consider intrastate gas transmission in Texas and find that 'most firms operate at substantial decreasing returns to scale' (1993:79). Similarly, until relatively recently long-distance telephone communications was viewed as 'obviously' a natural monopoly. However, anyone claiming that Melbourne-Sydney long-distance telephony is a natural monopoly today is likely to be greeted with shrieks of laughter.

If the facilities to be regulated by the CPRA do not exhibit natural monopoly characteristics, it is far from clear that third-party access is desirable even if an 'essential' input for an end market is provided. But the preliminary work to determine which facilities may warrant access regulation has not been carried out. Without this work, the relevant authorities have no basis for judging whether a facility is or is not a natural monopoly or whether it would be economical to develop an alternative, competing facility.

The costs of access. Finally, there has been little discussion of the direct and indirect costs of third-party access. These costs will, in part, depend upon the regulatory regime and the infrastructure used to support this regime. The relevant federal and State regulatory bodies will not be free. The requirements that these regulators place upon declared facilities may involve substantial costs of negotiation, arbitration and compliance. As well, allowing access may incur substantial direct costs related to the loss of economies of scope. For example, Kaserman and Mayo (1991) show that the costs arising from the loss of vertical economies in separating electricity generation from distribution through arms-length contracts may be significant.

Invoking a 'light handed' regulatory regime will not necessarily reduce these costs and may, in fact, exacerbate the problem. For example, in New Zealand there is no statutory requirement for the owner of the existing telecommunications network, Telecom New Zealand, to allow interconnection access to a competitor. Access issues were deliberately left for the courts to interpret under section 36 of New Zealand's Commerce Act 1986, which deals with abuse of a dominant position. As a result, the issue of interconnection between the local network that is being established by Clear Communications and the existing network of Telecom New Zealand led to a long-running court battle that culminated in a ruling by the Privy Council (see Ross, 1995). This protracted battle has involved significant direct costs to all participants and also a substantial delay in interconnection. Similarly, the use of a negotiated interconnection regime for telecommunications in the UK resulted in a four-year delay following the licensing of Mercury in 1982. Eventually, the Director General of Telecommunications had to step in and rule on the conditions for interconnection between Mercury and BT (Armstrong et al., 1994).

The potential costs of access have not been considered in Australia. While it is hoped that the CPRA will result in swiftly negotiated agreements, it may become mired in forced arbitration, appeals and disputes on points of law. The fundamental question of whether the potential gains to competition are worth the costs remains to be answered.

Negotiated Access Regimes

The CPRA envisages, in the first instance, that the facility owner and the parties requiring access will negotiate mutually agreeable conditions for access. This is in line with the preferred approach outlined in the Hilmer report.

At first glance, access agreements that are directly negotiated between the facility owner and the firm requiring access have significant economic merit. Despite the possibility of 'game playing' between these parties when negotiating agreements, there are good reasons to believe that such bargaining would be reasonably efficient. It is in no party's interest to bargain to an outcome that results in a loss to one party that is not matched by a gain to the other. While the access provider may have a significant incentive to stall negotiations if it is also operating in the end market, negotiated access with forced arbitration if no agreement is reached would appear to provide a path to sensible access agreements.

Yet access agreements that are efficient for both the provider and purchaser of access services need not be economically efficient: quite the contrary. The incentives in access negotiations will be to maximise the benefits that can be divided between the access provider and those firms using access as an input to a final product. If the access provider has monopoly control over an essential input, then the way to maximise these benefits is to use the access regime to ensure monopoly pricing in the end markets.

To see this, consider that the access facility owner does not compete in the final market. It is then desirable for the access provider and one of the third parties wishing to buy access to sign a contract that ensures that they share the maximum

monopoly rents achievable in the final market. For example, they could set a simple two-part tariff involving a per unit price equal to the (short-run) marginal cost of the access services. The firm buying access will then set the overall profit maximising price in the final market, and the fixed component of the tariff can be used to share the monopoly profits. So long as this fixed component is equal to at least one-half of the monopoly rents, the access facility owner can offer an identical contract to all potential access purchasers, safe in the knowledge that it would never pay more than one firm to accept such a contract.

An alternative contract may be offered by the facility owner if it believes that there are likely to be numerous potential access purchasers who, given the opportunity, would compete vigorously in the end market. In such a situation, the access provider will wish to encourage competition in the end market so that the price in this market is driven down to cost. This cost will, however, include an inflated uniform price for access. By controlling the access price and encouraging competition, the access provider is able simultaneously to control the price in the final market and to retain any profits generated at this price. Again, access would be offered on a non-discriminatory basis. Further, the regime would appear to be highly successful in that it would result in intense competition in the final market.

These examples suggest that there will be strong pressure under negotiated access price agreements for monopoly pricing in the final goods market. This situation does not change significantly when the access provider also operates in the final goods market. In the first example, the access provider can gain monopoly profits by either leaving the final market to a single purchaser of access or by 'sharing' the final market with one or a small number of other firms who act as a cartel. In this latter case the access provider could gain the profits through the access regime and also enforce the cartel by 'punishing' any deviant firm through its power over access. In the second example, the access provider will be able to use its own presence in the end market to price aggressively and ensure that this market operates in a highly competitive fashion.

Investment and Access

A determination under the CPRA can require an access provider to extend its facility (44V.2.d), subject to that owner not bearing any of the costs of the extension (including on-going maintenance costs) (44W.1.e). Although such provisions appear reasonable when considering extensions that are necessary for access (such as an interconnection switch in telecommunications), it is far from obvious that these provisions will create the correct incentives for the facility owner to choose a socially optimal capacity level. Depending upon the specific access agreements and determinations that it faces, a facility owner will wish to manipulate capacity over time to maximise its profits.

As an example, consider that a facility owner faces an access regime that maximises economic efficiency given current capacity. If demand alters in a reasonably stable cycle over time, such a regime will include access prices set equal to short-run marginal cost when demand is low and the facility has excess capacity and rationing

demand by price when the facility is operating at capacity. This simple peak-load pricing scheme ensures that the facility is used optimally off-peak and that, in the peak period, when demand has to be rationed, available access goes to the highest valued users.[2]

Under such a pricing scheme, it is socially desirable for capacity to be expanded whenever the price in the peak period (weighted by the proportion of the cycle in which peak demand occurs) exceeds the marginal cost of such expansion (the 'long-run' marginal cost). However, the incentives that face the facility owner are significantly different. By constraining capacity, the owner of the facility can exert some monopoly power over peak demand. Expanding capacity undercuts this monopoly power by increasing the supply of the scarce resource controlled by the facility owner. In fact, from the facility owner's viewpoint, desirable capacity is not determined by the socially optimal rule of (weighted) peak-price equalling long-run marginal cost, but rather by the profit-maximising rule that marginal revenue at the peak equals this marginal cost. If price rationing is used for peak demand, the facility owner will generally wish to maintain or reduce capacity when it is socially desirable to expand.

This example clearly depends upon the specific rule used to price access. But similar problems will usually arise with any access arrangements. Whenever price is used to ration access, it will be in the interest of the facility owner to exert monopoly power over that price by limiting capacity. Conversely, if access prices are determined to give the facility owner a 'reasonable' or 'commercial' rate of return on the capital value of its facility, with peak access rationed by some non-price means, then the facility owner will wish to manipulate capacity to maximise its profits subject to the regulated rate. If the regulatory authorities set a rate that is below the true cost of capital, it will pay the access provider to allow its facilities to run down. Conversely, if the allowed rate of return is above the true cost of capital, the facility owner will want to expand capacity above the level that is socially optimal so as to maximise the capital on which its allowable returns are based.[3] In the simple case considered here, if the access price was set equal to long-run marginal cost and the regulatory authorities required that the access facility owner serve all customers at that price, the conflict between private and social incentives to expand capacity would disappear. If the (weighted) price that would ration peak demand exceeded long-run marginal cost, the facility owner would be forced to expand capacity to satisfy the requirement to provide access. However, it would never pay the facility owner to over-expand capacity as this would simply lead to idle capital for which it receives no return.

---

[2] For a formal discussion of peak-load pricing, see Mitchell and Vogelsang (1991). Also see Ng (1987) for a discussion of socially optimal capacity expansion over time for facilities with lumpy costs. In the discussion here we consider the simple case where there is only one, well-defined peak period.

[3] That rate-of-return regulation can lead to excessive capitalisation of production is well known and referred to as the 'Averch-Johnson effect'. See Train (1991).

There are, however, two reasons why such pricing is impractical and undesirable. First, long-run marginal cost pricing may lead to efficient capacity but it leads to inefficient use of that capacity by setting the price too high in off-peak periods. Second, it is unlikely that the regulatory authorities will know the value of long-run marginal cost with any accuracy and the access facility owner will have little incentive to provide this information correctly. As a consequence it is unlikely that the authorities could set price equal to long-run marginal cost. Further, such regulatory intervention is clearly contrary to the intention of the CPRA with its reliance on negotiated access agreements.

A similar problem arises with both the building of new facilities and the technology embodied in such facilities. The regulatory regime will affect these choices in ways that may be inimical to economic efficiency. For example, the CPRA requires that access determinations not prevent 'an existing user obtaining a sufficient amount of the service to be able to meet the user's reasonably anticipated requirements' (44W.1.a). This provision will affect the choice of a provider when building a new facility. If the facility is likely to last for, say, 20 years, it may be economically desirable to build a facility with significant excess capacity today in expectation of increased final market demand over time. However, if excess capacity can be utilised by potential final-market competitors in the years immediately following construction, then this will lower the facility owner's profits from participating in the end market even if access to the facility includes a 'commercial rate of return'. As a consequence, the investor may prefer to build a facility which is smaller than would otherwise be desirable so as to limit short-term excess capacity, and also to use as much of the available capacity as possible even if such use was completely wasteful. For example, it may pay a gas company to build a pipeline that is likely to reach capacity earlier than otherwise desirable, and in the short term to use any otherwise excess capacity to ship gas that is simply burnt off at the other end of the pipe and not sold in the final market.

The ability of potential access purchasers to by-pass facilities that have been declared under the CPRA may place some competitive pressure on the access provider. By-pass involves an end-market seller or an end-market customer investing in his own facilities to avoid using the dedicated access facilities. For example, by-pass in telecommunications can involve a large corporate customer setting up its own internal switching facilities and using designated lines to connect its major corporate offices in order to avoid using the public long-distance network, or to directly connect to a long-distance company in order to avoid using a local exchange carrier. (For an extensive discussion of by-pass, see Kahn, 1988.)

The ability to by-pass places a competitive burden on the facility owner that would otherwise not exist. However, it should be remembered that, under the CPRA, a facility will be subject to an access regime only if it is uneconomic for competitive facilities to be developed. Thus, in the context of the CPRA, by-pass will necessarily be economically wasteful: otherwise, the relevant facility should not be subject to declaration.

Inefficient by-pass will occur if the (total) price being charged for access exceeds the stand-alone cost of building an alternative facility. Thus, stand-alone costs place an upper bound on the price that the facility owner can charge for access without inducing by-pass. The discipline imposed on the facility owner by potential by-pass will, however, differ greatly depending upon the specific input being purchased, the number of third-parties requiring access and the relative use of the facility by the owner and other parties. In general, with a policy of 'open access', whereby the facility provider is able to set any non-discriminatory price for access that he desires, the possibility of by-pass is likely to impose only a small degree of restraint on the facility owner.

Conclusion

The Competition Policy Reform Act 1995 is based on good intentions. When dealing with third-party access, the Act retains the spirit of the Hilmer report and provides a long list of considerations to protect the interests of the access providers and the access purchasers. However, the Act ignores many of the serious practical problems that will arise in implementing any access regime. It brushes aside three important preliminary considerations of any access regime. The issues of market determination and whether or not an alternative facility can be 'economically' developed are left as one-line points to be considered in declaring a facility. The issue of access costs not explicitly related to access facilities, such as contracting costs and loss of scale economies, is not considered at all.

The emphasis in both the Hilmer report and the CPRA on negotiated access essentially disenfranchises the most important party to any access considerations: the final consumers. The interests of these consumers are reflected in the requirements that access must promote competition and that an access determination must take 'the public interest' into account (44X.1.b). However, the emphasis on negotiated access arrangements means that those parties with the least interest in competition and consumer welfare have the greatest say in any access arrangements.

Finally, the Act does not resolve the important conflict between static and dynamic economic efficiency that will necessarily arise with any access regime. An ill-founded access regime may lead to over- or under-investment in the relevant facilities and may potentially make consumers worse off than under monopoly provision even if it has the cosmetic effect of raising the number of firms 'competing' in the final market.

It is far from clear that the intentions of the Competition Policy Reform Act will be realised in practice. If State legislation is mirrored on this federal Act, the hopes raised by the Hilmer report and the subsequent analyses in the press and elsewhere may be dashed.

References

Armstrong, M., S. Cowan & J. Vickers (1994), *Regulatory Reform: Economic Analysis and the British Experience*, MIT Press, Cambridge MA.

Ellig, J. & M. Giberson (1993), 'Scale, Scope and Regulation in the Texas Gas Transmission Industry', *Journal of Regulatory Economics* 5: 79-90.

Hilmer, F., M. Rayner & G. Taperell (1993), *National Competition Policy: Report by the Independent Committee of Inquiry*, AGPS, Canberra.

Kahn, A. (1988), *The Economics of Regulation*, MIT Press, Cambridge MA.

Kaserman, D. & J. Mayo (1991), 'The Measurement of Vertical Economies and the Efficient Structure of the Electric Utility Business', *Journal of Industrial Economics* 39: 483-502.

Mitchell, B. & I. Vogelsang (1991), *Telecommunications Pricing: Theory and Practice*, Cambridge University Press, Cambridge.

Ng, Y-K. (1987), 'Equity, Efficiency and Financial Viability: Public-Utility Pricing with Special Reference to Water Supply', *Australian Economic Review*, 3rd. quarter: 21-35.

Ross, M. (1995), 'New Zealand's Experiment in Pricing Access to Essential Facilities', *Agenda* 2(3): 366-70.

Teece, D. (1990), 'Structure and Organization of the Natural Gas Industry: Differences between the United States and the Federal Republic of Germany and Implications for Carrier Status Pipelines', *The Energy Journal* 11: 1-35.

Train, K. (1991), *Optimal Regulation*, MIT Press, Cambridge MA.

This article is based on a discussion paper that the author prepared for the NSW Government Pricing Tribunal. However, the views expressed are those of the author not necessarily those of the Government Pricing Tribunal.

Agenda, Volume 2, Number 4, 1995, pages 433-444

'You Couldn't Give It Away': Privatising the Australian National Line

Keith Trace

In early 1991 the Australian Commonwealth government declared its intention to privatise the Australian National Line (ANL). Set up in 1956 to take over the business of the loss-making Australian Shipping Board, ANL was profitable in its early years, when it concentrated on coastal operations. But its financial position deteriorated following its entry into the highly competitive and cyclical overseas liner and bulk trades. During the 1980s the government kept ANL afloat by injecting further equity capital. The government's recent disenchantment stems from the Line's failure to achieve the goals set in its ambitious 1989/92 corporate plan.

ANL's Performance under Government Ownership

Between 1957 and 1969 ANL consistently returned operating profits of about $4.5m and after-tax profits of around A$2.3m, paying a regular 6 per cent dividend on its capital of $35.85m.[1] Thereafter its financial performance deteriorated, its operating losses amounting to around $10m in 1975 and 1976. The Line blamed the Commonwealth government's decision to hold down the level of coastal freight rates in an era of rising costs; the downturn of cargo volume in both coastal and overseas trades during the recession of 1974-75; the high level of industrial disputation on the Australian waterfront; and a rise in the Line's gearing ratio following the financing of ANL's overseas expansion by loan funds rather than equity capital. The Line's gearing ratio (the ratio of loans outstanding to funds employed) rose from 1.06:1 in 1970 to 4.3:1 in 1975 and to 13.58:1 in 1977.

ANL's financial situation further deteriorated in the early 1980s. By 1983 it was technically bankrupt, accumulated losses exceeding the Line's capital base, forcing the Commonwealth government to mount a rescue operation. The Australian Shipping Commission Amendment Act 1983 converted $60m of loan funds to equity and provided $30m of additional equity; appointed a new Chairman, Captain William Bolitho, while strengthening and rationalising the Line's management; and reduced government involvement in ANL affairs, giving management greater autonomy in the setting of freight rates, contractual arrangements and staffing.

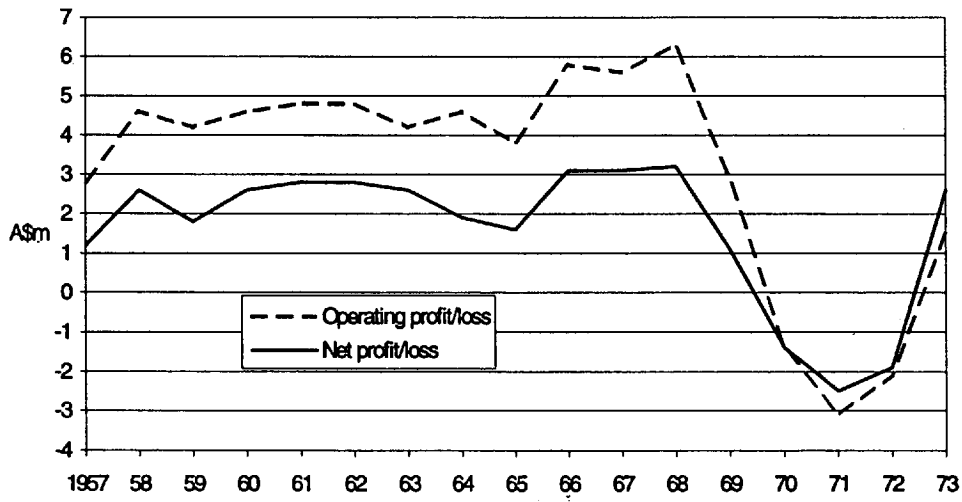
---

[1] By 1966 accrued dividend payments to the Commonwealth government amounted to $38.7m.

Keith Trace is Associate Professor of Economics at Monash University (Clayton).

Figure 1

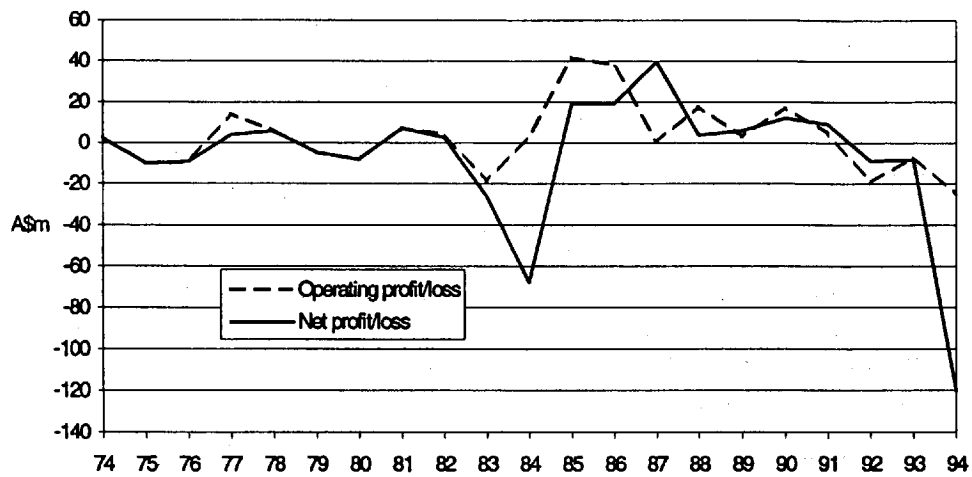
ANL's operating and net profit/loss, 1957-73



Source: ANL Annual Reports

Figure 2

ANL's operating and net profit/loss, 1974-94



Source: ANL Annual Reports

A 1984 review of ANL led to the closure of loss-making services, including those to North America, as well as the sale of uneconomic vessels and terminals. Fleet size was reduced from 33 vessels to 27. While returning to operating profitability ($3.3m) in 1984, ANL reported a record net loss of $67.8m brought about by extraordinary write-downs arising from the inadequacy of past depreciation policies,[2] by anticipated losses in respect of vessels to be sold in the 1984/85 financial year, and by losses in foreign-exchange transactions. Accumulated losses now exceeded capital and reserves by $3.7m. Once again ANL was technically bankrupt; the Commonwealth government bailed out the Line with an additional capital injection of $70.5m.[3]

In 1988 the ANL (Conversion into Public Company) Bill provided for the conversion of the Commission's capital ($196m) into one-dollar shares, all of which were to be held by the Commonwealth. ANL was now required to prepare a corporate plan, work towards an overall financial target agreed to by the Minister, pay an annual dividend, and revalue its assets at least every five years.

Despite managerial initiatives aimed at increasing efficiency, ANL's financial performance deteriorated in the early 1990s. Under its 1989/92 corporate plan, ANL:

- disposed of the two remaining Cape-size bulk carriers, acquired in the mid-1970s and employed carrying iron ore and coal to Japan;
- ordered two 2,700 twenty-foot equivalent units (teu) container ships for the Asian trades and two vessels for its Bass Strait service, enabling the Line to benefit from advanced technology and reduced manning levels;
- merged its fleet management operations with those of Associated Steamships to form ASP Ship Management;
- established a Joint Management Group with P&O to manage their combined interests in the UK/Europe to Australia and New Zealand trade; and
- entered into joint terminal ventures, including National Terminals (Australia) Ltd and Brisbane Gateway Terminals Ltd.

These initiatives effectively separated core commercial shipping operations from associated ship operation, terminal, cargo handling, and shore-based transport operations.

Notwithstanding these initiatives, the ANL Group incurred negative earnings before interest and tax of $37m in 1991/92, $7m in 1992/93 and $25m in 1993/94. The Board attributed the disappointing results to several factors, including poor trading

---

[2] In 1977 ANL management adopted a 20-year (rather than a 16-year) write-off period, but returned to a 16-year period in 1984.

[3] The loan allowed $50.5m of existing Treasury loans to be converted to capital. The remaining $20m was used to repay a treasury on-lent loan falling due on 1 June 1985.

conditions during the recession of the late 1980s and early 1990s; high interest payments stemming from the cost of re-equipment and the Commonwealth's failure to provide promised additional equity funding; and the costs of preparing for privatisation. In 1993/94 ANL reported a record net loss of $129m, including one-off restructuring costs and asset write-downs totalling over $100m. Prominent among the restructuring costs were provision for redundancy payments and a loss on the sale of ANL's shareholding in Australian Stevedores, while the Line also wrote-down the value of goodwill and conference carrying rights in various overseas trades.

Competition in the Shipping Industry

ANL's poor financial performance has been ascribed to several factors. Among these is the intense competition in both liner and bulk shipping markets during the past two decades. Such competition arguably stems from both cyclical and structural causes. Shipping is a 'feast or famine' business. In good years, excess demand for shipping tonnage sharply increases freight rates in the bulk trades. Profits earned in such booms enable owners to survive through the lean years, when the rate of growth of world seaborne trade slackens and when ships ordered in the previous boom continue to add tonnage to the world fleet. In such periods 'too many ships chase too few cargoes' and freight rates fall. Though ANL's profits/losses have varied across the cycle, as have those of other owners, profits earned in the booms have been insufficient to counter losses made in the lean years.

Major structural changes have occurred in shipping markets over the past quarter century. In the liner trades, escalating cargo-handling costs led to the introduction of purpose-built container vessels and associated cargo-handling equipment: labour-intensive cargo handling was replaced by a capital-intensive system. The entry of new lines, especially those of entrepreneurial Asian shipowners, intensified competition, forcing shipowners to seek cost savings through the introduction of larger vessels, the adoption of new types and patterns of service, and the minimisation of port calls. Thus, economies of vessel size have led to the introduction of large 'third' and 'fourth' generation container ships (up to 5,000teu capacity) where cargo volumes permit; shipowners have increased vessel utilisation by developing 'round-the-world' and 'pendulum' services; and port calls are limited to 'hub' ports, in which cargo is brought into and distributed from such ports by feeder vessels. Large third and fourth generation container ships now operate high-intensity services between North America, Europe and Asia, the three major trade generating regions of the northern hemisphere. Intense competition between shipping lines ensures that freight rates reflect the economies of vessel size. Australian overseas trade increasingly tends to flow into Asian hubs for on-carriage to Europe and America, threatening the traditional direct services to UK/Europe and North America.

A Poorly Defined and Ill-Focused Strategy

To survive in this competitive and fast-changing world, a shipping line must pursue a strategy valued by the market and compatible with its distinctive competences. Ar-

guably, ANL has followed inappropriate strategies for a small line operating in a high-cost economy.

The Commonwealth government encouraged ANL to enter the Australia-Europe liner trade. Though supporting containerisation, the government feared that it might strengthen the monopoly power of the conference lines. The government sought to gain an insight into the costs of container operations by encouraging ANL to join one of the emerging container consortia. ANL itself favoured entry to the Australia-Japan trade; having introduced roll-on-roll-off (ro-ro) vessels to the Australian coast, the line saw an opportunity to extend this technology to a deep-sea trade. During the 1970s ANL entered several more overseas liner trades, notably Australia-North America, Australia-Southeast Asia, and Australia-New Zealand.

ANL's overseas liner strategy was to deploy one or two vessels in a number of trades, usually operating within a consortium and invariably joining conferences. Whereas this strategy made sense in the early 1970s, when conferences were powerful and traditional trade patterns dominated, it became much less attractive in the late 1970s and 1980s given the developments in shipping markets outlined above. By the mid-1980s ANL's overseas liner strategy made little sense, since the line had failed to build a commanding strategic position in any of the trades in which it operated. The market conditions prevailing in the 1980s and 1990s mean that an undifferentiated, poorly focused liner service is unlikely to prove profitable.

Given its size, modest capitalisation and high-cost structure, ANL could not aspire to become a major player in container-shipping markets or a low-cost supplier of shipping services. However, ANL might reasonably have pursued either differentiation or focusing strategies. Differentiation strategies involve the development of a product or service that the firm's customers believed to be superior. The obvious differentiation strategy for ANL is that based on its specialist knowledge of distribution within Australia. A highly efficient door-to-door transport service, offered by ANL in strategic alliance with an Asian line, could lower the price sensitivity facing ANL.

Focus or niche strategies stem from the assumption that a firm is able to serve a narrow strategic market more effectively and efficiently than competitors following less focused strategies. Two niche strategies appear immediately attractive: the operation of a feeder container service from Australia to an Asian hub, and the development of specialist liner services catering for the peculiar needs of Australian trade (such as refrigerated-container or car-carrying services).

But, although ANL's management understood the deficiencies in the line's strategy, it lacked the funds to implement the necessary major strategic changes.

Government Interference in ANL Decision-making

Arguably, ANL's performance has been adversely affected by the actions of government. The board has not been able to operate as a commercial enterprise, free from intervention by politicians and/or bureaucrats. According to Captain Sir John Williams (1981:212), the first chairman of the Australian Shipping Commission, Ian Sinclair, Minister of Transport in 1968-71, viewed the Australian Shipping Commission as a 'political instrument', subject to direction by the Minister and Department of

Transport Bureaucrats.[4] As well, under Section 19 of the Australian Shipping Commission Act 1956, coastal freight rates were subject to ministerial approval. Ministerial refusal to sanction rate increases during the 1960s and 1970s led to a deterioration in the Line's financial position (ANL, 1970:6). Moreover, under the Whitlam Labor Government of 1972-75, ANL was viewed as a 'pacesetter' for an expanding Australian flag fleet and was encouraged to order four large bulk carriers suitable for the expanding Australia-Japan iron ore trade. Given the intensity of competition in bulk shipping, freight rates obtainable did not enable the vessels to operate profitably; ANL's financial crisis of the early 1980s in part reflects the losses incurred by these vessels. But ministerial involvement in ANL decision-making was reduced following the passage of the Australian Shipping Commission Amendment Act 1983 and the 1988 Act converting ANL into a public company.

Political control over borrowing and investment has likewise influenced ANL's financial performance. The Commonwealth's reluctance to increase ANL's capital during its expansion into overseas markets in the 1970s led to an increase in the gearing ratio from 1.06:1 in 1970 to 13.58:1 in 1977, sharply increasing interest payments on borrowings. More recently, ANL's former Chairman Captain Bolitho has criticised the government for failing to honour a commitment to provide $100m in equity to part-fund the Line's 1989 re-equipment program (*Daily Commercial News*, 20 September 1994), p.176). On the other hand, ANL has avoided the discipline that would follow from forgoing government guarantee of its debt and having to compete for equity funds.

ANL management and employees have been subject to public-service conditions of employment. This impedes operational flexibility and makes it difficult to maintain an appropriate incentive structure for senior management. The 1988 Act converting ANL into a public company provided that employees of the Commission would retain the same terms and conditions of employment: staff having rights under Part IV of the Public Service Act retained those rights.

High Operating Costs under the Australian Flag

Historically, Australian flag vessels have incurred much higher costs than their overseas competitors. But attempts have been made to reduce the (absolute and relative) costs of operating Australian flag vessels.

Dissatisfaction with the performance of ANL and, more generally, with the high price and poor quality of coastal shipping services led to political pressure for shipping industry reform in the early 1980s. Reporting in 1982, the Crawford Committee recommended a 'revitalisation' package aimed at encouraging investment in modern, fuel-efficient tonnage through the linking of fiscal incentives to reductions in crew size (Crawford, 1982). Under the Crawford package crew sizes fell from 33 or more to 26-29.

---

[4] Williams also alleges that he was instructed to sign the so-called 'Canberra Agreement', under which ANL entered the Australia-Europe trade in partnership with the container consortia Associated Container Transportation Ltd.

Since crew levels remained high relative to international best practice, the Hawke Government set up the Maritime Industry Development Committee (MIDC), whose 1986 Report *Moving Ahead* recommended the introduction of further financial incentives to encourage owners to invest in labour-saving vessels, made possible by 'integrating' deck and engine-room crews. Under the Ships (Capital Grants) Act 1987, later extended to 1997, such vessels qualify for a taxable grant of 7 per cent of their purchase price and owners are allowed to claim 20 per cent accelerated depreciation. Crew levels on new vessels have been reduced to 21-22 under the MIDC package; average crew size across the Australian flag fleet fell from 27.9 in 1989 to 22.5 in 1991 and 20.9 in 1992. But as manning levels have also fallen in other countries, Australia's relative competitiveness has improved only marginally. Moreover, measuring relative competitiveness by reduction in crew size tends to overstate the improvement in Australia's position. Under Australian award conditions, seamen enjoy relatively generous leave provisions, implying that an Australian vessel trading year round must employ 2.1-2.2 crews per vessel as against an OECD average of 1.6-1.7, and owners incur high capital costs to provide accommodation of an acceptable standard.

Improvements in manning levels are not of themselves sufficient to create a fully competitive Australian shipping industry, since manning costs account for only 8-10 per cent of the total costs incurred by a coastal vessel (Payne, 1994). The Australian Shipowners Association (1995:32) has argued that the creation of a fiscal regime comparable to those enjoyed by major shipowning nations is a necessary condition for the long-term survival of an Australian flag fleet. The settlement of the September 1994 waterfront strike over the sale of ANL included concessions by government that allowed seamen employed in Australian flag ships trading overseas to be exempt from income tax.

Does Australia Need a National Shipping Line?

Does the case for a national line hinge solely on profitability? Does a national line confer benefits above and beyond the bottom line? Supporters of national shipping lines have advanced different arguments for them.

'Window into conferences' and/or instruments for the control of monopoly. With a cost structure markedly higher than those of many of its competitors, ANL has always chosen to operate within conferences. The need to obtain information relating to conference pricing and investment decisions underpinned ANL's entry to the European trade. Yet the line's commercial interests conflict with its use as a 'window into conferences'. Conferences exerted considerable market power in the 1950s and 1960s. But today's liner trades are highly competitive. Moreover, conferences are unlikely to regain their earlier market power. The share of trades held by conference members has shrunk; independent non-conference lines and consortia offer genuine and viable alternatives to conference services. The power of shippers has increased at the expense of shipowners; the flexibility and ease of transhipment of containers enables them to be moved along a variety of paths, enhancing competition. Shippers are aware of price/quality trade-offs and freight forwarders seek to 'make a buck' by offer-

ing new products and services. And public policy favours competition rather than collusive action.

Balance of payments effects. Research has shown that domestic-flag vessels operating profitably make a positive contribution to the current account of the balance of payments (Centre for Transport Policy Analysis, 1988; Appelbaum, 1988; BTCE, 1988). However, this contribution is a limited one. Vessels are usually purchased and financed abroad; the majority of vessels trading internationally are drydocked and repaired overseas; and the profitability of vessels engaged in overseas trading is usually low. In any case, profitability (rate of return on funds invested) rather than balance-of-payments gains is the ultimate determinant of an industry's viability; the ability to achieve an acceptable rate of return on capital provides the economic justification for further investment. The rate of return on ANL investment in overseas shipping appears low compared with the rate of return reported in other industries.

Employment creation. Does the employment created within the Australian shipping industry warrant government support and/or subsidies? Viewed from the perspective of the industry and the maritime unions, subsidisation is the price of maintaining a potentially valuable pool of skills. However, subsidisation of such a capital-intensive industry is an extremely expensive way of creating jobs.

National security. National-flag vessels may be an asset from a defence or national security standpoint: ro-ro vessels with the ability to land troops and equipment at forward beach heads could be employed in the event of regional conflict; cellular container vessels and bulk carriers could be used as launching pads for helicopters. A national fleet would also provide a nucleus of vessels to carry essential imports and exports in time of war. However, such vessels are normally available for charter. And the fact that certain types of vessels may prove useful for defence purposes does not justify the general subsidisation of the shipping industry.

As Richard Goss (1994:30) has noted, it is difficult to find any theoretical arguments to justify general support for a national shipping line or, indeed, a shipping industry:

> Shipping is not necessary to promote overseas trade; it is not an infant industry; investment in it has no special effects on the balance of payments; as a capital intensive industry it provides little employment; there is no general case for protecting shipping for defence reasons; and, as a way of buying national prestige, it can become very expensive.

Privatisation: The Options

In June 1991 the Commonwealth government obtained Labor Party approval for the sale of 49 per cent of ANL; maritime union agreement was reportedly conditional upon a $100m capital injection to assist in re-equipping and modernising ANL's fleet.

Although the anticipated proceeds from the sale of 49 per cent of ANL were included in the 1992-93 Budget papers, press reports suggest that little interest was shown by potential purchasers, whether domestic or foreign.

The value of ANL is hotly disputed. A 1992 report by Potter Warburg/Price Waterhouse argued that ANL's value lay between $171m and minus $127m (*The Australian*, 24 August 1994). In contrast, the 'due diligence' study undertaken by Salomon Brothers/Price Waterhouse reported in August 1994 that ANL's 'indicative' value lay between minus $74.8m and minus $117.8m (*The Age*, 27 August 1994). The latter report apparently valued ANL on a 'fire-sale' basis rather than as a going concern, which accounts for the markedly lower values placed on vessels and fixed equipment.[5]

Reacting to the Salomon Brothers/Price Waterhouse valuation, Laurie Brereton, the Minister of Transport, declared in August 1994 that 'you couldn't give it [ANL] away, that's the reality' (*The Australian*, 24 August 1994). Mr Brereton immediately replaced ANL's board of directors, appointing former New South Wales Labor Premier Neville Wran to chair a new four-member board charged with producing a plan for the Line's reconstruction.

Union concerns over the future of ANL were heightened in early September 1994 when Mr Brereton announced that ANL's 25 per cent stake in Australian Stevedores would be sold to Jamison Equity. The Maritime Union of Australia (MUA) then called a strike which effectively shut down Australian ports. Union leaders let it be known that they had a mandate from their members to maintain bans for several weeks if they did not receive satisfactory assurances regarding the future of ANL.

In September 1994 the government changed tack and announced an industry assistance package that exempted from income tax the salaries and wages of Australian seamen employed on vessels trading overseas, confirmed that cabotage would be retained, and pledged to restructure ANL as an economically viable enterprise, while rejecting a proposal from the Shipping Industry Reform Authority to allow foreign ratings on Australian ships engaged in international trading. The MUA now abandoned its objective of retaining ANL in public ownership; and the government announced that ANL would be offered for sale through an 'open-tender' process, conditional upon the new owners retaining the vessels under the Australian flag.

In principle, a range of options is available to the government.

Stock-exchange float. ANL's poor financial performance, the likelihood of further losses if the line continues to operate its present mix of services, and the need to inject substantial funds in order to pursue more realistic strategies rule out a stock-exchange float in the foreseeable future.

---

[5] The Salomon Brothers/Price Waterhouse valuation included allowance for the cost of closing ANL's Head Office ($60m) as well as provision for redundancies ($69m). It is open to government to assume this debt prior to sale.

Trade sale. A trade sale has emerged as one of the preferred options. During late 1994 and early 1995 the new board reportedly held negotiations with several potential purchasers, including the British P&O Group, the American-owned Sea-Land, and the French-controlled Australia New Zealand Direct Line (ANZDL).

P&O has strong historical links with the Australia/Europe liner trade which it continues to serve in alliance with Contship Container Line. Over the past decade P&O has been strengthening its strategic position in several Australian overseas liner trades. In addition to the European trade, P&O now operates in the Australia-Southeast Asia, Australia-East Asia, Australia-Middle East, Australia-North America, and trans-Tasman trades. Given P&O's market share in key trades, acquisition of ANL might attract the attention of the Trade Practices Commission.

Sea-Land has withdrawn from contention following the rejection of its initial bid. The Line may retain an interest in entering a strategic alliance with a restructured ANL.

ANZDL took part in a 'due diligence' process but ultimately declined to submit a bid for ANL, leaving P&O as the only trade bidder as of August 1995. The sale of ANL to P&O — for under $20m — is said to be the preferred option of senior ministers.

Retention of present ownership (with or without equity injection). Retention of ANL, which appeared unlikely earlier in 1995, is now back on the political agenda. While the government may prefer to sell ANL to P&O, it may also wish to avoid the politically damaging waterfront strike that seems likely to accompany its sale. Minister Brereton has signalled that, if the sale to P&O is ruled out, the government would be forced to consider a major restructure of the Line (*The Australian Financial Review*, 10 August 1995). ANL management has reportedly prepared two restructuring options. Option A envisages ANL withdrawal from the Australia-Europe container trade; the sale of ANL's 50 per cent share in Coastal ExpressLine to Union Shipping; the sale of non-core land- and technology-based businesses; and a reduction in the size of corporate HQ. Option B builds on Option A, with ANL withdrawing also from the trans-Tasman trade and selling the two vessels currently employed in that trade. Option B would imply a significantly scaled-down ANL, focusing on the Asian and (to a more limited extent) the Australian coastal trades. In effect, Option B converts ANL to a niche operator in the Asian trades.

Management and/or union buy-out. In September 1994 the MUA proposed the formation of a consortium to acquire a majority interest in ANL. The American ocean carrier Sea-Land and Australian transport group Linfox were mentioned as possible partners. The proposal appears to have been abandoned.

Merger with 'like-minded' line. This option was preferred by ANL management in the late 1980s and early 1990s. The search for a 'like-minded' line interested in merging with or purchasing a minority interest in ANL foundered when the most

likely candidate, K-Line, ruled out acquisition of a significant shareholding (*Daily Commercial News*, 9 October 1991).

Package and sale of separate businesses. Arguably, ANL's businesses might yield better prices if sold separately. ANL's conference shares in, say, the UK/European trade may be valuable to a line interested in building market share, while ANL Intermodal may be of interest to a firm introducing or enhancing a door-to-door transport service. For the approach to be successful, imaginative packaging and accurate pricing of the individual businesses would be critical. Politically, such an approach could be difficult to sustain, given that the purchaser of, say, ANL conference rights in the UK/Europe trade might not be interested in purchasing the ANL vessels currently operating in the trade. Even if willing to purchase them along with the cargo rights, a purchaser might be reluctant to operate them with Australian crews.

Sale of non-core assets. Arguably, many non-core assets have already been sold. Should ANL continue under government ownership, further disposal of non-core assets would be dependent on a redefinition of ANL's core business.

Concluding Remarks

In September 1995 the federal government, P&O, and the maritime unions agreed to defer the decision on ANL until 31 October. P&O and the maritime unions have agreed to negotiate during this period 'in good faith' the industrial relations issues associated with the Line's sale. Should they be unable to reach agreement, the government is committed to restructure ANL.

Privatisation offers potential benefits but is also associated with certain risks. Efficiency gains should be experienced as a result of: the removal of constraints associated with public ownership (especially the shortage of equity capital and political and bureaucratic interference in decision-making); superior operating efficiency; exploitation of synergies with existing international and/or coastal shipping services; and the adoption of superior strategies. ANL's goodwill and conference-carrying rights may be valuable to a line seeking to build market share in Australian liner trades.

However, the sale of ANL is unlikely to provide a windfall gain to Treasury. ANL operates twelve vessels, only four of which are owned outright. Government insistence that they continue to employ Australian crews, under Australian award conditions, will lessen their attractiveness to potential buyers, although the September 1994 reform package reduces the cost penalty.

Would competition increase as a result of ANL privatisation? The answer is unclear. ANL is a very small player in international shipping markets. In the long run, the level of competition in Australia's overseas liner trades will depend on the supply-demand balance in container shipping and the further development of paths through which liner cargoes can be routed. Sale of ANL to a company already holding a substantial market share in one or more of our overseas trades would strengthen that company's strategic position in the short run.

The effect on coastal trades is linked to the government's September 1994 agreement to retain the cabotage system.[6] A potential bidder is likely to ask for guarantees concerning cabotage, and the government may agree in order to maximise ANL's sale price. In so doing, the government would deny Australian industry access to lower-cost coastal shipping services, as well as negating a potential advantage of selling ANL, namely, the adoption of an Australian shipping policy reflecting the public interest rather than the interest of the national shipping line.

Retention of ANL may appear the least costly option politically. However, it will cost the federal government a great deal of money either to restructure the line or to keep ANL operating in its present form. Restructuring along the lines of ANL management's Option B would put in place a coherent strategy. However, in the absence of further reform of shipping and the waterfront, profitability could not be guaranteed. Nor should restructuring be viewed as a cheap option. Repositioning ANL would require substantial investment in vessels and equipment, as well as a willingness to carry losses until such time as the Line is effectively repositioned in the market.

References

Appelbaum, J. (1988), *Impact of Increased Flag Protection on Australia's Balance of Payments*, Australian National Maritime Association, Melbourne.

Australian National Line (ANL) (1970), *Annual Report*, Australian Shipping Commission, Melbourne.

Australian Shipowners Association (1995), *Annual Review*, Melbourne.

Bureau of Transport and Communications Economics (BTCE) (1988), *Australian Shipping and the Balance of Payments*, AGPS, Canberra (Occasional Paper No. 99).

Centre for Transport Policy Analysis (1988), *Australian Flag Shipping and the Balance of Payments*, University of Wollongong, Wollongong.

Crawford, T. (1982), *Revitalisation of Australian Shipping: An Overview*, AGPS, Canberra.

Goss, R. (1994), 'Internationalism, Protectionism and Interventionism in Shipping', in J. Hawkins (ed.), *In Search of a Comprehensive Australian Shipping Policy*, Australian Maritime College, Launceston (Proceedings of the 'Aus-Ship '94' Seminar).

Maritime Industry Development Committee (MIDC) (1986), *Moving Ahead*, AGPS, Canberra.

Payne, L. (1994), 'External and Internal Costs in Australian Shipping', in J. Hawkins (ed.), *In Search of a Comprehensive Australian Shipping Policy*, Australian Maritime College, Launceston (Proceedings of the 'Aus-Ship '94' Seminar).

Trace, K. (1993), 'Australian Coastal Shipping: Cabotage or Contestability?', *Policy* 9(2): 24-8.

Williams, J. (1981), *So Ends This Day*, Globe Press, Melbourne.

---

[6] The cabotage policy effectively reserves coastal shipping for Australian-flag and Australian-crewed vessels. Technically, foreign-flag vessels may operate on the coast providing their crews are paid Australian award wages. No owners have taken advantage of this option. However, foreign ships may carry cargo under single voyage permits (see Trace, 1993).

Agenda, Volume 2, Number 4, 1995, pages 445-454

New Zealand's System of Citizens Initiated Referenda

Wayne Mapp

IN 1993 New Zealand took two major steps to modernise its democracy. One was the decision, made in a referendum held at the time of the 1993 general election, that parliament be elected by the Mixed Member Proportional (MMP) system, so that each of the parties' representation would reflect the proportion of votes received. The other reform, which passed almost unnoticed at the time, was the enactment of the Citizens Initiated Referenda Act 1993. It is likely that Citizens Initiated Referenda (CIR) will have at least as great an impact on shaping public policy as any reform of the method of electing politicians.

The Origins of CIR in New Zealand

Referenda have a long history in democratic societies. However, they have usually been initiated by politicians rather than by citizens. In New Zealand they have most often been used by politicians to settle constitutional or moral issues. In the last 50 years New Zealand has conducted six referenda on issues other than liquor licensing. The topics included compulsory military training (1949 — approved), off-course betting (1949 — approved), increasing the term of parliament (1967, 1990 — lost both times) and, most recently, electoral reform. Until recently, a referendum on prohibition or state control of liquor sales was a feature of every general election. This was always lost. In Australia, referenda have been conducted primarily on constitutional amendments, since the Constitution mandates that such amendments be sanctioned through the referendum mechanism. In both countries the results of such referenda are treated as binding, but whereas in Australia this is mandated by constitutional law, in New Zealand it is essentially a constitutional convention.

The current passion for referenda reflects the popular demand that they be initiated by the voters, on any issue that the voters choose. Referenda of this nature were first introduced in various states of the United States early this century by the Progressive Movement. Over the last 20 years, particularly in California, they have become an increasingly important democratic tool as groups of voters have sought direct political change outside the confines of representative government. Major government policy on specific matters can be directly decided by voters, and separated from the broad range of issues that voters face when electing a legislature or a government.

Wayne Mapp is Associate Professor of Commercial Law at The University of Auckland.

The move towards CIR in New Zealand was inspired by the United States experience. Conservative and populist groups, notably the Social Credit Party (now known as the Democratic Party) had long promoted the principle of direct democracy as a means of circumventing what was viewed as the entrenched bureaucratic and establishment support for the liberal social agenda. In 1984 the Democratic Party introduced the Popular Initiatives Bill into the House of Representatives. This Bill was referred to the Royal Commission on the Electoral System (which is notable for the fact that it recommended the MMP electoral system). The Royal Commission's report noted a high level of public support for referenda, especially on 'moral' issues that are typically the subject of a 'conscience' vote in parliament. But it opposed the widespread use of referenda on balance, arguing that they may be little more than expensive opinion polls or could be used by the opposition parties to effectively thwart the elected government's program. The Royal Commission on the Electoral System (1986:175) concluded:

> In general, initiatives and referenda are blunt and crude devices which need to be used with care and circumspection. Their frequent use would amount to a substantial change in our constitutional and political system. They would blur the lines of accountability and responsibility of Governments and political parties, and blunt their effectiveness.

The only exceptions considered by the Royal Commission were for major constitutional change and the occasional conscience issue. It thought that in both cases the results should be binding on parliament.

Notwithstanding the recommendations of the Royal Commission, the concept of direct democracy struck a chord with conservative rural activists within the National Party, particularly in regions where Social Credit had traditionally enjoyed strong local support from small dairy farmers and businesspeople. These activists were able to convince National Party politicians of the desirability of limited reform, and the legislation for non-binding CIR was enacted in 1993.

Although CIR was originally promoted by the populist Right, the most extensive use of CIR petitions in the two years since the legislation came into force has been made by groups promoting issues that are traditionally the concerns of the Left. It is quite possible that CIR could be used as a major weapon in a concerted effort to roll back the reforms that have occurred in New Zealand over the last decade.

The CIR Legislation

The 1993 legislation is a cautious approach to what is clearly a major innovation in New Zealand's democracy. Referenda have been used only infrequently in New Zealand, and it was not the intention of the government that voters should be suddenly overwhelmed by a large number of referenda on widely disparate issues.

Promoters of referenda issues have to persuade at least 10 per cent of registered voters to sign a petition before a referendum can be held. Once this threshold has been crossed, the referendum must be held. However, even if a referendum is sup-

ported by more than 50 per cent of the voters, the result is not binding on the government of the day.

Under the CIR procedure, the promoters of the issue must draft a question for an indicative referendum petition that is capable of being answered in one of only two ways, normally 'yes' or 'no'. This question is submitted to the Clerk of the House of Representatives for consideration. The Clerk consults interested parties, who may make submissions on the question. Following the consultation period, which is three months, the Clerk determines the question for the petition. On determination the proposed question is advertised in the *New Zealand Gazette*.

The promoters then have twelve months to promote the petition and obtain the signatures of 10 per cent of the registered electors on the electoral roll. This amounts to approximately 232,000 electors. If the promoters succeed in obtaining the necessary signatures, the petition is delivered to the Clerk, who then verifies, on a sample basis, that the petition has the support of 10 per cent of eligible electors. The Clerk is assisted in this task by the Government Statistician. The Chief Electoral Officer then checks, on a sample basis, whether the signatories are on the electoral roll. The Clerk has two months from the date of receipt of the petition to undertake the verification process and to certify that the petition is correct. If the Clerk is unable to certify the correctness of the petition, the promoters have two further months to gain additional signatures and to resubmit the petition to the Clerk. If the petition cannot then be certified correct, it lapses.

Once the petition has been certified correct the referendum must be held within twelve months. However, the referendum can be delayed by up to 24 months so that it is held at the time of a general election if parliament so agrees by a 75 per cent majority. But in the event that a general election is to be held within the twelve months after the presentation of the petition to the House of Representatives, the House may pass a resolution requiring the referendum to be held on the day of the election. Since voter turnout for elections is likely to be in excess of 85 per cent of registered voters, it would seem sensible that all referenda should take place at the time of general elections. In contrast, the indicative referendum on electoral reform held in September 1992, one year prior to the general election, had a turnout of 55.2 per cent of registered voters.

Once the referendum has been held, the results in terms of two answers to the question are provided to the Minister of Justice and are made publicly available. Since voters have either to support or to oppose the question, there will always be a decisive outcome (barring a tie). As the result of the referendum is not binding on parliament, the CIR legislation makes no further provision for anything to be done with the results of the referendum.

Once a referendum has been held on an issue, no further proposals for a petition can be made within 60 months. Since there is a twelve-month period to gain the necessary signatures of 10 per cent of the voters on the electoral roll, and between twelve and 24 months after a successful petition before a referendum is held, referenda on the same issue cannot be less than seven years apart. This restriction does not apply to petitions that fail to gain the necessary 10 per cent of signatures to enable a referen-

dum to take place. Thus it would be possible for promoters of a failed petition to put the same question immediately to the Clerk for approval for a new petition.

The legislation includes special provisions designed to subject publicity relating to the referendum to financial limitations. No one, either alone or in combination with others, may spend more than NZ$50,000 in respect of the twelve-month period during which the petition can be open for signatures. Should the petition be successful and a referendum held, the supporters and opponents have a further period of twelve months to marshal their publicity. As with the petition, the spending limit, either by a person alone or in combination with others, is $50,000. Clearly, the total amount spent either in support or in opposition to the petition or the referendum can be greater than $50,000, provided the parties do not act in concert.

The United States, in contrast, allows vigorous, well-funded campaigns both for and against referenda propositions. This can be justified on the grounds that the results of referenda are binding upon the government of the state or municipality.

The Use of CIR since January 1994

The CIR Act has been in force since January 1994. In that time concerned citizens have eagerly grasped the opportunity provided by the legislation. Already, twelve petitions are circulating on a range of issues.

Six of these petitions have been proposed by one organisation, the Next Step Democracy Movement. The other six propose:

- prohibiting production of eggs from battery hens, proposed by the Society for the Prevention of Cruelty to Animals (the twelve-month period for gathering signatures starting on 28 April 1994);

- giving judges the power to recommend that prisoners convicted of murder should be imprisoned for the 'whole of their natural life', promoted by the Christian Heritage Party (23 June 1994);

- the reduction of the number of members of parliament under the MMP system from 120 to 100, proposed by members of parliament Michael Laws, Winston Peters and Geoff Braybrooke (18 August 1994);

- that political parties be legally required to observe their constitutions and honour their manifesto promises, promoted by W. M. Maung (17 November 1994);

- that the number of firefighters be not less than that employed as at 1 January 1995, proposed by the New Zealand Professional Firefighters Union (9 February 1995); and

- that the laws of New Zealand apply equally to all New Zealanders irrespective of ethnic origin, proposed by One New Zealand Foundation (23 March 1995).

A number of these petitions have either reached or are close to reaching the end of the twelve-month period available for gathering the signatures of 10 per cent of eligible electors. It is apparent that some of these petitions have failed to gain the necessary signatures and will therefore lapse. However, the CIR Act does not prevent the promoters from submitting a new proposal for a petition on the same issue to the Clerk of the House of Representatives at any time after the expiry of the twelve-month period.

The six petitions proposed by Next Step Democracy Movement form the political agenda of the Left. The questions are:

- should all New Zealanders have access to comprehensive health services which are fully funded by government without user charges;

- should all New Zealanders have access to public education services from early childhood to tertiary level which are fully funded and without user charges;

- should full employment with wages and conditions which are fair and equitable be the primary goal of government economic policy;

- should all New Zealanders on income support and benefit receive an income based on what it actually costs to live;

- should increases in New Zealand's electricity demand be met from energy conservation and from sources that are environmentally sustainable; and

- should New Zealand's defence expenditure be reduced to half its 1994/95 level by 2000 with the savings spent on health, education, conservation and promotion of full employment.

The Next Step Democracy Movement had proposed these questions in June 1994. They were subsequently withdrawn and substituted to the Clerk in December 1994 and finally approved in February 1995. The intention was to use the run-up to the general election as a means of increasing public awareness of the petitions, and to focus public attention on the political issues facing the electorate at the first MMP election, which must be held no later than November 1996.

The twelve-month period for gathering signatures on the petition for the proposed referendum of prohibiting egg production from battery hens closed on 28 April 1995. The Society for the Prevention of Cruelty to Animals was apparently successful in obtaining signatures from 10 per cent of the registered voters. However, the Clerk of the House of Representatives found sufficient errors in the ages and names of signatories to prevent him certifying that the Society had obtained the necessary 10 per cent of registered voters. The Society used the additional two months available to it to gain further signatures, and resubmitted the petition for certification by the Clerk in August 1995. If approved, a referendum will take place, probably at the time of the

next general election, which is expected to be held in late 1996. This is outside the twelve-month period which allows the House of Representatives to pass a resolution by simple majority that the referendum shall take place at the same time as the general election. Thus the House of Representatives will be asked to vote by a 75 per cent majority that the referendum is to take place at the same time as the general election. Since there is no pressing reason for the referendum to take place any earlier than the general election, it is expected that the House will pass the necessary resolution.

The referendum proposed by the New Zealand Professional Firefighters Union not to reduce the number of firefighters below that employed in 1 January 1995 has received substantial public support. Within two months of the petition being open for signature, 400,000 people (about 17 per cent of all registered voters) had signed the petition. The Clerk certified the correctness of the petition. Preliminary discussions were held among the political parties in parliament as to whether the referendum should be postponed to the date of the general election. As it was apparent that there was insufficient support for such a delay, the referendum will take place I December 1995. This arguably suited the government by shifting a potentially embarrassing issue away from the general election. A stand-alone referendum is estimated to cost $11 million. A referendum undertaken at the time of the general election would clearly cost less and would also have a higher turnout of voters.

This referendum is somewhat unusual in that it directly concerns not a political issue but rather an employment one. Although the New Zealand Fire Service is a state-owned entity, its management is autonomous. In the event that the referendum is approved, the result could be included in the collective employment agreement, or parliament could pass appropriate legislation. Alternatively, both the government and the Fire Service could ignore the results of the referendum.

The Prime Minister, Jim Bolger, recently expressed his belief that the referendum process was inappropriate for settling industrial-relations disputes. Sir Geoffrey Palmer, the former Prime Minister, has stated that CIR is not appropriate in an MMP electoral environment, and that parliamentarians ought to have the sole prerogative of making law. This view ignores the desire of voters to directly indicate to parliamentarians their views on particular issues. Referenda give this opportunity to electors without requiring them also to decide which political party to support.

CIR Litigation

The referenda petitions have already produced litigation. The Egg Producers Federation of New Zealand initiated proceedings against the Clerk of the House of Representatives and the Society for the Prevention of Cruelty to Animals to challenge the wording of the proposed referendum on the production of eggs from battery hens. The Society for the Prevention of Cruelty to Animals had proposed the wording: 'Should the inhumane practice of battery egg production be phased out within five years from this referendum?'. This was modified by the Clerk to read: 'Should the production of eggs from battery hens be prohibited within five years of the referendum?'. The Egg Producers Federation considered that the word 'battery' was emotive. However, the Chief Justice considered that the wording was not so prejudicial as

to invalidate the question. He also noted that since the topics for referenda are chosen by the promoters, there would always be some difficulty in ensuring a fair contest. The role of the Clerk is to ensure that the criteria set out in Section 10 of the Act are observed, so that the question shall clearly convey the purpose and effect of the indicative referendum, and that only one of two answers may be given to the question; moreover, account shall be taken of the promoter's proposal, by comment made on it and the results of the consultation. The Chief Justice considered that the Clerk, in fulfilling his obligations, could not frame a question in emotive or prejudicial terms.

One of the issues that the Chief Justice referred to was the scope of referenda. He noted that the subject matter of referenda was not limited to 'matters on which action by Government would be competent or appropriate', referring to the possibility that there could be a referendum on whether a named captain of the All Black rugby team should have been dropped from the team.

It is noteworthy that the other twelve referenda petitions deal with a wide range of matters. With the exception of the those on the number of firefighters and the enforceability of political manifestos, the petitions all raise issues that the government could be reasonably expected to deal with in a modern democracy.

Should Referenda be Binding?

The current CIR legislation provides only for non-binding referenda. However, referenda in New Zealand have traditionally been binding in practice, in that the government has undertaken to introduce appropriate legislation into parliament, and political parties understand the convention that such legislation should be passed into law. The crucial difference between this traditional approach and the new CIR legislation is that the voters can now require a referendum on any issue, notwithstanding the views of government and political parties. Can the electorate be trusted to directly make law on any issue they choose?

The United States experience with CIR provides an insight into the possible future direction and use of referenda in New Zealand. Many states and municipalities of the US permit use of CIR, usually called 'initiatives' and 'propositions'. The California constitution guarantees the right of referenda and initiatives, which are 'reserved' to the people. In most cases the results are binding on state governments or municipalities.

The binding nature of initiatives and propositions has meant that the voters typically approve specific legislation. In the case of the initiative, the legislature implements the legislation to enact the referendum, while in the case of propositions the voters directly enact the legislation, which is distributed to voters in advance or appended to the ballot paper. In both cases it is essential that the measures are capable of being enacted by government. Considerable concern has been expressed that popular legislation is bad legislation, since it does not go through the usual committee procedure to iron out defects, and voters do not have the same resources as legislators to carefully weigh the merits of particular measures (Fontaine, 1988). But the enduring popularity of binding referenda stems from the fact that voters have the opportunity to make their own law without the interference of legislators.

In general terms, state and local referenda can have the same scope as the powers of the state or local legislature. Given the limited authority of state and local legislatures, referenda tend to be held on matters relating to state or city budgets, whether to mandate expenditure or to limit the power to collect revenue. They may also be held on matters directly affecting private property rights, such as zoning and planning restrictions. However, referenda cannot override the US Constitution or federal legislation. Yet even these limitations leave considerable scope for referenda on a wide range of issues of social and political significance. Thus, at the elections in November 1994, Californian voters approved a measure that will prevent children of illegal immigrants from attending state-funded schools. The measure has been challenged in court on the grounds that it infringes the equal protection provisions of the Bill of Rights. The lower courts have already found the measure to be unconstitutional. This latter point is of great significance.

It is not possible under the US Constitution for a majority of voters to approve a measure that would deny the rights of a minority where those rights are protected by the Constitution. In addition, many state constitutions provide for the protection of fundamental rights. It may be that written constitutions and Bills of Rights act as important bulwarks against the tendency of referenda to deal with emotional issues without regard for the civil rights of minorities.

New Zealand currently has a limited Bill of Rights Act (see Mapp, 1994). This Act is not supreme legislation, although the trend of the cases is that legislation that directly infringes the Bill of Rights Act needs to be very specific to override the provisions of the Act. Generally, legislation is applied in a manner that accords with the Bill of Rights Act. It could therefore be anticipated that the courts would so interpret any legislation derived from a CIR referendum as to avoid a conflict with the Act. In addition, the non-binding nature of referenda provides an opportunity for the legislature to ensure that any legislation derived from a CIR referendum would not infringe the Bill of Rights Act. The US experience suggests that a Bill of Rights should become supreme law in advance of any move to make CIR binding. The Canadian Charter of Rights shows that such a status for a Bill of Rights can be achieved in a parliamentary democracy. Alternatively, CIR legislation could include a provision that any binding referenda be subject to the Bill of Rights Act.

Concluding Comments

The option of direct democracy provided by CIR is clearly a major development of the constitutional framework of New Zealand. The enthusiasm shown by proponents of the various issues that have been the subject of referenda petitions is a very clear indication of the popularity of direct democracy. The fact that the firefighters could convince 17 per cent of all registered voters to sign a petition within two months demonstrates the electorate's desire to have a say on particular issues distinct from the electoral choice of political party.

The CIR legislation could be improved by requiring all referenda to take place at the time of a general election. This would save money. More important, it would ensure that referenda properly reflected the views of the community given that typi-

cally in excess of 85 per cent of all registered voters exercise their franchise at general elections. The reality is that New Zealand voters will become accustomed not only to choosing their parliamentary representatives, but also to expressing their views on a range of specific issues.

However, in order to be effective, referenda do need to be confined to specific issues. The questions posed by the Next Step Democracy Movement demonstrate the limitations of referenda. The wide-ranging nature of these petitions pose awkward dilemmas. It would be quite possible for voters to elect a centre-right government and also to support one or more of these petitions in a referendum. It is hard to imagine how such a government could implement the results of the referenda and still honour its own manifesto commitments (which a current referendum petition would require it to do!). Alternatively, a centre-right government may argue that it is promoting free education by providing a voucher system, that the free market is the most appropriate method of promoting full employment, and that income support and benefits are in fact based on what it costs to live. But this presumably would not be how the promoters of the petitions envisage the fulfilment of the electorate's wishes.

Referenda are not a suitable means of implementing a complete political agenda. The issues are more complex than six short but open-ended questions. Affirmative answers to the questions leave enormous leeway for governments to implement the results in ways quite possibly at odds with the agenda of the promoters. Referenda containing such open-ended questions would frustrate voters since there is no guarantee, even if the results were binding, that parliament would implement them in a manner acceptable to the promoters. Voters need to know that, when they support a referendum, it will result in specific legislation implementing the measure they have supported. A succession of referenda on issues susceptible of fulfilment in a wide variety of ways would quickly dim the enthusiasm for referenda.

If New Zealand follows the example of the United States, the results of referenda will become binding and will be an important part of the legislative process. But two reforms are required for binding referenda to be an effective part of a liberal democracy. First, a Bill of Rights that overrides all other legislation, including that derived from binding referenda, would be necessary if the results of referenda were binding. The status of the Treaty of Waitangi would also need consideration. Incorporation of the Treaty of Waitangi into a Bill of Rights, as was proposed in the 1986 White Paper on a Bill of Rights, may also be desirable. This would ensure the protection of minority rights and the rights of Maori enshrined in the Treaty of Waitangi. In effect, binding referenda would not be able to deal with issues that directly affected rights guaranteed by a Bill of Rights that was supreme law.

Second, referendum questions need to be limited to issues that can be effectively dealt with by specific legislation which is known in advance. The legislation can either be promulgated by parliament in advance, as occurred with the 1993 Electoral Act, or the legislation could be part of the referendum as an annexure to the question. In the latter case, the select committee process would not be an appropriate way to modify the legislation after it had been approved by referendum. The option of referenda with annexed legislation would suit only those issues that are narrow in scope, such as

the term of parliament. Such legislation would not require the legislative fine tuning of the select committee process following the referendum. It would obviously be important to ensure that the legislative measures had been subject to careful scrutiny before the referendum is put to the electorate for approval.

However, even the current non-binding referenda on specific questions capable of clear resolution by parliament will have a major impact on law and policy-making. It can be expected that politicians will be reluctant to ignore the results of referenda, particularly where there is a substantial majority in support of a particular proposition.

References and Bibliography

Borchers, P. (1989), 'California Local Initiatives and Referenda: An Argument for Keeping the Progressive Flame Burning', *Pacific Law Journal* 21: 119-45.

Campbell, E. (1989), 'Changing the Constitution: Past and Future', *Melbourne University Law Review* 17: 1-23.

Capital Letter (1994-95), various issues.

Charlow, R. (1994), 'Judicial Review, Equal Opportunity and the Problem with Plebiscites', *Cornell Law Review* 79: 527-630.

Eule, J. (1990), 'Judicial Review of Direct Democracy', *The Yale Law Journal* 99: 503-90.

Fountaine, C. (1988), 'Lousy Lawmaking: Questioning the Desirability and Constitutionality of Legislating by Initiative', *Southern Californian Law Review* 61: 735-76.

Mapp, W. (1994), 'New Zealand's Bill of Rights: A Provisional Assessment', *Agenda* 1(1): 81-9.

Royal Commission on the Electoral System (1986), *Towards A Better Democracy*, Report of the Royal Commission on the Electoral System, Government Printer, Wellington.

Walker, G. de Q. (1988), 'The People's Law: Initiative and Referendum', *University of Queensland Law Journal* 15: 33-45.

Agenda, Volume 2, Number 4, 1995, pages 455-466

Ontario's Employment Equity Legislation: An Act Not to Follow

Saul Fridman

IN recent decades much attention has been paid to social inequality in Australia, and in particular to the position of women. The Australian Law Reform Commission's recent report *Equality Before the Law: Women's Equality*, which includes comparisons with the Canadian experience, recommends the adoption of a legislative guarantee of equality, in which the meaning of equality would be determined in a contextual fashion, thereby promoting 'a more substantive understanding of equality as a response to economic, social and political disadvantage of women' (ALRC, 1994:53).

Australia has so far not adopted any requirement of discrimination in favour of 'disadvantaged groups'.[1] But positive measures to redress apparent inequalities are becoming fashionable. For example, the Australian Labor Party in September 1994 decided to set a quota of 35 per cent of female candidates in 'winnable seats'. Dr Clare Burton, a former Equal Opportunity Commissioner, has called for quotas to be introduced to the private sector by 2000. In her view, industry should set targets immediately 'which are realistic, given the presence of women as employees, small-business owner/managers and consumers in each industry sector. . . We should set targets [for boards] now, like the ALP if you like' (*The Australian Financial Review*, 28 September 1994, p.19).

The mechanics of affirmative action, however, have attracted little attention. But we can observe schemes that have been employed elsewhere in the world. Perhaps the most radical scheme of affirmative action currently in operation is that adopted by the Canadian Province of Ontario. In January 1994, the government of Ontario secured the passage of the Employment Equity Act, which requires employers in the Province to comply with state-imposed quotas in employment. On-

[1] The Sex Discrimination Act 1984 (Cth) prohibits discrimination on the basis of sex. An example of the current legislative treatment of positive discrimination can be found in the recent decision of *Proudfoot and Ors v ACT Board of Health and Ors* (1992) EOC para 92-417, where three men challenged the ACT government's women's health program on the ground that it discriminated against men. Although the program survived this challenge, it was held that it did involve discrimination on the basis of gender. The Human Rights and Equal Opportunity Commission ultimately applied exemptions contained in the Sexual Discrimination Act 1984 in order to conclude that the services were not unlawful. *Equality Before the Law* recommends that such programs ought not be considered discriminatory at all (ALRC, 1994:51).

Saul Fridman is Lecturer in Law at The Australian National University.

tario firms are now in the process of ordering their affairs so as to comply with its terms.

Ontario's Employment Equity Act 1994

The preamble to the Act states:

> The people of Ontario recognise that Aboriginal people, people with disabilities, members of racial minorities and women experience higher rates of unemployment than other people in Ontario . . . The people of Ontario recognise that this lack of employment equity . . . is caused in part by systemic and intentional discrimination in employment. People of merit are too often overlooked or denied opportunities because of this discrimination. The people of Ontario recognise that when objective standards govern employment opportunities, Ontario will have a workforce that is truly representative of its society.

This passage contains an obvious inconsistency. It is said that when 'objective standards' prevail in Ontario, the workforce of the province will be 'truly representative of its society'. But how can mandating employers to make employment decisions *on the basis of race, disability or gender* promote the application of 'objective standards'? This has always been an underlying difficulty of programs, such as this one, that seek to combat the effects of past oppression and discrimination by effectively reversing the process.

All employers to whom the Act applies must comply with five broad principles of employment equity. These principles are set out in Section 2 of the Act:

> 1. Every person who is a member of a designated group is entitled to be considered for employment, hired, retained, treated and promoted free of barriers that discriminate against them;
>
> 2. Every employer's workforce, in all occupational categories, and at all levels of employment, shall reflect the representation of the designated groups in the community;
>
> 3. Every employer shall ensure that its recruitment, hiring, retention, treatment and promotion practices and policies are free of barriers that discriminate against the designated groups;
>
> 4. Every employer shall implement positive measures for recruiting, hiring, retaining, treating and promoting members of the designated groups; and
>
> 5. Every employer shall implement supportive measures for recruiting, hiring, retaining, treating and promoting members of the designated groups, which will also benefit the workforce as a whole.

During the debate preceding passage of the Act, the Opposition proposed an amendment that provided that nothing in the Act removed or diminished an employer's right to hire or promote the most qualified person for a position. This proposal was defeated in committee. It is clear that the Act is remedial in nature and could be classified as 'affirmative action' legislation. It is equally clear that the legislation will impose what it describes as 'equity' with little regard to merit and that employers will henceforth be obliged to document very carefully their hiring and promotion decisions, and be prepared to respond to complaints where the burden will be on them to justify their actions.

How the Act Works

Generally speaking, employers are obliged to conduct a Workforce Survey to obtain a 'snapshot' of their current employees. They must also conduct an 'Employment Systems Review' in order to remove barriers to employment and promotion. The information thus obtained is used to develop and implement an 'Employment Equity Plan', which will remain in effect for three years, and will set out the barriers to be eliminated, the qualitative and supportive measures to be implemented, numerical goals and timetables for the hiring and promotion of members of the designated groups, and the process to be followed in monitoring progress towards the goals.

Relevant employers must survey their workforce to determine the extent to which they employ members of the designated groups. Every nine years, a questionnaire must be distributed to all employees, stating that each employee has the right to decide whether to answer the questions and may nominate himself or herself as a member of one or more designated groups.

The definitions of some of the designated groups are vague. Consider two of the definitions: 'racial minority' and 'person with a disability'. The relevant questions on the questionnaire are as follows:

> 2. For the purposes of employment equity, a person is a member of a racial minority if, because of his or her race or colour, the person is in a visible minority in Ontario. . . Based on this description, do you consider yourself to be a member of a racial minority?
>
> 3. For the purposes of employment equity, a person is a person with a disability if the person has a persistent physical, mental, psychiatric, sensory or learning impairment and,
>
> (i) the person considers himself or herself to be disadvantaged in employment by reason of that impairment, or
>
> (ii) the person believes that an employer or potential employer is likely to consider him or her to be disadvantaged in employment by reason of that impairment.

Based on this description, do you consider yourself to be a person with a disability?

What exactly does the term 'visible minority' mean? Some minority groups who have persistently been the targets of the most pernicious discrimination are not distinguished by physical characteristics. Are these groups somehow excluded from the definition? As for the disabled, which disabilities count? It has been held in Canada that alcoholism is a disability under the Canadian Human Rights Code.[2] Does this mean that alcoholics may consider themselves to be persons with a disability under the Act? Remember that the definition that must be applied turns on a determination of disability by the employee.

The Regulation to the Act, Section 15(2), provides that a policy or practice is a barrier to the hiring, retention or promotion of members of a designated group 'if it has a direct or indirect adverse impact on members of the designated group'. This means that, in view of the goal of a workforce that reflects the demographic make-up of the community, any deviation from this pattern will constitute prima facie evidence of barriers in a place of employment. One important qualification to this, however, is effected by the Ontario *Human Rights Code*, which provides that employers may apply a requirement, qualification or factor that has the effect of excluding or preferring members of a particular group so long as that requirement, qualification or factor is 'bona fide in the circumstances'.[3]

Numerous decisions have been made on what is meant by the concept of 'bona fide occupational qualification'.[4] It is likely that 'barrier' will include any job requirement or job practice that is not job-related, not a business necessity and not consistently applied. Any practice causing an adverse impact or undue hardship on members of a designated group will probably be held to be a barrier. But the clear message conveyed by the Act is that it is the *effect* of a given practice rather than the *intention* of the employer that determines whether discrimination exists.

Perhaps the most controversial aspect of the Act is the requirement that Employment Equity Plans set out specific goals and timetables with respect to the composition of the employer's workforce. The Regulation defines a numerical goal as the proportion of opportunities for entry into the occupational group during the term of the Plan that will be filled by designated employees. The Ontario government has insisted that the Act does not mandate quotas, since the statutory body set up to enforce the Act, the Employment Equity Commission, will not impose any specific percentage on an employer. Nonetheless, while employers are given the task of setting numerical goals, they will have to do so on the basis of guidelines es-

---

[2] See *Niles v Canadian National Railway*, [1991] CHRD. No 6.

[3] *Human Rights Code of Ontario*, RSO 1990, Chapter H 19, s.11(1).

[4] See *Ontario Human Rights Commission v Etobicoke*, [1982] 1 S.C.R. 202, *Alberta Human Rights Commission v Central Alberta Dairy Pool*, [1990] 2 SCR 489 and *Large v Stratford Police Department*, (1992) 9 OR (3d) 104 (Div. Ct.) confirmed by the Ontario Court of Appeal, unreported, 22 December, 1993.

tablished under the Act. The goals set must be reasonably achievable with good faith effort by the employer and they must constitute reasonable progress toward achieving the ideal goal of parallel representation. In practice, this second principle means that employers will aim for the same representation in each job as exists in the community in which the workforce is located. Employers must therefore estimate the number of openings they will have in each job in the next three years and must calculate how many of any new openings must be filled by members of the designated groups in order to achieve parallel representation. If there is significant under-representation, or the number of new openings is small, employers could be required to fill all openings by members of the designated groups. (This approach is not without some precedent in Ontario. In 1985, the Ontario College of Art announced that, on account of the low number of female instructors on its staff, it would not hire any male candidate at entry level for the next 10 years.)

The History of Ontario's Employment Equity Legislation

In a review of the legislative history of the Act, Professor Robert Martin (1994:409) has recounted the history of the concept of 'affirmative action', tracing the genesis of the modern use of the term to a policy implemented by the United States government in the late 1960s to require companies that entered into contracts with the US government to take 'affirmative action' to hire certain numbers of employees who were members of minorities. The 1977 Ontario Human Rights Commission report, titled *Life Together: A Report on Human Rights in Ontario*, considered the imposition of certain forms of affirmative action to remedy what was termed as 'a climate of hostility and indifference' and a 'proliferation of racial slurs and hate propaganda' (p.57). It recommended affirmative action falling short of the imposition of quotas:

> Some jurisdictions, particularly in the U.S., have attempted to remedy long-established patterns of discrimination against various groups by requiring employers to hire quotas of people belonging to the groups. The Commission believes that this is a crude and simplistic approach to a complex problem. Such an approach casts doubt on the legitimacy of minority group achievements. Moreover, it betrays the basic principle of equality of opportunity if people are given jobs or promoted not because they are competent, but because they belong to a minority group. Such reverse discrimination, though well-intentioned, is discrimination none the less. It still spells condescension and, in the long run, it may do far more harm than good. At the bottom it is the antithesis of human rights legislation. (p.35)

Nevertheless, the slide towards quotas had begun. In 1983, the Canadian federal public service formally adopted principles of affirmative action. The program then introduced was mandatory, but the Minister responsible stated: 'The numerical goals which we will be introducing as part of affirmative action are not quotas' (Knopff, 1985:97).

The federal legislation followed the publication of a 1984 report, titled *Equality in Employment*, of an influential Royal Commission chaired by Judge Rosalie Abella. Mindful of the difficulties of employing the term 'affirmative action', Abella preferred to refer to the measures she suggested as 'employment equity'. The Report said, 'No great principle is sacrificed in exchanging phrases of disputed definition for newer ones that may be more accurate and less destructive of reasoned debate' (p.7). The report contained no reference to quotas. It was instrumental in persuading Canada's federal government to adopt its own employment equity legislation in 1986.

However, the problem with the Abella Commission was that it was convinced of the existence of an epidemic of racism and racial discrimination on the basis of scant evidence. The Report asserted, 'Non-whites all across Canada complained of racism. They undeniably face discrimination, both overt and indirect' (p.47). But according to Martin (1994:416),

> Abella held a series of public meetings across Canada. The people who attended these meetings were self-selected and, given the purpose of the Commission's enterprise, it is understandable that they complained about racism.

In addition to this pattern of asserting the evidence needed to justify the legislation, claims of discrimination have repeatedly been based on misuse of statistical evidence. The Canadian Bar Association's Task Force on Gender Equity (1993:157) concluded that women were seriously underrepresented in both legal practice and the teaching arm of the profession. Their conclusions were based on scant empirical evidence. For example, the Report merely states the percentage of staff constituted by women law professors and, after observing that 28 per cent of full time teachers in Canadian faculties of law are women, concludes, with no further analysis, that 'the representation of women in Canadian law teaching remains tentative and circumscribed'. As for minority-group representation, the Report states: 'There were so few minority law teachers in these faculties that it made little sense to construct population estimates or inquire further about minority teaching experiences in the general faculty survey.' This did not prevent the Task Force from recommending that 'law schools should give priority to the recruitment of members of minority groups into faculty positions' (1993:159). The 'evidence' on which this and other recommendations having to do with instituting and supporting programs of affirmative action are made consists of impressionistic statements made by respondents to the Task Force's survey. In the Task Force's own words: 'The survey of faculty included open-ended questions' (1993:161). Thus, the 'evidence' upon which most of the recommendations are made consists of impressions, feelings and statements of experience. The Report is riddled with testimonial statements which are then used as proof of the assertions contained therein. In the context of the law schools, this 'evidence' is then used to justify programs of affirmative action to make the faculties more 'representative'.

Professor Constance Backhouse's case for employment equity is likewise based on the misuse of statistics. In a paper dealing with the question of female teaching staff at the University of Western Ontario, Backhouse (1990) presents an array of statistical data which, in her opinion, proves that that university continues to discriminate against women. The statistics are convincing enough: there is a low number of women in full-time academic positions, women's earnings are on average less than those of men, and women predominate in the lower rungs of the professoriate. Yet nowhere does Backhouse ask whether women are underrepresented by reference to the numbers of women available or qualified for employment in full-time academic positions. The closest she comes is to compare the percentage of staff who are women with the percentage of students who are women.

By contrast, in an analysis of hiring trends in Canadian universities over the past 40 years, Grant Brown (1994:99) concludes:

> We are repeatedly told that women do not get a fair shake, either in hiring or in promotion, at Canadian universities. What are regarded as 'moderate' commentators admit that things have begun to change in the wake of the Federal Employment Equity Act and the Federal Contractors program, which were put into law in 1986. According to this 'moderate' view, 1986 or 87 was the cross-over point, when women ceased being discriminated against on a widespread scale and began receiving a fair shake, or possibly even a small break in university hiring.
>
> In fact, the data indicates that the actual cross-over point took place somewhere around 1970; since then, Canadian universities have increasingly favoured women in hiring. Although the recent data that is available to me is not complete, it suggests that qualified women are typically twice as likely as qualified men to be hired for university positions.

At no point does Backhouse present any evidence of the number of women graduating with relevant qualifications at the relevant times. She assumes that the number of women on the teaching staff should reflect something other than the percentage of qualified women or women available for employment.[5] But Brown calculated the proportion of women in the qualified applicant pool at the relevant time (that pool being comprised of women with either masters or doctoral level post-graduate degrees) and compared it with the proportion of women hired in the relevant period to faculty positions. His research reveals that the percentage of women holding relevant qualifications was greater than the percentage of women holding appointments as full professors for the period up to about 1970. However, he is careful to indicate that there may well be explanations other than discrimina-

[5] 'I firmly believe that men and women have an equal capacity to contribute as faculty in Canadian universities. I wait to be convinced otherwise, but so far have been provided neither with data nor arguments which refute this belief. I therefore assume that since the ratio of men and women is not roughly 50:50, that something must be seriously amiss' (Backhouse, 1990:55).

tion that account for the difference, such as the interruption of career for child-rearing or geographical move (1994:102).

Australian Debate about Affirmative Action

The afore-mentioned Australian Law Reform Commission's Report *Equality Before the Law: Women's Equality* recommends that Australia adopt an Equality Act that would contain a 'guarantee that everyone is entitled to equality in law' (ALRC, 1994:58). The Report contains much criticism of the approach labelled as 'formal equality', which is meant to refer to the approach of treating men and women the same (p.45). The Commission's preferred approach to the meaning of equality is clearly designed to secure favourable outcomes for the 'disadvantaged' group:

> Equality needs to be defined in terms of outcomes, that is, there needs to be a broad definition of equality which overcomes the limitation of formal equality before the law and its lack of recognition of historical and cultural factors which produce unequal results. (p.48)

The Report assumes that women have been and continue to be the subject of virulent discrimination. But like the Abella Report in Canada, the Report contains little or no statistical evidence to support this assumption.

One of the few references to statistical evidence appears in the Report's chapter on 'Women in the legal profession':

> Women make up 50 per cent of law school graduates, and 25 per cent of the legal profession as a whole. However, women leave the profession at a much higher rate than men, and they are clustered in the lower ranks of the profession. This chapter will . . . recommend that lawyers' professional associations take a more active role in changing the work practices and culture of the profession. (p.176)

Here the Report repeats the same error made by Backhouse in the Canadian context: the comparison of statistics taken out of the correct time frame. It is on the basis of this sort of scant statistical analysis and the 'stories' of self-selecting witnesses that the Report reached its conclusions. Those conclusions apparently also flow from the assumption that the profession and the judiciary ought to be more 'representative'. By contrast, the more orthodox view is that appointment to judicial office ought to be on merit rather than on some vague notion of achieving a 'representative' bench. In the words of Sir Harry Gibbs, former Chief Justice of Australia: '. . . the policy which is sometimes propounded by politicians that more women and members of ethnic groups should be appointed to the Bench, without regard to whether they are the persons best qualified for appointment, must surely be misconceived' (*The Australian*, 27 September 1993).

Conclusions

The Ontario Employment Equity Act presents a model of what measures designed to achieve 'proportional representation' in the workplace might look like. What emerges is a policy founded on generalised assumptions, either unsupported by evidence or supported by statistical evidence that has been incorrectly interpreted. Where no evidence is available, anecdotes or stories appear to suffice.

There is more to be said about the cost that such legislation or any close approximation would impose. Speaking solely of legislation designed to eradicate sex discrimination, Posner (1993:1334) writes:

> . . . it is possible that women as a whole have not benefited and have in fact suffered. Because of the heterogeneity of women as an economic class and their interdependence with men, laws aimed at combating sex discrimination are more likely to benefit particular groups of women at the expense of other groups rather than women as a whole. And to the extent that the overall effect of the law is to reduce aggregate social welfare because of the allocative and administrative costs of the law, women as a group are hurt along with men. Sex discrimination has long been on the decline, for reasons unrelated to law, and this makes it all the more likely that the principal effect of public intervention may have been to make women as a group worse off by reducing the efficiency of the economy. . . if by reducing the wages of men sex discrimination law propels more wives into the job market, with the result that (since they still bear the principal burden of household production) they work harder, have fewer children, and have less stable marriages, it is not clear that they are better off on balance than they were when their husbands had higher wages and they stayed home.

And what of the fairness of discriminating in favour of one group at the expense of another? The essential problem is equating past disadvantage of one group with present advantage of that group. It has often been observed that the problem this presents is that those who benefit have not necessarily suffered, while those who suffer have not necessarily benefited. Aside from this is the moral question of whether the discrimination *against* those who are not members of the favoured group can be justified by the need to remedy past injustices. Writing in support of the adoption of legislation prohibiting discrimination against women only, Nicola Lacey (1987:419) referred to the problem of discrimination against men:

> This [an equality guarantee aimed at women only] would be aimed at attaining equality in terms of some more substantive measure, such as resources, in the longer term. This would not, of course, be to imply that discrimination against men on grounds of sex is morally unproblematic, although it certainly does imply that non-discrimination on grounds of sex conceived in formal equality terms is not a moral absolute. But the main thrust of such a strategy would be to acknowledge that sex discrimination against men is not

> a social phenomenon of the same order, does not involve comparably damaging and oppressive effects as does sex discrimination against women, and that this clear social difference justifies and, indeed, calls for a totally different legal response.

Few adherents of positive discrimination even admit to this difficulty. In this sense, legislation like the Ontario Employment Equity Act strikes at the concept of individualism: the world thus created rewards not individual achievement so much as membership of the right group.

This is likely to create further difficulties, such as animosity towards members of the advantaged group. Hunter (1991:202) has observed,

> Affirmative action does not ameliorate racial animosities: it exacerbates them because one minority individual or group benefits from the programme while another individual or group does not. . . individual applicants must identify themselves in terms of racial or sexual characteristics in order to gain employment or promotion. Such programmes retard rather than advance genuine progress toward equality.

The very factors we hope to eradicate become institutionalised, maintaining the relevance of gender or ethnicity, just as society is moving in the opposite direction.

Furthermore, the adoption of affirmative action risks marginalising the achievements of members of the disadvantaged groups. For example, a US Navy pilot recently crashed her F-14A Tomcat on approach to an aircraft carrier. In the aftermath, suggestions were made that the crash, which was found to have been caused by engine failure rather than pilot error, was the result of placing an unqualified female pilot in a demanding position: a decision made on grounds of affirmative action (*The Age*, 15 March 1995).

Inevitably, the adoption of legislation creating a present advantage for members of groups that can lay claim to victim status will generate an incentive to portray one's own group as victim. The ultimate result of such a trend will inevitably be the division of society along lines of race or gender, with each group claiming to have been victimised to a greater extent than the others, especially in times of economic decline.

> It is not difficult to imagine the resentment soon felt by individuals in the amorphous majority who are turned upon in this way. This resentment may be expressed in an emotional 'backlash' directed against all members of the victim group. In other words, the victim group and the amorphous majority soon become polarised into opposing camps. (Roberts, 1994:408)

It seems odd that, at a time when many Americans question the continuation of affirmative action programs in their country after 30 years of experience, Australia should be considering taking the same path. Voters in California have succeeded in

placing a proposition on the ballot in next year's election which, if successful, would eradicate all affirmative action programs in that state (*The Canberra Times*, 19 February 1995). Even President Clinton, an ardent supporter of affirmative action in the past, has initiated a review of federal affirmative action programs with a view to eliminating unjustifiable ones. He may have been preempted by the US Supreme Court, which recently upheld a challenge against the federal government's 'minority contracting' program — a program that has parallels in Australia (*The Australian*, 14 June 1995).

It is hardly surprising that many of those arguing for the adoption of affirmative action programs are either members of groups who would benefit directly or else white males at the top of the career ladder who would not be burdened by the institutionalisation of discrimination against their group. Given the severe moral hazard that their arguments present, any choice to follow them would appear to be unjustified, on both moral and practical grounds.

Postscript

On 8 June 1995, Ontario elected a new Progressive Conservative government with a solid majority in the provincial legislature. On 20 July the Ontario Premier, Mike Harris, announced that the Employment Equity Act would be repealed. 'My government is opposed to any form of discrimination', he said. 'But the Employment Equity Act is not the vehicle to fight discrimination in the workplace. It is a quota-driven system.' He foreshadowed an 'equal opportunity' plan that would combat discrimination and allow employers to choose the best person for the job (*The Australian*, 21 July 1995, p.8).

References

Australian Law Reform Commission (ALRC) (1994), *Equality Before the Law: Women's Equality*, Sydney (Discussion Paper No. 54).

Backhouse, C. (1990), 'Women Faculty at the University of Western Ontario: Reflections on the Employment Equity Award', *Canadian Journal of Women and the Law* 4: 36-58.

Brown, G. (1994), 'Discrimination in University Hiring: Against Women or Men?', *Inroads* 3: 98-104.

Hunter, I. (1991), 'When Human Rights Become Wrongs', *Gazette* 25: 197-203.

Knopff, R. (1985), 'The Statistical Protection of Minorities: Affirmative Action Policy in Canada', in N. Nevitte & A. Kornberg (eds), *Minorities and the Canadian State*, Mosaic Press, Oakville.

Lacey, N. (1987), 'Legislation Against Sex Discrimination: Questions from a Feminist Perspective', *Journal of Law and Society* 14: 413-27.

Martin, R. (1994), 'Challenging Orthodoxy: A Critical Analysis of Racially-Based Job Quotas', *Canadian Labour Law Journal* 1: 409-23.

Posner, R. (1989), 'An Economic Analysis of Sex Discrimination Laws', *University of Chicago Law Review* 56: 1311-37.

Roberts, R. (1994), 'Employment Equity – Unfair', in M. Charlton & P. Barker (eds), *Contemporary Political Issues* (2e), Nelson Canada, Scarborough.

Task Force on Gender Equity (1993), *Touchstones for Change: Equality, Diversity and Accountability*, The Canadian Bar Association, Ottawa.

Agenda, Volume 2, Number 4, 1995, pages 467-478

Television Stations' Compliance with Australian Content Regulation

Franco Papandrea

WHEN television was introduced in Australia in 1956, it was expected that much of the programming would be produced in Australia. But, according to the Australian Broadcasting Control Board (ABCB, 1960:38), 'by December 1959, the majority of the commercial stations televised practically nothing but imported films between 7.30pm and 9.30pm on any evening'. Consequently, in 1961 regulation of the quantity of Australian programming on commercial television was introduced. It is now a permanent feature of the industry. It has been reviewed and amended on many occasions, and the obligations on commercial broadcasters have been steadily increased. It is now once again under review, and further increases in the obligations of broadcasters are in prospect (ABA, 1994).

Yet the objectives of the regulation are not readily identifiable. Over the years, the regulation has been deemed to serve a variety of indeterminate employment and cultural objectives. The latter objectives, in particular, are essentially intangible and have eluded a quantifiable definition.

This article assesses how effective the current Australian programming requirements for commercial television have been in achieving their explicit and implied objectives. It does not address the issues of whether the regulatory objectives are desirable or whether the regulation is efficient in the sense of generating a net welfare gain. The analysis therefore deals mainly with the television companies' degree of compliance with the regulatory requirement. Since regulation aims to alter behaviour that would otherwise result from the pursuit of market incentives, it implies the presence of a cost that rational broadcasters would attempt to minimise. Consequently, results that consistently approximate mandated outcomes would indicate that the behaviour of operators is being driven by the regulation. Conversely, regular substantial over-performance would indicate that other factors are influencing behaviour.

Franco Papandrea is a doctoral scholar in the Graduate Program in Public Policy at The Australian National University and a Research Leader in the Bureau of Transport and Communications Economics (BTCE). The views expressed in the article are those of the author and should not be attributed to the BTCE or any other organisation.

A Brief History of the Regulation

When television was introduced in Australia in 1956, commercial operators were subject only to a general obligation, under the Broadcasting and Television Act 1942 (s.114 (1)), to employ 'Australians, as far as is possible, in the production and presentation of programs'. Although the Royal Commission on Television had been sympathetic towards arguments favouring program regulation, it believed that it was not practicable to set quotas 'before any actual experience has been gained as to the amount of talent available or its capacity to provide a good standard of programme' (1954:157). The general employment obligation, however, proved ineffective and was eventually replaced by specific programming obligations.

From 1961, commercial stations that had been established for at least three years were required to use Australian material for not less than 40 per cent of their total transmission (50 per cent from 1965) and at least one hour a week (two hours after 1962) of Australian material during prime viewing time (7.30-9.30pm). Prime time requirements were increased to twelve hours every 28 days in 1967 and to 18 hours every 28 days in 1969. The first program-specific requirements were introduced in 1967.

Those early requirements, and their administration by the ABCB, were strongly criticised by the report of the Senate Select Committee on the Encouragement of Australian Productions for Television (the Vincent Committee). The Committee was particularly critical of the 'inadequate' level of domestic programming and of the resultant 'undesirable sociological and cultural consequences' (Vincent Committee, 1963:15-16), and was concerned about the lack of employment opportunities for creative people.

In the late 1960s various interest groups initiated concerted lobbying for program regulation to generate increased employment opportunities. This culminated in the establishment of the 'TV — Make it Australian' committee by a group of actors and performers. The committee attracted the support of trade unions and the Labor Party and its campaign was a major influence on the nature and structure of subsequent regulatory provisions (ABT, 1991a, vol. 1:188). In 1971 prime time requirements were increased to 45 per cent Australian content overall (50 per cent in 1972) and six hours of drama every 28 days. As well, stations had to transmit four hours of children's programs every 28 days at times suitable for school-age children (ABCB, 1971).

Following the election of a Labor government in December 1972, the quota arrangements were replaced in 1973 by a 'points system' designed to generate further increases in Australian programming and to encourage greater diversity and quality. Under those arrangements, Australian programs were accorded points ranging from 0.5 to 10, based on their contribution to desirable diversity and their 'quality, cost, employment opportunities and time of presentation' (ABCB, 1973: 110). Stations had to earn a points total at least equal to the number of hours of transmission by the station between 6am and midnight each 28 days. They also had to broadcast six hours of first-release Australian drama each 28 days during prime time (subsequently increased to 104 hours plus four 'big-budget specials' a year).

The points system was replaced by the current provisions in 1990. Currently, 50 per cent of a commercial station's actual transmission time between 6am and midnight, averaged over the year, must be occupied by Australian programs. In addition, sufficient first-release Australian drama and diversity programs have to be broadcast to secure a minimum annual drama/diversity score of 1,320 points a year and 4,260 points over three years. The points' score for eligible programs is calculated by multiplying the program's duration in hours by an 'Australian' factor and by a 'quality' factor (the latter is related to program costs). Additional quantitative requirements for children's programming also apply.

Effectiveness of Earlier Regulations

The pre-1973 regulatory mechanisms were aimed at inducing television operators to increase the amount of Australian programs broadcast and ensure that some Australian programs were broadcast during the evening prime time. The ABCB's desire for an 'adequate' level of Australian content was balanced by the expressed concern that the burden imposed on stations should not be onerous. Although the stations made some attempt to comply partially with the requirements, breaches were commonplace (ABCB, 1966). The breaches themselves seem not to have attracted any penalties other than being recorded as annotations in the ABCB's annual reports. So the regulation appears to have been little more than the statement of an aim that the stations were expected to pursue.

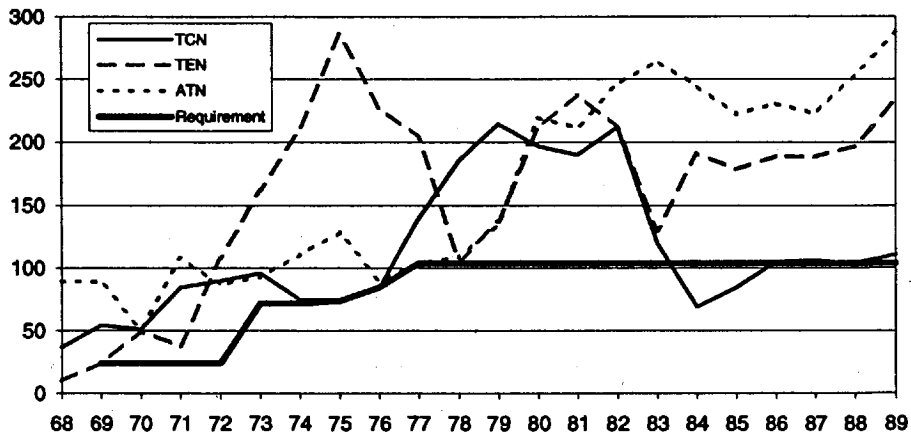
The points system introduced in 1973 was 'designed to achieve more, and better quality Australian programming' and 'to encourage production in fields which have been relatively neglected, with the object of offering viewers a wider choice of entertainment' (ABCB, 1973:113). Although promoted as a major change to the regulation of Australian content on television, its impact was minor. In a detailed critique of the system in the period to 1978, Harrison (1980) concluded that it had failed to achieve its major objectives of raising program quality and increasing the quantity and diversity of local programs. According to Harrison, the stations easily met the point targets without major change to their programming. Thus, the targets contributed little to the scheme's objective of promoting higher quality (high point scoring) programs. The available data for the period after 1978 tend to support Harrison's conclusion that the points system had little influence on stations' Australian content and program schedules.

The increase in overall Australian content in 1973-89 can be directly attributed to the expansion of sports and 'news and current affairs' programs. The annual reports of the ABCB and the Australian Broadcasting Tribunal (ABT) show that the yearly average number of hours devoted to those programs by metropolitan stations increased by 1,110 hours, compared with an overall increase in the average total time devoted to Australian programs of 1,078 hours. Since sport and news and current affairs programs were not specifically encouraged by the points system, their growth is unlikely to have been related to the regulation. Similarly, although the impact of the first-release drama requirement on the performance of stations

cannot be established clearly, the outcome appears to have been influenced substantially by other factors.

Figure 1

Sydney commercial stations' first-release drama in prime time: hours a year, 1968-89



Notes: 1983: annualised performance based on nine months data to March 1983.
1984, 1985: excludes non-peak drama credited to TCN as peak performance.

Source: ABCB and ABT annual reports.

Figure 1 shows the amount of first-release Australian drama broadcast during prime time by each of the Sydney stations along with the minimum amount set by regulation.[1] The figure shows that for several years TCN's performance was only just adequate to comply with the regulation, and that in 1984 and 1985 its actual performance fell short of the minimum requirement.[2] By itself, this would suggest that the regulation had been exerting substantial pressure on TCN's performance. However, this would be inconsistent with the performance of the other two stations and with the performance of TCN itself in other years. Had the regulation been the main determinant of behaviour, it is unlikely that the substantial over-performance clearly evident would have occurred.

[1] Because of the extensive use of networking, the figure is broadly representative of commercial services in mainland State capital cities.

[2] TCN (and associated stations in other cities) achieved nominal compliance with the quota by obtaining the ABT's agreement to credit 35 hours of non-peak viewing first release drama in 1984 and 20 hours in 1985 towards its quota obligations.

Other evidence suggests that stations were responding to audience preferences. As early as 1969, the ABCB (1969:101) noted that stations were willing to televise Australian programs 'to a much greater extent than is required' in response to improved popularity with audiences. In a recent assessment of that period, Moran (1993:22) observes that Australian serials had become the 'backbone of the program schedule' and were used to ensure 'a solid audience for the other program offerings of particular networks'. Figure 1 is consistent with these observations. In the late 1960s and early 1970s, all three networks developed drama series in response to the increased audience demand. Unlike the other two networks, however, TCN failed to develop drama serials with sustained audience and eventually largely abandoned them in favour of sports and current affairs.

Although the output of television stations does not appear to have been directly related to the preceding regulatory requirements, the regulation possibly acted as a catalyst for changed behaviour. Australian drama has often achieved relatively high audience ratings; yet it is not uncommon for some imported drama programs to achieve comparable ratings (ABT, 1991a, vol. 3:9-54). But imported drama has a substantial cost advantage and can readily be purchased for less than a third of the price of domestic drama. Under such circumstances, domestic drama may not have been sufficiently popular to overcome the reluctance of commercial stations to broadcast it without regulatory pressure in the form of a minimum performance standard.

How effective then is the current regulation?

Transmission Quota

Data on compliance with the regulation are currently available only for the years 1990-93. The data indicate that generally all stations have met or exceeded each of the annual requirements.[3] All three Sydney commercial stations complied with the transmission quota requirement each year (ABA, 1993, 1994). TCN has maintained its traditional relatively high level of Australian content and has exceeded the quota by a substantial margin. In contrast, TEN had to increase its quantity of Australian programming by about five percentage points to comply with the quota and will need to maintain the higher level for future compliance. ATN increased its Australian content marginally to ensure compliance with the quota over the period. The impact of the quota on ATN and TEN suggests that the regulation is producing the intended small increase in Australian content.

Drama/Diversity Score

Drama and diversity programs are subject to two specific requirements. Sufficient combined drama and diversity programs have to be broadcast to achieve an annual minimum score of 1,320 points and an annual average of 1,420 points over three

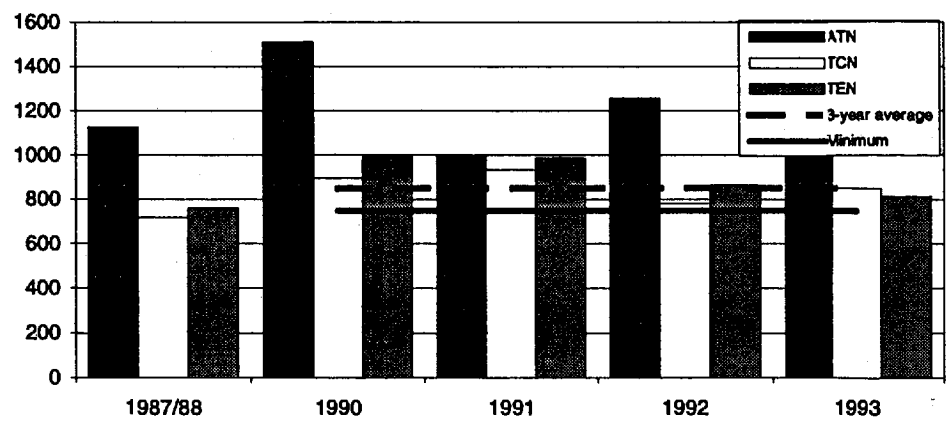
[3] The only reported breach relates to a scheduling oversight by QTQ Brisbane resulting in a two-points shortfall in the station's minimum children's drama score (ABA, 1993).

years. Although both types of programs are encouraged, the requirement emphasises drama. A minimum of 750 points annually must be gained from Australian drama (annual average of 850 over three years). An additional 170 points each year (125 in 1990 only) must be gained from children's drama. Any drama (adult or children) in excess of the minimum score earns points for the diversity score.[4]

ATN has exceeded both the annual minimum and the three-year average (annualised) scores for drama/diversity and adult drama by a substantial margin each year. While the other two stations complied with the minimum score requirements each year, their medium-term (three-year average) performance just met or slightly exceeded the requirements. During the period under review, the performance of both TCN and TEN was marginally higher than their performance in 1988-89. Given that TCN was barely complying with the requirements in 1988-89 (see Figure 1 above), it is highly likely that the current regulation has induced that station to broadcast a higher level of drama/diversity programs than it would otherwise have chosen. Such a conclusion is consistent with reports of statements by the network's executive chairman (*ABA Update*, 1993:12-13). To a lesser extent, this may also be the case for TEN. The adult drama scores achieved by the Sydney stations are shown in Figure 2.

Figure 2

Sydney stations' adult drama score: points, 1987-93



Source: ABA (1993,1994) and ABT (1988, 1991a).

The principal aims of the adult drama component of the current regulation were to secure a small increase in the quantity broadcast and to encourage an improvement in its quality. In the first two years of the current arrangements, the total

[4] Excess children's drama may also be used as a substitute for adult drama. Diversity points cannot be substituted for drama.

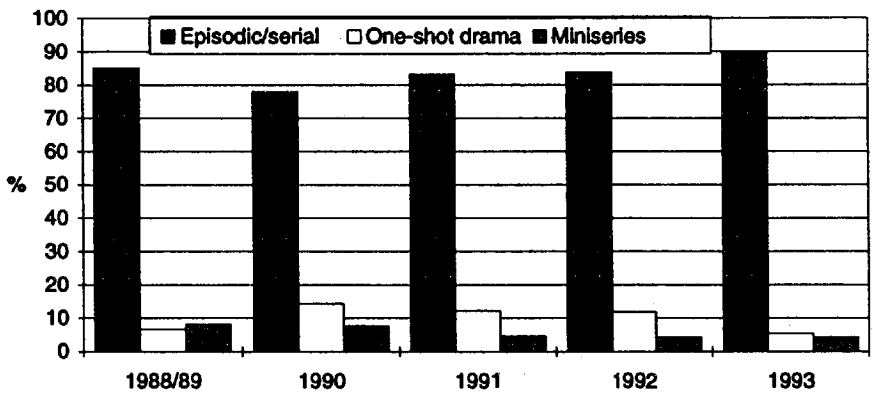
quantity of first-release drama (adult and children)[5] broadcast by the Sydney stations was approximately 100 hours more than the level prevailing in 1988-89. By 1993, however, the quantity of first release drama had declined to a level marginally higher than the 1988-89 level (ABA, 1993, 1994). This outcome was not surprising since the adult drama score had been set at a level roughly equal to the 1988-89 average performance of the stations.

High Quality Drama

The second element of the aim was to encourage the broadcasting of higher quality drama, defined in terms of average expenditure per hour of program prevailing at the time the requirements were set by the ABT. Increased quality, as envisaged by the regulation, would have been reflected by increased usage of higher cost programs such as 'one-shot' drama and miniseries. While the usage of such programs increased as a proportion of total drama broadcast by the stations in 1990, in subsequent years the proportion declined steadily. Thus, the regulation does not appear to have achieved its aim. The composition of the drama programs on Sydney stations is shown in Figure 3.

Figure 3

Composition of Sydney stations' drama programs, 1988-93



Source: ABA (1993, 1994).

The ABT's strategy to encourage stations to use higher-cost programs was based on a schedule of points that ensured that broadcasters faced roughly the same cost per point irrespective of the type of drama selected. That strategy, however,

[5] Particularly because the current regulation has necessitated an increase in children's drama by all stations, it is unfortunate that separate data are not available.

provided little incentive to broadcasters to increase usage of higher-cost programs since it failed to take account of differentials in the profit potential of different programs.

Although successful mini-series and one-shot dramas tend on average to attract relatively larger audiences than lower-cost drama, the differential is seldom sufficient to justify the additional cost involved. For example, a serial with an average 1988-89 cost of $110,000 an hour has a quality factor of 1.1, whereas that for a miniseries with an average cost of $330,000 an hour is 3.3. While successful miniseries generally attract larger audiences than successful serials, the extra audience is seldom large enough to generate the additional advertising revenue of at least $220,000 an hour to cover the higher program costs.

The disincentive facing operators is aggravated by the relatively higher risk associated with one-shot drama and miniseries. Audience appeal can be determined only after a program is broadcast and cannot be guaranteed by high production costs. Serials and series representing the lowest-cost form of drama have advantages over higher-cost products in this respect, since the popularity of a serial can be tested in advance by the screening of a 'pilot' episode. Furthermore, if the serial fails to generate adequate audiences, production of further episodes may be discontinued to minimise losses. On the other hand, once a serial becomes established with audiences, it is generally assured a following for an extended period of time. The replacement of a serial by an equivalent number of hours of one-shot drama programs or mini-series (restricted to a maximum of 13 hours) would thus highly compound the level of risk faced by the broadcaster. In addition, the regulation itself contains an inherent disincentive against higher-cost programs, since all programs, irrespective of cost, are of equal value for transmission quota purposes.

Children's Programs

The performance of the Sydney stations clearly shows that the requirements for children's programming and children's drama are having a substantial influence on broadcasters' behaviour. In both cases the stations are screening just enough programming to ensure compliance with requirements (ABA, 1993, 1994, and personal communication). Stations generally appear to be reluctant to supply children's programming without some form of regulation. This is mainly the result of financial disincentives arising from the relatively low advertising revenue earned by stations during the specified children's programming time bands. For example, the 1994 agency rate-card for ATN in Sydney quotes an average weekday rate of less than $300 per 30 seconds advertisements during most of the afternoon designated time band for children's programming.[6] This compares with an average rate of over $5,000 per 30 seconds advertisements for the period 6pm-10pm.

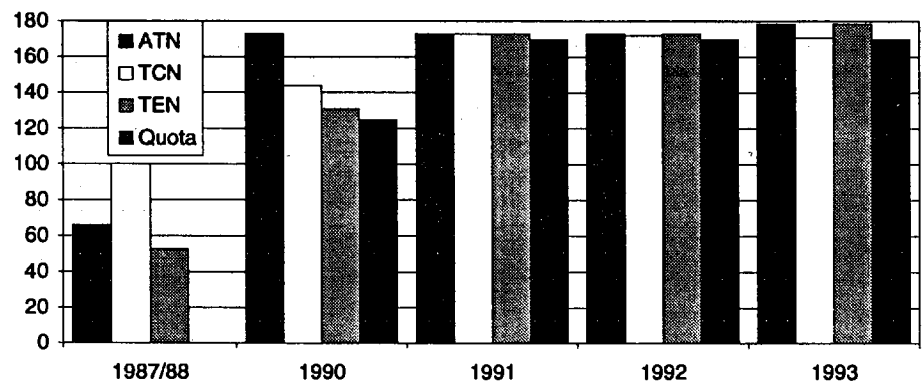
The results with respect to children's drama are particularly interesting (see Figure 4). The increases in children's drama broadcast by the stations in 1990 and 1991 are clearly related to the changes in the quota. The reluctance of stations to

[6] A rate of just $700 per 30 seconds is quoted for the half hour period starting at 4.00 pm.

exceed the quota, even though any excess children's drama can be offset against their adult drama obligations, is understandable. In the case of drama, the financial disincentive of stations against children programming is aggravated by the much higher programming cost involved: in 1988-89, the average cost of children's programming and of children's drama on commercial television was approximately $11,200 and $130,000 per hour respectively (BTCE, 1991). From the stations' viewpoint, therefore, the children's drama requirement largely represents a cost burden that they endeavour to minimise.

Figure 4

Sydney stations' children's drama scores: points, 1987-93



Source: ABA (1993,1994) and ABT (1988, 1991a).

Effects on Employment

Although the regulation does not set specific employment targets, the current provisions are clearly linked to the regulation's underlying employment objective. Stations have always had the general obligation to employ Australians in the production and presentation of programs.[7] More important, the current regulation gives 'Australian' status only to programs employing Australians in virtually all aspects of production. Consequently, to the extent the regulation generates increases in programming output it also generates increased employment.

Increased employment is likely to be an important feature of the first-release drama/diversity provisions only. Drama and diversity programs tend to be more

[7] Although not adopted by the Broadcasting Services Act 1992, the provision of the earlier legislation was converted into an ABA-administered standard by the Broadcasting Services (Transitional Provisions) Act 1992 (s.21(3)).

labour-intensive than other programs. Drama programs also generate substantial demand for post-production labour resources. The transmission quota, in contrast, is unlikely to generate sizable increases in employment since all Australian programs, including repeats, qualify for the quota.

Technological Environment

Government regulation effectively controls most operating aspects of television services, including the number, type, location, coverage area and technical operating conditions. To some extent, such regulations have been justified by the limited amount of the electromagnetic spectrum available for the distribution of television signals. Recent developments in information and communications technologies, however, practically eliminate the earlier spectrum constraints and make possible the provision of hundreds of services (BTCE, 1994). Indeed, some new services are already in operation and compete directly with free-to-air television for audiences and program material.

Of the new services already introduced, only pay television is subject to a form of Australian-content regulation. Under the Broadcasting Services Act 1992 (s.103), licensed pay-television services must ensure that 10 per cent of programming expenditure on channels devoted predominantly to drama is spent on new Australian drama programs. Narrowcasting services and other specialised audio-visual services are not subject to Australian programming regulation. Nor, of course, are any services that may be broadcast by international satellites that are beyond the reach of Australian regulation.

The audience for traditional free-to-air television services undoubtedly will be eroded as demand for new and emerging services grows. In the United States, for example, where they have been established for many years, pay-television services attract more than 30 per cent of all television audiences (National Cable Television Association, 1993). Erosion of their audience will reduce both the audience influence and advertising revenue of commercial television services. In turn, reduced advertising revenue will weaken the capacity of operators to sustain the cost of compliance with the Australian programming regulation.

In any event, as the number and variety of services expand, continued application of the current regulatory approach will mean that only a diminishing proportion of the available services will be subject to the Australian-content regulation. This will not only weaken the effectiveness of the regulation but will also distort industry structure and competition among the available services.

Conclusion

The above analysis demonstrates that, while some elements of the current Australian content regulation are having a substantial influence on the behaviour of commercial operators, other elements have little or no effect.

The transmission quota is the element of the regulation with the least impact. The quota was set at a level that was regularly exceeded by stations in earlier years

when no specific quantitative requirement was in place. Consequently, its effect has been largely confined to the TEN network, which had to increase marginally its transmission of Australian programs. Since any program, even if a repeat, qualifies for the transmission quota, the resultant financial burden on the network should be minimal. The transmission quota, by itself, is also having little impact on employment generation.

More substantial effects flow from the drama requirements for both adults and children. It is evident that at least one network (TCN) would screen a lower level of adult drama and that all three networks would screen substantially lower levels of children's drama without the regulation. Because compliance with the requirements is secured only by first-release drama programs, produced with predominantly Australian resources, it is likely that a substantial flow-on employment effect is also generated. In those respects, therefore, the effects of the regulation appear to be consistent with its aims. The regulation, however, has proved ineffective in encouraging stations to broadcast higher quality (higher cost) drama.

It is also possible that, without the regulation, some stations might have been, or would be, reluctant to risk broadcasting Australian programs, since imported programs are readily available, relatively inexpensive and popular with audiences. As well, the mechanisms may have had some impact by setting minimum standards for expected outputs that the stations are willing to adopt in the hope of averting the possibility of greater regulatory intrusion in their operations.

Notwithstanding the limited effectiveness of the present arrangements, it is also doubtful whether regulatory intervention in its current form will be sustainable in the years ahead. The multitude of audio-visual services expected to be generated by the rapid technological advances in communications undoubtedly will erode the audience of free-to-air television as well as the effectiveness of Australian-content regulation. Consequently, should the supply of Australian programming to audiences continue to be a desirable national objective, other forms of market intervention, more appropriate to the new industry structure, will need to be developed.

References

ABA Update (1993), 'Australian Content: New Rules and Policies?', December, Sydney (Conference report, Centre for Media Telecommunications Law and Policy Seminars, 30 October).

Australian Broadcasting Authority (ABA) (1993), *Trends & Issues*, No. 2, Sydney (October).

—— (1994), *Australian Content: Review of the Program Standard for Commercial Television*, Working Paper, Sydney.

Australian Broadcasting Control Board (ABCB) (various years), *Annual Report*, AGPS, Canberra.

Australian Broadcasting Tribunal (ABT) (1988), *Annual Report*, AGPS, Canberra.

—— (1991a), *Oz Content: An Inquiry into Australian Content on Commercial Television*, vols.1-3, Sydney.

—— (1991b), *kids tv: An inquiry into Children's and Preschool Children's Television Standards,* vols. 1 and 2, Sydney.

Bureau of Transport and Communications Economics (BTCE) (1991), *Economic Aspects of Broadcasting Regulation,* AGPS, Canberra (Report No. 71).

—— (1994), *New Forms and New Media: Commercial and Cultural Policy Implications,* Communications Futures Project, Canberra (Work-in-Progress paper No. 3).

Harrison, K. (1980), *The Points System for Australian Television Content – A Study in Symbolic Policy,* Royal Institute of Public Administration, Brisbane (National Monograph Series No. 5).

Moran, A. (1993), *Moran's Guide to Australian TV Series,* Australian Film Television & Radio School, Sydney.

National Cable Television Association (1993), *Cable Television Developments: March 1993,* Washington DC.

Royal Commission on Television (1954), *Report,* Commonwealth Government Printer, Canberra.

Vincent Committee (1963), *Report,* Commonweath Government Printer, Canberra.

The author is grateful to Robert Albon for advice and comments and to two anonymous referees for comments on an earlier draft of this article.

Agenda, Volume 2, Number 4, 1995, pages 479-488

REVIEW ARTICLE

Beyond Picking Winners? Recent Writings on Australia's Industry Policy

Heather Smith

*Jenny Stewart, **The Lie of the Level Playing Field**, The Text Publishing Company, Melbourne, 1994*

*Ian Marsh (ed.), **Australian Business in the Asia Pacific Region: The Case for Strategic Policy**, Longman Cheshire, Melbourne, 1994*

*P. J. Sheehan, Nick Pappas & Enjiang Cheng, **The Rebirth of Australian Industry: Australian Trade in Elaborately Transformed Manufactures 1979-1993**, Centre for Strategic Economic Studies, Victoria University, Melbourne, 1994*

JUST when you thought the Australian industry policy debate was over, three recent contributions again call for a grand vision to create a viable manufacturing sector. But the nature of the debate has shifted. Debate over tariff protection is all but over. There is a consensus over the damage done to Australia by past protection, including the legacy of an inward-looking and uncompetitive manufacturing sector.

This consensus arose during the 1980s as several reports drew attention to the Australian economy's need for reform and greater international orientation. Apart from the pace of tariff reform, the point of departure between the so-called 'economic rationalists' and the 'interventionists' centred on what governments could best do to achieve sustained export competitiveness and growth. From the economic rationalist camp, the Hughes Committee (1989) highlighted the importance of macroeconomic policies consistent with the objective of improving Australia's export performance. Meanwhile the Garnaut Report (1989) argued for the continued internationalisation of the Australian economy, but was most widely quoted for advocating the removal of tariffs by 2000. The Industry Commission (1990) then

Heather Smith is a Postdoctoral Fellow in the Northeast Asia Program in the Research School of Pacific and Asian Studies at The Australian National University.

questioned the relevance to Australia of looking towards the rapidly growing East Asian economies for examples of successful government targeting.

At the forefront of the interventionist camp was the Australian Manufacturing Council's (AMC) (1990) report, *The Global Challenge: Australian Manufacturing in the 1990s.* This report differed from the others in advocating the use of positive measures to create export firms in high value-added manufactures. All the three books under review share this theme. They argue that Australia should 'tilt the playing field' and adopt a strategic approach to 'create' export winners. This, it is claimed, represents the East Asian industrial experience.

It's All Down Hill From Here

According to Jenny Stewart's *The Lie of the Level Playing Field,* Australia is in economic decline. Since the mid-1970s, each recession has been a little worse, more prolonged than the last. Without an explicit, determined industry policy the country is doomed.

> As deindustrialisation continues, young Australians will be forced to leave this country in search of work. When this happens the economic rationalists will no doubt identify yet another 'inevitable' trend, and wax lyrical over the new international mobility of labour. . . The societies to which they will go are no luckier than Australia, except in one respect. They are not burdened by elites who find it difficult to concentrate on the main game, and then only from the distorted perspective of the level playing field. (p.13)

Such is the tone of this book: a call to arms to save manufacturing from the economic rationalists in the bureaucracy and academia. Like recent contributions of this *genre*, the term 'economic rationalist' is used consistently and pejoratively. Australian policy-makers, Stewart argues, have lacked any real sense of the importance of manufacturing to Australia's economic future. Canberra bureaucrats have had little understanding of the practical realities of manufacturing, with officials unlikely to even encounter a manufacturer. Meanwhile, the attitude of most of the intelligentsia towards profit-making business was one of slight disdain. 'After the old protectionists retired or were squeezed out, the new wave of conventionally trained economists often showed a deep-seated ambivalence about their role' (p.185). All of this is a 'hangover from the heady days of the 1970s when most Australians thought that they were, indeed, denizens of the lucky country' (p.186). Stewart apparently sees herself as a latterday Donald Horne. But whereas Donald Horne made an important contribution by tweaking a national nerve, Stewart's rhetorical attack on Australian 'elites' is somewhat dated and seem less likely to impinge on our national consciousness.

Beyond this, Jenny Stewart's main point is that a successful industry policy requires an implicit working partnership between business, government and unions. Both the public and the private sectors need to work actively to extract 'every ounce of opportunity from the changing circumstances of industrial, governmental and

working life'. The emphasis, says Stewart, is not so much on 'intervention' as on 'co-determination' based on the commingling of the resources of the public and the private sectors. This includes the adoption of policies (what Stewart calls 'dispersed responsibility') such as 'buy Australian' campaigns and government purchasing preferences, and more nebulous measures such as officials passing on word about contract opportunities or suggesting a partner in a grant application.

Stewart is not advocating that governments pick winners, because, as she says, it is never really clear why certain industries should be singled out for special attention. But she then goes on to advocate selecting industries that are likely to generate links to other worthwhile activities. Governments can thus encourage and develop industry clusters. Evidence of such policies, Stewart suggests, are to be found in East Asia and most of the industrialised world. Japan is the pre-eminent practitioner. Although, Stewart says, we do not really know how these industry policies worked, it seems that they were devised with the needs of particular firms and chains of production in mind.

Stewart seems unaware of the considerable research effort undertaken on the East Asian development experience, of which Japan and Korea are the most studied cases. No clear consensus exists among Japan specialists on the effectiveness of Japan's industry policy. But a balanced view attributes Japan's success to a combination of MITI policy, market forces, and Japanese business leadership. MITI's record is by no means unblemished, extending well beyond the Honda case acknowledged by the interventionist literature as the only example of unsuccessful targeting the economists can find. Two trends are discernible in recent Japanese industry policy. Industry policy has become less important in overall government economy policy; and MITI's role as a major player has declined as it has placed greater emphasis on other aspects of industry policy. As Stewart acknowledges, Japanese industry policy during the 1980s has been most effective in dealing with industries in trouble and needing structural adjustment. Meanwhile, Korea is still paying a high price for its targeting of capital-intensive industries in the 1970s, a point usually conspicuously missing from accounts of Korea as an example of successful industry targeting. Its highly politicised industrial targeting has left a legacy of distorted credit markets, heavily indebted firms and a high concentration of industrial power.

Stewart's rhetoric portrays international trade and investment as a game of winners and losers. Trade liberalisation is viewed as a zero-sum game to which Australia has slavishly committed itself under the GATT. Although no evidence is presented as to why this is so, Stewart claims that Australia, 'would not be one whit worse off today had we never joined GATT' (p.12). Estimates of Australia's share of economic benefits stemming from the Uruguay Round differ, but the lowest estimate sees Australia benefiting by a minimum of $2.5 billion by 2002 (DFAT, 1993). The Australian-led Cairns Group's insistence that the Round include an agreement on agriculture was rewarded by improved access for a wide range of Australian products. Increased market access will also accrue to Australian exporters of a wide range of manufactures.

While the trend within the Asia Pacific region is towards increasing economic integration and cooperation, Stewart says we should ignore the retaliatory consequences of attempting to 'resurrect and reconstruct' industries. Indeed,

> [t]o weather this kind of (usually stage-managed) opprobrium requires a measure of national self-confidence, and the ability to apply policy by subterfuge where that is appropriate. Australia, like the rich kid on the block we used to be, tries to curry favour by buying presents for everybody and conspicuously being 'good'. Such behaviour is deeply confusing to older and wilier nations who are convinced it must disguise deeply duplicitous behaviour of some kind. (pp.40-1)

There is an emotional appeal in denying trading opportunities in retaliation against the distortions of others. If Australia were richer, we might be able to contemplate indulgence of this kind (Garnaut, 1991:30).

Stewart's mercantilist view is at odds with statements elsewhere in her book that, as trade barriers have fallen with increasing globalisation, assistance has taken the form of functional incentives such as training and know-how and new technology. This, says Stewart, helps keep firms at home and acts as a substitute trade policy by enabling firms to strengthen their competitiveness against imports. This is confused. Rather, increasingly globalisation of production, trade and investment creates what Jagdish Bhagwati (1991:16) calls a 'veritable spider's web', where everyone is now in everyone else's backyard. The trend of firms to share the burden of R&D or gain access to foreign markets through joint ventures and strategic alliances complicates any definition of national economic interest, weakening the role of government in industry policy. Stewart's prescriptions for greater local ownership and controls on foreign investment, allegedly crucial to industry policy in Europe and in Asia, seem equally flawed. Some of the most spectacular recent successes of East Asian development, such as in Malaysia and Thailand, have been led by export-oriented foreign direct investment from Japan and the newly industrialising economies. Foreign investment is being helped by increasingly liberal trade regimes, and in turn is creating pressures for further trade liberalisation.

Yet in other policy prescriptions, Stewart is probably more at home with the economist's view of the role of government in industry policy than she is willing to admit. Few would dispute Stewart's stated role for government in providing the macroeconomic and microeconomic conditions that firms need to prosper and grow. For example, in East Asia investment in education has been particularly well focused on the acquisition and mastery of technology.

Stewart is at her best when writing on science policy, about which she displays detailed knowledge. She highlights past disparate approaches to science and technology policy development, and the need for greater priority to be given to technological development. Unlike in the mining and agricultural sectors, a considerable gap exists between the manufacturing sector and major research bodies such as the CSIRO. Stewart shows just how long this has been a problem, although there are

increasing moves to put relations between business and the scientific community on a more commercial basis.

Despite some interesting sections, Stewart's book is loaded with unsubstantiated and opinionated assertions. Academics, says Stewart (herself an academic), will not like her approach because she is 'cavalier with disciplinary boundaries and because she sees her task in Australian terms, rather than curating the opinions of British or American authors. . . . All this suggests to me that I have probably got it about right' (p.14). For this reviewer, the straddling of disciplines is the core weakness of her book. It contributes little to the literature on industry policy. It is not rigorously analytical in its policy prescriptions, and is too populist in its view of what economic theory has to say on the role of the state and especially on what lessons the East Asian industrial experience may hold for Australia. Too many sweeping assertions are presented as self-evidently true when they are not. The most sweeping one of all states:

> As in individual life, a lack of confidence among a nation's citizens produces an undervaluation of collective assets. Non-Aboriginal Australians had (and many still have) a scant regard for animals and plants which are not European . . . The same attitude results in an undervaluation of home-produced goods as well, most noticeably by the so-called elite. Being run over by a Volvo is more likely on the campus of the Australian National University than just about anywhere in the world, yet Volvos have been justly described as the Holdens of Sweden. (p.273)

The book's contribution consists of a set of principles to guide policy-makers in formulating industry policy, many of which are already observed in daily government-business networks and dealings. Some readers (presumably economists and the 'elites' in academia and the bureaucracy) will find the continual swipes disparaging and tedious, especially in the final chapter. Alternative policies are too vaguely and rhetorically argued to be translated into action. But other readers will cheer in the stands.

Still Looking to East Asia

Like Jenny Stewart, some of the contributors to *Australian Business in the Asia Pacific Region* seem to feel they have been marginalised from the debate. For example, Colin Carter, a principal author of the Australian Manufacturing Council's *The Global Challenge*, is perturbed that since the release of the report neither he nor his coauthors have received a single phone call from the bureaucracy.

The book arises from a conference held by the Australian Graduate School of Management and the Committee for the Economic Development of Australia (CEDA) in 1994 and is part of a CEDA series on strategic issues in economic development and public policy. The first of three major sections is devoted to the quality of industry policy debate in Australia and alternative economic strategies to achieve competitiveness. The second section examines opportunities in selected

high-value-added service and industry sectors: telecommunications, health, education, processed foods and tourism. The final section focuses on implementation issues. The book is heavy going. It has some good contributions, but it perhaps tries to cover too much ground. The editor could have been a little more selective in deciding which conference papers to include.

The book's central theme is that Australia must adopt a strategic industry policy if it is to successfully enter markets for high-value-added goods and services. Ian Marsh contrasts the free market or 'neutral' approach based on economy-wide action by government with a strategic industry approach involving selective incentives designed to suit particular sectors. Competitiveness, Marsh argues, does not need to be achieved in every activity associated with the value chain of the targeted sector. 'Just as Japan maintains inefficient rice-growing or distribution in the interest of solidarity, equity and high levels of employment, so inefficiencies can be preserved in some sectors and for similar reasons' (p.xv).

In reviewing the industry policy debate in Australia, Colin Carter asks why Australian policy-makers dismiss evidence of successful selective industrial intervention in East Asian and other countries, usually, according to Ian Marsh in his introduction, 'with a morally charged slogan that impugns the motives, not the arguments, of proponents' (p.xx). This is somewhat exaggerated. The real reason why economists are not convinced by the interventionist literature on East Asia is that its proponents have not satisfactorily established the effectiveness of industrial policies. The majority of these authors (including the contributors here) do not seek to evaluate explicitly and quantitatively various forms of government assistance to specific industries. A common but simple-minded argument is that since Japan had a targeted industrial policy and a high growth rate, Japanese-style targeting must work. But strategy-centred interpretations of East Asian industrialisation must also demonstrate, rather than assume, that strategies matter. For example, Taiwan's policy in the early 1980s of promoting 'strategic' high-technology industries with financial and fiscal incentives was not what it seemed on paper: government actually protected industries with declining comparative advantage, not export winners (Smith, 1995).

Given these concerns, claims by Ian Marsh, Bruce Scott and Colin Carter that strategic industry policy draws on actual practices in East Asia should be treated with caution. Rather, these contributors resemble certain American writers like James Fallows (1994) and Clyde Prestowitz (1988) who call for the adoption of strategic policies for industries with high growth potential, high added value, large linkage effects and rapid technology change. Paul Krugman, an author of earlier theoretical work on strategic trade theory, has recently debunked much of this line of thinking. Over the past ten years a massive international economic research program has explored the prospects for strategic trade theory, mainly in the context of industrial economies. According to Krugman (1994), several broad conclusions have emerged. First, it is very difficult to determine both the industries that should receive strategic promotion and the appropriate form of promotion. Second, the payoffs of even a successful strategic industry policy are likely to be modest. Third, the criteria advocated for picking strategic winners have little merit, since any indus-

try may exhibit one or more of the relevant characteristics. Advocates assume that 'high-value-added' industries involve high technology, which in turn is thought desirable. But this is typically not the case: for example, the steel and car industries add more value per worker than high-technology industries. As for 'linkages', these seem to refer to catalysts for the rest of the economy in the sense that one industry's output is in turn used as an input by a number of industries. But the fact that some industries produce inputs for other industries does not of itself provide evidence of market failure or indicate that markets underinvest in the relevant industries.

Much has been made of Michael Porter's *The Competitive Advantage of Nations* (1990). The chapter by Philip Yetton, Jane Craig, Jeremy Davis and Fred Hilmer shows why Porter's diagnostic framework is of limited use to public policy-making in small or resource-based economies like those of Australia, New Zealand and Canada. This chapter and Peter Warr's (1994) quite different discussion on how Porter and others (including contributors to this book) have confused the notion of comparative advantage and competitive advantage are two of the most rigorous critiques so far undertaken of Porter's framework.

The most interesting chapters are those that explore the opportunities in particular sectors, namely, telecommunications, health, tourism, education, food processing and resources. Not all of these sectoral case studies assign a major role to government incentives. Clem Doherty's contribution on the high-value specialist-treatment segment of the health sector and John Keniry's on the food-processing sector highlight the export opportunities for Australia in the Asia Pacific. Doherty argues that Australia has more and better quality health-care resources and is more cost competitive than any other country in the region. For example, an eleven-day hospital stay for open cardiac surgery in Australia costs half that of comparable treatment in the United States. Demand for high-quality health care will grow as the populations of the Asia Pacific age and become more affluent. But this potential is being constrained by frequent changes to health policy by successive federal and State Governments. This, says Doherty, makes the industry highly unstable and gives it a predominantly domestic rather than a regional focus.

Keniry likewise assesses opportunities in the processed food industry on the basis of growing per capita incomes of East Asia. Export opportunities, Keniry argues, will not be realised without an active role from government in the form of assisted export-market development. But there are more substantial obstacles: the traditional strong domestic focus of the industry; impediments in international markets; and impediments in the Australian business environment arising from assistance to other industries and from inefficiencies in transport and freight handling.

The conclusion of the sectoral chapters is that microeconomic reform is still what matters most. In 1994, the Hilmer Report produced a long list of reforms that would be required for the Australian economy to work to its full potential. It was clear that Australian businesses were at a disadvantage compared with their overseas rivals, mainly because of higher input costs, including transport, shipping, communications and wages. Many of these areas were tackled during the 1980s, but there

are still concerns that reforms have not occurred in many other sectors of the economy.

Now For Some Facts

The most informed assessment of Australia's manufacturing sector, past and present, is provided in Sheehan, Pappas and Cheng's *The Rebirth of Australian Industry*, which is described as the 'first report' of the New and Old Industries in Australia Project. Drawing on the resources of the International Economic Data Bank at The Australian National University, the authors document the growth in exports of Australia's high-value-added manufactures (elaborately transformed manufactures, ETMs) since 1985, and sift through the reasons for their strong performance, albeit from a low base.

Between 1985 and 1993 real ETM exports have grown by 14.3 per cent a year, compared with 1.9 per cent between 1980 and 1986. Improvement has been widespread, but the authors find that export growth has been highest in manufacturing sectors characterised by oligopolistic market structures, non-price competition, and industry-specific policies. These, predominantly high-technology, sectors are identified as pharmaceuticals, computing equipment, telecommunications equipment, transport equipment (particularly aerospace and shipbuilding), road vehicles and clothing. In 1985-93, real exports of this group (called policy ETMs) have grown by 21.7 per cent, nearly twice the rate of other ETMs.

The success of policy ETMs exports since the mid-1980s is explained by a combination of cost reductions, a positive change in Australian attitudes to competitiveness and exporting, the success of a range of industry-specific policies targeting export growth, and the expansion of world import demand, especially from East Asia. In particular, the authors present empirical evidence that this growth is not easily explained by changes in world demand and relative prices. This, they claim, supports the hypothesis that a range of non-price factors may have played a significant role: factors such industry policies, changes in the tariff regime and other factors influencing the basic structure of the economy.

If this strong growth continues for the rest of the decade, the improvement in Australia's current-account imbalance is expected to permit sustained growth of up to two percentage points of GDP higher than at present (growth in the order of 5 per cent of GDP a year, compared with the currently accepted maximum of about 3.5 per cent a year), accelerating the fall in unemployment. This assumes that all the other factors explaining past growth continue to operate. The authors conclude that specific policies to stimulate export growth in these areas have been, and will continue to be, central to the expansion of exports of policy ETMs and other ETMs.

The book is valuable as a discussion of structural change in the Australian economy since the mid-1980s and as a detailed and technical analysis of the structure and performance of Australia's exports. However, the authors' hypothesis linking industry policy initiatives and ETM export growth is not convincing. As they have not gone far enough in empirically establishing the relative contribution of each of

the factors that explain ETM growth since the mid-1980s, their conclusion that industry policy is a major factor is not robust. The problem is partly one of data, as the authors readily concede; it is difficult to identify the contribution of the factors in quantitative terms. But it seems reasonable to assume that more deep-seated structural forces are at work and that ETM exports have been responding in the expected manner to changes in competitiveness and attitudes. Growth has been too widespread across sectors to be attributable principally to industry incentive schemes. Other studies have argued that reductions in protection are the most prominent specific policy factor driving Australia's integration into the international economy and might be one of the explanations for the increase in both imports and exports over this period (see for example Bullock, Grenville & Heenan, 1993).

Perhaps the authors should have stressed that any boost to the competitiveness of export industries provided by the current systems of industry assistance would be quantitatively small in comparison with, for example, the combined reductions in inflation, interest rates and exchange rates. Moreover, the macroeconomic environment for tradable goods, continuing reductions in protection and other microeconomic reforms are also likely to be more important to the continuation of strong growth in exports of manufactured goods and services than the different forms of direct assistance.

Conclusion

All three books under review (but especially *The Lie of the Level Playing Field* and *Australian Business in the Asia Pacific Region*) focus on the question of what governments should do to create a competitive manufacturing sector. All draw on East Asian experience to support a more activist industry policy. But none really goes beyond a cursory discussion of East Asian policy outcomes. None gives sufficient weight to the central elements of East Asian success: macroeconomic stability, competitive exchange rates, and high rates of savings and investment, combined with judicious investment in human capital and infrastructure.

It is important to future living standards that Australia has a diversified export structure, which includes an internationally competitive manufacturing sector. But the preoccupation of all these studies with the manufacturing sector obscures the strong performance of Australia's services sector in recent years. Jenny Stewart acknowledges that the services sector exists, but says that by the beginning of the 1990s services growth was slowing and that the prospects for fully employing a still expanding labour force appeared increasingly remote. Really? Australia's service exports have been growing at about 7 per cent annually since 1983/84, and account for about 66 per cent of total domestic production, compared with manufacturing industry's 30 per cent. A recent study by the Bureau of Industry Economics (1995) found that in 1993/94 services absorbed 80 per cent of employment and 50 per cent of investment, and generated two-thirds of national output and a fifth of export earnings. Moreover, the services sector is expected to provide most of the jobs growth over the course of the 1990s. On what basis could we justify adding to the cost burdens of this increasingly important sector?

Past concerns over government's ability to pick winners remain valid. In 1990 the AMC's *The Global Challenge* report argued that Australia's best prospects lay in the automotive, computer and telecommunication equipment, aerospace and pharmaceutical industries because of linkage effects with other industries. In 1994, the best prospects were identified as being in telecommunications, health, education, tourism and food-processing sectors. Jenny Stewart would have government not 'target' but 'direct' (which in fact is the same thing) resources to manufacturing industries on the basis of high added value and linkages to other industries. Sheehan et al. would have government continue its programs in high-technology sectors, but cannot effectively establish whether exports of these sectors grew because of increased competitiveness from reductions in protection, or from government incentive schemes, or from a combination of these and other factors. None really makes a strong case for giving some sectors preferential treatment at the expense of the others.

References

Australian Manufacturing Council (1990), *The Global Challenge: Australian Manufacturing in the 1990s*, Final report of the Pappas Carter Evans and Koop/Telesis study for the Australian Manufacturing Council, Melbourne.

Bhagwati, J. (1991), *The World Trading System at Risk*, Princeton University Press, Princeton.

Bullock, M., S. Grenville & G. Heenan (1993), 'The Exchange Rate and the Current Account', *Proceedings of a Conference: The Exchange Rate, International Trade and Balance of Payments*, Reserve Bank of Australia, Sydney.

Bureau of Industry Economics (1995), *Industry Brief of the Services Sector*, Canberra.

Department of Foreign Affairs and Trade (DFAT) (1993), *Uruguay Round: Outcomes for Australia*, Canberra.

Fallows, J. (1994), *Looking at the Sun: The Rise of the New East Asian Economic and Political System*, Pantheon Books, New York.

Garnaut, R. (1989), *Australia and the Northeast Asian Ascendancy*, AGPS, Canberra.

—— (1991), 'Trade and Industry Policy', *Economic Papers* 10(2): 18-33.

Hughes Committee (1989), *Australian Exports: Performance, Obstacles and Issues of Assistance*, Report of the Committee for Review of Export Market Development Assistance, chaired by H. Hughes, AGPS, Canberra.

Industry Commission (1990), *Strategic Trade Theory: The East Asian Experience*, AGPS, Canberra.

Krugman, P. (1994), 'The Fight over Competitiveness', *Foreign Affairs* 73(4): 186-203.

Porter, M. (1990) *The Competitive Advantage of Nations*, Free Press, New York.

Prestowitz, C. (1988), *Trading Places: How We Allowed Japan to Take the Lead*, Basic Books, New York.

Smith, H. (1995), 'Industry Policy in East Asia', *Asian-Pacific Economic Literature* 9(1): 17-39.

Warr, P. (1994), 'Competitive Advantage and Comparative Advantage', *Asian-Pacific Economic Literature* 8(2): 1-14.

Comments from Heinz Arndt are gratefully acknowledged.

Agenda, Volume 2, Number 4, 1995, pages 489-497

NOTES AND TOPICS

William Baumol's Contributions to Public Utility Economics

Robert Albon

SEVERAL aspects of public utility organisation and regulation have recently become the subject of widespread discussion in both Australia and New Zealand. This has coincided with moves by governments in both countries to reform the main public utilities, especially those in energy, transport, and communications, through restructuring and exposure to greater competition.

The well-known American economist, William Baumol, has made major contributions to our understanding of public utility issues. Baumol has been involved both academically and practically in the analysis of public utilities. After a long and distinguished academic career, including many years as Professor of Economics at Princeton University, Baumol is now Director of the C. V. Starr Center for Applied Economics at New York University and a highly successful economic consultant. His research on public utility economics has involved many co-authors, including David Bradford, Alvin Klevorick, John Panzar, Gregory Sidak and Robert Willig.

This note provides a brief guide to Baumol's many contributions to public utility economics. While best-known perhaps for co-authorship of the Baumol-Willig rule for interconnection pricing, Baumol has made major contributions to all main areas of public utility analysis.

Contestability Analysis

Perhaps Baumol's most famous publication is the book written jointly with Panzar and Willig: *Contestable Markets and the Theory of Industry Structure*. Published in 1982, this work is a major contribution to understanding the nature of natural monopoly. It has had a major impact on thinking about the implications for allocative and cost efficiency of exposing natural monopolies to greater competition. The term 'contestability'— the idea that under certain circumstances establishing the potential for competition can force a natural monopoly to price and operate efficiently — has become part of the vocabulary in public utility discussions.

The Baumol-Willig Efficient Component Pricing Rule

In several access cases that have emerged in different countries in recent years — especially involving telecommunications and rail — attention has centred on the so-

called 'efficient component pricing rule' (ECPR) associated with Baumol and Willig.

Where a vertically-integrated firm opens part of its network to a competitor, the rule suggests charging the entrant the full incremental cost (including incremental capital cost) of its use of the component plus all of the opportunity costs of the entry to the owner of the facility, including any lost contribution to overhead costs and any lost monopoly profits.

The ECPR has apparently not arisen from Baumol's academic work, but emerged in presentations at regulatory hearings. On the many occasions when Baumol has applied the ECPR to access pricing in court or regulatory hearings in telecommunications and rail cases in a number of countries, he represents the incumbent rather than the rival. For example, he has recently represented New Zealand Telecom (see Baumol & Willig, 1991; Ross, 1995).

That the ECPR preserves monopoly rents is clear from the following statement. The required payment to the component supplier is to:

> . . . include all *opportunity costs* incurred by the supplier. . . . Here opportunity cost refers to all potential earnings that the supplying firm forgoes . . . [including] by offering services to competitors that force it to relinquish business to those rivals, and thus forgo the profits on that lost business. (Baumol & Sidak, 1994b:94; emphasis in original).

This implication of the rule has been very controversial.

The Second Efficiency Rule

In their most recent paper, partly in response to a critic of the unqualified use of ECPR (Tye, 1994), Baumol and Sidak emphasise:

> the second economic efficiency requirement that, in addition to the efficient component-pricing rule, final product prices must be constrained by market forces or regulation so as to preclude monopoly profits. (1995:178)

This has not previously been stressed.

A Floor and a Ceiling

Baumol (1995) has argued that the first (ECPR) efficiency rule should operate within a floor and a ceiling.

A rival seeking access should never be charged less than the average incremental cost of its usage of the incumbent's facility. This is to avoid cross-subsidy. As defined by Faulhaber (1975), cross-subsidy inherently involves pricing below incremental cost. At the other extreme, the rival should never be charged in excess of the stand-alone cost. The stand-alone cost ceiling is important for markets that are not contestable.

Where appropriate the floor and the ceiling have to be defined on a 'combinatorial' basis, involving a series of tests on the prices of different segments. This is explained in Baumol (1995:266-7).

Ramsey-Boiteux Pricing

Ramsey (1927) set out to solve the problem of how to raise a given amount of taxation revenue from a set of commodity taxes with the least overall cost to economic efficiency. Ramsey's idea was rediscovered by Boiteux (1956) in the context of public utility pricing. In the case of the natural monopoly, the aim is to cover all variable and non-variable costs through a single tariff on the different user groups with the least cost to overall economic efficiency. For efficiency, mark-ups on marginal costs for different services or customers would have to vary inversely with the elasticity of demand.

This 'Ramsey-Boiteux' pricing approach received little attention in the literature until given prominence by Baumol and Bradford in their 1970 paper in the *American Economic Review* on optimal departures from marginal cost pricing. As they put it in the their opening sentence:

> The need for this paper is a paradox in itself and indeed it might be subtitled: *The Purloined Proposition or the Mystery of the Mislaid Maxim.*

Baumol has not emphasised Ramsey-Boiteux pricing with respect to component pricing. But there is extensive discussion in Baumol (1995) of the role of what he calls 'Ramsey pricing' in the pricing of final products. On the one hand, Baumol notes that:

> Ramsey pricing . . . is a pricing rule that produces an optimal compromise between the requirement that the regulated firm be able to earn a fair rate of return . . . and the requirement that the prices be those that most effectively promote economic efficiency. (p.261)

However, there are two further observations. First, 'customer interests will often be served better by flexible price arrangements such as two-part tariffs . . . or multi-part tariffs . . .' (p.259). Second, he refers to 'measurement difficulties' (p.261) and the possibility in some cases that where 'evidence favouring rebalancing [according to Ramsey principles] were only marginal and lacked robustness, that evidence would merit little credence' (p.279).

The Averch-Johnson Effect

When a public utility operates under rate-of-return regulation and the allowed rate of return exceeds the cost of capital, it will have an incentive to operate with an excessive capital base, since the allowed rate applied to a larger base results in an increase in absolute profits. The process of excess capitalisation — sometimes

known as 'gold-plating' — was first analysed in a seminal article by Averch and Johnson (1962). The Averch-Johnson effect was analysed further and more formally in an important paper by Baumol and Klevorick (1970), which provided a graphical analysis and derived a corollary proposition that lowering the allowed rate of return will increase the degree of overcapitalisation.

Conclusion

In recent years William Baumol's name has been associated with a widely-discussed rule — the Baumol-Willig efficient component pricing rule — for pricing access of rivals to part(s) of the existing operator's production facilities. This rule has been discussed in relation to public utility industries such as telecommunications, gas and electricity in a number of countries. One notable case — the access dispute between Clear Communications and Telecom New Zealand — revolved around ECPR and attracted worldwide attention.

However, Baumol's work on public utility economics extends well beyond the analysis of access pricing to encompass most major aspects of the literature. His many contributions, spanning over 25 years, have helped to clarify the definition of a public utility, how it behaves and how to achieve an efficient outcome. His work has helped to guide efficient policy-making with respect to each of structure, regulation and exposure to competition.

References

Averch, H. & L. Johnson (1962), 'Behaviour of the Firm under Regulatory Constraint', *American Economic Review* 52(5): 1052-69.

Baumol, W. (1995), 'Modified Regulation of Telecommunications and the Public Interest Standard', pp.254-82 in M. Bishop, J. Kay & C. Mayer (eds), *The Regulatory Challenge*, Oxford University Press, New York.

—— & D. Bradford (1970), 'Optimal Departures from Marginal Cost Pricing', *American Economic Review* 60(3): 265-83.

—— & A. Klevorick (1970), 'Input Choices and Rate of Return Regulation: An Overview of the Discussion', *Bell Journal of Economics and Management Science* 1(2): 162-90.

——, J. Panzar & R. Willig (1982), *Contestable Markets and the Theory of Industry Structure*, Harcourt Brace Jovanovich, New York.

—— & J. Sidak (1994a), 'The Pricing of Inputs Sold to Competitors', *Yale Journal on Regulation* 11(1): 171-202.

—— & J. Sidak (1994b), *Toward Competition in Local Telephony*, AEI Studies in Telecommunications Deregulation, American Enterprise Institute and MIT Press, Cambridge MA.

—— & J. Sidak (1995), 'The Pricing of Inputs Sold to Competitors: Rejoinder and Epilogue', *Yale Journal on Regulation* 12(1): 177-86.

—— & R. Willig (1991), 'Brief in Evidence: Economic Principles for Evaluation of the Issues Raised by Clear Communications Ltd on Interconnection with Telecom Corporation of New Zealand Ltd', mimeo.

Boiteux, M. (1956), 'Sur la gestion des monopoles publics astreints à l'équilibre budgétaire', *Econometrica* 24(1): 22-40.

Faulhaber, G. (1975), 'Cross-subsidization: Pricing in Public Enterprises', *American Economic Review* 71(5): 1083-91.

Kahn, A. & W. Taylor (1994), 'The Pricing of Inputs Sold to Competitors: A Comment', *Yale Journal on Regulation* 11(1): 225-40.

Ramsey, F. (1927), 'A Contribution to the Theory of Taxation', *Economic Journal* 36: 47-61.

Ross, M. (1995), 'New Zealand's Experiment in Pricing Access to Essential Facilities', *Agenda* 2(3): 366-70.

Tye, W. (1994), 'The Pricing of Inputs Sold to Competitors: A Response', *Yale Journal on Regulation* 11(1): 203-24.

Robert Albon is Senior Lecturer in Economics in the Faculty of Economics & Commerce at The Australian National University.

The Wealth Cycle and Macroeconomic Policy

Tony Makin

THE state of the Australian economy is usually assessed by reference to the flow aggregates measured in the national accounts. Of primary interest are the standard measures of GDP, national income, consumption, investment and saving, the behaviour of which have implications for inflation, employment and the current account deficit. However, another largely neglected approach to assessing the economy's performance involves examining macroeconomic stocks rather than aggregate flows. This approach centres on changes in the value of the nation's assets (net of foreign claims), which is also a measure of national wealth.

There are two reasons for being interested in wealth movements. First, national wealth estimates provide a supplementary measure of macroeconomic welfare. Any individual household's economic welfare depends not only on its annual income but also on the value of its net assets. So it is for the nation as a whole. Whereas it has become standard practice to report and analyse flow national income data, this is not yet the case for national wealth estimates. Second, movements in national wealth, especially those attributable to changed expectations about the future income-generating capacity of the existing capital stock, have implications for the business cycle of macroeconomic boom and bust and how this cycle is managed by the authorities.

Measures of the standard national accounting aggregates ignore the influence of capital gains and losses on the value of residents' asset holdings, in accordance with international macroeconomic accounting practice. However, the convention of eliminating changes in the valuation of the economy's total capital assets deprives analysts of important macroeconomic information. In effect, it means that macroeconomic behaviour is assessed without regard to the central roles played by the economy's capital assets or by the financial markets that are perpetually evaluating and re-evaluating the worth of those assets. Curiously, we have all become quite used to analysing the short-run macroeconomic dynamics of capitalism by explicitly ignoring the role of capital markets and the capital stock itself.

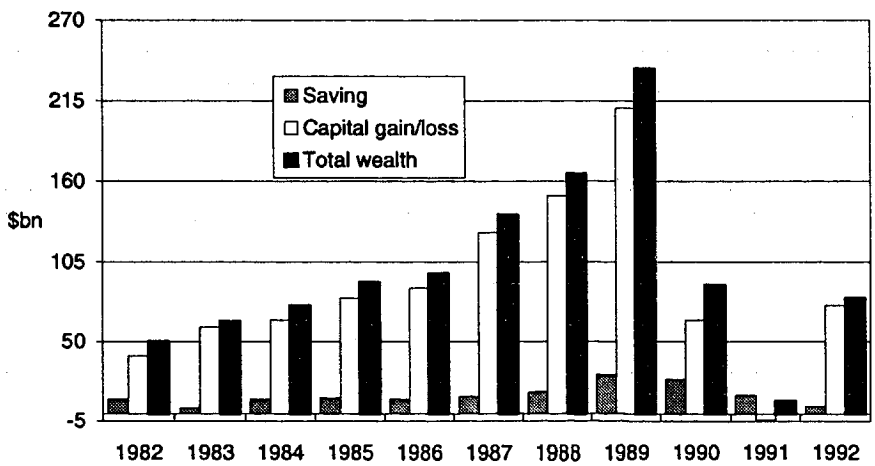
This neglect of the capital stock in the interpretation of capitalist processes is attributable to the influence of Keynesian analysis. Keynes (1936) presumed that the market valuation of capital was grossly inefficient, a presumption which stands in radical contrast to the orthodoxy of the modern finance literature (after Fama, 1976). A central tenet of finance theory has been that financial markets tend to reflect all relevant information about economic fundamentals in valuing financial claims to capital, including prospective income streams. (Malkiel, 1989, provides a useful summary of the so-called efficient markets hypothesis.) The Keynesian and efficient markets interpretations of capital market behaviour thus remain poles apart, and there is little prospect of the twain ever meeting.

Another Measure of the Boom-Bust Cycle

The level of the economy's wealth, as measured by the market value of its accumulated capital, can increase either as a result of additional saving by Australian residents, which permits further capital accumulation, or through higher market valuation of the existing stock of capital assets. Using estimates of national wealth, it is possible to identify separately how much of Australia's national wealth has grown due to its saving effort and how much has been due to market valuation changes. Such a decomposition is depicted in Figure 1.

Figure 1

Saving, valuation effects and Australia's national wealth: changes on a year earlier, 1982-92 (current prices)



Source: Makin (1994:5).

What is most striking about this decomposition is that annual changes in Australia's wealth tend to be dominated by capital gains and losses rather than changes in national savings. As well, the nation's wealth position can change markedly from year to year and bears a strong relation to the macroeconomic cycle of boom and bust.

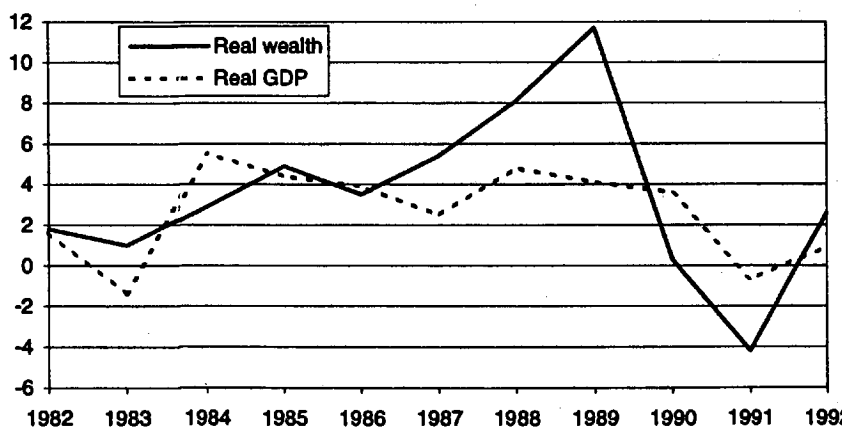
The cycle of economic boom and bust has traditionally been measured with reference to changes in real GDP, a flow measure that abstracts from changing financial market perceptions about prospective returns on capital. The year-to-year change in real wealth, however, is a macroeconomic stock-based measure that does explicitly capture market perceptions.

The relationship between the standard business-cycle measure and the real wealth measure is conveyed in Figure 2. Since these estimates were prepared, the ABS (1995) has also, for the first time, published its own 'experimental' national wealth estimates which are broadly compatible with the data in Figure 2, except that the ABS

data (for 1989-92 only) also include land values on the asset side of the national balance sheet.

Figure 2

Real wealth and real GDP: % change on a year earlier, 1982-92



Source: Makin (1994:6).

Note that the annual fluctuations in real national wealth tend to coincide with movements in real GDP from peak to trough, yet are considerably more severe. For instance, the boom of the late 1980s and recession of the early 1990s were far more pronounced according to the real percentage change in national wealth than was actually indicated by the percentage change in real GDP.

Implications for Macroeconomic Policy

What do wealth fluctuations imply for macroeconomic policy management? Indeed, to what extent are fluctuations in these measures themselves attributable to domestic policy influences?

According to Keynesian macroeconomics, the main justification for macroeconomic policy intervention is to mitigate economy-wide disturbances stemming from changes in business sentiment about private-sector investment. Keynesians simply presume that interventionist fiscal and monetary policies stabilise the business cycle by smoothing out booms and busts. Yet, in practice, macroeconomic policy interventions can themselves generate unfounded market expectations and introduce an additional source of uncertainty about the future. For instance, activist monetary policy that forces short-term interest rates below long-term rates can artificially stimulate asset prices, creating a temporary wealth boom. Alternatively, monetary policy that forces up short-term interest rates can artificially depress asset prices and temporarily generate a recession, as recent experience has shown.

One striking feature of the earlier charts is that, in the late 1980s, the sharp rise in Australia's wealth was overwhelmingly determined by valuation effects. Even between June 1987 and June 1988, there was still a strong overall rise in national wealth despite the much vaunted October 1987 stockmarket collapse that prompted monetary expansion in Australia and abroad. This monetary expansion, working with the usual lag of up to 18 months, fuelled the subsequent boom of the late 1980s. In response to this boom, the stance of monetary policy was sharply reversed, as indicated by short-term interest rates peaking at 18 per cent in mid 1989. This severe monetary contraction contributed to the collapse of national wealth between 1990 and 1991 and the worst conventionally measured recession in decades, which pushed the unemployment rate over the 11 per cent mark.

The recent pattern of the wealth cycle weighs against the proposition that Australia's macroeconomic policy-makers have the wherewithal to manage overall activity smoothly and costlessly. To the extent that the wealth cycle can be partly explained by the overuse of macroeconomic policy, this strengthens the case for placing more emphasis on rules to limit the discretionary powers presently exercised by the fiscal and monetary authorities. Rule-based alternatives, for instance, would include the adoption of a target for money-base growth as well as explicit limits on the extent to which discretionary spending and tax rates could change from year to year, in order to minimise fiscal uncertainty. Of course, this is not to suggest that less interventionist macroeconomic policy would entirely eliminate the real wealth and real GDP cycles. Even with less manipulative fiscal and monetary policy, the economy would still be subject to a range of other domestic and foreign influences.

References

Australian Bureau of Statistics (ABS) (1995), *National Balance Sheets in Australia: Issues and Experimental Estimates*, Canberra (Cat. No. 5241.0).

Fama, E. (1976), *Foundations of Finance*, Basic Books, New York.

Keynes, J. (1936), *The General Theory of Employment, Interest and Money*, Macmillan, London.

Makin, A. (1994), *National Wealth Statements: New Estimates and Uses*, University of Queensland, Brisbane (Department of Economics Discussion Paper No. 154).

Malkiel, B. (1989), 'Efficient Markets Hypothesis', in J. Eatwell, M. Milgate, & P. Newman (eds), *The New Palgrave: Finance*, Macmillan, London.

Tony Makin is Senior Lecturer in Economics at the University of Queensland.

Agenda, Volume 2, Number 4, 1995, pages 499-514

REVIEWS

The New Interventionism

Dan Corry, David Souter & Michael Waterson, ***Regulating Our Utilities,*** *Institute for Public Policy Research, London, 1994*

Michael Beesley (ed.), ***Regulating Utilities: The Way Forward,*** *Institute of Economic Affairs, London, 1994*

Reviewed by ***Charles Crouch***

THE recent return of regulation to respectability among economic rationalists in Australia is, on the face of it, puzzling. Those who championed deregulation throughout the 1980s are often now advocates of regulation across a number of industries, albeit in a different form and with different ends from before.

In Australia, regulation is not commonly discussed outside the world of specialists, largely because, until now, decisions made by professional industry regulators have had little appreciable impact on consumers. State-owned utilities have generally had their prices and terms of supply regulated directly by government, so that if prices rise (fall) it is government that gets the blame (praise). In the UK, by contrast, the various industry regulators make and are seen to make the key decisions that directly affect consumers, and so the nature and quality of the regulators are the subject of widespread discussion. The debate on regulation in the UK will probably be mirrored in Australia.

In *Regulating Our Utilities,* a publication of the leftish IPPR, Dan Corry identifies two strands to the regulatory debate. One strand consists of esoteric discussion by experts of the means of regulations. The other consists of general statements, usually condemnatory and not always well-informed, of the results of regulation. According to Corry, these strands rarely meet. The authors of *Regulating Our Utilities* seek to combine the two strands and so to develop a coherent policy framework for regulation, concentrating on why regulation is necessary as well as how it should be done.

There is a sensible and convincing discussion of the problems associated with regulation such as technological change and capture of the regulators. The apparent paradox of regulating for competition is comprehensively discussed. But David Souter is not obviously correct in claiming that 'politicians and regulators believe that market forces alone should deliver the widespread customer benefits they seek' (p.24). Such overstatements are the main problem with the book. Considerable space is devoted to establishing that regulation will be required on a long-term rather than temporary basis in some cases and that competition cannot be intro-

duced into all utilities — propositions that are uncontroversial in Australia. These points tend to be unconvincingly generalised: for example, the problems associated with introducing competition into difficult areas like water are cited to prove that competition cannot be introduced into any utility characterised by natural monopoly.

It is difficult to disagree with Corry's conclusion that:

> Regulation is likely to grow in importance. Sensibly the Left has generally lost interest in ownership, wanting to see a predominantly market driven economy without arbitrary intervention *but operating in frameworks set by government and decided through the democratic process.* It is important therefore that thinking goes beyond short term efforts to stop excess job-loss, profits, prices and executive salaries — important though these are — and tries to think of the national interest in the medium term. (p.6; author's emphasis)

Yet it is disconcerting to read that 'regulating in the national interest' does not mean maximising competition in order to deliver the benefits of greater efficiency to customers. Rather, regulation is about delivering 'sectoral industrial policies' in energy, communications, transport and water. Corry et al. do not distinguish between the present need for pro-competitive regulation and the old, largely discredited, interference with market forces. Instead, having demolished the apparently widespread belief that continued regulation is unnecessary, they infer that as regulation is necessary, and central planning is regulation, central planning is therefore necessary. The authors' proposed 'industrial policy approach' aims to regulate industries in the collective interests of the stakeholders. They call on government to 'seek to establish a framework . . . which provides an overall balance between the interests of different stakeholders' (p.44), but miss the point that it is precisely the market's job is to resolve such competing demands and interests.

It is perhaps surprising in the light of the arguments presented in *Regulating Our Utilities* that the opponents of pro-market reform in Australia have not seized upon the general acceptance of new forms of economic regulation as strong evidence that the deregulatory reforms of the past decade have been a mistake. But readers of the book may well conclude that this argument will sooner or later be made, and this conclusion is perhaps the book's most valuable contribution.

Regulating Utilities: The Way Forward, published by the free-market IEA, superficially falls into Corry et al.'s category of esoteric discussion among experts of the best technical means of regulating a particular industry. Yet it is much the better written of the two books. It is actually a series of lectures, each dealing with a different industry, its problems and the best means of regulation. Although none of the lectures explicitly deals with Corry et al.'s 'key issue' of what regulation is for, there is a clear underlying assumption that regulation is about ensuring that benefits flow to the consumer as they would in a competitive market. So the technical discussion about the relative merits of 'rate of return' and 'CPI minus X' regulation,

asset valuation, efficiency gains and so on does not come at the expense of wider policy considerations. The discussion constantly relates the merits of various regulatory alternatives to the peculiar features of the industry under discussion and the ends that are to be served. To this extent, Corry's implicit complaint about pointy-headed technocrats imposing their technically elegant, ivory-tower solutions oblivious of the ends they are serving is not especially convincing. But Corry et al. are on firmer ground in bemoaning the lack of an informed *debate* about these ends. Since virtually all of the articles in *Regulating Utilities* take promotion of a competitive market as the purpose of regulation, the debate within its pages tends towards means rather than ends, and none of the contributors seriously analyses the question of what regulation is for.

Nevertheless, Stephen Littlechild does broach this issue in response to a proposition expressed very mildly by an earlier contributor, Dieter Helm, an Oxford energy economist. It is worth quoting as it raises issues that are by no means satisfactorily answered in *Regulating Our Utilities*:

> He paints as quite distinct alternatives either a rather doctrinaire favouring of competition, or a realistic acceptance of the fact that governments will tend to intervene. . . Do you look for a system which, on the whole, tries to maximise the scope for markets and competition to take decisions and allocate resources, tending to limit the scope for government intervention? Or do you look for a system which tends to minimise the scope for markets and competition, and tends to maximise the scope for government?
>
> The sort of suggestions that he has made elsewhere . . . obviously give government a very great deal of control indeed over the development of the industry. All the evidence is, I think, that government planning tends to lead to much higher costs and much larger-scale mistakes. (pp.113-14)

We may hope that the future of regulation in Australia follows Littlechild's rather than Corry's view. Based on developments to date, the danger of competition regulation being an effective Trojan horse for opponents of competitive markets is minimal. However, the same arguments will undoubtedly occur to Australian anti-market forces as have already been discovered by their British counterparts. Just as it has taken time for the anti-competition lobby to realise the implications of the Hilmer Report on competition policy, the fact that these arguments have not yet been made does not mean that they will not be made in the future.

Charles Crouch is a Senior Consultant with ACIL Economics and Policy.

Roads Leading Nowhere

*Reuven Brenner, **Labyrinths of Prosperity: Economic Follies, Democratic Remedies**, The University of Michigan Press, Ann Arbor, 1994*

*Reviewed by **Michael James***

IN the late 1970s it looked as if Keynes was dead. But as Paul Krugman shows in *Peddling Prosperity* (1994), he was quietly revived in the 1980s. And the response to the recession of the early 1990s showed that Keynes still had a central place in the public imagination. Encouraged by recidivist chatter about 'kickstarting' and 'the multiplier', and Australian Prime Minister Paul Keating's loose talk about the levers in his pocket, everyone suddenly seemed to 'know' that governments could create jobs by resorting to budget deficits. Economic commentary in the media is dominated by the great macroeconomic aggregates. The Keynesian revolution is apparently complete.

According to Reuven Brenner, a Professor of Management at McGill University, emphasis on macroeconomics has locked us into a range of fallacies, liberation from which will require not only intellectual but also institutional changes. The most obvious sign of our thraldom is what Brenner calls our 'illusions of precision': the conviction that statistics can in principle come up with indicators reliable and meaningful enough to ensure policy success. One problem here is surely the media's demand for easy news and the financial commentators' eagerness to supply it by droning endlessly and forgettably on about 'the numbers', especially when they are staging their monthly mercantilist melodrama about the nation's 'import bill'. And although we do every so often remind ourselves of the shortcomings of indicators, we soon forget them and carry on as before. But Brenner tries to incorporate the limitations of statistics in a serious reform proposal. Central banks should be made responsible solely for price stability, he says, but this stability should not be expressed as a precise target. Instead, bureaus of statistics should publish two price indices: one for unregulated markets, the other for regulated ones. They should also publish two series of price indices following significant changes in fiscal policy or import prices or a devaluation: one series would include the effects of the changes, the other exclude them. In all cases the margins of error should be made explicit and stressed.

Brenner's fundamental objection to macroeconomics is that it cannot answer the most important things we want to know about public spending and budget deficits. Do they create jobs or destroy them? Do they stimulate investment or crowd it out? Brenner thinks that the evidence is inconclusive, for the good reason that 'It all depends on what the government does with the money and on the timing of its expenditures' (p.19). He is impressed by the fact that America's growing budget deficits in the 1980s were accompanied by falling inflation and interest rates, and rising investment. He suggests that high defence spending increased Americans'

sense of security at a time of rising international tension, and so had the effect of crowding investment in rather than out. In this instance, defence spending was in line with Americans' preferences, and so amounted to an investment. In other circumstances such spending might not have reflected their preferences, so amounting to waste. But mere statistical aggregates, including those that break down spending into 'consumption' and 'investment', cannot distinguish between spending that does reflect citizens' preferences and spending that doesn't.

The need to interpret macroeconomic data in this way leads Brenner to be sceptical about the claim that higher national savings will promote higher investment and, therefore, growth. This belief encourages governments to cut spending in aggregate, even though some such spending represents true investment rather than a reduction in national saving. (Brenner himself doubts whether high saving and investment are a cause of prosperity, but thinks they are probably consequences of it.)

For Brenner, prosperity requires not so much a focus on national macroeconomies but rather an international emphasis on incentives to invest and access to capital markets. Just as commentators in 17th-century Europe wondered at the prosperity of Amsterdam but overlooked its actual causes (Brenner thinks they included fiscal responsibility, trustworthy institutions and financial innovativeness — he might have added a lack of statistics), so nowadays Western economists tend to make the same mistake with regard to the successful Asian countries. The first lesson we should learn is that in those countries macroeconomic policy stays in the background.

The question that Brenner's analysis leads to is this: how can we determine whether a public-spending program represents an addition to or a subtraction from a nation's wealth? This is where institutional reform is needed. Brenner observes that many Western governments have arrived at a condition of fiscal paralysis — what Jonathan Rauch has called 'demosclerosis' in a book so titled — whereby the ordinary political process vetoes serious spending cuts or tax increases. Recalling Joseph Schumpeter's observation that radical political change has often been triggered by state bankruptcy, Brenner thinks that the age of the popular initiative and referendum is at hand. These institutions, he argues, are going to be needed to reveal whether particular spending programs reflect citizens' preferences. As he shows, the number of important decisions — and not only constitutional ones — being made by referendum is slowly increasing. It is indeed quite likely that near-bankrupt countries like Italy, whose government has recently been close to defaulting on either public-debt interest payments or age pensions, will be forced to delegate fiscal-reform decisions directly to the people.

To bolster his argument, Brenner stresses the joys of Switzerland, a rich and peaceful country where institutionalised regular initiatives and referendums 'diminish the importance of politicians' opinions, theirs and bureaucracies' power, and incentives for lobbying groups to organise' (p.157). Indeed, the Swiss system produces politicians who are characterised by a deeply attractive ordinariness, absence of charisma, and, best of all, international anonymity: as Brenner says, 'one does not hear much about them' (p.156). Brenner is aware (as perhaps some pub-

lic-choice theorists are not) that direct democracy, in subjecting taxes and regulations to a more rigorous test than they receive under representative democracy, would not necessarily produce fewer of them. But this would not worry Brenner, for whom the issue is not how big or small government should be, but whether each intervention enhances national prosperity.

Brenner is on the right track in recommending a greater role for direct democracy in fiscal decisions. Nevertheless, if referendums are to do the job he wants them to, they need to be constrained in various ways; and advocates of direct democracy do typically recommend checks such as requiring initiatives to be endorsed by large proportions of voters, and referendums to be carried by qualified rather than simple majorities. Even so, voters, like politicians, can be mistaken about the effects of the programs they sanction; and some spending programs represent transfers rather than investments in public goods. The real strength of direct democracy lies in its potential to get rid of counterproductive programs that are too well defended by vested interests for the politicians to tackle unaided.

Labyrinths of Prosperity has several attractive features. Brenner shows how economists can draw on sociology, history and political science to supplement their analyses of the conditions of prosperity. The main text, written in plain but lively English, takes up only about two-thirds of the book; most of the technical analysis and supporting data are relegated to appendices and notes. Let Brenner have the last word, in a passage that usefully summarises and connects several of his main ideas:

> In spite of worrying about deficits, some economists are still trapped in Keynesian semantics and talk about the stimulus of deficits, of spending on public works (now called 'infrastructure'). . . The issue is responsible governance and political institutions to enforce them [*sic*], rather than reliance on one or another economic theory, or one way or another of counting numbers. The theories are just frequently repeated opinions without foundation, and frequently the numbers bear no relationship to facts. The roads may lead nowhere, and the schools may produce illiterates with diplomas. (p.49)

Michael James is Editor of ***Agenda.***

Promoting Agricultural Research

*Derek Tribe, **Feeding and Greening the World: The Role of International Agricultural Research**, CAB International in association with the Crawford Fund for Agricultural Research, Wallingford, 1994*

*Reviewed by **Grant M. Scobie***

THE sustainable production of the world's food supply is prominent on the agendas of many national and international forums. But the quality of the debate is mixed. Doomsayers paint a picture of inevitable famine, usually as a prelude to the case for population control. Green lobbies depict modern agriculture as raping the environment. Those claiming to speak for the rights of indigenous peoples berate the first world for the alleged theft of plant materials. Yet many from the rich countries, with their obscenely subsidised agricultural sectors, are more preoccupied with disposing of their surpluses and limiting production than with the challenge of maintaining adequate food supplies in the developing world.

The rhetoric of these groups stems more from emotion, politics, ideology, and even genuine altruism, than from fact and analysis. Those international agencies whose mandates include addressing the question of food production and the environment are themselves under increasing attack, being seen as part of a capitalistic mafia, operating largely in the interests of their wealthy donor members, enriching their own bureaucracies at the expense of the poor who they are meant to serve. The extensive protests at the annual meetings of the Asian Development Bank in Auckland by students, the unemployed and the champions of indigenous rights exemplify some of the difficulties faced by the international community.

Not for one second should we dismiss the voices of protest out of hand. There are serious questions that underlie all of the concerns. But it is not always easy to put these in proper perspective when the message is delivered in an aggressive manner.

To this confused and tempestuous debate, Professor Derek Tribe, currently executive director of the Melbourne-based Crawford Fund for International Agricultural Research, brings a cool, reasoned, yet forceful message. In short, investment in agricultural research has a demonstrably high pay-off. The systematic application of new knowledge to farming is necessary to ensure continued growth in world food supplies. Above all, the good news is that such an approach has been, and can continue to be, consistent with better stewardship of the environment.

That Professor Tribe concludes with his own plea for more funding for that investment comes as no surprise. In fact, doubtless conscious of the potential for critics to point the finger at him, he notes that 'The argument for greater funding for agricultural research and development [R&D] is far from being just another case of special pleading' (p.242). Any such criticism would be totally unwarranted. True, Professor Tribe is among a handful of academics (disproportionately from Austra-

lia) who, in addition to a distinguished career within their universities, have played an important role in guiding and managing the international agricultural research community. Truth in advertising requires that the reader be aware that your reviewer could be tarred with the same brush, being Director-General of one of the largest international research centres, whose case for funding is so eloquently made by Professor Tribe.

Feeding and Greening the World is at once a history of agriculture, an overview of the world food and population scenes, a guide to emerging technologies, a reference work on the origins and structure of the international agricultural research systems, and a statement of the costs and benefits of investment in research. It is a breathtaking agenda, which is both its strength and its weakness. Those who have had little or no contact with the topic will find a comprehensive and balanced treatment. Those who stridently push particular barrows would find reason, not emotion or ideology. For all, its simply written, uncluttered prose will be a joy. Those who seek a deeper treatment may be left a little frustrated. But to have covered this range of material in a cogent 274 pages is a commendable feat. To those wanting more, a brief but up to date list of further readings is incorporated. I would have preferred more citations in the text. Sometimes, other studies are used to illustrate a point, but only referred to as, for example, 'a World Bank study' (p.23). But freedom from citations and footnotes surely enhances the readability and widens the access.

Access by whom? The only clue is in the author's preface where he refers to the book as 'a plea to politicians and bureaucrats'. But I suspect that it will be more widely read. There is a large community of people with interests and concerns for questions of international development. Scientists, policy-makers, analysts, students and journalists could well be added to Professor Tribe's own modest list.

The hugeness of the task of feeding the world is highlighted by the fact that in the next 30 years the world will need to produce twice as much food as was produced in the last 30 years. The increase needed in the next 30 years will be more than all the food ever produced in the history of the world up until 1920. And all of this has to be accomplished with little or no expansion in the cultivated area. Above all it will have to accomplished in a way that preserves the productive capacity of the natural resources.

Based on the past experience of the application of knowledge to agriculture which he documents, Professor Tribe is optimistic that this can be achieved. His caveat is that a necessary condition will be adequate investment in research to ensure the continued expansion of the stock of knowledge. Nor does he see a necessary threat to the environment. Modern agriculture, when based on sound practices has the capacity to increase output on existing lands, and in the process relieve the pressure on marginal and fragile areas where so much of the degradation has occurred.

While we might well accept that the science industry can deliver, we should continue to be concerned about the political and social contexts. Almost every challenge that is faced in enhancing food supplies has a political dimension. The

pollution of the environment, the misuse of water, the salination of lands, the claims to rights over plant materials, and the very mechanisms for funding research all have a common theme involving property rights and the institutional frameworks needed to ensure increased, sustainable food supplies.

Professor Tribe recognises these issues. But in the end he returns to his plea for increased funding. Unquestionably, that is a necessary input. But the reader will be largely left to contemplate the ways in which institutions will need to evolve. New systems for the ownership and control of water, new linkages between the public and private sectors, new roles for the non-governmental organisations, new relations between national, regional and international bodies, new structures of property rights for plant materials and new arrangements for the governance and funding of agricultural research will need to emerge in response to today's pressures.

Professor Tribe has set the scene and highlighted the challenges of demonstrating the benefits from that elusive international public good called international agricultural research, in a way that sustains the funding. What must follow is the evolution of the institutional settings, and the adoption of policies conducive to realising the benefits of research.

Grant Scobie is Director-General of Centro Internacional de Agricultura Tropical, Colombia.

The Closing of the Australian Mind?

*Alan Barcan, **Sociological Theory and Educational Reality**, NSW University Press, Sydney, 1993*

*Reviewed by **Brian Crittenden***

THE title might lead us to expect a contrast, but this is not the line of argument. The author, now an honorary associate in the Department of Education at the University of Newcastle, intertwines two stories: of sociology and its influence on educational theory and practice, and of changes in Australian schools and other educational institutions since about 1950. In effect, we have two books in one. The account of sociology in education runs through Chapters 1, 2, 3, 6, 7 and 9; the recent history of Australian education occupies Chapters 4, 5, 8 and 10. I followed the author's own suggestion and read each strand separately. In these comments I shall be mainly concerned with the treatment of sociology of education.

Although the book runs to about 400 pages, it attempts to cover far too much. Inevitably, complex issues, especially in the theoretical strand, tend to be treated very summarily, and the 'answers' emerge too neatly. Yet the book contains many interesting facts and sound critical comments. It also reflects the historian's temptation to package the flux of events in precisely defined periods. Everything falls into three neatly divided stages: the welfare state (1949-67); pluralist society (1967-87); contemporary Australia (1987 to the present). Did Australia as a welfare state come to an end in 1967? Did pluralism emerge in Australia as late as 1967? The pseudo-precision of the boundaries that mark historical changes in this book is misleading.

The chapters on sociology of education cover a vast territory. The first provides a brief survey of the major theorists (Comte, Marx, Durkheim, Weber et al.) who shaped sociology as a distinct field of inquiry. Durkheim is treated in two pages. His influence on Basil Bernstein is noted, but there is no reference to his sociology of knowledge and hardly anything on his significant work on moral education. On the beginnings of the study of education from a sociological perspective, Barcan briefly notes the work of Mannheim and Clarke in the UK, the influence of sociology on the role of the school as an agent of social reconstruction in the US, and some faltering steps in the field within Australia. He concludes that by about 1950 the stage was set, in several countries, for the development of sociology of education. However, as he points out, the general discipline was not established in any Australian university before 1959.

Barcan's sketch of the growth of sociology refers briefly to changes in its characteristic methods, particularly the move from an association with history to precisely quantified empirical inquiry (reflecting the influence of positivism). There is a passing reference to some use of qualitative methods. There is no comment on the

philosophical arguments about the nature and scope of sociology and the other social sciences. As Barcan points out, sociology of education, in its earlier phase, concentrated on the interaction of the school institution and the general society, in particular on the question whether the school could be a reforming agency or was bound to be an instrument of the status quo. Not much attention was given to the sociological issues at the micro-level of the individual school and classroom.

Barcan claims that, during his so-called 'welfare state' period, sociology of education and its parent discipline were only beginning to develop in Australia. Although this is probably an accurate enough generalisation, there is no mention of work in sociology of education at the University of Sydney (supervised by W. F. Connell, W. J. Campbell and others) in this period. As the era of the welfare state was (apparently) coming to an end around 1966, the 'old' sociological tradition (which had barely been established in Australia) was also in decline. Apart from mentioning the expansion of the white-collar class as one of the contributing factors, Barcan offers no explanation for this change. More curious, of course, is the claim that the welfare state was then drawing to a close, especially as Barcan himself claims that 'in the late 1980s the economic crisis of the welfare state transformed educational policy' (p.286).

Chapter 6 begins with the exaggerated precision to which I have referred: 'in 1971 a new sociology of education was proclaimed'. The chapter refers to the neo-Marxist version of sociology that drew heavily on the work of Louis Althusser. In sociology of education, the curriculum became a central issue (in particular, the relationship between socio-political power and what the school transmitted as knowledge). We are taken on a roller coaster ride through the theories of Gramsci, Althusser, Bourdieu, Bernstein, Young, Bowles and Gintis. One or two critics are mentioned, although there is no reference to the challenge by John White and other philosophical theorists of education (including some in Australia) during this time. By the mid-1980s, as Barcan notes, the neo-Marxist versions of sociology of education were being displaced by the fashions of postmodernism. (The shift to relativism has been much more severe than Barcan seems to recognise.) Despite the crush of theorists packed into this chapter, the author manages three paragraphs on the 'new' sociology in literature, including a note on Derrida.

The discussion of sociology of education in Australia over the past 25 years focuses mainly on those who followed, usually in a fairly naive way, the neo-Marxist line. More than passing attention is given to the work of Bob Connell, Kevin Harris and Rachel Sharp. Barcan makes the sound point that the neo-Marxist sociologists of knowledge were interested in formal schooling as an instrument of socio-political power rather than of education. He offers good criticisms of Connell's simplified division — useful for dramatic effects — between the ruling and the working class. However, he does not comment on Connell's curious advocacy of a distinct working-class curriculum. He raises the interesting question of how Harris managed to be an exception to the product that, in his theory, schools inevitably produce: a consciousness 'suited to the capitalist mode of production' (p.199). As Barcan points out, the pessimistic determinism of neo-Marxism led to its rejection

by many otherwise sympathetic teachers who believed that schools could be agents of reform. He also wryly notes that many former neo-Marxists joined what they had earlier regarded, following Althusser, as the Ideological State Apparatus.

In his account of the past decade, Barcan claims that, with the decline of both the neo-Marxists and neo-progressives, sociology of education has tended to fragment as exponents attempt to advance the cause of one or another of the increasing number of interest groups. The last he refers to as the phenomenon of pluralism, but there is no discussion of how it relates to the traditional theory of pluralism associated with liberal democracy. His general conclusion is that sociology of education has declined in significance and quality. But his judgment that 'by the beginning of the 1990s the desolation of educational theory throughout Western culture was obvious' (p.296) goes well beyond the scope of this ambitious book. Perhaps there are no stars (such as Dewey) around at present, but there are still many very competent theorists representing a variety of discipline perspectives.

In the second 'book', Barcan offers a large number of interesting factual details and challenging opinions about developments in, or affecting, the practice of Australian schools and other educational institutions over the past four decades. The account has a number of deficiencies. For example, Barcan claims that 'social justice in education' is a new movement. But the issues covered by the expression 'social justice' were placed firmly on the education policy agenda in the Karmel Report of 1973 — as Barcan's own few references to the report show. There is very little on the significant changes to the design of senior secondary schooling in Victoria and other States over the past decade; there is virtually no analysis of the enthusiasm in recent public reports for so-called generic key competencies (for employment) and the 'convergence' of general and vocational education; the Hobart Declaration in April 1989 is not mentioned; and there is scarcely any reference to the current efforts at comprehensive curriculum development that it initiated. Nor is there any mention of the substantial increase in retention rates to Year 12 and in tertiary education enrolments since the late 1980s.

While the restructuring of Australian higher education that began in 1988 is critically evaluated (the picture of John Dawkins on page 352 says it all), Barcan could have given more attention to the entrepreneurial and managerial approach that has gripped our universities (or credentialling factories), the undermining of the collegial model and the consequent decline in morale among academics.

A persistent theme throughout the book is Barcan's pessimism about the survival of liberal humanist values in education. In this, I believe, he is excessive, but not without some justification. Yet at the very end he strikes a note of high optimism. Challenged by the excesses of instrumentalism, some educators, he claims, are returning to the ideals of a liberal humanist education. After the long, sad story that he tells, such a happy ending seems incongruous. But, as the account he gives tends in many respects to exaggerate the negative features of our educational practices in recent decades, there are some grounds for cautiously endorsing his conclusion.

Brian Crittenden is Professor of Education at La Trobe University.

Decultured Paternity

David Blankenhorn, Fatherless America: Confronting our most urgent social problem, Basic Books, New York, 1995

Reviewed by ***Brian T. Trainor***

THE orthodox view of fathers is that they are superfluous, dangerous to wives and damaging to children. But for David Blankenhorn, founder and president of the Institute for American Values, it is a matter of great concern that 'tonight, about 40 per cent of American children will go to sleep in homes in which their fathers do not live', and that 'before they reach the age of eighteen, more than half of our nation's children are likely to spend at least a significant portion of their childhoods living apart from their fathers' (p.1).

Blankenhorn sees the father as an irreplaceable caregiver, moral educator and family breadwinner. Fatherhood was once understood as — and in his view, in essence, it still is — an indispensable, intimate presence in the procreation and rearing of a child. But today, he complains, the 'good father' or 'model father' has become 'culturally invisible'; as an ideal to be emulated, he is conspicuous by his absence in today's anti-marriage, pro-divorce culture:

> A decultured paternity necessarily fractures any coherent social understanding of fatherhood. As fewer children live with their biological fathers, and more live with or near stepfathers, mothers' boyfriends, or other male 'role models', biological fatherhood is being separated from social fatherhood. In turn, social fatherhood, once detached from any one man, becomes more diffuse as an idea and elastic as a role — less a person than a style of relating to children. (p.16)

Blankenhorn views with concern the rise of what he calls 'volitional fatherlessness'. Whereas the principal cause of fatherlessness was once paternal death, which does *not* undermine the idea and importance of fatherhood, today the major cause is paternal choice, which *does* undermine that idea and its importance. And the consequences, he holds, are socially and personally disastrous for children. The boy who commits crime, who has a deeply misogynistic sense of rage against his mother, women and society, and who exhibits an aggressive hypermasculinity or 'protest masculinity' is generally the fatherless boy who cannot become the son of his father. So 'if we want to learn the identity of the rapist, the hater of women, the occupant of jail cells, we do not look first to the boys with traditionally masculine fathers. We look first to boys with no fathers' (p.31). Yet discussions of youth crime simply ignore 'the elephant in the room called fatherlessness' (p.29).

The simple message or moral of this book is that each child *needs* a father, not a 'father substitute', not different men each performing a fatherhood role for a

child, not different men successively playing the role of father in the life of a child, not a biological progenitor reduced to the role of visiting his child or sending cheques in the mail, but a father who is there for his children. That is why fatherless children so frequently upset their mothers by persistently fantasising or questioning their mothers about 'my father'. According to Blankenhorn, 'we no longer focus on the objective situations of children. Instead, we discuss the subjective feelings of adults' (p.177). Likewise, against the view that living in a step-family with a 'new father' constitutes a 'new source of stability' or that it has no significant negative effects on children, Blankenhorn writes:

> Step-families comprise the most unstable and volatile family form in our society. They are inherently fraught with bad outcomes for children. More specifically, the great majority of step-fathers are not — cannot ever be — replacement fathers or even extra fathers. In almost all of the most important ways they are not fathers at all. (p.190)

Unfortunately, while we have been regarding sexism, racism and 'homophobia' as the major evils of the late 20th century, Blankenhorn's analysis suggests that the chief and most real evil, namely 'adultism', has been running rampant just beneath the range of our preoccupied adult gaze — quite literally, under our feet!

In the final chapter, the author turns his attention to the burning question, 'How is a culture shift in favor of fatherhood to be effected?'. But his answer is disappointing:

> A culture shift in favour of the Good Family Man cannot draw its main strength from Washington politicians, Hollywood scriptwriters, Madison Avenue advertising firms, or the conferences of professional family scholars. Cultural elites can help or hinder social change, but their views, mercifully, are not all that matters. For fatherhood, the seedbeds of renewal must be local and immediate. The real shift must occur from the bottom up, around kitchen tables, less a reflection of elite fashion than a revolt against it. (p.225)

But if it is true that 'the fish rots from the head down', then the only way that a new cultural story celebrating fatherhood and motherhood as laudable gendered roles can emerge is if the current intellectual/cultural elite abandons as implausible its present cultural narrative or if a section of this elite (a new section or an old section with new ideas) gains a foothold in elite culture and begins the slow, laborious process of establishing a new, pro-fatherhood narrative or paradigm. The great achievement of this book is that it helps to establish just such a foothold.

Brian Trainor is Senior Lecturer in the Faculty of Humanities and Social Sciences at The University of South Australia (Whyalla).

Terrified of the World?

*Graeme Campbell & Mark Uhlmann, **Australia Betrayed: How Australian democracy has been undermined and our naive trust betrayed,** Foundation Press, Perth, 1995*

*Reviewed by **Mark Schubert***

GRAEME CAMPBELL, federal Labor MP for Kalgoorlie, and his assistant Mark Uhlmann appear to display a certain courage with their politically incorrect stance on a number of sensitive issues. *Australia Betrayed* is, however, an almost irredeemably unstructured book, desperately in need of an independent edit. This must be said at the outset because it completely overshadows the book's content and any courtesy a reader would expect of a writer. Readers are advised to refer to Campbell's open letter (pp.196-202) for a reasonably good summary of what they have just read or are about to read.

The book's thesis is that, as governments are increasingly unable or ideologically unwilling to regulate their economies to the extent they once did, regulators have turned to regulating the attitudes of citizens and the social processes in which they take part. As a result, the state and associated institutions work against the interests and wishes of the majority. The regulated majority are '"old" Australians' (p.viii) or of 'old Australian stock' (p.ix). Those born overseas of non-English background are dismissed as only 10 per cent of the population. The regulators comprise bureaucrats, academics, big business interests, politicians, media, churches, and professional 'ethnics': what the authors continually refer to as 'elites' and, less frequently, as the 'New Class'.

The policies that have betrayed 'old' Australians include those relating to immigration and multiculturalism, native title, the practice of access and equity, funding for the arts, the Commonwealth's overriding of States' rights, the appropriation and manipulation of symbols such as federation, and the use to which institutions like museums are being put. Of these, immigration and multiculturalism are 'central' to the entrenchment of the 'dominant ideology' (p.ix). Old Australia (and also most immigrants) have been betrayed because governments of all persuasions have refused to stop or significantly slow immigration despite a broad consensus against immigration and multiculturalism. As well, immigration has brought increasing crime and exposure to health risks, along with a deterioration in living standards, social cohesion, environmental quality, and opportunities for Australian students as tertiary institutions chase full-fee-paying Asian students. Australians' cultural attitudes and work practices play, it seems, only a marginal role in the country's economic decline, which is caused mainly by immigration-fuelled population increase and the current-account deficit.

The Australia Council is identified as an instrument for the funding and promotion of New Class anti-mainstream agendas. Museums are exposed as being

used to rewrite history and recast the nation's self-identity. At this point in the book an advertisement appears soliciting support for a campaign against such an attempt at a Sydney museum. This is not the only advertisement in the book: which, to this reviewer, suggests some confusion as to the book's purpose.

The individuals who are criticised include not only New Class activists like Irene Moss, a former Race Discrimination Commissioner, but even Western Mining's Hugh Morgan, who, it seems, has recently called for higher immigration levels. Nor does B. A. Santamaria escape censure. Though 'genuinely concerned about Australia's national interest' (p.43), he is apparently wrong when he argues that a large immigration program is one way to have some control over the immigration levels that would probably otherwise be pressed upon Australia by the United Nations. The authors do, however, pay a partial compliment to a parliamentary Joint Standing Committee, which, for new citizens, stressed 'the desirability of learning English and basic outlines of Australian history and institutions' (p.195). But even of this Campbell and Uhlmann remain sceptical.

To review, even a little negatively, a book whose back cover describes 'the bulk of academics, artists and others' as 'intellectually corrupt hirelings' exposes the reviewer to the accusation that he too is 'intellectually corrupt'. In fact, it is not difficult to agree with many of the authors' points. It is true that something like a New Class exists and that governments are legislating to change citizens' attitudes. But one has to read more than half the book before finding a theme that warrants lumping such a wide array of subject matter into one volume, apart from it all being a result of elitist or New Class design and behaviour. The authors claim that Australian elites are being driven by an 'internationalist' agenda that stresses 'the need for high levels of immigration to invigorate the country, both economically and socially' and the need to join 'economic groupings of nations such as the European Community and the North American Free Trade agreement' because 'Australia will be left behind if it does not make a similar agreement' (pp.128-9). Most nationalists, in contrast, 'call for government intervention to assist local industry and deny that there is any such thing as a level playing field'; they stress 'the importance of maintaining good relations with Asian countries' and believe that 'all these things can be done without sacrificing our own traditions' (p.129).

This 'intelligent outward looking nationalism' (p.130), as the authors call it, has a certain superficial appeal. But doubts about the possibility of a nationalism that is neither 'insular' (p.128) nor 'isolationist' (p.130) arise when the authors reflect on problems that could be caused by the events planned for the centenary of federation in 2001. They complain that 'hundreds of thousands of people would be encouraged to descend on Australia, many of whom would take the opportunity to stay on without an invitation' (p.191). The reader could be forgiven for feeling that the book has been written by two people who are absolutely terrified of the outside world or, perhaps, simply want others to be.

Mark Schubert is an anthropologist currently working for the Institute of Public Affairs.

Agenda, Volume 2, Number 4, 1995, pages 515-520

CORRESPONDENCE

From John Langmore and John Quiggin

TOM VALENTINE'S recent review article 'A Consumers' Guide to Recent Critiques of Economics' (*Agenda*, vol. 2, no. 2, 1995, pp.233-40) reviews three books, including our *Work for All: Full Employment in the Nineties* (Melbourne University Press, 1994). Our book is about economic policies for a return to full employment. It is not and does not pretend to be a critique of economics. However, in order to assist potential consumers, we wish to respond.

Valentine's second paragraph is worth quoting in full. He says:

> At the core of all three books is a critique of economics. In some cases (such as Langmore and Quiggin) the criticism is directed towards 'rational economics', but this term seems to denote no more than the application of mainstream economic theory to policy questions. The authors use the word 'rational' in a pejorative sense, apparently because it evokes the impressions of such horrors as expenditure cuts and reductions in employment. In the remainder of this review the adjective is dropped and the term 'economics' is employed alone. (p.233; quotation marks in original)

In reality, we never mention the term 'rational economics' in *Work for All*, and use the word 'rational' exclusively in a positive sense. Valentine appears to believe that, because we refer to other people's use (both favourable and pejorative) of the term 'economic rationalism', it is acceptable practice to fabricate quotes in order to represent us as not only as critics of 'rational economics', but as being frightened of the very word 'rational'. While unconventional in academic terms, this treatment of textual evidence is quite consistent with Valentine's attitude towards inconvenient empirical evidence.

For the record, this is what we say about economic rationalism:

> The term 'economic rationalism' first entered the Australian lexicon in the period of the Whitlam government and was used primarily in a positive sense. The connotation was that of policy formulation on the basis of rational analysis, as opposed to tradition, emotion and prejudice. With the exception of support for free trade, there was no presumption in favour of particular policy positions. Views were generally in the economic mainstream of the period. (p.42)

We make it quite clear that we support the rational application of mainstream economics to policy formulation. Precisely for this reason, and because many people still use the term 'economic rationalism' in the sense described above, we

reject it as an appropriate description of the body of economic and political thought we are criticising, preferring the term 'economic fundamentalism' to describe an irrational approach which invariably regards markets as operating perfectly satisfactorily, regardless of the empirical evidence, and rejects intervention in the interests of either efficiency or equity.

The problem here is more than semantic. Valentine's attempt to claim that 'economics' equals his brand of economics is a common rhetorical manoeuvre in this kind of debate. However, this manoeuvre is rarely as blatant as in Valentine's references to our work as 'non-economists' views about economic questions' (p.240) and to our alleged belief that 'if economics-is wrong, their own views must be right' (p.235).

Equally common, but entirely self-contradictory, is Valentine's point that our 'criticisms [of the competitive model] are not new. They have been raised and discussed in economics textbooks and courses for as long as I can remember' (p.235). This is, of course, true, and we cite such eminent economists as Keynes, Baumol, Samuelson, Meade, Tobin and Vickrey as our sources for particular arguments. But if our criticisms of economic fundamentalism are based on standard economic arguments by mainstream economists, what becomes of Valentine's claim that our position represents a rejection of mainstream economics and indeed of economics *tout court*? Nothing more than the fact that Valentine has decided that he is right and that Keynes, Baumol, Tobin and Samuelson are wrong. According to the exigencies of his argument, Valentine shifts from defining economics as agreement with his own views to a definition that would allow Samuelson, Tobin and perhaps even Keynes into the mainstream.

A related rhetorical trick is at work when Valentine says 'Langmore and Quiggin *appear* to believe that [the falsity of the rational egoist model] means people do not react to economic incentives at all' (p.235; emphasis added), then goes on to point out various instances in which we recognise that incentives do matter. If the review were focused on our actual views rather than those imputed to us by Valentine, such contradictions would disappear.

Our principal crime appears to be the view that the elasticity of employment with respect to real wages is smaller than the –0.5 per cent estimated by studies such as that of Russell and Tease (1991), and is of minor relevance to policy. If this view is enough to define us out of the economics profession, what would Valentine say of Card and Krueger (1994), who find no significant impact of the minimum wage on American employment? Worse, what of the referees and editors of the *American Economic Review* who accepted the article for publication, or the members of the American Economic Association, who awarded Card the J. B. Clark Medal? The economics profession as defined by Valentine would be a small and select body.

Valentine says that we launch

> a vicious attack on a straw man: the suggestion that real wages should be reduced by 30 per cent. So far as I know no economist has advocated this policy. Any substantial reduction in wages would be disruptive. (p.239)

The reference to disruption is a red herring since we discuss only the long-term consequences of such a wage cut. Also, Valentine does not mention our observation (on the following page) that, while some commentators have endorsed the idea of a 30 per cent wage cut, the majority of economic fundamentalists have declined to nominate any target wage cut.

The minority that has accepted the case for specific large wage cuts includes John Stone, who, in his article titled 'Cut wages for more jobs' in *The Australian Financial Review* of 3 June 1993, quoted Gregory's estimate that 'to restore full employment, real wages would need to fall by about a third' and asked why Gregory and others had not 'expressed outrage that our nationally disastrous unemployment figures are allowed to persist'.[1] It includes John Howard and John Hewson, whose *Jobsback* package included cuts of more than 30 per cent in minimum youth wages. It also includes Valentine (1993), who presents a simulation claiming to show that unemployment would have been eliminated if annual real wage growth since 1964 had been cut by 0.7 per cent. The implied real wage reduction by 1995 is over 20 per cent.

Valentine criticises us for claiming that dividend imputation is 'regressive' (p.239), but does not deny that our claim is true. His subsequent argument has nothing to do with tax incidence, but is simply a reiteration of the standard efficiency case for imputation. The question of whether any efficiency benefits justify the adverse income distributional effects is not even addressed. This is simply confirmation of our claim that economic fundamentalists are unconcerned with equity, at least as the term is used in mainstream economics.

On financial deregulation, Valentine claims that it is as inappropriate to examine movements in bank margins as a guide to the benefits of deregulation as it would be to examine the profitability of BHP on the basis of margins between input and output prices, since such a comparison 'ignores all other costs' (p.239). We, along with other mainstream economists who have debated the issue, would suggest that the critical issue is precisely that of movements in costs, and that profitability is a side issue. The whole basis of deregulation was that competition would lead to efficiency gains and therefore to cost reductions. However, if profitability is the issue, it is disingenuous to quote the 1991 Report of the Martin Committee as evidence of declining profits. Surely Valentine is aware that in the period since 1991, a number of banks have reported record profits.

In summary, Valentine's main argument is based on invented quotes and on a wilful or reckless misrepresentation of our position. His attempt to claim sole ownership of the term 'economics' for himself and his clique is arrogance that is not backed up by performance. His specific criticisms of our work are sloppy and inaccurate. Consumers who want to decide for themselves, and to see what has called forth this kind of attack, should read our book.

---

[1] To be fair, Stone suggested that this was an overestimate of the necessary cut. But his support for large wage cuts to restore full employment is unequivocal.

References

Card, D. & A. Krueger (1994), 'Minimum Wages and Employment: A Case Study of the Fast Food Industry in New Jersey and Pennsylvania', *American Economic Review* 84(4): 772-93.

Russell, B. & W. Tease (1991), 'Employment, Output and Real Wages', *Economic Record* 67(2): 34-45.

Valentine, T. (1993), 'The Sources of Unemployment: A Simple Econometric Analysis', *Economic Papers* 12(4): 1-20.

***Tom Valentine** responds*:

WHERE is one to start? The letter from John Langmore and John Quiggin suffers from the same weaknesses as their book. It is highly emotional and relies heavily on debating tricks and invective when, as frequently happens, logical argument fails the authors. What light is thrown on policy differences by their reference to a 'clique'? Does the publication of a paper in the *American Economic Review* or the award of a prestigious medal to one of its authors indicate that its model is correct or relevant? In fact, the article by Card and Krueger has been subjected to considerable criticism, and the issue remains unresolved.

An example of the debating tricks used by Langmore and Quiggin is the allegation that I have decided that I am right and that Keynes, Baumol, Tobin and Samuelson are wrong. Where did I make this claim? What I did was to point out that the criticisms given in the three books I reviewed were 'not new' (p.235). In fact, I regard most of the criticisms as valid, but not as justifying a rejection of free-enterprise economics.

Langmore and Quiggin frequently use the term 'economic rationalism' (see Chapter 4 of *Work for All*). 'Rational economics' is a widely used alternative to it. It is true that Langmore and Quiggin prefer the term 'economic fundamentalism', but this is because of its pejorative flavour. It has no other virtue. Nor, as Langmore and Quiggin suggest on page 40 of their book, is it commonly used. Langmore and Quiggin wish to depict those who favour the outcomes of free markets over those produced by government regulation as desiccated calculating machines, basing their recommendations on economic models drawn from first-year textbooks, interested only in efficiency and ignoring all non-economic aspects of human life. This is a straw man. The people that Langmore and Quiggin cite in their letter as favouring real wage cuts do so because they are concerned about the economic and the non-economic costs of unemployment. This is certainly made clear in the article of mine that they cite (Valentine, 1993).

In *Work for All*, the construction of the fundamentalist straw man quickly descends into name-calling:

> An unremarked feature of the work of economic fundamentalists is their pedantry. They deregulated only for the powerful but increased petty regulation of the weak. (p.47)

Did they really mean to use the word 'pedantry'? It is not appropriate, but it does add to the picture they are attempting to paint. An example they give of this 'pedantic' regulation of the weak, unaccountably missed by other commentators, is the imposition of taxes on financial transactions. In fact, most people who regard themselves as economic rationalists view these taxes as highly undesirable.

Langmore and Quiggin criticise me for saying that 'Langmore and Quiggin appear to believe that [the falsity of the rationalist egoist model] means people do not react to economic incentives at all' and then noting that they recognise the effect of economic incentives in certain situations. My actual criticism was that Langmore and Quiggin accept this assumption when it is convenient but reject it as having a relevant role in economic theory. Any reader who doubts this should look at page 101 of *Work for All*.

Langmore and Quiggin object to my use of the word 'appear' in the quotation discussed in the previous paragraph. Unfortunately, the word is necessary in reporting many of the statements in their book because they have a tendency to imply conclusions rather than stating them directly. Another example is found on page 49 of *Work for All*: 'The rise in unemployment was blamed on the real wage "explosion" under the Whitlam government.' Langmore and Quiggin appear to doubt this conclusion, but there is no direct statement of their reservations.

It is apparent that Langmore and Quiggin have been unable to cite an economist who has actually suggested a 30 per cent wage cut as distinct from favouring a modest wage cut or (what amounts to the same thing in the current environment) wage flexibility. It is not clear why disruption is a 'red herring', but it is clear that we are dealing with another straw man. The most important question is why these views (and other analysis relating unemployment to wage growth) are not discussed in the book. In *Work for All* Langmore and Quiggin attribute 'a totalitarian impulse' (p.43) to those who support economic rationalism in that they are supposed to ignore evidence that contradicts their views. This description seems more accurately to fit the approach Langmore and Quiggin adopt in their book.

In my own article (Valentine, 1993), I stressed that the need for wage reductions disappears if economic growth is sufficiently strong. In addition, wage flexibility is likely to promote economic growth, a possibility which Langmore and Quiggin ignore and which invalidates the analysis of the effects of wage cuts given on page 51 of *Work for All*. The analysis is questionable in other respects too.

Langmore and Quiggin criticise me for concentrating on the efficiency aspects of the imputation system of corporate taxation. I raised this question because Langmore and Quiggin ignored this aspect. In any case it is not clear that it is equitable to tax one form of income twice. This whole question requires a more thorough analysis than that provided by Langmore and Quiggin. It is also interesting

that they look for a measure of the balance of the equity/efficiency outcomes of this tax, because this approach is not applied to any of the policies they support.

Langmore and Quiggin's comments on financial deregulation are hard to follow. They now appear to accept that interest-rate margins are not the basic test of the success of financial deregulation, although they cited them as such in their book (p.72). According to Moore (1995), banks have reduced their ratio of operating costs to operating income. To this extent, deregulation has been successful, though Moore believes that further cost reductions are possible.

The major weakness of *Work for All* is that its authors present no economic model to replace the ones they reject. As a result there are no economic arguments underpinning their proposals, and no serious attempt is made to predict the effects of their proposals. That is why I do not regard *Work for All* as an 'economics' book.

References

Moore, D. (1995), 'Has the "Competition" Goal of Deregulation been Fully Recognised?', *Australian Banking Law Bulletin* 10(7): 57-66.

Valentine, T. (1993), 'The Sources of Unemployment: A Simple Econometric Analysis', *Economic Papers* 12(4): 1-20.

Agenda, Volume 2, Number 4, 1995, pages 521-528

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)

Getting Value for Money from the Overseas Aid Community

Ross H. McLeod

CARE AUSTRALIA, a high-profile non-government organisation (NGO) delivering Australian aid to countries such as war-torn Rwanda and Bosnia, has recently been forced to defend itself against charges by former employees that it has deliberately misled the general public, the government, and even the United Nations, about its use of donor funds. These allegations bring to view a fundamental problem with the provision of overseas aid through NGOs.

The Underlying Problem

As donors, we are concerned about the plight of people in other countries who are suffering as a result of war, natural calamity, extreme poverty, or whatever. Strange as it may seem, it is no simple matter to give to people in such circumstances. In practical terms, we cannot do so acting individually: the mere cost of travelling to the countries in question to deliver our gifts would far outweigh their value in almost all cases.

Foreign-aid NGOs have emerged as a response to this gap between our desire to help and our practical inability to do so as individuals. They are able to exploit economies of scale in purchasing, transporting and distributing aid supplies, organising the provision of medical services, and so on. What is impractical for us as individual donors becomes practical when large numbers of us accept an NGO as our agent.

Our problem, however, is that it is extremely difficult for us to monitor the use of our donations. If we hire a removalist to shift our belongings from one city to another, we can see for ourselves how quickly the goods are packed, transported and unloaded, what goes missing, what is damaged — and how much it all costs. But if the 'removalist' is taking our money at one end, and delivering food and blankets at the other to individuals with whom we have no contact, how can we know if a good job is being done, and at a reasonable price? How many of the dollars we contribute are used up in administration, transport costs, bribes to corrupt officials and so on? How many dollars-worth of aid supplies are actually delivered to their intended recipients? And how appropriate is the particular form of aid chosen? Would medicines be more valuable than blankets? Would funds be better spent on doctors to deliver health services than truckies to deliver flour? The answers to these questions depend on the circumstances, of course, but donors on the other side of the world have little chance of knowing whether the best choices are being made.

A New Government Agency Would Be Counterproductive

In view of these considerations, it was predictable that one of the immediate reactions to the Care allegations was to propose that the government should act as a watchdog over Care and other NGOs which raise voluntary donations from the public (and which, in many cases, enjoy access to non-voluntary taxation revenues through the Australian Agency for International Development). Such calls belong to the 'magic wand' approach to problem solving. They ignore the costs involved, and blithely assume that the concerns raised in this case — but which are inherent to the work of all overseas aid NGOs — are capable of being dealt with effectively in this manner.

There are perhaps more than 130 extremely diverse Australian NGOs involved in overseas aid work, and the very fact that their operations are spread over scores of poor countries, often in isolated locations, ensures that adequate bureaucratic monitoring of their work would be monstrously expensive relative to the aid flows concerned. Moreover, it requires a giant leap of faith to imagine that it would succeed in its aims. The cost of such activity would almost certainly be met by drawing upon the aid budget. Limited administrative resources within the NGOs would be diverted to reporting to the bureaucracy and to ensuring compliance with the new operating guidelines that would inevitably be introduced. The net flow of assistance to the poor and desperate in other countries would be correspondingly reduced.

Private Sector Solutions

The problem is best dealt with by the NGO community itself. It has a strong incentive to act decisively, because if it fails to maintain public confidence the flow of donations and tax subventions to it will surely dry up. Notwithstanding their non-profit, altruistic motives, NGOs compete strongly among themselves for limited donor funds. It is this competition which, at least potentially, holds the greatest

promise that our interests as donors will be well served in the future, just as competition between removalists helps to ensure that we can obtain the most strongly desired combinations of service and price. Firms that fail to provide such combinations will eventually go out of business.

In principle, competition for donor support could encompass a willingness on the part of each NGO to argue that funds channelled through it are being used more effectively than by others — just as profit-oriented firms must try to convince potential customers that theirs is the tastiest hamburger, the whitest-washing soap powder, or whatever. But such is the fear of where this would lead that the Code of Ethics of members of the Australian Council for Overseas Aid (ACFOA) contains a requirement that members 'promote [themselves] in ways that do not denigrate other Agencies'. Likewise, the ethics standards adopted by Interaction, a US organisation similar to ACFOA, require that member organisations 'shall not undertake negative advertising or criticise other member organisations to benefit themselves'. But why should it be unethical for one NGO to inform us that its administrative expense level is lower than those of others doing similar work? Why should it not be allowed to explain to us why certain varieties of aid are inferior to its own? Why should it have to stay silent if it knows that another NGO is failing to do what it has promised its supporters?

Paradoxically, this well-mannered unwillingness to criticise other NGOs actually seems to have contributed to the concealment of the allegations concerning Care (even though Care is not a member of ACFOA). At least some of these allegations had been around for some years, and if NGOs had accepted the idea of honest public criticism of each other's work as an aspect of legitimate competition for donor support, they would have been brought into the open long ago. If public criticism were an accepted part of the rules of the game, each organisation would have to think very carefully about how it handled its responsibilities to its supporters; and Australia's overall contribution to the amelioration of human misery in other parts of the world could become significantly more effective.

An NGO Ratings Agency?

An alternative means by which NGOs could publicise their relative merits, but within the framework of the existing ACFOA Code of Ethics, would be to borrow a practice from the world of high finance: third-party evaluation of borrowing institutions by ratings agencies. These agencies, such as Standard and Poor's and Moody's Investor Service, perform a function analogous to what seems required in the NGO business. They evaluate the creditworthiness of organisations that seek to borrow funds from the public (or from large-scale investors), by closely studying their financial condition and by paying particular attention to the quality of their management, the external conditions they face, and so on.

Undertaking such investigations would be prohibitively expensive for individual investors, just as it would be prohibitively expensive for individual donors to investigate fully the activities of any given NGO. The results of a ratings agency investigation are made available to potential investors in the form of a ranking for the bor-

rower on a scale of ratings such as AAA, BB minus, and suchlike. Investors may then use this simple summary of all information considered relevant to the risk involved in lending to the institution in question as a basis for their investment decisions. By analogy, a ratings agency for NGOs would provide summary information on individual NGOs' efficiency and effectiveness as agents for individuals wanting to provide assistance to others in less fortunate circumstances.

An institution of this kind already exists in the US: the National Charities Information Bureau. The Bureau writes and issues detailed reports on charities, which evaluate the charities' performance relative to the Bureau's own standards (which themselves are also carefully explained). This work is funded by contributions from individuals, corporations, foundations and various other sources, but not by the charities being evaluated. By contrast, financial ratings agencies derive most of their income from fees paid by the institutions being rated themselves. The latter find it worthwhile to pay to be rated (as opposed to merely singing their own praises) in order to generate investor support. Those unwilling to pay this price risk being unable to raise the funds they need, or paying higher interest rates than necessary. Obviously, the ratings agencies can expect to survive only if they establish and maintain a reputation for accuracy and objectivity: if they were to provide unduly optimistic or pessimistic ratings for their customers, their opinions would soon count for nought and they would go out of business.

This then is the private-sector equivalent to what some observers have called upon the government to do in the wake of the Care allegations. There is no obvious reason why taxpayers in general should be called upon to bear the cost of monitoring and evaluating the work of NGOs, since not all taxpayers donate to causes supported by them. Nor are there grounds for believing that a taxpayer-funded government agency would do a better job of rating NGOs than an independent private agency that had to rely on the quality of its work for its continued existence: on the contrary.

If the problem of mismanagement of donor funds is truly significant, this will manifest itself in declining public support for the NGOs. It will then be up to those organisations to act to arrest that decline by whatever means they think appropriate. They will — and should — live or die by their own ability to persuade the public that they are doing a good job.

Ross McLeod, an economist in the Research School of Pacific and Asian Studies at The Australian National University, is a joint author of ***Doing Good: The Australian NGO Community*** *(Allen & Unwin, Sydney, 1991).*

Unpaid Work and Equal Opportunists

John Logan

THE equal opportunity lobby and the feminist movement have alerted us all to the 'unpaid' work that is performed in the home, generally by the senior female member of the family, and to its significant contribution to the true Gross Domestic Product (GDP). But it does not follow that such work should attract some monetary emolument. On the contrary, consistent application of the philosophy of equal opportunity suggests that unpaid work should instead be taxed.

Why Work for No Pay?

Figures from the Australian Bureau of Statistics (ABS) (out of *dX* by Econdata) suggest that, out of the 5.3m women between 20 and 64 years of age, about 1.9m are not in the labour force at all, and a further 1.4m are in the labour force only part-time.

What is it worth not to be in the labour force? Not being in the full-time labour force is, in the absence of legislation that directly conscripts women into housework, still a voluntary choice. Housework must therefore be worth at least the monetary wage, net of tax, that could have been earned in the market for one's paid services. For example, if Ms Average's salary were A$30,000 — roughly average earnings — then performing unpaid work full-time must at least be worth this amount minus $6,642 (tax plus Medicare levy). That is, housework must at least be worth $23,358 a year after counting costs of production such as amortisation on the vacuum cleaner, Handy Andy, and so forth. Naturally, this figure is a lower bound to a more accurate measure of the value that is created in the home.

If $23,358 is representative (hypothetically of course) of the average market net wage for women, the 1.9m women in full-time unpaid employment in the home would be generating services worth about $44.4 *billion* that are not counted in the GDP statistics. Assume (purely for purposes of the exercise) that the 1.4m part-time paid workers are 'on average' half-time workers, so that that they are half in, but are also half out, of the paid labour marketplace. Taking their salary as $15,000 yields a net wage of $12,870 after tax and the Medicare levy. By volunteering for half-time unpaid work, these women sacrifice $23,358 minus $12,870, or $10,488 a year, net of tax. Similar calculations to those used above suggest that additional GDP worth $14.7 billion would be generated in the part-time unpaid workplace.

The omission of an imputed value of unpaid work seriously underestimates the GDP. The above exercise suggests that the Commonwealth Statistician is overlooking just over $59 *billion*. This is a serious, if not a grave, error.

Just think of the political advantage that could be obtained from immediately recognising the value that is generated by unpaid work in the home! Not only would this action cloak the government with an aura that would, in other circles, have almost automatically resulted in canonisation, but it would also result in an immediate leap in the measured GDP of an enormous 14 per cent. What other government would ever have achieved such an awesome rate of economic growth? Even if my rough calculations exaggerate bv 100 per cent, a growth in measured GDP of 7 per cent without the need for a calming rise in interest rates would still constitute a momentous political achievement.

There would be other beneficial side-effects. The procedures of estimation that would be required of the ABS would no doubt lead to valuable and original research into the darker corners of labour market theory — a challenge indeed for academics as well as for ABS public servants. Indeed, the ABS (1990, 1994, 1995), as well as several well-known economists, have attempted to measure the value of unpaid work and have discovered a total value that is at least three times as large as my crude estimate. My hypothetical calculations were conducted in terms of averages for earnings and the like, whereas the task of measuring the values of unpaid work for 'non' averages in the real world might pose some insurmountable measurement problems. In the words of the eponymous Forrest Gump, 'You never know what you're gonna get'. (At the end of this essay, I suggest a means of completely removing such measurement problems by a simple device of redefining tax liability.)

Unpaid Work, Taxes and Subsidies

Feminists as well as equal opportunists have argued that unpaid work is evidence of discrimination against those who have chosen to work in the home rather than in the marketplace. This leads them to propose that an unpaid worker should receive a monetary reward on top of the non-money gains that attracted the voluntary choice of 'unpaid' work in the first place.

Yet both the proposition of negative discrimination and the policy for its redress are inconsistent with the philosophy of equal opportunity. As argued above, unpaid work must be at least as valuable to the worker as the net money wage that is necessarily given up when work in the marketplace is forsaken. At the margin of choice, the two alternative occupations must just about balance in respect of remuneration (whether it be in terms of cash or non-money gain), so that a person is indifferent between a little extra paid work and a little extra unpaid work. For example, the margin of choice is evidently such that many people (1.4m of women aged between 20 and 64) strike a balance by working partly in the paid market and partly without pay.

At least at the margin, an unpaid worker is therefore on an absolutely equal footing with the paid worker. An additional monetary reward would disturb this balance. It would impose double negative discrimination upon paid workers, male and female, both because an unpaid worker would receive double pay, and because

a compulsory tax would have to be raised upon paid workers in order to finance the discriminatory subsidy.

On the contrary, strict and fair application of the philosophy of equal opportunity would dictate that an income tax be raised on the imputed income that is produced in unpaid occupations such as housework, and that it be raised according to the same scale that is normally applied to wage and salary earners.

Consequences of Equal Tax Opportunity

What consequences would flow from such an equitable application of equal opportunity? In terms of my example, if the Commissioner for Taxation imputed $23,358 to full-time unpaid workers and $10,488 additional income to part-time unpaid workers, then he or she could raise $4,291 from each of the former, and an extra $2,915 from each of the latter, as additional tax and Medicare levy. This would yield a first-round tax revenue of just over $12.2 billion, or an extra 22 per cent on the personal income tax revenue for 1994/95.

However, imposing a tax on unpaid work would disturb the equilibrium configuration of net rewards as between the paid and unpaid workplaces; the net return to unpaid work would fall below the net return to paid work. People at the margin would no longer remain indifferent between the alternative locations of their labour services, and would tend to drift out of unpaid work and into paid work. This would place downward pressure on gross wages in the paid-work marketplaces, and would, at the same time, raise marginal productivities in the unpaid workplace, so tending to elevate the value of unpaid work. Adjustments of this nature would persist until a point was reached at which the net rewards in each alternative occupation were again in balance. This would occur at a gross pay (cash or imputed value) of somewhere between $23,358 and $30,000.

Of course, by now the Commissioner for Taxation sensibly would be imputing the value of unpaid work as the *gross* wage in the paid-work market, thereby facilitating convergence to an efficient equilibrium where marginal product is equal in both paid work and unpaid work. The Commissioner would also grab more tax. The tax yield per person in paid work would fall while that per person in unpaid work would rise. However, in the final equilibrium everybody would receive the same reward for services rendered, adjusted for margins of skill, and would therefore pay the same tax: an equal opportunist's dream come true.

Assume that equilibrium gross pay were to fall to $27,000. Suppose also that the equilibrating drift of people into paid work had resulted finally in 0.5m extra full-time paid workers, of which 0.3m previously were not 'in the workforce' and another 0.2m had upgraded from part-time paid employment. In this case, to the inestimable joy of the Treasurer, the total tax take would in fact have *risen* by about another $1.1 billion. Although the equalised gross pay had fallen, the accompanying erosion of the paid-work tax base would have been more than offset by the tax bonanza from unpaid work.

Thus the final equilibrium gain to the Treasury would be about $13.3 billion in the form of additional tax revenue (minus additional costs of collection), or an in-

crease in total personal income taxes of about 24.5 per cent. Yet even these beneficial reforms would have failed to achieve global equality in opportunity. One reason is that the value of leisure would remain both unrecognised and untaxed. Suppose, then, that the Commissioner of Taxation were to tax leisure, the consumption of which is simultaneous with its (unpaid) production. Because the final equilibrium (after all adjustments into and out of the paid and unpaid workplaces had taken place) would entail an equal net return in each pursuit, the equal opportunist's goal of global equality would finally have been achieved.

But even greater benefits to society are anticipated. The first additional benefit would flow from the calculation of the tax. Because all work and leisure would return the same value at the margin, the Commissioner sensibly would calculate each workplace participant's and non-participant's annual tax liability as equal to 24 hours times 365 days times the hourly tax rate. In this way, achieving the goal of global equality would enable the government to dispense entirely with the complex system of tax thresholds and so greatly simplify the application of tax legislation.

Second, global equality achieved through such a simply administered tax would render the problems of measurement alluded to above completely irrelevant. It would be a simple task indeed for tax office computers to multiply 24 by 365 by the tax hourly rate, and to assign the result as a tax liability to taxable participants in our society. One may even conjecture that, for purposes of effective marketing, the unhappy term 'tax' would be replaced by, say, 'Membership Fee' for Club Australia.

Most important, however, global equality would be achieved through the *de facto* imposition effectively of a head tax that would remove the dreadful distortions to work-effort trade-offs and the like which are frequently cited as the bane of our current tax system.

References

Australian Bureau of Statistics (ABS) (1990), *Measuring Unpaid Household Work: Issues and Experimental Evidence*, Canberra (Cat. No. 5236.0).

—— (1994), *Unpaid Work and the Australian Economy*, Canberra (Cat. No. 5240.0).

—— (1995), *Recent Changes in Unpaid Work*, Canberra (Cat. No. 4154.0).

John Logan is a private consultant specialising in health economics, and a Research Fellow of the Centre for Independent Studies.