Some products and services are such an important component of business and consumer expenditure that their pricing can have widespread implications for the efficiency and well-being of significant groups of business or consumers. Where firms producing such items face little or no competition, incentives exist for prices to be set in ways that compromise those interests. Consequently, governments may seek to regulate those prices to ensure outcomes acceptable to the community.

Public utilities, including water, energy and telecommunications, are traditionally regulated for such reasons. The regulators tasked with the job of setting or approving prices or price changes usually operate within parameters given to them directly by government. These rules usually require the prices to be ‘efficient’. They frequently require them to be ‘fair’.

Economics offers guidance as to what is meant by ‘efficiency’ in price setting. There is much less consensus about what constitutes a ‘fair’ price. Fair against what criterion? Fair to whom? There is even less consensus about the relative importance of the two criteria. If making a price fairer were also to make it less efficient, how is a solution to be reached? Are such trade-offs likely, or even inevitable?

In this paper, the idea of fairness in pricing is explored in the practical context of utility price regulation. The pricing principles and decisions of a number of Australian and foreign utility regulators are considered, and the ways in which fairness considerations are reflected in their price determinations are identified. Actual and potential conflicts with efficiency objectives are analysed. Finally, conclusions are drawn about the role of fairness in public policy more generally. The paper begins, however, by establishing the extent to which fairness is a consideration for utility price regulators.

Requirements for fairness in regulated pricing

Examination of the objectives of a small and fairly random selection of Australian and foreign utility regulators reveals that fairness figures explicitly in almost every case (Box 1). Where it does not, related notions are generally cited, including the social impact of decisions, consumer protection, equitable access, the achievement of certain ‘minimal levels’ of provision, or the prevention of unfair practices.

However, while the term ‘fairness’, or one of its synonyms, appears frequently in such objectives, it is rarely defined in specific, operational terms.

Jan Muir is a research economist who has worked in a number of government departments and agencies. The views expressed in this article are her own and should not be attributed to any other individual or organisation.
Regulators are simply required to set prices that are ‘fair’, ‘fair and reasonable’, ‘fair, reasonable and non-discriminatory’, ‘just, reasonable and affordable’ or ‘equitable’.

**Box 1: Fairness and the Objectives of Regulators**

### Retail Services

<table>
<thead>
<tr>
<th>Organisation</th>
<th>Function</th>
<th>Fairness Principles</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Australian Water Corporation (SA Water)</td>
<td>Pricing of (retail) sewerage and wastewater services <em>(inter alia)</em></td>
<td>‘To make sure that South Australia has a widely acceptable, fair and efficient sewerage pricing system…’ <em>(SA Water 2000a:1)</em></td>
</tr>
<tr>
<td>Western Australia Office of Energy</td>
<td>Connection of regional and remote communities to regional electricity systems <em>(inter alia)</em></td>
<td>‘Equitable access to reliable electricity service at commercial rates that support the economic, social, cultural and environmental structure of regional and remote communities.’ <em>(WA Office of Energy, 2000:10)</em></td>
</tr>
<tr>
<td>Victoria Office of the Regulator-General (ORG Victoria)</td>
<td>Pricing of retail electricity charges (connection and usage) <em>(inter alia)</em></td>
<td>‘…to approve, on a fair and reasonable basis, miscellaneous charges that may be imposed by the [electricity] distribution companies… subject to a fair and reasonable test’. <em>(ORG Victoria, 2000:2 and 4)</em></td>
</tr>
<tr>
<td>New South Wales Independent Pricing and Regulatory Tribunal (IPART)</td>
<td>Maximum prices for government monopoly services including water, electricity and urban transport <em>(inter alia)</em></td>
<td>The Tribunal must ‘have regard to … factors [including] the social impact of decisions [and] greater efficiency in the supply of services …’ No guidance is given concerning the relative importance of the factors. <em>(IPART, 2000:2)</em></td>
</tr>
<tr>
<td>ACT Government</td>
<td>Regulatory framework for ACT utilities <em>(inter alia)</em></td>
<td>‘Governments need to provide regulation [of utilities] because there is a need to:  • ensure fair prices to consumers,  • ensure a fair rate of return to the owners of the utilities, …’ <em>(ACT Government, 1998b:1)</em></td>
</tr>
<tr>
<td>Australian Government (Minister for Communications)</td>
<td>Retail price controls on Telstra <em>(inter alia)</em></td>
<td>‘… protecting consumers — particularly those of limited means — against paying too much for vital telephone services … special safeguards for low spending residential customers.’ <em>(Alston, 1999:1)</em></td>
</tr>
<tr>
<td>UK Office of Gas and Electricity Markets (Ofgem)</td>
<td>Retail price controls in monopoly areas of gas and electricity markets.</td>
<td>‘…remove barriers to the competitive market … [especially those faced by] disadvantaged and low income customers …’ <em>(Ofgem, 2000a:1)</em></td>
</tr>
<tr>
<td>UK Office of Telecommunications (Oftel)</td>
<td>Framework for utility regulation <em>(inter alia)</em></td>
<td>‘… the primary duty of the regulator is to protect the interests of the consumer: … access, price, quality, choice and fairness’; ‘… concepts of transparency and fairness in the regulatory process’; ‘Regulation not only has to be fair, but has to be seen to be fair.’ <em>(Oftel, 1999b:2 and 6)</em></td>
</tr>
<tr>
<td>Oftel</td>
<td>Telecommunications market regulation</td>
<td>Consumers are entitled to expect that ‘all standard [contract] terms are fair’. <em>(Oftel 2000:2)</em></td>
</tr>
<tr>
<td>US Federal Communications Commission, (FCC)</td>
<td>Regulation of cable television <em>(inter alia)</em></td>
<td>‘Consumers should expect a fair deal from their local cable company …’ <em>(FCC, 1999:2)</em></td>
</tr>
<tr>
<td>FCC</td>
<td>Regulation of telephone subscriber line charges <em>(inter alia)</em></td>
<td>‘… ensure that all Americans can afford at least a minimal level of basic telephone service …’ <em>(FCC, undated a:1)</em></td>
</tr>
<tr>
<td>FCC</td>
<td>Price caps for local telephone exchange carriers <em>(inter alia)</em></td>
<td>‘…encourage growth in productivity … while … ensuring that … customers share in the benefits of productivity growth …’ <em>(FCC, 1997:4)</em></td>
</tr>
<tr>
<td>FCC</td>
<td>Universal telecommunications service <em>(inter alia)</em></td>
<td>‘… quality service at just, reasonable and affordable rates …’ <em>(FCC, undated b:2)</em></td>
</tr>
</tbody>
</table>
Box1: (continued)

**Wholesale Services**

<table>
<thead>
<tr>
<th>Organisation</th>
<th>Function</th>
<th>Fairness Principlesa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Council of Australian Governments</td>
<td>Uniform national framework for access to gas pipelines (inter alia)</td>
<td>‘… providing rights of access to natural gas pipelines on conditions that are fair and reasonable for the owners and operators of gas transmission and distribution pipelines and persons wishing to use the services of those pipelines …’ (OffGAR, 2000a:1)</td>
</tr>
<tr>
<td>WA Office of Gas Access Regulation (OffGAR)</td>
<td>Gas pipeline access and tariffs</td>
<td>‘… give proper consideration to the impact … on the small consumer end of the market … enhance competition between suppliers of gas services to such small consumers.’ (OffGAR, 2000b:2)</td>
</tr>
<tr>
<td>Ofgem</td>
<td>Wholesale price controls in monopoly areas of gas and electricity markets (inter alia)</td>
<td>‘… prevent prices being manipulated by those who are able to abuse their market power.’ (Ofgem, 2000c:1)</td>
</tr>
<tr>
<td>Oftel</td>
<td>Regulate conditional access for digital TV services (inter alia)</td>
<td>Prices must be ‘fair, reasonable and non-discriminatory’. (Oftel, undated a:1)</td>
</tr>
<tr>
<td>FCC</td>
<td>Regulation of cable television program access (inter alia)</td>
<td>Prohibits unfair practices in the supply of pay TV programs to cable companies, proscribing undue influence and discrimination, price discrimination and exclusive programming (inter alia). (FCC, 1993)</td>
</tr>
</tbody>
</table>

a: Italics added

The few exceptions that exist give some insight into the intentions of those setting the objectives. In the United States, for example, ‘[telephone] rates are typically considered just and reasonable if they are based on cost’ (Federal Communications Commission (FCC, undated b:3). Similarly, certain US (and Australian) telephone charges are required to be averaged geographically, so that the rates ‘charged … to subscribers in rural and high-cost areas shall be no higher than the rates charged … in urban areas’ (FCC Common Carrier Bureau, 1999:3). The United Kingdom requires access to digital television services to be offered at prices that ‘must be fair, reasonable and non-discriminatory’ in terms of ‘the relationship between the costs involved in providing the service(s) and the prices offered, and … the relationship between prices offered to others for the same (or related) services’ (Oftel, undated a:15). The FCC (1999:2) considers that cable television customers are entitled to expect ‘reasonable rates that fairly reflect the cost of doing business’.

Sometimes the objectives, rather than prescribing fairness, instead proscribe unfairness. The United Kingdom prohibits unfair terms in consumer contracts, the United States prohibits unfair practices in the supply of cable television programming, and the trade practices legislation of many countries contains sanctions against abuse of market power. According to the UK’s *Unfair Terms in Consumer Contracts Regulations 1999*, unfairness hinges on whether the terms of the contract create a significant imbalance in the parties’ rights and obligations under the contract to the detriment of the consumer, and whether that imbalance
appears to amount to a dishonest intention or an absence of good faith by the business in question (Oftel, 2000:5).

Sometimes the objectives indicate to whom the conditions are supposed to be fair. In the case of retail services, consumers generally, or particular groups of consumers, are typically the target. However, the ACT Government (1998b:1) is not alone in requiring all parties to the transaction to be considered, and seeks both fair prices for consumers and a fair rate of return to the owners of utilities. In the case of wholesale services, all parties to the transaction typically figure. The Western Australian Office of Energy (2000:4) is concerned about equity among consumer groups when it states that its guiding principles include equity ‘between regional and metropolitan communities, Aboriginal and non-Aboriginal communities and between new and established businesses within regional communities’. Similarly, the ACT’s Independent Pricing and Regulatory Commission (1999:34) ‘seeks to ensure that ACTEW’s [now ActewAGL] pricing policy does not disadvantage one group of customers relative to others’.

These might seem ambitious — and ambiguous — objectives. They become more so when, as in most cases, they are required to be balanced with other objectives, including efficiency. The way in which they are applied in practice can be explored by examining the pricing decisions of the regulators involved.

**Fairness considerations in regulatory price setting**

Those decisions demonstrate considerable diversity of approach, as is clear from the examples of regulated retail pricing shown in Box 2. Retail pricing shows greater diversity than wholesale pricing. This is perhaps because it is at the retail level that the impact on final consumers is most obvious and consequently, where the greatest pressure exists to ameliorate any perceived unfairness in that impact. Approaches by regulators to wholesale pricing, on the other hand, tend to be more consistent and more explicitly cost-reflective.

**Price structures**

Cost structures are typically complex in networked services. The main costs of most utilities with network characteristics lie in providing and maintaining connection to the service. Once this distribution infrastructure is in place, provision of units of the service itself is likely to be much less costly. To a large extent, these cost structures are mirrored in the price structures seen among the regulators considered: a flat charge is made for continuing connection to the network, with per-unit charges in respect of actual consumption. This implies that higher-volume consumers will contribute more than lower-volume users, but that a minimum charge will be levied on all consumers regardless of use.

The only exception to this pattern among the regulators considered occurred in relation to South Australian sewerage charges, which contain no usage-related element. There, the estimated full cost of providing the sewerage service is simply distributed across rateable (business and residential) properties in accordance with
### Box 2: Fairness and the Pricing Decisions of Regulators

<table>
<thead>
<tr>
<th>Service</th>
<th>Price structure</th>
<th>Price differentials</th>
<th>Non-commercial service</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Flat charge</td>
<td>Per unit charge</td>
<td>Users</td>
</tr>
<tr>
<td>Sewerage charges (SA Water)</td>
<td>Based on improved property value (minimum applies)</td>
<td>No</td>
<td>Higher rate for country customers (reflecting lower property values), pensioner concessions</td>
</tr>
<tr>
<td>Charges for non-franchise electricity customers (Office of the Regulator-General, Victoria)</td>
<td>Yes</td>
<td>Yes</td>
<td>Price controls have produced different outcomes for different customer types</td>
</tr>
<tr>
<td>Electricity charges (ACTEW)</td>
<td>Yes</td>
<td>Yes</td>
<td>Separate business/residential controls; some concessional rates (e.g. pensioners)</td>
</tr>
<tr>
<td>Telecommunications charges (Australia)</td>
<td>Yes</td>
<td>Yes</td>
<td>Separate business/residential controls; some concessional rates (e.g. pensioners, light users)</td>
</tr>
<tr>
<td>Telecommunications charges (UK)</td>
<td>Yes</td>
<td>Yes</td>
<td>Separate business/residential controls; special arrangements for light users</td>
</tr>
<tr>
<td>Local exchange carrier charges (US)</td>
<td>Yes</td>
<td>Yes</td>
<td>Subsidised rates for rural, insular and high cost areas, low income consumers, schools, libraries, rural health care providers</td>
</tr>
<tr>
<td>Telephone line charges (US)</td>
<td>Yes</td>
<td>Not applicable</td>
<td>Capped rate for primary residential lines</td>
</tr>
</tbody>
</table>

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*a While some consumers may be charged prices which are below the (full) cost of supplying them, other consumers pay above-cost charges, so that aggregate revenues cover aggregate costs.*
their improved value (some exemptions and concessions apply). This results in consumers with higher property values paying more than others. If high property values are associated with greater use of sewerage and wastewater services (more occupants of the property, for example), such a system may generate an outcome consistent with higher-volume users contributing more. The charging regime is currently under review by SA Water and the South Australian Government.

Price structures that mirror cost structures do not necessarily mean that prices are cost-reflective or even cost-recovering in the strict sense. The proportion of fixed and variable costs recovered from the fixed and variable components in the prices may differ. This is typically the case in telecommunications, where the fixed (monthly line rental) component of consumer charges is usually maintained at a lower level than would be required to cover the estimated costs of network operation and maintenance, usually for reasons of affordability. However, the information available from the regulators considered did not enable the actual extent of cost-reflectiveness in the various price components to be identified.

*Price differentials*

Few utilities charge the same amounts to all their customers, irrespective of their ability to pay or the cost of supplying them. Consequently, price differentials arise. Most such differentials arise at the retail level and appear to address the ability to pay of different groups of consumers. The provision of concessional rates to particular categories of users (residential, low-income households, low-volume users, pensioners) or uses (educational, religious, not-for-profit uses) is a common practice. The categories tend to be based on generalised assumptions about ability to pay, and are clearly intended as a form of benign price discrimination, aimed at ensuring affordable service to major consumer groups. Some utilities place the onus for claiming the concession on the consumer, while others extend them automatically on the basis of the status of the consumer.

Another common practice is the geographic averaging of charges. This involves the provision of service to all customers within the geographic reach of the utility at a uniform charge, or set of charges. Where geographic averaging is imposed on utilities, it is usually intended to reduce or eliminate rural/metropolitan price differentials which might be seen as compromising service access or affordability. In some cases, there may also be efficiency reasons for a utility to seek to maintain streamlined pricing schedules.

Both types of policies result in a mismatch between costs and charges at the level of individual customers. Whether they do so at the aggregate level depends on how any cost overhang associated with the price concessions is recovered. The particular circumstances of the utility itself may be an issue when a number of firms supply a particular service in the market. In the US, the generally lower level of earnings (ability to pay) of certain incumbent local telephone exchanges is used to exempt them from certain provisions under the price control arrangements (FCC Common Carrier Bureau, 1999). Generally, however, utility services are provided by a single firm and such issues do not arise. As input services,
wholesale services are much more likely than retail services to be charged at cost, irrespective of the merits, ability to pay or other characteristics of the purchaser. Price differentials in wholesale service tend to relate to cost differentials of servicing particular customers (their location, volume of business, etc).

**Non-commercial service**

If a utility is required to service some of its customers at charges that do not reflect the full cost of service provision, it will seek to recover any resulting losses. Some utilities are required to recover them from other customers, by balancing loss-making charges to high-cost customers against profit-making charges to others. This may result in some categories of customers effectively cross-subsidising others. Geographic averaging and concessional charging regimes are used to fund ‘universal service’ in many utilities, including telecommunications, and are likely to involve elements of cross-subsidy in many cases.¹

Among the regulators considered, these methods of charging appeared to exist in some form in almost every case of retail supply. South Australia’s sewerage charging system appears to have the greatest potential for implicit cross-subsidy. There, consumers occupying highly-valued properties pay more than those in lesser-valued properties, regardless of provisioning cost or consumption. The charge is effectively a tax, levied in an apparently progressive way.

There is less potential for cross-subsidy in the charging regime of the ACT’s electricity and water provider (ACTEW). There, charges approved by the Independent Pricing and Regulatory Commission (IPARC) are uniform within the two broad categories of residential and business consumers, and any concessions are budget-funded rather than cross-subsidised by other consumers. Consequently, no price differentials exist within categories. ACTEW claimed in 1998 that business customers cross-subsidise residential customers, and IPARC subsequently agreed to allow some ‘rebalancing’ of the differential between categories (IPARC 1998:19).

Wholesale services do not tend to be provided on non-commercial terms.

**Interpretations of fairness**

These cross-subsidy decisions suggest certain patterns in the interpretation of fairness by regulatory price-setters. At the retail level, consideration of a customer’s ability to pay appears to dominate. Underlying this concern appear to be attempts to improve the affordability of the service to lower-income consumers, those who are costly to supply or those with particular ‘merit’ claims (such as educational organisations or community organisations). This, in turn, is likely to be underpinned by a concern to extend affordable service to all citizens as a social

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¹ Cross-subsidy is defined as the provision of service to some customers at a charge which is below (avoidable) cost, with the loss recovered through higher charges to other customers.
right. It follows that fairness is not apparently interpreted at the retail level in the strict sense of non-discrimination among customers (anonymous equity), which would tend to produce equal (cost-related) prices for everyone.

Of course, measuring a customer’s ability to pay requires information, such as household income and circumstances, which may be difficult to access or analyse. Consequently, other more observable characteristics may be used by regulators as proxies. The status of customers as pensioners or other beneficiaries or as business consumers, the value of their residential or business property, or even the level of their consumption of the service in question may be sufficient to place them in a concessional category. To the extent that membership of such a category does not actually coincide with an individual’s wealth or need, some individuals in those categories will not, in fact, be within the intended target group, while others outside the categories will form part of the intended target. Older people in inner-city properties with high rating values, small businesses, or wealthy people with holiday homes using services such as phones and electricity only intermittently may all be included or excluded in an unintended way by the use of such proxies. Where ‘misfires’ of this type occur, the objectives of the regulator in applying concessions based on such proxies in the interests of fairness will be compromised.

Fairness does not tend to be interpreted, at least at the retail level, on the basis of intensity of demand for the service (willingness to pay). This may reflect the fact that the services involved are essential services and are not generally supplied in a way that would warrant competitive bidding among intending consumers. In addition, with the exception of certain telecommunications and related services, the services tend to be homogeneous in quality and so unlikely to display differential demand patterns associated with different quality attributes. Perhaps because of such factors, price discrimination exploiting demand characteristics such as quality differentials, urgency, timeliness, lack of substitutes and so on appears uniformly absent from the utilities considered. Elements of ‘user pays’ approaches are certainly apparent. The use of per-unit charges for services over which the customer has considerable discretion in use is almost universal.

At the wholesale level, fairness appears to be interpreted almost without exception in terms of cost-reflectiveness. Identifying those costs may, however, be a complex and resource-intensive exercise, as experience in devising price controls for retail telecommunications services testifies (FCC, 1997; Access Economics, 1998).

**Fairness and efficiency**

Departures from cost-reflective pricing are clearly widespread, at least in the retail pricing of utilities. This may enable regulators to satisfy fairness objectives. However, regulators typically must satisfy efficiency objectives as well. To what extent do such decisions compromise those objectives?
In market economies, prices convey signals about value to producers and consumers and influence what is produced and consumed. Prices are regarded as efficient if they result in a community’s resources being converted into a particular volume and mix of goods and services which the community values more highly than any other (allocative efficiency), and those goods and services then being distributed to those individuals and businesses within the community who value them most highly (distributional efficiency). This criterion underlies the Kaldor-Hicks test, which considers a distribution optimal if no redistribution of resources or products could leave an individual better off, without leaving someone else worse off, after allowing for compensation of any losers by the gainers. A time element, which considers the pattern of production and distribution over time, may also be considered (dynamic efficiency). Despite the conceptual difficulties of inferring valuation from the willingness to pay of individuals who may have different opportunities, income and knowledge, and the inability of the model to deal with certain types of goods and services (public goods, and those generating external benefits and costs) and non-market arrangements (government), the logic of this approach is clear and its influence has been powerful.

Prices which accurately reflect the level and structure of production costs are essential to the achievement of such an optimal state. In particular, the relativities among prices are crucial. Prices which are maintained at a level above cost, when others are not, are likely to generate investment incentives which will draw resources away from production valued more highly by consumers, resulting in loss to the community as a whole. Prices which are too low will discourage investment and result in under-production relative to the optimum. In both cases — and depending on the responsiveness of consumption to price levels — consumption is likely to be encouraged at levels which misrepresent the true value of the product or service to consumers.

In the case of utilities, cost-based pricing is likely to imply multi-part prices, with different prices charged for different network services (connection, continuing subscription, use of services) in accordance with the costs of providing those services — some would argue that as actual costs may be inflated by inefficient technology or practices, the relevant costs are those which would be incurred by an efficient operator. Cost-based pricing requires utilities to recover their costs where those costs arise, and not (deliberately) to over-recover or under-recover those costs. In its strict form, it would seem to exclude price discrimination intended to improve profitability, the geographic averaging of charges, and the cross-subsidy of particular services or particular consumer groups by others. Cost-based prices return to producers sufficient revenue to ensure continuation of supply, while ensuring that consumption occurs only if consumers value the product or service in question at least as highly as the value of the resources expended in producing it.

Where prices cannot be strictly equated to costs — for example, where the goods are subject to taxes, or where the structure of costs is such that conventional
pricing rules (marginal cost pricing) do not enable full cost recovery — pricing principles which minimise the resulting efficiency losses have been developed. For example, the English economist Ramsey (1927) showed that the efficiency cost of recovering a given amount of revenue from the sale of a particular product can be minimised by charging rates to individual consumers or groups of consumers which are inversely proportional to the own-price elasticity of their demand for the product. While originally applied to taxation rather than pricing problems, this ‘inverse elasticity rule’ underpins the preferred approaches of many economists to the allocation of common costs across the various products of a utility, where it is referred to as Ramsey-Boiteux pricing. Nevertheless, even if cost-based pricing cannot be achieved, driving prices closer to costs can almost always be shown to produce efficiency gains.

The Hilmer Committee’s recommendations

Cost-based pricing principles were strongly endorsed by the National Competition Policy (Hilmer) Review (1993) and now underpin the approach of all Australian governments to the regulation of utilities. The Hilmer Committee examined a number of principles which might be used to assist the National Competition Council in framing recommendations on appropriate price behaviour. It (p. 279) concluded that:

… [pricing] principles should focus on competition and efficiency concerns, rather than broader and potentially conflicting social and political goals.

The Committee recognised that such principles were likely to affect the community service obligations (CSOs) of utilities, particularly those funded by cross-subsidies. However, it concluded that improved transparency and more efficient funding of CSOs, possibly directly from government budgets, were desirable goals in themselves.

The trade-off between fairness and efficiency

A trade-off between fairness and efficiency considerations would therefore seem inevitable. Indeed, the possibility is well-recognised by regulators. The United Kingdom’s Director-General of Telecommunications, David Edmonds (Oftel, 1998b) noted that:

Regulators may sometimes be pulled in two directions, to encourage competition and at the same time intervene in the market to protect consumers

Fully cost-reflective prices are unlikely to satisfy a number of fairness criteria, including the provision of services to consumers on an affordable basis, in accordance with their ability to pay. Multi-part prices which include fixed charges
for network access, regardless of use, may in addition be considered regressive. If the charges are sufficiently high, they may either induce individuals to disconnect from the network, compromising access objectives, or will exact a substantial opportunity cost in terms of the amount of alternative consumption foregone. Similarly, attempts to charge different rates to different consumers on the basis of the relative elasticity of their demand are likely to be viewed by some as discriminatory (Bonbright, Danielson and Kamerschen, 1998:533-4).

Prices which satisfy certain fairness criteria are similarly unlikely to be considered efficient. Services made available at charges that are below cost may be over-consumed relative to their real valuation by consumers, causing resource misallocation and consequent loss to the community as a whole. Those losses will be exacerbated if external costs, such as pollution, result from consumption. The extent of both will depend on the responsiveness of the use of the service by the consumers involved to its price level. Consumers required to cross-subsidise such provision by paying relatively high prices are likely to experience the opposite effect. At the same time, the willingness of competitors to enter the market, or of investors to upgrade infrastructure, will be eroded by low prospective returns relative to other options.

The extent of the trade-off might, of course, be reduced if the means by which fairness considerations influence prices were explicitly designed to minimise the efficiency penalty. For example, affordability could be improved without distorting consumption by focusing on the flat (lump-sum) component, rather than the usage component, of the charges in a multi-part pricing regime. Similarly, particular consumer groups could be charged below-cost rates without directly penalising others if the resulting loss were funded by direct budget supplementation rather than by cross-subsidy from other products or other consumers.

Examples illustrating the relationship between fairness and efficiency considerations in particular pricing regimes may be organised into a contingency table as follows:

<table>
<thead>
<tr>
<th>Efficient</th>
<th>Unfair</th>
</tr>
</thead>
</table>
| **Quadrant 1**
Cost-reflective prices, with *budget-funded concessional charges* to targeted groups | **Quadrant 2**
Cost-reflective prices with lump-sum components which exploit differences in the *willingness to pay* of different consumers |
| **Quadrant 3**
All components of the price based on *ability to pay* | **Quadrant 4**
Geographic averaging of charges involving a *cross-subsidy* of one group of consumers by another |
Certainly, fairness and efficiency considerations often conflict (Quadrants 2 and 3). The pricing regimes cited in those quadrants include some of those examined earlier, and encompass some which are well-known to Australian consumers. Some traditional solutions might even violate both fairness and efficiency principles (Quadrant 4). However, solutions which meet both considerations, at least on some criteria, are clearly possible.

**Fairness and efficiency**

The exhortations of the Hilmer Committee to use prices to focus on competition and efficiency concerns rather than broader social and political goals appear to have been heeded by Australian utility regulators. It is clear from the pricing determinations and other published material of those considered here that they now regard as inevitable a move towards more cost-reflective pricing. This assessment not only appears in the rhetoric of the regulators and the governments which set the parameters within which they operate, but is also apparent from recent pricing decisions (and reviews) themselves.

This is not to suggest that fairness considerations are to be abandoned, or regarded as mere ‘side constraints’ on otherwise efficient solutions. As shown earlier (Box 1), the emphasis on fairness in the extracts from the regulators’ own terms of reference remains both explicit and compelling. The direction of the move appears not to be simply from the lower half of the table above (inefficient) to the upper half (efficient), but from unfair, inefficient outcomes (Quadrant 4) to fair, efficient outcomes (Quadrant 1).

A number of factors explain the shift. The first is competition. Cross-subsidies, and even differential pricing arrangements, are difficult to sustain in an environment of open competition. If, in some regions, or for some types of customers, expected revenues do not match expected costs, then the prospect of competitive entry into the market will be directly affected. As network access regimes increasingly enable competition using existing infrastructure, this is a genuine dilemma for regulators. A potential competitor will have an incentive to enter a market where revenues exceed costs, and no incentive to enter a market where costs exceed revenues. The phenomenon whereby low-cost service areas or groups are targeted by new entrants because of the profit potential has been referred to variously as ‘cream skimming’, ‘cherry picking’, or even taking the ‘low hanging fruit’ (National Bandwidth Inquiry, 1999:executive summary). To the extent that competition benefits consumers, then those in high-cost areas or categories will be denied those benefits. If cross-subsidies are to be retained, alternative arrangements, including direct government intervention in the form of infrastructure investment or other means, may be needed to ensure choice and new investment in high cost areas.

Another factor is a generally greater appreciation of the role of incentives in achieving desirable outcomes. For example, water and energy consumption have environmental effects. Reducing excess consumption, or consumption for lower-value uses (such as car washing), may be desirable on environmental grounds.
alone and is also likely to extend the time before infrastructure extensions are required. If demand is, in fact, price-responsive, then charging a price which reflects the ‘true’ resource cost of supplying the service, rather than one which encourages and facilitates over-use relative to the optimum, is likely to bring a range of benefits.

A further factor is the desire for greater transparency in the operation of government-owned or regulated enterprises. Possibly allied to this has been recognition of the potential benefits to all consumers of achieving lower charges through more efficient decision-making.

A final factor may be renewed recognition that fairness and efficiency may be linked, rather than independent, phenomena. The former senior Treasury officer, Fred Argy (1998), argued recently that equity and efficiency are not separate attributes of a policy, and that the equity of a policy influences its efficiency, just as its efficiency might alter equity outcomes.

A more conventional approach might consider the implications of the decisions of particular individuals for the community more generally (the ‘externalities’). For example, if social participation improves with access to the telephone, or if health is affected by access to water and energy, then the consequences of an individual’s disconnection from that service, or even under-use due to income constraints, may be more than a simple loss of utility to that individual. The consequences may extend to loss of longer-term social and economic capability, with associated effects on families and the rest of the community, and ultimately greater welfare dependency.

Conclusion

The idea of fairness remains a compelling one in public policy. While welfare and taxation policies remain the most direct, and transparent, means of articulating and addressing equity and distributional objectives, fairness considerations extend to, and persist in, the pricing objectives of utility regulators in many countries. Those regulators take it seriously, despite the conceptual and practical difficulties of defining and applying fairness in practice. Some regulators, like the FCC’s Commissioner Susan Ness and Oftel’s David Edmonds, claim to weigh fairness considerations at least as heavily as other criteria as they seek to balance apparently conflicting objectives for the pricing regimes they control. Devising ways of satisfying government exhortations for fairness in pricing without compromising consumption, production and investment incentives, and environmental outcomes will continue to test the skills and creativity of regulators and their advisers. Increased competition and corporatisation in utility industries

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2 For example, Ness claimed in a 1997 judgement that ‘We have … sought to achieve as much fairness as is humanly possible… At the end of the day, fairness to all parties and demonstrable benefits to consumers are the standards by which we will all be judged’, (FCC, 1997:77). Edmonds claimed a further imperative: ‘Regulation not only has to be fair, but has to be seen to be fair’, (Oftel, 1998b).
has increased the urgency of such matters and has stimulated vigorous debate in Australia, as elsewhere. Such debate can only assist in reaching better, more transparent regulation and utility prices that are perceived to be both efficient and fair.

References


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Truth-In-Advertising Law: New Zealand’s Experience

Grant Hannis

New Zealand’s Fair Trading Act is the country’s truth-in-advertising law. It is an important piece of legislation, forming an integral part of the government’s pro-competitive economic policy. The Act is pervasive, applying not only to transactions between consumers and businesses but also to business-to-business dealing. The penalties for breaching the Act can be severe. Large fines and compensation orders have been imposed, and a firm that breaches the Act can expect to see its transgressions publicised in the media, damaging a reputation that the firm may have taken many years and considerable expense to establish.

Given the importance of the Act in New Zealand’s economic landscape, it is worthwhile investigating the economic impact of the law. The Act was passed in 1986, and since then a considerable body of case law has developed. This article considers that case law in light of the economic theoretical debate over truth-in-advertising legislation. The first section summarises the Act. The following section considers the statute’s objectives and the economic theoretical debate. Case law under the Act for the ten years ending May 2000 is then reviewed. Lastly, the general conclusions are presented.

Summary of the Act

Under Section 9 of the Fair Trading Act, no person in trade can engage in ‘conduct that is misleading or deceptive or is likely to mislead or deceive.’ In addition to this general prohibition, certain false or misleading representations are specifically banned. For instance, Sections 10, 11 and 13 prohibit false representations about the attributes of products. For example, traders cannot give false representations about the quality, origin, or price of products. Similarly, Section 14 prohibits specific false representations regarding the sale, or grant, of an interest in land. These provisions have the effect of requiring truth-in-advertising. They also ban any other form of misrepresentation traders may make to consumers (for instance, a misrepresentation made by a salesperson during a conversation with an individual consumer). Although often thought of solely as a consumer protection law, the Act also prevents traders from making misrepresentations to other traders.

Other sections in Part I of the Act prohibit certain unfair business practices. For example, Section 24 prohibits pyramid selling, which is where a network of

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people sells products for reward, with the primary method of making money being the recruitment of others to the network. Pyramid selling has little chance of financial success — the market for new recruits is soon saturated, so most people who join pyramid selling schemes lose money.

The Act contains several other provisions, including the requirement for three consumer information standards and five product safety standards. As we are primarily interested in the Act insofar as it promotes truth-in-advertising, these other provisions are not germane to our discussion and are not considered further.

The Fair Trading Act is enforced by the Commerce Commission, a government agency. As well as prosecuting, the Commission can enter into agreements and settlements with traders it believes are engaging in practices that breach the Act. Typically, under these agreements an offending trader must cease the practice, undertake remedial action (such as placing advertising to correct misleading impressions) and introduce a compliance programme to avoid breaching the Act in future. On average, in the five years ending 2000, for every Commission court case completed, the Commission issued nine warnings and entered into two settlements with traders (Commerce Commission, 1996-2000).

The Commission is also required to ensure traders are aware of their obligations under the Act. For example, the Commission produces guidelines for traders and publicises its prosecutions, warnings and settlements (Commerce Commission publications may be accessed at www.comcom.govt.nz/publications).

Consumers and traders can take their own prosecutions under the Act. A member of the Commerce Commission (Harrison, 1997:61) has observed that allowing such private action reduces the cost of enforcing the Act:

The Commerce Commission has the job of policing the Fair Trading Act, but its resources are limited. Accordingly, it cannot hope to prosecute more than a fraction of alleged infringements. By empowering private individuals or corporations to take enforcement action, the Act vastly extends its ‘reach’.

Consumerists also support this aspect of the law. David Russell, Chief Executive of Consumers' Institute a New Zealand consumerist organisation which publishes Consumer magazine (the Australian equivalents are the Australian Consumers’ Association and Choice magazine), sees trader-to-trader cases under the Act as having an important benefit for consumers (Russell, 1997:80):

If one trader believes that another is behaving in a misleading or deceptive way and successfully pursues a case through the courts, then consumers are protected by the stopping of the complained-about practice.

Civil and criminal penalties can be imposed for contraventions of the Act. Only civil penalties apply if a trader breaches the general prohibition against misleading or deceptive conduct. The court can, for example, grant an injunction
to stop the practice, order the placement of corrective advertising and order compensation to be paid.

If a person contravenes other provisions of the Act, criminal penalties can also apply. The courts can impose fines of up to $100,000 per offence for companies and $30,000 per offence for individuals, plus costs (all dollar amounts in this article are New Zealand dollars). Under Section 39, disputes tribunals (New Zealand’s small claims courts) can hear all cases under the Act other than those under Section 9. But unlike the courts, the disputes tribunals cannot impose fines. They can merely direct an offender to refund money or return property to the person who has suffered a loss.

Generally, the Act applies even when there was no intention to breach the Act, but there are some exceptions. Most notably, if the breach was due to a reasonable mistake, or was due to reasons outside the person’s control and the person had diligently taken reasonable precautions to avoid breaching the Act, a trader would not face criminal liability, but would continue to face civil liability.

**Economic Theory of the Act**

In the years immediately following the election of the Labour Government in 1984, many of the regulations that had long controlled the New Zealand economy were removed in an effort to make the economy more competitive (Silverstone, Bollard and Lattimore, 1996). The Fair Trading Act, passed in 1986, was part of that pro-competitive reform process. As the Minister of Consumer Affairs noted at the time, the Act ‘complements other aspects of the Government’s economic policies that promote effective competition in markets within New Zealand’ (Shields, 1986).

The Fair Trading Act encourages the competitive process by promoting fairness in economic transactions, and by reducing consumers’ search costs.

**Promoting fairness**

The Fair Trading Act is acutely concerned with issues of fairness. One need look no further than the Act’s name to see proof of that.

The notion of fairness is deeply ingrained in society. Most parents teach their children about the importance of fair play, and in Australia and New Zealand the belief that everyone deserves a ‘fair go’ is regarded as a trait of the national character. In consumer markets, among other things, fairness can be taken to mean the information traders provide consumers must be truthful. That is, it is wrong to lie. It also means that outright fraudulent activity that preys on more vulnerable consumers should be banned. For instance, pyramid-selling schemes are banned because the schemes exploit less mathematically aware consumers, who do not realise that such schemes have no chance of success. A Commerce Commission representative has observed that, with pyramid-selling schemes, ‘Only a small number of people at the top can ever make money, and that is by ripping-off the people below them’ (Commerce Commission, 1999a).
Although some may think notions of fairness exist outside the sphere of pure economics, some economists have acknowledged the importance of fairness in economic policymaking. Governments cannot be blind to concerns over the fairness of economic transactions, it is held, as to do so could imperil a pro-competitive economic policy. As Viner (1960:68) observes:

No people will have a zeal for the free market unless it operates in a setting of distributive justice with which they are tolerably content.

Indeed, the historical context of the Fair Trading Act makes it clear that the Act seeks to legitimise market processes by ensuring markets behave fairly. The government believed the Act would provide ‘a fair deal for consumers’ and would be ‘a significant step on the way towards recognising that consumers often bear the brunt of any ill effects arising from traders’ efforts to pursue profit’ (Shields, 1985 and 1986). As well as protecting consumers, the government anticipated that the Act would ‘enhance the position of ethical traders in relation to the unfair competition that results from deceptive advertising and other conduct’ (Shields, 1985).

Reducing search costs

As well as promoting fairness, the Act seeks to reduce consumers’ search costs. Traders supply much of the information provided in the marketplace, and although advertising can offer consumers useful information about goods and services, there is always the suspicion the information is tainted. After all, advertising is typically designed to portray the trader in the best possible light. For instance, a well-regarded brand name on a product provides consumers with useful information on the likely performance of the product. A firm’s good reputation imparts similar benefits. But against this, consumers are often unable to check many of the claims made by traders. Few consumers will have the time to check a trader’s claim that their prices are ‘the best in town’. Moreover, consumers often do not understand the technical nature of many goods and services, and therefore may not be in a position to judge whether a traders’ claims about its products are accurate. For example, few consumers would be able to judge the veracity of the technical specifications a retailer gives about the computers they have for sale.

Yet, if consumers are poorly informed, the market will not perform efficiently — producers will be able to exploit false product differentiation or sell goods at inflated prices (Martin and Smith, 1968; Ramsay, 1989).

The Fair Trading Act reduces the cost consumers incur checking the accuracy of the information provided by traders. That is, traders that disseminate misinformation risk prosecution, so traders have an incentive to provide only truthful information. Consumers do not have to check every claim made by traders, they can simply make a reasonable assumption that the claims are truthful. Even if a certain claim does turn out to be false, the consumer can seek redress
under the Act. By improving the level of information in the market, the Fair Trading Act promotes efficient market outcomes.

The government made it clear at the time the Act was passed that the objective of reducing consumers’ search costs was as important as the fairness objective. The Minister of Consumer Affairs noted that the Act ‘is designed to ensure that competition centres on the key areas of price, quality, and service, and that product comparisons are not distorted by misleading, deceptive, or unfair practices’ (Shields, 1986).

Not all economists are convinced about the need for truth-in-advertising law to reduce consumers’ search costs. Jordan and Rubin (1979) argue that few firms have an incentive to mislead. They claim there are only three essential types of goods (taken here to include services) — search, experience and credence goods. Search goods are those for which consumers can obtain sufficient information to make an informed buying decision prior to purchase (a pair of shoes for instance), an experience good is one that must be consumed to be evaluated (such as the taste of a chocolate bar), a credence good is one whose qualities cannot be measured by the consumer even after consumption (such as information in an encyclopaedia, which the consumer assumes is correct). Jordan and Rubin hold that suppliers of search goods have little incentive to use misleading advertising, as consumers will verify the quality of the goods before purchase. Suppliers of low-priced experience goods will have little incentive to mislead, as they will lose repeat custom. Suppliers of expensive experience goods have little incentive to mislead as they may face lawsuits that are expensive to defend and damaging to the traders’ reputations. Suppliers of credence goods who have invested in a reputation stand to lose those reputations if they mislead, so they do not mislead.

The only suppliers likely to mislead, according to Jordan and Rubin, are suppliers who do not care about their reputations and brands, and sell either mid-priced experience goods or credence goods. In the former case, consumers are unlikely to sue if misled because the price of the good does not warrant the cost of litigation. In the latter case, traders are in the best position to mislead as consumers cannot verify the quality of the products.

Another criticism of truth-in-advertising law is that it is not necessary for all markets, as it is unnecessary for every consumer to be well informed for the market to operate competitively. If firms cannot differentiate consumers that search out information and those that don’t, and there are a reasonable number of search consumers in the market, firms will have to charge a competitive price, which benefits all consumers (Schwartz and Wilde, 1979).

Finally, Friedman and Friedman (1980:267) suggest truth-in-advertising will simply be enforced by competition, without the need for laws and government enforcement agencies:

If business advertising is misleading, is no advertising, or government control of advertising, preferable? At least with private business there is competition. One advertiser can dispute another.
Although we shall subject all three of these arguments to an empirical test, the Friedmans’ contention is not convincing on purely theoretical grounds. In part, this is because they overlook a free-rider problem. If a market has only two firms, A and B, and A engages in misleading advertising to increase its market share, B could issue corrective advertising or sue A in order to halt the promulgation of A’s misinformation. Consumers would then be fully informed and the market shares between A and B would return to their original state. Here, B reaps all the benefit of its policing of A’s advertising. However, if more firms are in the market, say four, A, B, C, and D, and A engages in misleading advertising, B’s advertising explaining this deception may switch consumer purchases not only to B, but also to C and D, who free ride on B’s policing work. As B does not capture all the benefits of revealing A’s deception, it may decide that engaging in further police work is not economic. A is then free to engage in misleading advertising. The existence of this free-rider problem suggests there is a good case for a government agency, such as the Commerce Commission to prosecute A, for the benefit of B, C, and D.

The Friedmans’ thesis also overlooks the case where all firms benefit from spreading misinformation. That is, if A, B, C, and D all benefit from A’s misinformation, none has an incentive to issue corrective advertising or to sue A. This is the case, for instance, with the tobacco industry, where none of the firms involved have an incentive to inform consumers about the dangers of smoking (Hadfield, Howse and Trebilcock, 1998).

These theoretical arguments are now considered in light of the judicial experience of the Fair Trading Act. As there is no detailed information on Fair Trading Act cases heard in the disputes tribunals, this paper confines itself to court cases and Commerce Commission warnings and settlements.

**Analysis of Case Law**

There is no exhaustive catalogue of cases heard in New Zealand courts. Briefcase and Linx legal databases (the best available) summarise many, but not all, cases. These databases provide a good indication of the nature and composition of cases, but understate the actual number of cases heard. From these databases, the author obtained summaries of cases over the past 10 years where the Fair Trading Act was the primary relevant statute (see table). The ‘success rate’ of various types of cases was also calculated, which is the number of cases where the complainant’s case was either wholly or largely successful, expressed as a percentage of all cases where the summaries indicate the court handed down a decision.

The author also reviewed cases summarised in *Fair’s Fair*, the Commerce Commission’s regular newsletter, for the same time period. This was done to pick up Commerce Commission cases not found in the databases, as well as Commission warnings and settlements. This information is not included in the table, but is considered in the text below.
The database search produced 647 Fair Trading Act court cases. Trader-to-trader cases (cases where one trader is suing another, with neither consumers nor the Commerce Commission involved) accounted for the lion’s share of court action under the Act (75 per cent). There were two major areas for trader-to-trader litigation. The first was claims of misrepresentations in dealing, that is, in negotiations and agreements (for instance, representations about the value of franchises and disputes over the details of business contracts). These represented 55 per cent of all trader-to-trader cases. In these cases, the Act was invoked merely to strengthen one party’s claim that information given by the other party was misleading. These cases do not involve issues of truth-in-advertising and are not considered further.

Of more interest are the 30 per cent of cases involving claims of passing off or other claims of misleading conduct. A passing-off action is where one firm
claims that a competing firm is offering a product that is similar to one supplied by the complainant, in an effort to exploit consumer awareness of the complainant’s brand. In 55 per cent of passing-off cases, the claim was successful. For example, Wellington Combined Taxis successfully obtained an interim injunction stopping a rival taxi firm using similar signage and logos (Wellington Combined Taxis v. Wellington Ace Taxis, Wellington High Court, 11 October 1996).

Looking at the other claims of misleading conduct in trader-to-trader cases, the claims have been successful in around 80 per cent of all actions. For example, car manufacturer BMW successfully sued retailer Pepi Holdings for knowingly selling imported second-hand BMWs with odometers that had been wound back. BMW sued because of the effect Pepi’s actions would have on BMW’s reputation. This result was upheld by the Court of Appeal (Pepi Holdings v. BMW New Zealand, Court of Appeal, 25 August 1997). Similarly, National Insurance, which offered a customer assistance service, successfully obtained an interim injunction stopping Allied Mutual Insurance advertising that Allied Mutual Insurance was the only insurer offering such a service (National Insurance v. Allied Mutual Insurance, Auckland High Court, 16 December 1992).

As will be recalled, Fair Trading Act advocates support the use of the Act by traders, arguing that this extends the reach of the Act. The case law suggests that this enthusiasm is warranted. The success of passing-off cases and other misleading conduct cases reduces the likelihood that firms will attempt to mislead consumers by engaging in such behaviour. This reduces consumers’ search costs.

It is significant that in all the cases of passing-off and other claims of misleading conduct (successful or not), the complainant was seeking to reap private benefits from the action that it alone would enjoy. With passing-off cases, the other trader is allegedly seeking to pass its products off as being those of the complainant. With the other claims, the other trader is allegedly engaging in conduct that undermines the value of the complainant’s brand. The author could find no instances where trader-to-trader cases involved the complainant seeking public benefits. That is, the complainant was pursuing an action that, if successful, would benefit all the firms in the market. Those actions were confined to the prosecutions undertaken by the Commerce Commission (as discussed below). These empirical results confirm the argument used above to refute the criticism of Friedman and Friedman. That is, firms will only enforce truth-in-advertising in cases where they reap all the benefits of such enforcement action.

Another 12 per cent of cases involved an individual consumer seeking redress. Given the cost of seeking redress through the courts, it is not surprising that the goods and services involved in consumer cases were typically relatively expensive. Only in cases involving such items as property, insurance, cars, major loans and professional services would the loss to the consumer merit the cost of litigation. Jordan and Rubin (1979) claim that sellers of expensive experience goods do not have an incentive to mislead as they risk facing costly court action. But many consumer cases centre on just such consumer products, for instance cars and professional services. This indicates that not all traders comply with Jordan
and Rubin’s theory. This may be because some traders erroneously anticipate that the cost of litigation will dissuade consumers from taking judicial action.

Consumers were not guaranteed success in their cases, only managing to succeed in around half their cases. They were successful only in cases where they had been genuinely misled and deserved the judgement to go in their favour. For instance, in one case a consumer purchased an unregistered car at auction. A notice on the vehicle said that the consumer would have to pay $619 to fit seatbelts in the back seats in order to bring the vehicle up to registration standard. But after paying the money and taking delivery of the vehicle, the consumer discovered the seatbelts had not been fitted. The court cancelled the sale, a decision upheld on appeal (Hammer Auctions v. Williams, Auckland High Court, 10 April 1997). In another case, the consumer was misled by a real estate agent as to the boundaries of a property. The consumer was awarded the difference between the lesser actual value of the property and the price paid, plus damages and costs (Baker v. Harvey Corporation, Henderson District Court, 21 July 1995).

The primary reason why consumers failed in the unsuccessful cases they took was that the claimed misrepresentation had simply not taken place. For example, in several cases the court found that the consumer was demanding that their insurance company honour a claim to which the consumer was clearly not entitled (see, for instance, Pooley v. State Insurance, Greymouth High Court 20 August 1990). In another case, a consumer claimed they had been misled, despite the fact the court found the contract to be clearly unambiguous (Garrett v. Max Pennington Motors, New Plymouth District Court, 7 February 1996). It is disturbing that consumers take such a high proportion of cases apparently doomed to fail, thereby imposing a needless cost on traders. This may indicate that consumers need to be better educated about their rights and to form more realistic expectations regarding the likely success of any case they may be contemplating.

On a more positive note, as with trader-to-trader cases, the successful consumer cases indicate how giving private individuals the right to sue extends the reach of the Act. Rather than complaining to the Commerce Commission, consumers sought redress themselves. But, once again in common with trader-to-trader cases, this activity only occurred where consumers were seeking private benefits that they alone would reap. That is, they were seeking compensation for private losses they had incurred. This implies it would be wrong to rely on traders and consumers to enforce those aspects of truth-in-advertising law that relate to public benefits. For this, we need the Commerce Commission.

Ten per cent of cases were Commerce Commission actions, most of which centred on misrepresentations. Seventy-one per cent of cases involved accusations of misrepresentation in consumer transactions and 11 per cent involved accusations of misrepresentation in business transactions. In fact, it was a business misrepresentation that attracted the highest total fine yet under the Act. Ashley Guy Rhodes and his four companies were fined a total of $130,000 for demanding payment for advertisements run in Rhodes’ magazines that businesses had not ordered, a decision upheld by the High Court (Zennith [sic] Publishing v. Commerce Commission, Auckland High Court, 20 November 1998).
remaining 18 per cent of Commission cases involved breaches of the product safety and consumer information standards and pyramid selling. The Commerce Commission succeeded in around 80 per cent of the cases it took.

The Commerce Commission cases strike further blows against Jordan and Rubin (1979), who claimed that those selling search goods will not mislead, as consumers can obtain sufficient information prior to purchase. In many Commerce Commission cases, the trader attempted to mislead consumers even though consumers would have become aware of the deception prior to purchase. For instance, when ANZ Bank ran newspaper advertisements for mortgages stating that it had halved its standard fee to no more than $500, the small print of the advertisement said that the maximum fee could be as high as $1000 if the consumer did not take their other banking business to the ANZ. The Commission successfully prosecuted the bank for this and other misleading promotions. The court found that the bank’s advertising campaign had generated more than $1 billion in home lending business, and that consumers might have been enticed to apply for finance from the bank even after being told the real situation (Commerce Commission v. ANZ Banking Group, Wellington District Court, 23 February 1996). Likewise, in 1996, Ford advertised the price of a car, but only mentioned additional costs in the advertisement’s small print. Ford entered into an agreement with the Commission to refund these additional costs to all those who had bought the advertised cars (Commerce Commission, 1997a). In 1999, Telecom entered into a settlement with the Commission acknowledging that some of its cellphone advertisements breached the Act. The advertisements contained small print that qualified the cellphone offers by adding extra fees and conditions (Commerce Commission, 1999b).

In all these cases, consumers would have become aware of the deceptions prior to purchase, despite the fact Jordan and Rubin’s (1979) theory is that deceptions involving information that can be verified by search would simply not occur. It would appear the traders’ strategy was to entice consumers towards a purchase using a misrepresentation, and then to correct that misrepresentation immediately prior to purchase in the hope consumers would still go through with the transaction. The momentum towards purchase may be such that consumers still proceed, despite learning before committing themselves that the offer is not as good as they had been initially led to believe. In such cases, consumers who later think better of the purchase would be unlikely to sue. This is for two reasons. First, the consumers have not suffered a direct loss and therefore could not sue for compensation. True, they have still been misled, so could prosecute in order to see the trader fined. But any fine imposed would pass to the government, rather than the consumer. Second, only courts can impose fines, so the consumer would have to incur the expense of bringing a court trial.

Many reputable companies appear on the list of Commerce Commission prosecutions and settlements, names like ANZ Bank, Ford and Telecom. Unlike private court action, Commerce Commission actions typically receive wide media coverage. The cases are publicised on the Commission’s website, in Fair’s Fair, the daily newspapers, Consumer magazine and on the radio and television news.
It is probably fair to say that, given its newsworthiness, the more well-known and highly-regarded a company is, the more likely its prosecution under the Fair Trading Act will be widely publicised. This runs counter to the predictions of Jordan and Rubin. It suggests that companies with a reputation to protect may still breach the Act. Perhaps firms do not value their reputations as highly as economic theorists might suppose, or do value their reputations but suffer occasional lapses of judgement when devising marketing campaigns. Whatever the reason, it is clear that reputations and branding, although very desirable market signalling devices, are not necessarily alternatives to truth-in-advertising law.

As will be recalled, Schwartz and Wilde (1979) argue that truth-in-advertising law may be unnecessary as not all consumers need to be well informed for a market to operate competitively — if firms cannot differentiate between those consumers that search out information and those that don’t, as long as there are a reasonable number of searchers in the market, firms will have to charge a competitive price, which benefits all consumers. This may be so, but not all markets exhibit these characteristics. There have been many instances in the Commerce Commission case law where firms have been prosecuted for misrepresentations where it is unlikely that a sufficient number of consumers would have had the knowledge and resources to see these misrepresentations for what they were and shopped elsewhere. For instance, in some cases, firms have been prosecuted for misrepresentations that only technically knowledgeable consumers would have identified as such. Consider Edge Computer, which was fined $50,000 for selling computers which did not contain the memory the firm claimed was in them (Commerce Commission v. Edge Computer, Wellington District Court, 20 February 1997). The effect of the deception was widespread — any New Zealand-assembled 486 computer could have Edge Computer components inside it. If a computer contained Edge Computer components, it would work slower than it should and some programmes may not have run at all. It was only the suspicions of some technically aware consumers, realising that their computers were not running as fast as they should, that led to the deception being uncovered. In the absence of Commerce Commission action, it is unlikely that such a relatively small group of consumers would have acted as a competitive discipline on the traders involved. That is, this small group of consumers may have complained and obtained a refund, but most consumers would not have realised that the reason their computers were running slow was because the computers did not contain the claimed memory. Indeed, most consumers did not realise anything was amiss.

The same point is highlighted by the 1997 prosecution of appliance retailer Bond and Bond. It was prosecuted by the Commerce Commission for, among other things, promoting price savings on Bond and Bond’s usual prices when the retailer had not normally charged those usual prices. For this and other breaches of the Act, Bond and Bond was fined $63,000 (Commerce Commission v. Bond and Bond, Christchurch District Court, 7 May 1997). As most consumers do not habitually record the prices charged by retailers, they are unlikely to know that the claimed previous prices had in fact not normally been charged. Traders could
make such false price comparisons with relative impunity were it not for the Commerce Commission.

The evidence therefore suggests that in these cases at least, there are insufficient searchers in the market to remove the need for truth-in-advertising law. Yes, truth-in-advertising law may only be necessary for those markets, but it seems ridiculous to suggest the government should carefully assess each market to see whether truth-in-advertising law should be applicable to that market. The cost and time involved would be prohibitive. It is far simpler to have a truth-in-advertising law that applies to all markets. To be fair to Schwartz and Wilde (1979), though, their insights can be helpful in judging whether, in addition to being subject to general truth-in-advertising law, certain markets should require the disclosure of specific information. An example is the disclosure of the finance rate (also known as the annual percentage rate) in consumer finance markets. Such disclosure, required under so-called truth-in-lending laws, can assist consumers in identifying which of a host of competing finance deals charges the lowest price.

The various Commerce Commission cases again highlight the limitations of Friedman and Friedman (1980). That is, the Commission prosecuted firms that engaged in misrepresentations in instances where other firms were unlikely to take action because of the free-rider problem. For instance, although another bank could have issued corrective advertising in response to the ANZ Bank’s advertisements, no bank had the incentive to do this as all banks not charging the additional fees would have benefited. Likewise, another computer retailer could have revealed Edge Computer’s deception, but the benefits of this would have been shared by all other computer retailers.

The analysis so far has concentrated on the search-cost argument in favour of truth-in-advertising law. But in promoting truthfulness in economic transactions, the Fair Trading Act also attempts to ensure markets behave fairly. If it is accepted that the government has a role to play in ensuring markets are fair, this is another reason for the Commerce Commission, a government agency, to enforce the law and publicise its activities.

Society’s dim view on unfair business practices is highlighted by the pyramid-selling cases heard under the Act. These have attracted the most severe penalty meted out under the law. In September 2000 (that is, outside the time coverage of this paper’s consideration of the case law), the Commerce Commission successfully prosecuted the Maximus pyramid-selling scheme. Maximus was ordered to pay over $3.1 million in compensation to those who had invested in the scheme. Maximus’s bank accounts were frozen, its assets seized and liquidators appointed (Commerce Commission, 2000). Other large compensation orders and fines have been awarded in pyramid-selling cases (Commerce Commission, 1997b and 1999a).

Similarly, the Rhodes prosecution mentioned above attracted a large fine because Rhodes and his companies were seen as exploiting hard-working businesses that did not have time to check all their invoices. Rhodes was seen as an unethical businessperson, fully deserving a large fine. Peter Allport, then-
Commerce Commission chairperson, noted ‘Advertisers pay out hard-earned money for what is no more than a scam.’ Among his tactics, Rhodes used debt collectors in an effort to obtain money from an old peoples’ home and took small businesses to the disputes tribunal. Rhodes’ employees swore at, threatened and personally abused people to obtain payment for advertising, none of which had been ordered (Commerce Commission, 1998).

**Conclusions**

The Fair Trading Act bans misleading representations and certain unfair business practices. It promotes competition in markets by ensuring markets behave fairly and by reducing consumers’ search costs.

Not all economists are convinced there is a need for such law. The first criticism is that only some categories of traders have an incentive to mislead. However, New Zealand case law does not support this. For instance, although those that sell search goods will supposedly not mislead, the Commerce Commission has successfully prosecuted traders that misled consumers and then corrected the misrepresentation before the purchase took place. Apparently, the hope was that the consumer had built up an inexorable momentum towards purchase. Were it not for a government agency enforcing truth-in-advertising law, it is likely such action would go unpunished.

The second criticism is that truth-in-advertising law is unnecessary in markets where traders cannot differentiate search consumers from non-search consumers. Maybe so, but not all markets reflect those characteristics. The case law revealed instances where few consumers would have known they had been misled. Rather than laboriously assessing the characteristics of every market, it seems expeditious to impose an economy-wide truth-in-advertising law.

The third criticism is that competing firms can be relied on to police truth-in-advertising, without the need for government regulation. However, this overlooks the free-rider problem. That is, it would only hold in cases where competitors would reap all the benefits of enforcement action. The Commerce Commission has prosecuted in cases where the free-rider problem exists.

The Fair Trading Act is a relatively unobtrusive form of market intervention. Traders can make whatever representations they like about their products, so long as the representations are not misleading. This allows firms to use reputations and branding, important market signals as to the quality of goods and services, but constrains traders who attempt to distort market processes.

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Good Public Policy Making: How Australia Fares

Richard Curtain

Al Gore (1999), called the ‘prince of policy wonks’, has claimed that ‘Industrial Age bureaucracies … have grown far beyond the professional classes they were envisioned to be, and at times seem to specialise in immobility and apathy, lacking the leadership and also the freedom to change with the changing times’. He argues that public policy is about showing leadership and responding to changed circumstances. He also infers that public policy is about setting broad directions. How does Australia rate in terms of public policy leadership and ability to set new policy directions?

The purpose of this paper is to identify the key elements of good public policy and to assess how well Australia’s record stands against the identified criteria. This exercise is not intended as detached analysis. It is a product of the author’s own ‘reflective practice’ as an independent public policy consultant over eight years. In particular, it draws on his involvement in three recent public policy exercises: the review of post compulsory education and training pathways in Victoria, the development of policy options to address the barriers to training for older persons and a paper for the Dusseldorp Skills Forum comparing the operation of mutual obligation arrangements in Australia and the UK (Curtain, 1999).

The paper uses, as its reference point, recent official statements on new policy directions in the UK, Canada and New Zealand and highlights the reasons for the new directions. It presents an outline of what is good public policy, based on governmental reappraisals in these three countries. Finally, it applies these criteria to assess three recent initiatives by the Commonwealth Government to develop new policy. These initiatives are: the Youth Pathways Action Plan Taskforce, the employment aspects of the National Strategy for an Ageing Australia and the Reference Group on Welfare Reform (the McClure report). Particular attention is given to assessing the latter review as an exercise in good public policy making.

This analysis indicates that there are clear signs that public policy making in Australia, compared with the countries cited above, is still deficient in a number of respects. Methods for identifying and analysing citizens’ needs are underdeveloped. This is reflected in the fact that the consultation processes involving the end users of the policies being formulated are often limited or

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absent. Ways of offering citizens more scope to take the initiative in their dealings with publicly funded services are not canvassed.

The paper concludes with some suggestions on ways to improve Australia’s performance in policy design and implementation. It is suggested that more independent sources of policy advice need to be fostered with greater contestability in access to public funding to facilitate this. Another way of improving public formulation is for governments to find more varied ways of seeking input from a wider range of stakeholders, including a large cross section of ordinary citizens. Two ways to improve the environment for policy innovation in Australia are discussed.

**Narrow Focus of Public Sector Reforms**

It is now acknowledged that public sector reforms undertaken over the last decade around the world have been too narrow in their focus (Kettl, 2000). There is an emerging consensus in the UK, Canada, US and New Zealand that the reforms have been mostly about internal restructuring to the detriment of good public policy making. The widespread use of the new structural arrangements based on the ‘purchaser/provider split’ to achieve greater accountability for outcomes has often meant that other aspects of public policy have suffered.

The March 1999 White Paper from the British Labour Government entitled *Modernising Government* makes this criticism forcefully. The White Paper notes that the management reforms of the last two decades have brought improved productivity, better value for money and, in many cases, better quality services. However, according to the White Paper (UK Government, 1999:11) these reforms have been achieved at the expense of broader issues that should be of concern to government:

… little attention was paid to the policy process and the way it affects government's ability to meet the needs of the people… in general too little effort has gone into making sure that policies are devised and delivered in a consistent and effective way across institutional boundaries - for example between different government departments, and between central and local government. Issues like crime and social exclusion cannot be tackled on a departmental basis. An increasing separation between policy and delivery has acted as a barrier to involving in policy making those people who are responsible for delivering results in the front line.

The Canadians also have identified a decline in policy research capacity in their country (Policy Research Initiative, 1999):

…policy issues and their interactions have become more complex. There is more overlap between issues and across jurisdictions, thus putting a premium on information sharing and on working across traditional policy boundaries. Ever growing volumes of information, easier access
through technology and greater ranges of information introduced by more horizontal perspectives are challenging everyone's capacity to keep up-to-date.

A Policy Research Initiative was created in July 1996 by the Canadian federal bureaucracy to strengthen the policy capacity of government to deal with more complex policy issues. An important second objective has been to foster wider participation from think tanks and academic institutions in the policy making process (Deputy Minister Taskforces, 1996). The Policy Research Initiative has been particularly successful in achieving the latter objective. Its second national conference held in 1999 attracted 750 participants from a cross section of Canadian society at $C600 per head. The Policy Research Initiative distributes over 7,000 newsletters and publishes a refereed journal. By 1999, its simple, low-cost web site had registered over 2 million ‘hits’ from 17 countries (Curtain, 2000a).

The problem of the narrow focus of policy is recognised in New Zealand as well. The State Services Commission of New Zealand has published several studies identifying ways to improve departmental capability to contribute to strategic priorities setting (State Services Commission, 1999). Its recent report *Essential Ingredients: Improving the Quality of Policy Advice* (State Services Commission, 1999:8 and 14) highlights the ‘prevailing short-term focus in policy development’ as follows:

the strongest impulses in the public management system are towards action: policy makers react to major problems, formulate quick solutions to them, take decisions, implement these and then move on to the next set of problems. Policy development processes tend, therefore, not to easily accommodate inputs that are reflective or require long lead-times, such as longer-term research and evaluation.

The particular gaps in the New Zealand policy process identified …are in areas of outcomes evaluation, issues identification (including anticipation of emerging problems), the notion of long-term and forward-looking research-based policy analysis, public consultation, and strategic analysis and management.

**Criteria for Good Public Policy making**

Public policy making is first and foremost about determining objectives or societal goals (Encyclopaedia Britannica, 2000). These societal goals refer to ‘big ticket’ issues such as the principles to underpin the conduct of foreign affairs, how to promote internal social cohesion, to how best to meet citizens’ needs during major life cycle changes.

It follows that public policy has to be effective (achieve its goals) and efficient (do so in a way that achieves the greatest possible benefit at the least possible cost). Goal setting in public policy needs to be long-term in perspective.
This means starting with a comprehensive understanding of the current environment and defining what society’s needs are in a way that an appropriate policy response can address. It could, for example, involve developing likely ‘futures’ scenarios in which a proposed policy might need to operate.

Good public policy also involves attention to process. This includes giving the end users ample opportunity to participate in a variety of ways. It also involves ensuring, for example, that the ‘silo’ effect of departments operating independently of each other is minimised. The opposite of good policy making is an *ad hoc* or short-term policy response to an immediate problem. Poor policy making often results from unintended consequences that a piecemeal approach has not taken into account.

In response to the declaration that ‘this Government expects more of policy makers’, the UK White Paper *Modernising Government* proposed a set of key principles for the development of a new and more creative approach to policy making (UK Cabinet Office, 1999). An important starting point is to ensure that the policy has a strategic focus in terms of becoming more forward- and outward-looking. According to the White Paper (p. 9), such a focus requires policy makers to:

- look beyond current activities and programs;
- improve and extend the capacity for contingency planning, and
- learn lessons from other countries by integrating an international dimension into policy making process.

Good policy also needs to be outcome-focused by identifying carefully how the policy will deliver desired changes in the real world. Policy makers also need to ensure that they are inclusive by putting in place policies that take full account of the needs and experience of all those likely to be affected by them, whether they be individuals or groups, families, businesses or community organisations.

Good policy also requires involving those outside government in policy making. This includes consulting with those who are the target of the policy, outside experts, and those who are to implement the policy. Policy decisions also need to be based on a careful appraisal of the benefits any measure seeks to achieve, the costs it entails and the cumulative burden of regulation on those responsible for implementing the policy. Linked to this is also the need for policy makers to improve the way risk is assessed managed and communicated to the wider community.

Finally, good public policy is based on learning from experience. Policy making needs to be a continuous, learning process, not as a series of one-off, isolated initiatives. This requires making use of evidence and research about the problems being addressed. It may also involve making more use of pilot schemes to encourage innovation and to test whether proposed options work. It also requires clearly specifying and evaluating independently the objectives of all policies and programmes and making public the lessons of success and failure and acting upon them. Policy evaluation should also involve obtaining feedback from
those who implement and deliver policies and services (UK Government, 1999:12).

The following sections of the paper look critically at how well the above principles of good policy making have been applied in three inquiries by the Commonwealth Government. The paper concludes with a discussion of the reasons underlying Australia’s approach to public policy and how that approach might be improved.

**The Youth Pathways Action Plan Taskforce**

The Commonwealth Government’s Youth Pathways Action Plan Taskforce (appointed in September 1999, final report submitted in November 2000) displayed several features that adhere to the above principles of good policy.

**Strengths**

The Taskforce was interested in approaches that looked at the needs of individual young people in a more integrated manner. The terms of references were broad in their coverage of a major life episode: the transition to ‘independence’. Its considerations also extended to all those affected by the failure of young people to make a successful transition from education to work, such as family and the community. The comprehensiveness of the Taskforce’s approach is shown by its focus on seven aspects of young people’s lives, from health to the availability of appropriate services.

The principle of seeking to join up policy across organisational boundaries is also explicitly addressed by aiming to develop and implement a whole-of-government approach. The principle of involving others outside of the responsible government departments was also observed. Captain David Eldridge of the Salvation Army chaired the Taskforce. Other members were drawn from community organisations, academia, and business. More importantly, the Taskforce included two young people representing end users. It was also the stated intention of the Taskforce to identify the kinds of partnerships with other groups in the community with the potential to help young people.

**Shortcomings**

However, the deficiencies of the Taskforce as an example of good public policy were several. The absence of an initial consultation or discussion paper to raise issues and possible solutions was a major flaw in how the Taskforce conducted its business. The purpose of such a document could have been to define what constituted a successful transition to ‘independence’ for young people. Is it achieving full-time work, or a threshold qualification? (see Curtain, 2000b). Or is it something broader and, if so, can it be easily measured? In the absence of a

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definition of independence, it is impossible to know what the Taskforce considered to be a successful outcome in young people’s transition to adulthood.

Another deficiency was the lack of mention in the terms of reference of any assessment of the risks or costs to Australian society of having young people failing to make a successful transition to ‘independence’ (see Natsem (1999) for an estimation of the costs to society of young people leaving school before the final year in Australia). Nor was there mention of what individuals, their families, governments and other stakeholders can do to manage this risk and how best to communicate the consequences of failure to those most exposed.

A basic strategic issue that needed to be addressed in a consultation document was a statement about how the Taskforce views young people. Three approaches are possible: young people perceived as either passive clients of government services who are passing through a series of developmental stages, as autonomous agents able to shape their own destinies or as constrained decision makers. Each starting point offers a fundamentally different approach to the type of policy options that could be developed (White and Wyn, 1998).

The strategic challenge facing the Taskforce was to work out how young people can be, not only at the centre of the refocused policy, but also how they themselves can play a much more active role in policy formulation and program delivery. This may also hold the key to achieving better coordination between departments and agencies, federal and state. Placing more discretionary power in the hands of the end user of the services helps to create a system of rewards for good service delivery, which is now absent in most cases.

However, despite its long gestation, the Taskforce did not produce an interim report. In the absence of a canvassing of innovative options, it could only offer its final report in a ‘take it or leave it’ fashion. Without adequately preparing the ground for its more innovative options, it is highly likely that State authorities will reject the report’s findings or simply fail to respond to the call for more ‘joined up’ services.

**National Strategy for an Ageing Australia**

The purpose of the National Strategy on Ageing is to develop ‘a broad ranging framework to identify challenges and possible responses for government, business, the community and individuals to meet the needs of Australians as they age’ (Bishop, 1999:7). The National Strategy also aims to take ‘a whole of government’ approach and will build on work already undertaken to look at possible impacts of ageing in particular areas. The Strategy is focusing on short, medium and long-term policy responses to population ageing as part of a coordinated national framework. Inter-Departmental Committees, drawn from 18 Departments and Agencies, are involved. The four themes are: independence and self-provision; world-class care; healthy ageing; and attitude, lifestyle and community support.

The focus here is on one aspect of the strategy familiar to the author: older people and employment (Cully *et al*, 2000). Under the theme of independence and
self-provision, an Issues Paper entitled *Employment for Mature Age Workers* has been released. The paper's objective is to raise for discussion the longer-term implications of Australia's ageing workforce for the social and economic opportunity of the nation. However, after presenting data on demographics, the changing nature of work, and the attitudes of employers, employees, the community and current initiatives, the paper concluded with just one paragraph on 'future directions' (Bishop, 1999b:44).

…Mature age workers need to take responsibility for their ongoing training and skilling. The ability to be adaptable and flexible in the mature age employment market is a key element for success. It is important to ensure that the Commonwealth Government, in collaboration with the business sector, is able to promote a climate where mature age workers are not encouraged out of the workforce simply as a result of their age. The challenge is to foster a cultural change in the way that the community values mature age workers and encourages initiatives which support their longer participation in the workforce.

The Issues Paper, despite its whole-of-government approach, failed to foreshadow any initiative whatsoever. No reference was made to an extensive literature on policy initiatives on the employment of older persons being implemented by governments and enterprises in Europe and North America. Ways of involving older citizens as active participants in the policy formulation process were not suggested. Nor was there any indication of how Government might initiate or facilitate the cultural change suggested among the other stakeholders such as employers, community groups and individuals. The above conclusion to the paper suggests that policy coordination through seeking consensus among a range of agencies and departments has led, in this case, to a non-outcome.

**Reference Group on Welfare Reform**

The focus of the Commonwealth Government’s review of the welfare system has been on ways to prevent and reduce welfare dependency. This was defined as encouraging those receiving social security income support to move from being passive recipients to being active participants in the labour market or socially active as volunteers. The review began in November 1999, issued an interim report at the end of March 2000, and a final report on 16 August 2000. The Commonwealth Government issued its response to the Review on 14 December 2000.

**Strengths**

How the Reference Group on Welfare Reform was set up and conducted its inquiry demonstrates a number of features that exemplify good practice. The membership of the Reference Group included service providers, academics, and
social policy specialists, although, as noted below, significant stakeholders such as the end users of the social security system were missing. An extensive consultation process before and after the publication of an interim report gave many stakeholders a chance to contribute to its deliberations. The consultation process generated 360 formal submissions prior to the release of the interim report. This was followed by distributing feedback questionnaires to all those who made submissions and focus group discussions with key stakeholders members. Some income support recipients also participated through focus group discussions. Other good policy features exemplified are a survey of international developments relevant to the review, a critical appraisal of the shortcomings of existing arrangements and the specification of key outcomes to be achieved.

**Shortcomings**

However, against the benchmark of good policy criteria identified above, the final report of the Reference Group has three major shortcomings. The first is that the key outcomes are specified in an open-ended way without specific targets. Two outcomes are specified in terms of achieving ‘a significant reduction’ (in the incidence of jobless families and jobless households and in the proportion of the working age population that needs to rely heavily on income support) without specifying what constitutes ‘a significant reduction’. A third specified outcome, as stated, is not measurable (‘Stronger communities that generate more opportunities for social and economic participation’).

The second shortcoming of the report is its narrow departmental focus. Despite the identification of major problems in coordinated service delivery, the department responsible for funding and regulating mainstream employment services was not represented on the Reference Group. The Welfare Review’s Interim report (Reference Group on Welfare Reform, 2000a:9) noted that:

> from the individual’s perspective, the linkages between services are not always clear and there can be gaps in assistance, as well as conflicting priorities … Difficulty can be experienced in obtaining more appropriate assistance, as an individual’s needs change.

The Review’s final report (Reference Group on Welfare Reform, 2000b:14) also noted that the current structure of mainstream (for example, Job Network) and specialist employment services (for example, Specialist Disability Employment Services) results in people being unable to move between these services according to need. Also noted was the inadequate servicing of people who are not catered for by either market. The final report concluded that the current structure of service provision needs to be examined and options developed that ensure barriers are broken down so people can move more easily between programs as their circumstances change.

However, the other federal departments with responsibility for a range of programs aimed at assisting people into work, including the Job Network, namely the Department of Employment, Workplace Relations and Small Business and the
Department of Education, Training and Youth Affairs, were not represented on the Reference Group. Nor were they even mentioned as key stakeholders in the final report’s recommendations. The report’s recommendations overwhelmingly refer to the agencies (such as Centrelink) and the programs that are the responsibility of the Department of Family and Community Affairs portfolio. Only two out of 56 recommendations relate (albeit somewhat indirectly) to the operation of the Job Network.

From the perspective of good public policy, the third major shortcoming of the work of the Welfare Review is the uncritical emphasis it places on ‘individualised service delivery’ as a major recommendation. ‘Individualised service delivery’ refers to the use of case managers and other brokers to assess and stream individuals into ‘levels of service intervention based on their capacity for economic and social participation’ (Reference Group on Welfare Reform, 2000a).

From the perspective good policy making, two flaws can be identified in this recommendation and supporting analysis. The first is the failure to provide an assessment of the costs involved against the costs or risk assessment of not implementing this approach. Mead notes that ‘supervisory paternalism’ makes severe demands on the capacities of government and is difficult to implement well (Mead, 1997). Feedback from the Review’s own consultations also noted that, to work well, individualised service delivery would require an huge investment in resources in the form of sufficient staff resources that need to be fully trained to carry out the complex assessments (Reference Group on Welfare Reform, 2000b:15). There was no attempt in the final report to specify or cost out what these resources might involve.

The second flaw in ‘individualised service delivery’ from a good policy perspective is the wide scope for discretionary power it gives to case managers. One obvious risk of this approach to service delivery is the reinforcement of the dependent attitudes of the income support recipient. Although the interim report notes the importance of individuals making their own choices, the Review’s two reports do not suggest any ways that this can be fostered in the face of the powers recommended for case managers.

The need for an alternative approach that improves the power balance between the individual reliant on social security support and his or her case manager was brought home to the author last year when conducting focus groups with long-term unemployed, older persons (aged 45 and over). Their accounts of dealings with case managers under Job Network’s Intensive Assistance Program for the long term unemployed suggested that case managers are exposed to a major moral hazard. Although funded to provide a range of forms of assistance, the Job Network operator has a strong incentive, because of open-ended nature of the assistance available, to provide their ‘client’ with as little information as possible about their options so as to maximise profits. This can mean that, in one instance cited by a focus group participant, a short computer training course (six weeks) was approved by the Intensive Assistance case manager rather than the more extended TAFE course sought by the long term unemployed person. This latter option, the unemployed 45 year old man saw as a more effective way in the
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long-run of improving his employment security. Other instances concerning the limited training options available from their case manager were cited by other older long-term unemployed.

One suggestion to overcome this problem would be a Government requirement that a customers’ or citizens’ charter be provided for those participating in any form of individualised service delivery funded by government. At present, the service charters of many federal government departments and agencies do not extend to publicly funded services delivered by non-government service providers. This charter could spell out what options and resources are available to allow ‘clients’ to negotiate with their case managers on a more equal footing. The purpose of such a charter would be to help long-term unemployed persons to learn from the experience of making their own choices through a negotiated process.

Another way to give ‘clients’ of the system more awareness of their entitlements would be to explore ways for a direct flow of funds to end users of the service. Individuals in dealing with Centrelink case officer or a case manager would need to be provided with sufficient information to make the best choice. However, this is likely to be a very different relationship to one based solely on a case officer’s own assessment of what is appropriate. The lack of attention in the Review’s reports to the perspective of income support recipients is shown by their absence on the Reference Group and a lack of awareness of the limitations of individualised service delivery as a vehicle for reducing welfare dependency. It is difficult to avoid the conclusion that a service provider perspective underpins many of the Review’s major recommendations.

Factors Inhibiting Policy Innovation

What is immediately noticeable about the state of debate about public policy making in Australia is the absence of equivalent official statements about what constitutes good policy similar to those of the British, Canadian and New Zealand Governments. The capacity to reflect critically on the shortcomings of existing policy processes and to draw lessons on how to improve them in toto does not appear to be a feature of the operating environment of Australian Governments or the Australian Public Service. The Commonwealth Government-initiated inquiries, discussed above, have in some aspects sought to address the shortcomings of past approaches to policy making. However, in the absence of a blueprint of what constitutes good policy, each of these attempts has major gaps in the range of issues addressed, the stakeholders involved and deficiencies in the assessment of the risks involved.

It is beyond the scope of this paper to identify and expound on the range of factors that might explain the constraints affecting the public policy setting process in Australia. These factors include the short term focus produced by the electoral cycle, arbitrary timing of elections and the legacy of our federal system where the Commonwealth Government does not have prime responsibility constitutionally for addressing the needs of citizens in crucial areas such as
education and health. It can be argued that there is also a defensiveness among Canberra bureaucrats about Ministers having access to other sources of policy advice. However, let me highlight two deficiencies of the policy formulation process without further elaboration as a means of suggesting new approaches. One is the lack of innovative ways of consulting ordinary citizens about what issues public policy should address. The other is the lack of alternative sources of policy advice in Australia compared with the USA, UK and Canada.

Some Suggestions for Change

Consulting ordinary citizens

Innovative forms of consultation now used in the UK and North America could better inform the policy process. These include surveying randomly selected members of the public through a mechanisms known in the UK as People’s Panels, based on a random sample of 5,000, to seek feedback on policy ideas and to assess the effectiveness of program implementation. Other innovative forms of consultation are ‘deliberative polling’ and ‘deliberative dialogue’. The former is a means of involving the public through scientific random sampling in intensive small group discussions to work through complex public policy issues. It is a technique that has been used to explore ‘big issue’ policy change such as the republic debate in Australia and devolution in Scotland.

Deliberative dialogue is a structured, face-to-face method of public interaction that takes place within small groups at community level over an extended time. This method has been used to canvass the issues to do with parents’ choice of schools in the United States. The benefit of both methods is that they provide a means for others in the community interested in policy change to better inform members of the public to understand the complexities of an public policy issue so that they can more easily come to an informed opinion about the issue.

Fostering alternative sources of policy advice

Governments in Australia tend to view the bureaucracy as the primary, if not the sole, source of public policy advice. In the words of the Minister Assisting the Prime Minister for the Public Service ‘… as an ongoing Service, it provides an unparalleled source of knowledge and experience … to the government of the day’ (Kemp, 1999). However, because public policy makers in the Public Service work within a hierarchical organisation structure, the market for new policy ideas can be viewed as a monopsony (Hamel, 1999). It requires only a single rejection from one person at the top of the hierarchy for the fate of the policy idea to be sealed. Senior managers in hierarchical organisations, whether they are public bureaucracies or operating in the market, have already ‘made it’ with all that this infers about attitudes to past practice. This means that they are likely to be the
most conservative about new ideas because they have the most emotional capital tied up in defending past policy actions (Hamel, 1999; see also Curtain, 2000c).

The challenge for those who believe that public policy is not simply the province of public servants is to generate the conditions that remove the monopsony to create greater contestability for policy ideas. One solution for achieving this would be for independently funded public policy think tanks to conduct their own research and to publicise new ideas. There are several reasons that could be given, not able to be elaborated on here, that make this a difficult option in Australia.

An alternative approach, proposed by Gary Hamel in relation to how established private sector firms can generate new ideas, is for Government to set up a fund to provide ‘venture capital’ for new policy initiatives (Hamel, 1999). The fund, modelled on a similar arrangement in Royal Dutch/Shell, could be presided over by a group of more open-minded senior public servants (likely to be those with alternative career options outside the public service) to allocate money to path breaking ideas submitted by interested parties.

Such a fund could be analogous to a ‘policy ideas’ version of the Australian Research Council. Interested parties in federal or State Government departments, advocacy groups, universities and others could seek funding, in a contestable way, to not only develop policy options but also to conduct a pilot or series of pilots to test their viability or to fine tune proposals. The Fund could also help to underwrite national and regional conferences on particular policy issues and support other initiatives to promote contact with all those interested in public policy as societal goal setting.

Australia needs mechanisms to not only generate new policy ideas that are a departure from the past. We also need ways to ensure that the new ideas can be further tested and implemented on a large scale where they are judged to be viable.

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Prioritising University Research: A Critique of the Kemp Reforms

Harry Clarke

In June 1999 Australia’s Minister for Education Training and Youth Affairs, Dr. David Kemp, released *New Knowledge, New Opportunities* (hereafter, the Report) to set out the government’s provisional tertiary education research and research training policy. Six months later, *Knowledge and Innovation* (hereafter, the Policy Statement) was released. This accounted for public discussion of the Report and provided policy conclusions. There were revisions in policy direction from the earlier Report but its core recommendations were retained. The Report remains of interest because it rationalises the Policy Statement. Both documents focus on encouraging research responsive to industry needs. The institution for achieving this is a restructured Australian Research Council (ARC) that will:

- Administer a unified National Competitive Research Grants Programme.
- Assist in linking business with research institutions.
- Provide strategic research direction advice to Government.
- Establish a broad verification framework supported by Research and Research Training Management Plans.
- Introduce performance-based funding of research training.
- Create a collaborative program to address regional needs.

While universities are given a priority-setting role for research and research training, their funding becomes dependent on past successes in gaining funding from all sources (including industry), their success in attracting students and their research output. A portable scholarship scheme forces competition for research training.

This paper critiques these policies.

**Assumptions and Objectives**

Recent emphasis on the importance of research in ‘knowledge-based’ economies suggests that certain types of public or privately financed research best enhance economic growth via a cooperative *Triple Helix* relation between universities, government and industry (Etzkowitz and Leydesdorff, 2000). Knowledge production is not seen as a disinterested pursuit providing free public goods. Instead discoveries are seen as delivering privately appropriable economic gains.

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provided researchers are entrepreneurial and intellectual property rights support discoveries.

The Report and Policy Statement are attempting to prioritise research, to enforce property rights and to foster an entrepreneurial culture in Australian universities. These documents see knowledge creation as occurring increasingly in:

- Multidisciplinary teams rather than individual or discipline-based efforts.
- A global environment where international links provide business and research talent migration opportunities.
- An environment producing much knowledge but deficient in entrepreneurial culture.

They therefore argue that Australian universities should:

- Display ‘global excellence’ in fields where they are research active.
- Be centrally managed using broad ARC objectives.
- Be locally managed by more specific, market-oriented proximate objectives.

These presumptions are first discussed. Then the suggested reforms are analysed.

**Research is Increasingly Team-Based**

The presumption that research is increasingly ‘team-based’ and ‘multidisciplinary’ (Report:Section 1.8) implies a case for concentrating and prioritising research to exploit scope and scale economies. Is this presumption accurate? Even if it is accurate, will proposed reforms support effective team formation?

First note that, even if multidisciplinary teams are increasing in importance, this does not mean they are (or should be) a major part of university’s research. The Report does not provide evidence on the relative extent of team research but there is evidence suggesting that it is mainly important in the physical sciences (Katz and Martin, 1997). In other disciplines research specialisation is dominant. Such specialisation provides benefits as well as costs. Advantages to multidisciplinary teams are offset by transactions costs of pursuing integrated efforts from different specialisations. Such costs limit the optimal extent of integration. In cases where team-based research is sought, they also suggest arguments for outsourcing in business settings rather than through integrated teams of diverse experts inside universities. If individual rather than team-based research is of primary importance there are reduced economies from prioritisation.

Indeed, even with a ‘team’ basis for research it is unclear that competitive grant-giving schemes optimally foster team formation. Such schemes create incentives to dress up proposals for funding in multidisciplinary garb to attract grants. Donning this attire however need not improve research outcomes.
Research Should Be Globally Prioritised

University research is portrayed by the Report (Section 1.11) as occurring in a global environment. Exchanges of faculty, the employment of non-nationals and modern communications imply a globally integrated environment with rapid knowledge transmission. The Report seeks to encourage this by prioritising research on the basis of global standards. There are several difficulties.

Long-standing criticisms from the humanities suggest that globally prioritised universities downplay national culture (Readings, 1996). These criticisms link globalisation (often ‘Americanisation’) with a declining interest in local culture and suggest that, with local cultural outputs, there is a diminished case for globalism.

In addition, Australian universities face difficulties in globalising because they are restricted from recruiting faculty globally by salary differentials that make such efforts expensive. Institutions therefore must also generate talent endogenously by capitalising on specific national resources. This seems sound policy, even ignoring cost factors, because a diversity of staffing and intellectual pursuits is important in generating innovative research. Diverse views are a source of new knowledge, so institutions should draw on local talent and local research paradigms. In addition, a globalised system will be one where talent is concentrated because of the salary differentials and associated agglomeration benefits.

A further case for national orientation in research arises from specific national advantages conferred. While global efficiency in knowledge provision may be maximised by free trade in talent within a global market for ideas, it may not optimise national advantage. Indeed the Report recognises that nationally significant research is undersupplied in a global environment thus requiring some priority for national research. However, beyond a minimum of nationally important research, it argues research should be prioritised at international ‘best practice’ standards. This implied two-stage procedure prioritises first at national and then at global levels. Questions over the reasonableness of such priorities then hinge on the weighting assigned at the first stage. Difficulties remain both in defining the globally prioritised component and in separating things in this way.

Note also that, with global research collaboration, the case for local research prioritisation diminishes given the reduced pressures to realise scope and scale economies particularly for individual rather than team-based research. Having an independent local focus provides incentives for diversity in forming such collaborations as well as prioritisation. While the Report considers this need for diversity, the thrust of its schemes acts to concentrate research efforts.

Once it is agreed that research should be both prioritised and diverse, the complexity of the research management task becomes clear. It need not, for example, be particularly advantageous to bring in international experts to assist the ARC in global prioritisations as the Report advocates.
Innovation and Entrepreneurship in Australia Are Deficient

Compared to other OECD countries Australia spends an average proportion of its GDP on R&D. However, the public sector, rather than business, funds most university research — in 1996 public funding provided 88 per cent of university research. The Report draws strong inferences from this. Australian research is seen as disconnected from innovations leading to economic gains and as lacking entrepreneurship to commercialise research. While evidence is not provided on these claims, various policies (tax, intellectual property, improving business awareness of research, fostering entrepreneurship in universities) are advocated to facilitate innovation.

The evidence on Australian entrepreneurship and innovation, however, is not as clear as the Report implies. From 1980-1994 Australia’s high-technology exports grew at one of the highest rates in the OECD (Department of Industry, Science and Resources, 1999:Table A5). While this occurred from a low base, the growth suggests increasing innovation. Indeed, the two main OECD proxies for the value of the output created by research are inventiveness coefficients (patent applications per 10,000 population) and coverage ratios (technology exports divided by imports). Australia’s inventiveness coefficient was 4.6 in 1996 compared to a total figure for the OECD of 5.8 — fifth out of 29 OECD countries. Australia outperformed Canada, the US and the UK in every year from 1990-1996 in per capita inventiveness. At 0.62 in 1996, Australian coverage ratios appear less favourable — tenth among 15 OECD countries examined. However, over 1990-96 the coverage ratio increased 72 per cent (Department of Industry, Science and Resources, 1999:chapter 5), suggesting improved innovatory performance. Clearly some foreign technology dependence makes sense for Australia that should be less self-reliant than larger countries such as Japan or the US.

A subsequent report (Department of Industry, Science and Resources, 2000) confirms that Australia has an entrepreneurial culture with high ‘early technology’ take-up, growth in real value-added of knowledge-based industries, tertiary education enrolments, flows of graduates into science and engineering, and high scientific publication rates. Rather than providing evidence of a weak scientific base, the Department of Industry, Science and Resources suggest the key issue is low public funding of education per capita. The Australian figure for 1995 (US$980) was 25 per cent below Canada’s figure and more than 40 per cent below those for Japan and the US.

There are conceptual difficulties in using the innovation measures here to calibrate innovation trends and entrepreneurship. But the evidence does not confirm a general failure to invent, innovate and export information-intensive outputs during the 1990s. Nor does evidence confirm a weakness in the national scientific base or in the proclivity of the private sector to innovate.
Research Quality is Declining

The Report (Section 1.41) claims that Australian researchers are currently rewarded for the breadth rather than quality of their research and that this has reduced quality. Thus universities should prioritise research. The evidence used to suggest declining excellence is ‘citation index’ trends. Even if this does suggest declining standards, recent education Australian policies have had negative effects on research in ways unlinked to the processes of research funding. For example critics contend that ‘creeping managerialism’ during the 1990s, with the creation of a pool of research-inactive professors has had disincentive effects on research and academic standards (Clarke, 1998; Crowley, 1998). In addition, universities have been subjected to two decades of funding cuts with declining faculty salaries.

With respect to research training, the Report identifies employer dissatisfaction with narrow curricula, student complaints of poor supervision and ‘wastage’ due to high dropout rates. There is therefore, it claims, a need ‘to broaden the base of the research training experience, strengthen the creativity, communication and problem-solving skills of graduates, and provide training opportunities and experience outside the academic environment’ (Report:10).

These claims are questionable. Undergraduate curricula have been expanded and operated at lower academic levels during the 1990s to accommodate expanded entry quotas not matched by proportionate funding expansion. With the preference for classes of several hundred students, it is not surprising that basic writing and reporting skills have declined, given unfunded costs of monitoring and evaluating such work. In addition, universities have established resource-intensive programs (for example, in tourism and ‘business’) in areas where they have had little past expertise. These trends affect training quality irrespective of how that training is managed. Much postgraduate supervision work now involves correcting basic language and math problems — issues that industry employers of graduate students also complain of. This again partly reflects university-funding problems. Furthermore, this deteriorating funding situation is unlikely to improve in the short-term. It will fall from 3.1 per cent of total Commonwealth spending in 1994/95 to 2.2 per cent in 2001/02. Public spending has already fallen from 1.5 per cent of GDP in 1975/76 to 1.0 per cent in 2000 with the staff-student ratio rising from 14.4 in 1989 to 18.5 in 1998 (Karmel, 2000). Despite this tightness in funding, enrolments increased from 441,000 in 1989 to 686,000 in 1999.

Dropout rates partly reflect the screening function of training. If students abandon a program for which they are ill suited this need not imply wastage. High dropout rates may (at most) indicate a case for improved up-front information and screening. Employer preferences for ‘experience’ in non-academic settings partly reflect incentives within firms favouring university provision of costly, job-specific training. ‘Broadening the base’ of research training can mean reducing program quality by provision of more generic skills.
Centralised Funding Will Improve Research Quality

Current research funding arrangements are described by the Report as ‘fragmented’. A connotation of inefficiency is attached to the word fragmented — the implicit argument is that ‘de-fragmenting’ or centralising research management will offset this inefficiency. It is unclear, however, that such management, implemented as a competitive arrangement, will improve research.

Politicians and education bureaucrats have incentives to seek research outcomes that advance both their own interest group advantages and society’s welfare. Two contrasting research management strategies can be contrasted:

- A top-down approach achieves central management using a competitive ‘tournament’ based on peer review. Universities then have nominal autonomy to choose direction, but to achieve funding, choices must reflect central priorities. The use of block grants that depend on past funding achievements likewise force targeting of central priorities. To work efficiently, central priorities must reflect social needs and must have the ability to select quality research.
- A bottom-up approach assigns autonomy to universities. The government decides how much it will allocate to research across universities and leaves it to universities to devise research programs. Then, for social efficiency, it is university priorities that must reflect social needs and academics who must be able to select quality research.

Present and proposed prioritisations contain elements of both top-down and bottom-up strategies. Present arrangements emphasise bottom-up strategies while those proposed stress top-down. An advantage of bottom-up is that prioritisations are decentralised with many independent groups assessing the social interest. Central political interests are less intrusive. In addition, efficiencies arise from the ability to utilise local knowledge and to use various policy instruments (staff recruitment, promotion, financial) to pursue quality. Possible disadvantages of bottom-up include disciplinary biases within universities and research duplication.

Some of the specific benefits claimed in the Report to arise with a top-down competitive structure seem unjustified. It is stated (again without evidence) that present arrangements encourage ‘grant-getting’ rather than ‘long-term strategic research’ (Report:10). However, ‘short-termism’ may increase with centralised competitive schemes if grants reflect commercial priorities and ex post reviews of achievement occur frequently (Geuna, 1999). Indeed it can be questioned how proposed reforms offset such incentives. Short-term ‘grant-getting’ is currently fostered by the threats and promises of research managers in universities: financial incentives are now offered to faculty who even apply for grants to offset high transaction costs of application given low expected returns. This propensity to provide incentives that drive ‘grant-getting’ will increase given plans to make even more funding dependent on past grants obtained.
It is not necessary to comment further on the net advantages of the alternative schemes here. The point emphasised is that information and incentive problems mean that research effectiveness is not obviously enhanced by leaning towards central management.

**Proximate Objectives**

The language of Report proposals is clichéd (‘leading edge’, ‘self reliant’, ‘dynamic’, ‘excellence’, ‘entrepreneurial’) but its core stated proximate objectives for tertiary institutions seem plausible at first sight. The Report seeks:

- Excellent research of world standard with a long-term orientation.
- Tertiary autonomy to determine what is researched and how (with a view to being responsive to global markets).
- Institutional responsiveness to informed student needs.
- Transparency, contestability and accountability in use of research funds.

One might seek to qualify the desirability of an unrestricted pursuit of excellence. There are educative payoffs from various levels of research and much research in Australian universities would cease if requirements for global excellence were imposed. Moreover it is unclear what is meant by excellence. Australian vice-chancellors regularly proclaim a commitment to excellence and describe programs as ‘world standard’ as a feeble marketing device. (Feeble because it is so universally and uncritically applied. At best there is defensive value in describing programs as excellent because other programs do so). Describing programs as excellent relative to others however promotes intellectual arrogance and a loss in cooperation between institutions (Brett, 2000). Words such as ‘excellent’ provide a language enabling weak comparisons of programs but such comparisons have low value given their lack of a clear referent: at best they weakly integrate divergent concerns (Readings, 1996:22-23) — who in a disputatious faculty will disagree with pursuing excellence?

While autonomy is an ultimate, as well as proximate objective, this is not pursued in proposed policies. Universities choose what to research given an ARC agenda that determines funding.

Encouraging institutional responsiveness to student needs seems laudable but asymmetric information issues in relations between suppliers and users of research training services make this an inappropriate ultimate objective (Clarke, 2000). Students do not initially understand what they need to know. Therefore relying on their revealed demands may provide inferior outcomes to rigorously preselecting academic faculty and then relying on academic judgement to mentor students into quality research.

Finally, use of competitive tournaments to obtain transparency in funding can result in higher transaction costs of research than would non-competitive *ex post* funding to those who deliver quality research outcomes. Issues of transparency and accountability in gaining research funds become crucial with a top-down
centralised research prioritisation. In a decentralised system, local knowledge makes it easier to assess comparative research productivity.

Neither the Report nor Policy Statement provides argument supporting the premises underlying their arguments for prioritisation. Claims regarding the team character of research, a claimed lack of Australian entrepreneurial zeal, alleged short-termism in current research grant applications and claimed poor performance of research training are not backed up.

The National Competitive Grants Tournament

The Report sees prioritisation of research as best facilitated when universities make individual judgements of their own strengths. Despite this the Government would still use funding incentives based on ARC strategic advice to encourage ‘sensible’ prioritisations. As the Policy Statement notes, ‘…the new ARC Act will provide the Minister with the power to give guidance to the ARC on the broad direction of its research activities within the context of the strategic planning process, including the … allocation of grants.’ (Chapter 6:5).

Given an institution’s research priorities and its consequent academic direction, projects will be advanced for funding through investigator-initiated proposals. The case for funding will then be assessed via a single ARC program subsuming all existing programs (except the Small Grants Scheme funded under the Institutional Grant Scheme). This is the National Competitive Grants Programme (NCGP). Current ARC review procedures will be ‘improved’ by giving a voice to industry. The reformed ARC will engage visiting researchers with experience in research management, to respond to emerging disciplinary and cross-disciplinary developments and to the needs of emerging researchers. Review committees will include discipline-specific international experts to rank projects.

The NCGP consists of a ‘discovery’ element to encourage excellent individual or team proposals and a ‘linkage’ element to promote collaboration between institutions, industry partners and groups such as the CSIRO. Both elements are assessed using peer review, which includes potential users to assess likely economic benefits ‘as well as social and cultural development.’ (Report:38).

The balance between forms of funding has been much discussed. In the Policy Statement, the discovery component is described as covering ‘fundamental’ research, but this is seen as implemented ‘within a wider framework that encourages links with users of that research’ (Chapter 6:3). Further, ‘It is a legitimate expectation that public investment in research will pay social dividends through contributions to problem solving as well as providing commercial opportunities’ (Chapter 6:5). Blurring distinctions between applied and basic research makes it difficult to assess how much basic research will remain supported and only weak guarantees are provided: ‘… the current balance between basic and applied research would be maintained for the time being’ (Chapter 6:6).
A feature of NCGP is that all Australian academic institutions are brought under its umbrella. For example in the Report, it was questioned whether the Australian National University’s Institute of Advanced Studies — currently block-funded — should be brought under the NCGP. The Policy Statement subsequently announced that Institute funding will become contestable, heralding the end of block funding. While criticisms should be made of the performance of the ANU Institutes, the proposition that all research should come under the competitive umbrella is questionable if only because implications of this new prioritisation are so uncertain.

Government will have a role in mapping out ‘broad’ strategic guidelines for research spending favouring areas such as biotechnology. The word ‘broad’ here is presumably inserted here to avoid impressions the Government is ‘picking winners’ though this is the effect. Government would also intervene to ensure universities provide environments conducive to excellence, to applying research in the ‘national interest’ and to structuring incentives to encourage ‘enterprise and innovation’. These objectives are ambiguous and potentially permit restriction of university autonomy and the promotion of questionable research options. Would the Government favour the Multi-Function Polis, renewable energy or very fast train projects? These dubious proposals have all received political support on ‘national interest’ grounds.

The NCGP allocates funds via a tournament. The Government declares its broad strategic research guidelines and the ARC then prioritises on this basis with weight given to industry concerns. Individual universities then ‘autonomously’ determine the direction given to this prioritisation. Individuals and teams submit proposals for funding and projects chosen are those ranked highest by tournament peer and industry panels. There are difficulties here.

NCGS Science Model Bias

The ARC procedure is an ‘experimental science-based’ view of how research proceeds. Research is viewed as an ‘open loop’ process with fully specified objectives implemented as a pre-planned procedure. Research is the implementation of this procedure with an interpretation of resulting outcomes.

Research however seldom proceeds this way in social sciences and, indeed, in many natural sciences. Moreover, insisting on such methodology can bias rewards toward easy-to-justify, though contrived, proposals rather than quality cerebral research.

Academics, outside the experimental sciences, implement research not by employing research assistants using purchased equipment and then conducting experiments but by reading, calculating and thinking. The process is ‘closed loop’ rather than open loop with objectives and strategies for achieving objectives changing as perceptions evolve.\(^1\) Closed loop research is implemented by

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\(^1\) The terms closed loop and open loop come from control engineering. Open loop plans have all procedural information known initially. Closed loop plans allow for procedural revisions as information unfolds.
individuals perhaps in dialogue with colleagues. The main input is time. While, under current large ARC Grant schemes, individuals can buy time ‘out of teaching’ for such research, this seldom occurs because of difficulties in discriminating between competing claims for teaching relief and because cerebral research has a closed-loop, difficult-to-sell character. What has therefore occurred is a substitution of resource-using projects for reflective research. Deans and Vice-Chancellors place weight on sponsored research, creating incentives to substitute resource-using projects for those relying on thinking. This creates the concern in preparing research proposals of finding items to budget — some departments are now overloaded with computers, unread books and journals as well as idle research assistants as academics scramble to devise ways of spending resources creatively accessed from the ARC. Past ARC Grant procedures in Australia have induced waste through the diversion of intellectual activity into inefficient resource-using activities. Expanding such programs increases this waste.

**NCGS Industry Orientation**

The Report and Policy Statement have an overwhelming message, repeated page after page, that more industry-relevant R&D is what is required. The Report sees university/industry collaboration creating positive externalities. Academics gain commercial focus while industry accesses a broader knowledge base. However, external benefits must work in both directions for such a contract to be necessary. If the only external benefits accrue to firms then employment contracts awarded to university researchers, internalise firm benefits. For example, with respect to teaching, firms can extend their training departments into ‘universities’. Indeed over 1,000 US corporations now have their own universities with the goal of achieving tighter control and ownership over learning by linking learning to business goals (Meyer, 1998:ix). The same idea can be extended to corporate research. This is the efficient market solution unless there are spin-offs from such research to universities.

Without externalities between industry and universities there are arguments against funding industry-relevant R&D in universities. The notion that this research can be provided at low-cost in publicly funded (and therefore low-cost) universities ignores the opportunity cost of funds used. Moreover, a case for dedicated provision holds even with general spill-overs to society from research: even when there are public good attributes, subsidies are most efficiently directed to the specific research in firms (or universities) rather than by fostering joint efforts. When research is a pure public good universities should publicly provide it.

Empirical evidence supports the view that basic research within firms is a more important determinant of productivity growth than R&D. In addition the most effective R&D research in firms is privately funded (Adams and Jaffe, 1996). Since most basic research in industrial societies occurs in universities, it is
risky to redirect such work by emphasising industry-orientation in publicly funded university research.

**NCGS and Research Concentration Among Universities**

Economies of scope and scale exist in research when it is capital intensive (as in physical sciences), multi-disciplinary and when there are high transaction costs of preparing funding proposals. The presence of fixed costs (minimum library requirements, laboratory or equipment needs) create arguments both for prioritisation among universities into dedicated research or teaching institutions, and of research tasks within universities — these priorities reflecting minimum investments needed to generate useful information. University departments with extensive research budgets, large administrative staff and low teaching loads have advantages in achieving funding of such research.

Individual-based, curiosity-driven research that forms the bulk of research in social sciences is much less subject to scale economies, particularly given modern media for transmitting messages and desktop computers for computing and organising data.

Applying a competitive research funding mechanism will further concentrate research into established institutions that currently implement most research. Other institutions will gain proportionately less funding and will drift towards their earlier focus of vocational teaching. Thus, plans to make research funding contestable will undo university reforms of the late 1980s, which sought to expand the range of institutions doing research. Market forces were eroding the effects of these reforms anyway — the new institutions have been under funded and achieving neither vocational nor non-vocational needs (Clarke, 2000).

The benefits of such a strategy are the costs saved through non-replication of research and the exploitation of economies in multidisciplinary, team-based research efforts. Costs comprise the losses of non-science based research particularly from investigators outside the larger wealthy universities. This is additional to costs from distorting practices within established universities through adverse effects on those not utilising science-based research paradigms.

**NCGS and Non-Vocational Research**

The Report and Policy Statement emphasise that non-vocational research effort and cultural pursuits will be protected. Often this is done briefly and in passing, seemingly as an afterthought to protect authors from charges of philistinism. Given that markets do not exist to value non-vocationally directed research, details of how non-industry related research is to be prioritised are necessarily vague in a document emphasising economic arguments for prioritisation. The suspicion, given emphasis on industry needs, is that underprovision will occur.

A criticism of these documents (and the earlier West Report) is their narrow perspective given education’s diverse aims. Vocational objectives tied to immediate social needs are one goal. Other aims include the cultural needs of
those educated, public good needs and ideas of changing attitudes to create a better society. The Report’s emphasis on industrial output is consistent with a view that mainly sees private goods as contributing to social prosperity. As mentioned, alternative views of a university see its role in contributing to national culture as well as economic growth. Universities assemble knowledge that helps to develop individual critical powers and character. Knowledge acquisition becomes a ‘conversation’ defining an individual’s identity, their social role and values. Such a liberal approach is productively efficient and culturally enriching, if markets undersupply cultural outputs.

**Flaws in the NCGS Ranking Procedure**

Imperfections exist in the proposed ranking procedure for several reasons. First, the NCGS denies any developmental role for research funding. The NCGS response to poor research performance (measured by grants gained) is to trim funding. An alternative approach would be to inject funds to improve performance giving funding a developmental role.

Second, NCGS tournaments award big prizes to those who win — but nothing to losers. Large gains to winners offset costly possibilities of losing. Large prizes ensure participation in the process but resulting grants need not reflect research needs. A major criticism of existing large ARC Grants is that while they fund a few projects with huge grants, the more modest needs of cerebral individual research are unaddressed. This suggests static efficiency losses from the allocation of resources to projects with low marginal value and dynamic losses from the incentives created to pursue excessively large projects.

Finally, self-reinforcement phenomena result in successful individuals gaining research resources that increase future chances of research success. Unsuccessful individuals get nothing. But research success may reflect luck not talent. Thus unwarranted self-reinforcement phenomena or *Matthew effects* arise\(^2\). Moreover, the successful concentrate in a few large schools (whose staff selection targets grant-gaining success) where the self-reinforcement cycle is compounded by colleagues comprising the selection committees who award prizes. Funds are then further misallocated across individuals and institutions.

**Transaction Costs of NCGS Tournament-Funded Research**

Efficiency in research effort is not always enhanced by market provision because market-based provision of resources for research faces transaction costs. These costs offset desired incentives. Competitive tournaments provide individuals with research opportunities provided they document for review panels what they will

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\(^2\) Merton (1968) calls these *Matthew effects* after the biblical passage ‘For unto everyone that hath shall be given, and he shall have abundance; but from him that hath not shall be taken away even that he hath’ (Matthew 13:12).
investigate and how they will proceed. The costs of preparing this information are significant and intensified if, as is widely understood, investigators see proposals as a deceit designed to elicit a one-line budget. These are opportunity costs of eliciting quality research if researchers would have implemented it because they have been appropriately preselected, have intrinsic interest in research, pursue promotion or seek peer respect.

Under these conditions a better approach is the offer and conditional renew policy (OCRP). An OCRP rewards researchers if they sustain research output after being initially given start-up grants on ‘trust’ (here any selection criterion not involving past performance). Providing modest funding on a renewable basis conditional on achievement may outperform a research tournament since transaction costs are avoided. Moreover, the need for ex ante fantasies and exaggeration is avoided with an ex post OCRP. Agents do not have incentives to deceive funding agencies by formulating proposals designed to impress rather than to work.

The NCGP involves evaluating proposed research ex ante. A proposal’s strength is compared to others with only an applicant’s Curriculum Vitae being used to assess whether the proposal draws on skills possessed by applicants. There are three difficulties: (i) a NCGP rewards good proposals rather than good research; (ii) a NCGP involves ex ante judgements by centralised groups subject to political manipulation; and, (iii) a NCGP can generate ‘Matthew effects’. An OCRP however initially assigns research funds on a limited basis to new researchers as ‘starter grants’. The funds can be used for quality research of any type. The OCRP is then renewed annually provided ‘reasonable’ effort, related to grant expenditure, is recorded ex post. If less-than-adequate research output is recorded then the grant is trimmed in a dampened way. If more than adequate research output is recorded the grant increases proportionately subject to budget. ‘ Forgiveness options’ are available to researchers who fail to perform and lose funding but who subsequently perform. With OCRP transaction costs of application are minimised and there are limited incentives to cheat the grant-giver. Rewards are based on performance not promises. There is no attempt to constrain the initial research choice set but quality is rewarded. Poor research outcomes due to discovery process uncertainty are not penalised excessively while good performance is rewarded subject to budget. As an ex post scheme, the OCRP avoids difficulty (i) of the NCGP. As a scheme managed within universities OCRP avoids (ii). Finally, Matthew effects are reduced because grant trimming is dampened.

**Institutional Grant Scheme**

From 2001 an Institutional Grant Scheme (IGS) will provide block funding to universities. This includes all funding from previous Research Quantum and Small Grants Schemes. Current Research Infrastructure Block Grants (RIBG) are retained. Under Report proposals the RIBG was to be abolished with resources reallocated to Commonwealth Granting Agencies in proportion to their share of
total competitive funding. The Policy Statement however decided to retain the RIBG. The IGS will be allocated under a formula reflecting success in gaining research income from all sources (60 per cent), higher degree completions (30 per cent) and publications (10 per cent).

The Policy Statement rejected Report proposals to abandon weight on publications but accepted the recommendation to weight equally all forms of research funding. With respect to the latter, the previous Composite Index formula formerly attributed to one dollar of national competitive funds grants twice the weight of a dollar from sources such as consulting. This decision to continue weighting research publications was wise since, while it is desirable to eliminate DETYA’s reliance on faculty ‘page counts’ as a research index, eliminating publications entirely means funding is driven entirely by input measures of performance — grant applications measure inputs not research output.

All institutions undertaking research are eligible for IGS funding provided they submit a Research and Research Training Management Plan and satisfy the Australian Qualifications Framework. These plans are designed to improve research management skills. They set out institutional priorities, budgets, intellectual property policies, incentives for staff who support priorities and performance measures by which institutions seek to be evaluated. They are public documents forming the basis for discussions with Government. The transaction costs of preparing such documents are considerable and, if the past is a guide, they will be close to vacuous statements of the type skilled university bureaucrats design to appease unpopular DETYA procedures — at a private institution I visited I remarked to a senior executive that the IGS proposals created the possibility for accessing more public funds. The response: ‘yes but then we must deal with DETYA and that is costly!’.

Note that the reappearance of block funding, independent of ARC competitive tournaments, is largely illusory. All IGS funding is tied partly to performance in tournaments. Individual curiosity-driven research must be partly met by a research tournament win by someone since IGS funding is partly competitive grant driven.

**Australian Postgraduate Research Student Scheme**

Research training is a major part of research investment ensuring the future provision of research. In 2000 the Report estimates $545 million of university operating grants supported postgraduate research student teaching with a further $94 million in scholarships, compared to $345 million for targeted research.

Postgraduate training is seen by the Report as inadequate in terms of breadth and supervision quality. It claims employers see graduates as ‘too narrow, too specialised and too theoretical’ (Report:31). Degree attrition rates are seen as ‘high’ and completion times as excessive. Finally, the labour market valuation of degrees is seen as too low. Research training should therefore: (i) be broadened to account for vocational destinations; (ii) be more multidisciplinary; (iii) have more coursework; and (iv) involve interactions with industry and consultants.
These claims are questionable. If research is seen as narrow and theoretical does this mean training should promote more vocational attributes or does it reflect industry attempts to cost save in on-the-job training? Are attrition rates high given the screening function of higher education? Does delayed completion partly reflect reliance of postgraduate students on part-time work and extensive reliance of established universities on PhD students to maintain teaching programs given budget cuts? Finally, if research is to be multidisciplinary and involve coursework and industry-experience, does this mean research must be pitched at a low academic level? Evidence and argument must be introduced to resolve these issues — Report claims do not become facts merely because they are stated dogmatically.

The Report argues that institutions should face incentives to improve training by placing greater weight on student preferences. Prospective students should be provided with information to facilitate an informed choice of training institution given current postgraduate student and employer views. The competitive mechanism for achieving student-orientation is via ‘portable tuition scholarships’ available to institutions whose research awards include external assessment (as under West proposals). Although awarded to institutions, after one year awardees could transfer to local or overseas institutions suiting their tastes. Universities that lose students would lose funding.

It is desirable for students to be given good information about research opportunities. However, as mentioned, complete student sovereignty is not sensible given information asymmetries between instructor and student. Moreover, making scholarships portable has disadvantageous effects on effort supplied by research supervisors in smaller, less well-known universities. For the reasons private firms under-invest in non-firm-specific human capital, supervisors may under-invest in training if they believe talented students will ‘credential-hop’ to more prestigious universities.

Scholarships will be awarded to institutions by means of a formula reflecting scholarships in the previous year, the share of total research-related income from all sources and the share of all research degree completions. Again, funding is linked to university performance in research tournaments — the twist is the emphasis on completions.

The Australian Research Council

The prospect of a unified, politically driven ‘enhanced’ ARC, managing most Australian university research is daunting. The judgements that have been made by politicians and DETYA bureaucrats post-Dawkins are seen by many as having degraded the Australian universities. Yet a major part of Report proposals call for a strengthening of the ARC by enhancing its role in providing advice to government and through its attempts to research manage universities by linking their research efforts to the ARC perception of national innovation needs.

Throughout history the state has sought to steer learning toward state-sought goals. Lysenko’s genetics, during the time of Stalin, claimed that wheat plants in
the correct environment produced seeds of rye. It is overly dramatic to suppose such absurdities could arise in Australia but it is conceivable that research policy will become politicised. Australian politicians have a record of supporting dubious research that reflects the narrow perspectives of interest groups. Moreover, the enhanced ARC is accountable only to Government through the Minister. The ARC will have the power to force a research agenda on any university seeking funding and has stated it will use its powers to ensure that research is in the national interest. In offering strategic advice to Government the ‘Council will have regard to guidance provided by the Minister on the Government’s overall economic, social and cultural objectives’ (Report:46).

This raises crucial issues. Will research critical of government or of prevailing public institutions find favour in an ARC responsible to Government? Will idiosyncratic, ‘curiosity-driven’ research find support? While visiting or part-time academics on ARC review panels can make constrained choices under the reforms, a ‘corporate board’ styled ARC will determine the research mix and this board is politically driven.

Conclusions and Final Remarks

It is important to critique public reports using standards of rigour applied to research itself. Such reports directly influence public policy so costs of error are potentially higher than research subjected to peer review before being considered as a basis for policy. On this basis the Report and Policy Statement must be judged unsatisfactory.

The premises used to rationalise suggested prioritisations of university research are unjustified. No evidence is provided showing that research needs have shifted in a direction favouring team-based research. Arguments that Australia is undersupplying entrepreneurship and innovation are unsupported. Claims of declining academic standards, while perhaps justifiable, partly reflect recent Government reforms in universities and the rise of a managerial, non-academic ethos. The view that research training procedures are failing, that ‘drop out’ rates are excessive and that more coursework should be introduced, are topics for analysis within universities, rather than assumptions on which a reform program should be based. Evidence of short-termism in research applications has not been provided and, importantly, arguments that short-termism will be reduced by a NCGP, seem fatuous.

That these premises are subject to dispute weakens the reform package. For example, if desired research is not team-based, the suggested case for prioritisation weakens.

Even ignoring criticisms of premises, the case supporting the advocated policies is weak. A significant difficulty is the proposal to base research funding on the outcomes of a tournament. The model used to justify this claim is science-based and relies on dubious claims about the need for industry orientation. The proposal would downgrade the role of individual-based and non-vocational
research. Benefits from sought incentive effects may be dominated by transaction costs borne by applicants.

Proposals for reforming research training are flawed. Information asymmetries between instructor and student provide sound reasons for the former providing leadership on issues of academic choice. Portable scholarships will lead to incentive problems for those providing research guidance in non-major universities.

Finally, the new role of the ARC is of concern. It is simplistic to suppose research orientation in universities can be dealt with by central management. To offer universities autonomy subject to a choice set formulated by a politically driven ARC is not to offer genuine autonomy at all. The presumption is that while individual universities cannot be relied on to provide sensible research directions that a centralised determination, subject to inevitable political pressure can do this on the basis of national interest concerns. This ignores reasons for establishing distinct tertiary institutions and standard arguments for decentralising decision-making.

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Digital Television Policy: A Squandered Opportunity

Franco Papandrea

Along with the centenary of the Australian Federation, the first of January 2001 marks the introduction of digital television in Australia. The event was unremarkable and unaccompanied by the usual fanfare and public commencement celebrations that are usually part and parcel of such occasions. There was no Prime Minister on hand, for example, to throw the switch to launch Australian television into the digital age. This was not because of a lack of opportunities to show something spectacular — imagine what a superb sight the simultaneously timed fireworks heralding the new year and the Centenary of Federation would have made on a wide-screen television set with cinema-quality pictures — but because there was virtually no reception equipment to be had by anyone wanting to watch the new digital pictures. The unavailability of reception equipment was just the latest of the negative attributes associated with a policy decision that seems to have nothing going for it. Apart from incumbent television broadcasters, who stand to reap considerable advantage from it, the decision has been widely criticised as a lemon by almost everyone.

Students or teachers seeking examples of poor public policy need look no further than any of the major broadcasting policy interventions over the past three-quarters of a century. The digital television policy is merely the latest example of policy makers and regulators ignoring the axiom that efficient public policy interventions should endeavour to maximise social welfare. As outlined in Albon and Papandrea (1998), although the rhetoric accompanying major policy changes invariably pays lip service to the public interest, most of the decisions appear to be driven by an unholy coalition of political and media players intent on protecting or advancing their mutual interests. As a result, the Australian public has regularly been denied access to popular services that people in other countries had been enjoying for many years.

Free-to-air broadcasting uses the electromagnetic spectrum as the transmission medium. Because of potential interference between services broadcast on the same or adjacent channels, only a few channels can be used in any one locality. To avoid interference between services, the current Australian channel distribution pattern provides for a maximum of only six television services (of the 55 notionally available) in any one locality. Using analog transmission technology, once set the channel allocation pattern is both very difficult and very expensive to alter as a change of channels in one area sets off a

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chain reaction of changes in both that and other areas. To a large extent, therefore, the structure of the broadcasting industry has been predicated by historical technical considerations.

With digital broadcasting, the television industry is at the threshold of massive change. Digital delivery is much more technologically efficient than the analog system it is intended to replace. Each 7MHz digital channel (the same size as a current analog channel) can accommodate simultaneous broadcasting of three to four television services of a quality similar to the current analog services. Furthermore, digital broadcasting does not suffer interference problems between channels. Notionally, therefore, more than 160 standard digital television services could be accommodated in the spectrum currently reserved for television thus ending the spectrum shortage which predicated historical regulation of the industry’s structure. Consequently digital conversion provided an unprecedented opportunity for the development of efficient, market-oriented industry structures that maximise economic and social benefits to society. The path chosen by the government, however, has largely squandered this unprecedented opportunity and seems set to encumber the industry with inefficient structures for decades to come.

This paper reviews the digital television policy and some suggested remedies to improve its efficiency and limit the extent of its ongoing damaging effects.

History of Protectionism

Australia has a long and unflattering history of protectionist broadcasting policy motivated by political, rather than public interest, considerations. For example, for more than three decades prior to the mid-seventies no additional metropolitan radio stations were licensed, to protect incumbents from competition (Cole, 1966; Papandrea, 2000a) and according to Myles Wright, chairman of the then regulator from 1966 to 1976, the decisions were ‘very substantially influenced by political considerations’ (quoted in Armstrong, 1979). Most of the more recent major policy initiatives appear to have been influenced by similar considerations. What motivates this protection of incumbents by policy makers is difficult to ascertain. But it might be conjectured that the politicians’ own short-term interests are likely be better served by keeping on side powerful media proprietors who can exercise substantial influence on public opinion at subsequent elections.

The digital television decision is only the latest in a long list of major broadcasting policies that have been surrounded by controversy. While the details change, industry protection seems to be a common denominator to all of them. However, two of the major earlier policy decisions (FM radio and pay TV) are worth reviewing briefly because of their obvious parallels with the digital television policy (additional details are available in Papandrea, 2000a).

FM radio

As early as 1948 the government announced that FM radio would be introduced to provide additional ABC services but that its use for commercial services would be
prohibited. After an inquiry in 1957 by the then broadcasting regulator, no services were introduced primarily because of strong opposition by incumbent broadcasters. Following a new inquiry by the regulator in 1970, the government announced its decision (in 1972) to introduce an internationally unique FM radio system. Standard receivers used overseas were not suitable for the proposed service and the intention had been to develop a special receiver for the Australian market. The announcement was followed by widespread criticism. After attracting extensive opposition and fierce criticism from the then influential Senate Standing Committee on Education, Science and the Arts, a new independent inquiry was established. Finally, following that inquiry, international standard FM radio was introduced in Australia.

Pay TV

Despite strong demand emerging as far back as the early 1970s and a recommendation for its introduction by the Australian Broadcasting Tribunal in 1982, pay television was not introduced until the 1990s. Indeed in 1986, introduction of pay television was banned for at least four years ostensibly to remove competitive pressure on regional commercial television operators then involved in the extension of commercial free-to-air services (FTAs). Pay TV services, however, were also banned in metropolitan areas not affected by the extension of regional services. A proposal to introduce a limited pay TV service delivered by satellite was announced in 1992 and was expected to be operating before the end of 1994. When an entrepreneur attempted to introduce terrestrial pay TV services using a new transmission technology, the legislation was amended to prohibit alternative services until after the establishment of the satellite service. To protect commercial FTAs, the sale of advertising or sponsorship announcements on pay TV was banned until 1 July 1997 with subscription fees required to remain the predominant source of revenue beyond that date. Additional protection prevents pay TV from obtaining exclusive rights to major sporting and other specified events that must be offered first to FTAs.

Digital Television

Broadcasting of radio and television signals uses the radiofrequency spectrum as the carrier from the broadcasting station to the consumer. With traditional (analog) technology, the image (or sound) to be broadcast is simply converted to electronic form and is then superimposed on the carrier frequency for transmission. The electronic signal varies continuously even if a still image is being broadcast. At the receiver, the carrier frequency is filtered out and the signal is then converted back to the original image. The received image, however, is prone to distortions caused by interference from various sources during broadcasting or reception.

With digital transmission, the electronic signal representing the original image is first converted to a series of binary codes representing discretely stepped
observations of the original signal (that is, the signal is not continuously variable). The binary codes are then broadcast and are used by the receiver to reconstruct the original signal. Digital broadcasting is a more efficient user of the spectrum because substantially less of it is required to transmit discretely stepped observations than is required for analog transmissions. As the digital process facilitates compression of the broadcast signal (only changes to an image need to be transmitted to enable accurate reconstruction) efficiency in the use of the spectrum is further enhanced. The improved efficiency in spectrum use means that three to four standard digital television services can be accommodated on a conventional 7MHz analog channel. Alternatively, the spectrum can be used to transmit the higher levels of information needed for the broadcast of high definition (cinema quality) images or for other services.

Technically, digital transmission is capable of delivering conventional and high definition television services, several different programs (multichannelling) instead of just one per channel, interactive programs, enhanced programming allowing viewers to access alternative or complementary content to a broadcast program (for example, different camera angles in a sports program), high speed Internet services and a range of other services such as pay television, shopping channels and information services. The number of services carried by a single channel, however, depends on their bandwidth requirements. For example, the transmission of high definition television leaves little spectrum for the carriage of additional programs, enhanced or interactive programming, or for other purposes.

Another major efficiency improvement generated by digital transmission is that a television station requiring two or more transmitters (translators) at different locations to broadcast its programs throughout its licence area can use the same frequency channel for all the transmitters. With analog transmissions a different frequency channel is required to avoid interference between the transmitters. In Sydney, for example, each analog television service requires five different channels for its main transmitter and translators to distribute its analog signal, but requires only one channel to distribute a digital signal throughout the same coverage area. Furthermore, digital transmission is not prone to adjacent channel interference and thus also avoids the need of analog transmissions to maintain unused buffer channels on either side of the transmitter channel to prevent such interference. This capacity for much more intensive use of the spectrum can generate substantial efficiency gains in the use of the spectrum.

The increased spectrum efficiency of digital television (both more intensive use of the spectrum and the capacity to carry multiple programs per channel) expands prospects for the delivery of a large range of additional and new entertainment and information services to consumers. It also provides an opportunity to move beyond the current limitations on the number of free to air television services. Spectrum shortage has provided a prime justification for the licensing and regulation of commercial television services to both allocate the scarce spectrum and safeguard the community from undue influence on public opinion by the small number of possible mass services. The freeing up of spectrum would make possible the introduction of additional services in the
market (both free-to-air and pay) with the ultimate number being determined by market demand rather than by regulators. The availability of new services would also increase diversity and reduce the influence of the small number of current operators. The number and range of services that are established would determine the extent to which regulation to promote diversity remains necessary.

These possibilities, however, have been squandered at least for most of the next decade. The government’s decision on digital television ensures that the bulk of the available spectrum remains tied up in the hands of existing broadcasters with a very limited allocation to new services. Furthermore, the use of the spectrum for new services is strictly controlled by banning its use for additional commercial television services or for services likely to compete with FTAs.

The Digital Decision

The main elements of initial digital conversion decision, announced in March 1998, as it relates to television, were:

- A requirement for metropolitan FTAs to start digital transmissions by 1 January 2001, and for non-metropolitan FTAs by 1 January 2004.
- The loan to FTAs of an additional 7MHz channel without charge to allow the required simulcasting of programs in analog and digital formats for at least eight years.
- Mandatory transmission of a minimum level of high definition programming (subsequently set at 20 hours per week).
- Prohibition of the use of the digital spectrum for multichannelling or subscription television services by existing FTAs pending a review by 2005. Multichanneling by national broadcasters is permitted.
- Available spectrum not required for digital conversion will be allocated competitively for the transmission of datacasting services (defined as services other than traditional television). Existing FTAs are precluded from bidding for the additional datacasting spectrum, but may use a portion of their loaned spectrum for datacasting and will be charged fees for providing the services.
- A ban on the allocation of new commercial television licences until 31 December 2006.

Seeking to justify this highly prescriptive decision the Minister for Communications (Alston, 1998) stated that while the Government ‘would normally welcome additional competition, in any industry, as healthy and likely to lead to benefits for the consumer’, the free-to-air and pay television industries deserved ‘a degree of special treatment’ because:

Australia has a world class TV system, with a strong local content component and a highly skilled production sector. This could be threatened if the existing networks had to battle a new competitor at the same time as paying huge sums to transfer to digital broadcasting, or if
the Pay TV networks found themselves faced with significantly stronger free-to-air opponents while still trying to find their feet.

The Government’s decision was widely criticised by the popular media, many independent commentators and subsequently by the Productivity Commission (2000) in the report of its Broadcasting Inquiry. The Australian Financial Review (1998a), perhaps the strongest critic at the time of the decision, labelled it ‘information age mockery’ and argued that it ‘shackled the new information economy in the familiar old world of heavy government regulation and media-mogul politics’. Its assessment was that the decision was not made on the basis of an open and transparent public policy review, but was designed to grant a political favour — from which it expects a political reward — to the incumbent broadcasting oligopoly.

There were also claims that the decision ignored advice from key Government Departments. According to alleged details from a ‘leaked’ Cabinet Submission published by The Australian Financial Review (1998b) departmental advisers argued that the decision:

- was inconsistent with ‘the non interventionist approach which the Government had endorsed for developing the information economy’;
- would ‘result in inefficient use of valuable spectrum’;
- would ‘restrict consumer benefits from a wider range and flexibility of services’;
- conferred benefits to commercial interests that ‘already enjoy significant private benefits at public and community expense’; and
- ‘inadequately deals with a complex and important new technology which could have far-reaching implications for the future of Australia’s communications sector and its impact on the community’.

Overall, the decision represents an extraordinary level of overt protection of the interests of existing commercial television operators — extraordinary even by past standards of protection accorded to the industry.

Digital conversion is occurring at a time when rapid technological developments are transforming information and communication industries generally and are eroding the traditional technical boundaries between them. Concurrently with making alternative delivery of media services increasingly feasible, new technologies are also making prescriptive industry protection mechanisms, such as those introduced by the digital television decision, increasingly ineffective. For example, technology enabling broadband connections over existing telephone lines is already being deployed and can be used to deliver services similar to those prohibited by the digital television decision. The same technology can also provide broadband connections to the
Internet for access to video services in other countries from sources well beyond the reach of domestic regulation. More generally, in an environment of rapid technological change, prescriptive policies are highly risky because while industry transformation is certain, how an industry will change is difficult to predict. In such an environment, efficient industry development is encouraged by less, not more, prescriptive regulation of the kind imposed by the government.

As noted by the Productivity Commission (2000:6):

The current technological revolution provides an opportunity to look forward, through the digital conversion process and beyond, in developing broadcasting policy. .... If we fail to grasp [the] opportunities to develop a convergent policy framework, Australian media and communications industries will not realise their potential. They will continue to be distorted and stunted by regulatory impediments, with adverse implications for the community and the economy generally.

**Ramifications of the Digital Policy**

The broadcasting spectrum is and has been a scarce and highly sought commodity. As indicated above, the development of digital technology has greatly increased the productivity and efficiency of use of the available spectrum providing the potential to accommodate a much larger range and number of services than is possible with analog technologies. The securing of this potential is the principal motivator for the conversion of television services from analog to digital. Because there is high demand for broadcasting spectrum and the services it can sustain, the rapid conversion from analog to digital is highly desirable and would produce substantial consumer benefits. Therefore, the Government’s stated intention for Australia’s early adoption of the new technology to ‘…encourage the use of television spectrum to provide a range of new information/data services’ is commendable. Its attempt to prescribe the nature and range of services that are permitted, however, is condemnable.

By mandating the introduction of high definition television, prohibiting new commercial television services and strictly prescribing datacasting and multichannelling services, the digital conversion policy has serious ramifications for efficiency and social welfare. Briefly, the principal ramifications are inefficient use of spectrum, distortion of market processes, inhibition of industry development and loss of consumer welfare. Discussion of these issues follows.

**Inefficient Use of Spectrum**

The digital conversion policy provides for the loan of a 7MHz channel, free of charge, to existing FTAs to provide them with the means of implementing the mandatory transmission of a high definition signal as well as their analog signal during the simulcast period.
The Australian broadcasting spectrum plan was designed to cater for six analog television services in any one locality, five of which are tied up for analog transmissions of commercial and national television services. As most areas already received five services (three commercial and two national) only the spectrum for the sixth planned service remained uncommitted. To implement the digital decision, spectrum had to be found for the simulcast of analog and digital signals. The channels reserved for the uncommitted sixth service thus became the primary source for transmission of the digital signal. Very little spectrum is available for other services. Scarcity is highest in Sydney where only one (possibly two) channels have been identified for potential transmission of services such as datacasting.

The transmission of a high definition signal (as well as a standard digital signal) uses up virtually the whole of the channel bandwidth. At times when the standard digital signal only is transmitted, part of the bandwidth is available for the transmission of other services. However, commercial FTAs are prohibited from using the bandwidth other than for datacasting or enhanced programs.

A more efficient use of the available spectrum would have been not to mandate high definition transmissions but to follow the approach used to introduce digital television in the United Kingdom where existing FTAs were provided with free additional spectrum sufficient to broadcast a standard digital television signal only. Had that approach been taken, two 7MHz channels would have been more than sufficient to enable the five existing FTAs (commercial and national) to simulcast a digital signal with their analog signal. The remaining spectrum — at least four channels — would have been sufficient to accommodate up to 12-16 additional standard digital services or other information and entertainment services, or high definition transmissions. A market mechanism could have been adopted to allocate the spectrum without constraint on its use, thus ensuring its application to the highest value use.

While it would be desirable to pursue all possible efficiency improvements, as noted by the Productivity Commission (2000), the digital decision’s spectrum allocation is of ‘less significance for efficiency, competition and new services than is future retention of the substantially greater spectrum now reserved for analog services’. Provided digital conversion and analog switch-off is achieved quickly, the inefficiency inherent in the current allocations would dissipate in a relatively short period of time. However, there is a substantial risk that other aspects of the digital decision, unless they are remedied, will delay analog switch-off considerably.

**Analog Switch-Off**

A condition of the ‘free’ loan of a digital channel to existing FTAs is the relinquishment of their analog spectrum at the end of the simulcast period. When digital conversion is completed, the several analog channels that are currently tied up by each FTA to broadcast its signal and avoid interference with other services will provide a sizeable boost to the spectrum that can be used for new and
additional services. In Sydney, for example, analog switch-off will release a minimum of 25 channels for other uses and represents at least a fivefold increase in the pre-digital capacity to supply television and related services.

There is a legislated minimum simulcasting period of eight years, but no maximum period has been set. Although unstated, analog switch-off will be contingent upon a very high proportion of households having digital reception equipment. A low consumer take-up rate, therefore, will most likely prolong the simulcast period. Although digital transmissions have only just begun and consumer reaction to it is difficult to assess, several aspects of the decision strongly suggest that consumer take up of digital receivers will be both low and slow. These will be discussed below.

Some elements of the current policy provide a strong incentive to incumbent broadcasters to continue analog simulcasting for as long as possible, despite the cost of continuing analog transmissions. Although the digital decision prohibits the licensing of new commercial broadcasters before 2007, in reality the ban remains effective until the end of the simulcast period as there is no spectrum available for the purpose until then, particularly in major capital cities. By retaining their analog spectrum, incumbent operators are effectively exercising a ban on the entry of new competitors and have a strong incentive to ensure it stays in place for as long as possible. The current policy, therefore, should be amended to mitigate these incentives and prevent delays in the analog switch-off date.

**Digital Television and Consumers**

Mandatory transmissions of high definition programming and related audio requirements set Australia’s digital television system apart from the rest of the world. Because of its uniqueness, digital receivers, including set-top converter boxes, have to be made especially for it — receiving equipment used elsewhere in the world cannot be used here. No one is yet manufacturing receivers for use in Australia, but a major manufacturer has recently indicated it will start supplying standard digital receivers for $5000 and high definition receivers for $8000 later this year (Bryden-Brown, 2000). Until recently, no one was even manufacturing the set-top boxes. Faced with a launch of digital television that no one would be able to see, the incumbent broadcasters, under pressure from the Government, hastily commissioned the manufacture of a few thousand set-top boxes for use with analog television receivers. A small number arrived soon after the start of digital transmissions for distribution to major retailers as ‘demonstration’ units. Subsequent deliveries became available for sale to consumers at a price of $700.

Despite the proclamations by the Government and the incumbent broadcasters, the current digital policy provides few real benefits to consumers and is thus not likely to encourage early take up of digital television (Papandrea, 2000b). At this early stage of the conversion process, it is difficult to see any

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1 Apart from the high definition related requirements, the Australian standard is similar to the European standard. For historical reasons, the US system uses a different technology.
significant incentive for rational consumers to purchase a set-top box (the only available method to receive digital signal).

A set-top box provides little more than the option of receiving the digital signal and, in some cases, a slight improvement in picture quality. Eventually, when they become available, they will also enable reception of datacasting services, program enhancements transmitted by FTAs and any multichannelling provided by the ABC and SBS. The television programs will be no different from those the existing set can receive in analog format. Quality improvements will be largely unnoticeable. Anecdotal reports from retailers indicate that most consumers cannot differentiate between analog and digital pictures (Mitchell and Grayson, 2001). Nonetheless, because the digital signal is resistant to ‘snow’ and ‘ghosting’, picture quality should improve slightly in areas prone to such reception problems. For most people, however, slight picture quality improvements alone are unlikely to be a sufficient incentive to purchase a set-top box. Indeed, in many situations, similar picture quality improvements could be achieved with the installation of an outdoor antenna at a much lower cost.

The consumer take-up of digital television, therefore, is likely to hinge on the benefits offered by new digital services. The amount and range of new digital services is severely restricted because most of the available spectrum to deliver new services has been reserved for high definition transmission. Furthermore, what is permitted is heavily regulated to prevent the new services from competing with existing television programs. The use of multichannelling by commercial broadcasters is restricted to the provision of some basic enhancements (for example, showing different camera angles in a sport program or getting additional information on items of interest in a lifestyle program) and for ‘overlaps’ (for example, allowing a scheduled news program to proceed concurrently with an overrunning cricket match). Datacasting is prohibited from showing anything that remotely resembles television programs. The datacasting restrictions are so extensive that major players such as News Limited, Fairfax and Telstra, that had been lobbying strongly for the introduction of datacasting, have decided not to participate in the trialing of the service. It seems unlikely, therefore, that these heavily restricted services will have sufficient appeal for widespread consumer adoption of digital television.

Purchase of a digital television set is likely to prove even less attractive to consumers. At $5000, a standard digital set is considerably more expensive than comparable analog sets. Apart from the aesthetic appeal of not having a set-top box, a digital set will have a wide-screen format (a 16:9 rather than a 4:3 aspect ratio of analog screens). With one significant difference, its reception capabilities will be the same as those of a set-top box. The wide screen format will be fully compatible with the picture format, but not the quality, of high definition transmissions. On an analog set, a high definition picture would suffer from the so-called ‘envelope effect’ producing a long but narrow picture across the screen much like that experienced when viewing some foreign films on SBS. The full high definition experience is available only on a high definition set with a projected price of $8000. While there is no doubt that high definition provides an
improved viewing experience, there is much doubt that most people will consider it to be worth the cost.

Overseas experience with consumer take-up of digital television is not encouraging. The United States (US) where high definition is encouraged, but not mandated, has experienced a low consumer take up rate. Up to the end of the third quarter of 2000, factory sales to dealers had been approximately 550,000 digital television display units and only a few thousand high definition sets with significantly fewer sales to consumers (Levy, 2000). In part this is due to the high cost of sets, particularly high definition sets. But it also partly due to the fact that digital television there offers little by way of new services other than the high definition experience. Most households in the US access their television services via cable. Through the cable systems they have access to a large number of services, including free-to-air services under ‘must carry’ rules. The incremental benefits of additional free-to-air services (multichannelling and datacasting are not restricted in the US and are not subject to must carry rules by cable systems) are likely to be small and demand low.

In the United Kingdom, in contrast, where free-to-air services are the main source of television programming, the use of the digital spectrum to provide additional standard (not high definition) television services, as well as facilitate the supply of a range of other services, appears to have been more successful. Rather than restricting multichannelling and other services made possible by digital technology, the UK digital system is built on promoting them. The UK Government is also eager to encourage a rapid transition to digital television and is seeking to identify and remove obstacles that may hinder progress. Competition is encouraged ‘in all areas of provision in the digital TV supply chain’ (OFTEL, 2000). According to the Independent Television Commission (2000), ‘take-up of digital television has been driven largely by the main commercial pay television companies’. These companies have been encouraging a relatively rapid take-up of digital television by bundling the set-top box with monthly subscriptions. As at 30 June 2000, less than two years after the start of digital transmissions household penetration was ‘around 20 per cent’ (approximately 5 million households) and was expected to 6.5 million by the end of 2000.

By mandating high definition television and placing extensive arbitrary restrictions on other services, the current digital policy imposes a very high opportunity cost on society for the promise of small and uncertain benefits. If only a few households are likely to want or afford high definition television, it follows that the resultant benefits to society would also be small. Alternative use of the spectrum for the development of services with much wider appeal to consumers, would undoubtedly increase the benefits to society. But such use is precluded by the mandatory requirement for high definition transmissions. Mandating of high definition television in such a situation, should be done only if there are substantial public interest reasons for doing so. But no such reasons appear to exist. The Productivity Commission (2000) says that it ‘evaluated the reasons advanced for high definition and has not been convinced that any justify such a policy …’.
The longer the current arrangements are allowed to persist the greater will be the loss to society. It is imperative, therefore, that early amendments be made to facilitate the earliest possible conversion to digital television. In what was perhaps the most important recommendation to arise from its Broadcasting Inquiry, the Productivity Commission (2000) recommended that the digital conversion plan should be amended to:

- set a firm and final date (1 January 2009) to end the simulcast period in both metropolitan and regional areas;
- auction the analog spectrum two years earlier; and
- facilitate earlier switch-offs in areas where it becomes possible to do so.

Auctioning off of the spectrum would create a new class of owners with a direct interest in ensuring efficient use of the resource. It would also mean that incumbents would be faced with the cost of using the spectrum beyond the switch-off date if they chose to continue broadcasting their analog signal. To provide added economic incentives for incumbents and new entrants to expedite digital conversion and encourage diversity and innovation, the Commission recommended further modifications to the current arrangements to:

- Permit, not mandate, high definition television, which appears likely to become ‘a premium service for a small number of viewers’. As well as increasing industry costs, it constrains development of new services, reduces consumer take-up and prolongs the conversion process.
- Allow commercial broadcasters to use digital spectrum for multichannelling and enhanced programming without restrictions. They would still be able to allocate spectrum for high definition television in the event of a high consumer demand for such a service.
- Remove arbitrary restrictions imposed on datacasters that preclude them from offering potentially valuable services likely to encourage a more rapid consumer to take-up of digital television.

These changes would encourage the industry to take full advantage of the capabilities of digital technology and develop new and innovative services in response to market demand. Consumers would also benefit from the expanded range and volume of programming likely to be available to them and would have a greater incentive for an early take-up of digital television.

Conclusion

The digital conversion policy is the latest in a long series of broadcasting policy interventions that places the private interests of incumbents well ahead of the public interest. The ramifications of this policy, however, are much more far-reaching and more serious than those of earlier, similarly motivated, polices.
With the introduction of digital technology, broadcasting is entering a new age with an unprecedented opportunity to rectify many of the inefficiencies and distortions that have been inflicted by poor policies of the past. The conversion from analog to digital transmissions enables the industry to overcome the chronic shortages of spectrum that has been used to justify most of the existing regulatory structure. Digital conversion, therefore, provides the potential for the industry to make a new start towards the development of efficient industry structures delivering services that are responsive to markets and consumer needs. The web of inefficiencies and distortions that afflicts the industry was highlighted by the Productivity Commission (2000:254) in the report of its broadcasting inquiry:

Participants have emphasised how broadcasting policy is a structure built by *quid pro quos*: barriers to entry are balanced against programming obligations; free to air networks are prohibited from multichannelling to help subscription services which in turn are disadvantaged by restrictions on advertising and antisiphoning rules; free to air networks are required to broadcast in high definition because they have been lent the spectrum to do so; and so on and on

It is not the time to add more *quid pro quo* bricks to the wall, but to take the opportunity to design a structure to serve Australians better. Greater competition, less regulation, spectrum licensing reforms, and the rapid release of spectrum are the best means of achieving this objective.

According to the Productivity Commission ‘without substantial changes, the digital conversion plan is at serious risk of failure’. Its report made a series of recommendations for change and provided a framework for the development of an innovative and efficient industry, responsive to consumer demands and capable of taking advantage of the many opportunities provided by digital technology. The report, however, appears to have fallen on deaf ears.

After almost a year since receiving the Commission’s report, the Government is yet to announce its response to it. The signals are not positive. All subsequent Government actions relating to the digital policy suggest that the report was not to the Government’s liking. There is no sign that the Government has any intention to alter the current digital conversion scheme in any way. By refusing to face to the almost certain failure of its policy, the Government is squandering the many potential economic and social benefits that other countries are set to enjoy and is condemning the industry to another generation of inefficiencies and distortions conferring substantial private benefits to powerful incumbent broadcasters.

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REVIEWS

The Way We Live


Reviewed by Michael Keating

This book is an interesting and lively interpretation of the Australian people and our nation as we embark upon our second century. Terrill is frankly optimistic about Australia; apparently more so than when the first edition of this book was published in 1987. He finds ‘an Australia not without dignity and self-assurance.’ Terrill is ‘confident that Australia can hack it in a competitive world.’ He sees ‘nationalism as having matured. A leap has been made to reliance on technology and globalisation. Race has become a less vexatious issue. Australia is a more plutocratic society and (a little) more hard-nosed towards laggards.’ ‘The nation savours prosperity, stands tall in Southeast Asia, and tries to embrace globalisation without letting go of the Aussie way of life.’

Terrill argues that Australian nationalism has strengthened in the late twentieth century, but the meaning of this nationalism has become more opaque, as nationalism now offers varying points of entry for different people. For some it represents pride in Australia’s commercial success. For others it is pride in Australian achievement in the arts. Increasingly Australians are being recognised internationally, and not just for uniquely Australian productions, but also for the development of themes that resonate internationally. We have now reached the point where Terrill argues that cosmopolitanism is just as strong an impulse as nationalism among Australians. ‘Within Australia, neither Britishness, nor assertive Aussie nationalism, nor a disembodied multiculturalism, nor yet attachment to the land, could be the framework for the sense of identity of millions of people in a diverse society.’

Terrill concedes that ‘It is possible, as some fear, that race and immigration, the sufferings of the bush, and various issues arising from globalisation will divide Australians in the midst of adjusting to a post-British and Asia-oriented world.’ But he is optimistic because of the strength of Australia’s admirable and well-tested institutions. Indeed, Terrill considers that the sharp lines of debate over identity have softened. ‘More fundamental unity probably existed in Australia as the century ended than at any time since the outbreak of the Vietnam War.’ ‘It is morning for Australian civilisation’, which Terrill hopes and expects will become Eurasian. But he doesn’t argue about that vision with those who disagree, as ‘it will come about through a thousand incremental decisions, and many involuntary
happenings, transcending the policy of any particular political party or the will of one generation’.

These conclusions seem likely to find an appreciative audience among many Australians. What is the basis for them; how authoritative are they? First, Terrill as a long-time expatriate Australian claims to combine the advantages of an outside perspective with a knowledge that only an insider can have. Certainly, Terrill draws compellingly on his knowledge of Australian history and his childhood remembrances. In addition, his shrewd and perceptive observations about many features of Australian life may have been sharpened by an understanding gained from living in another country. To bring himself up to date, Terrill seems to have relied largely on interviews with many prominent Australians and travel, particularly around northern Australia where he mainly seems to have mixed with the mining bosses and the local businesses. Their views are well portrayed. However, the views of other Australians and their concerns are often ignored in the selection of material presented.

Terrill commences with an excellent summary of Australian history up to the end of World War II and how that moulded us. The sense of Australian life in the 1940s and 1950s is very well evoked through his description of his own upbringing. As a contemporary who also grew up in rural Victoria before going on to Melbourne University, Terrill’s description has a familiar and authentic ring. The change in Australia since then is mainly developed by focussing on the administrations of the significant ‘tall poppy’ Prime Ministers from Menzies, through Whitlam, Fraser, Hawke and Howard. These are useful summaries, although hardly original, and it is not clear why Keating is dismissed.

Contemporary Australia is elucidated by descriptions of Sydney, Melbourne, Perth, Brisbane and Darwin which aim to draw out the contrasts between them. To my mind these descriptions rely too heavily on the conventional stereotypes of these cities. While Terrill reflects a common Australian perception that emphasises their differences, I think that what is outstanding about these major Australian cities is the extent of their similarity – much more similarity than exhibited by the major cities of other countries, including much smaller countries such as France or Britain. Moreover, one might argue that the differences within our major cities (culturally and economically) are more important than the differences between them, but Terrill ignores these differences and what they might tell us about contemporary Australia. Equally important, the differences between the metropolises and the way of life and views in the rest of the country are also passed over. But these are some of the divides that are currently most significant in Australian public policy making.

*The Australians* is also intended to allow Terrill to convey his point of view. Terrill is concerned about the influence of a ‘politically correct’ group whom he accuses of a type of social engineering. This new left is to be found in universities and the ABC and represents a break with the traditional agenda of Australian Labor. These self-righteous cultural gatekeepers are guilty of claiming group rights on behalf of ‘an assortment of self-styled “New Dispossessed”: women, indigenous people, gay men and women, ethnic minorities, the environment seen
as a persona’. Terrill maintains that ‘rights’ need to be matched by ‘obligations’, a policy first resuscitated by the Keating Government in Working Nation, although Terrill is inclined to give the credit to Howard. Terrill also objects to what he regards as the intolerant methods of the ‘New Dispossessed’, and their alleged preference for the politics of redistribution over the politics of development.

Terrill’s preference for development does not, however, make him a closet economic rationalist. He briefly asserts the conventional wisdom that ‘Further business tax reduction and further industrial relations reform are required’, but he also refers favourably to ‘Public policies that favour the producer rather than the consumer’. In particular, Terrill is concerned to push the cause of the north which he envisages being ‘dotted with cities, railways, natural gas pipelines, and world class holiday resorts’. Naturally the Alice Springs to Darwin railway meets with his approval, including on (dubious) defence grounds and despite the unwillingness of the defence authorities to ever contribute to its construction. It is claimed that mining ‘is much more difficult these days. The main reason is aboriginal land rights’. However, no evidence is cited to substantiate this accusation, nor is there any consideration of the willingness of many miners to negotiate while they thought there was a chance of overturning the legislation. More generally Terrill considers that the north is being held back by the mentality of the leadership in the Sydney/Melbourne/Canberra corridor. Presumably this leadership, which has to find the money for the grand visions of the north, asks too many probing questions of a group who are already disproportionately dependent upon other taxpayers’ funds. Moreover, it is difficult to see why the ‘knowledge nation’ would need or want to relocate from the temperate eastern seaboard to the mudflats of Darwin. Indeed most migrants, including those from Asia, disproportionately choose to live in Sydney and Melbourne.

Terrill also argues that ‘completion of the move beyond the [regulated economy of the] Australian Settlement can only occur by a quasi-consensual evolution’. To hand down change from above is to invite contention. Terrill seems to favour change keeping in step with a changing culture, which takes time. His criticism of Keating and his favourable assessment of Howard seem to relate to Keating’s disparagement of consensus politics and his willingness to move ahead of popular opinion in the hope that he would then be able to shape that opinion.

To my mind it is impossible to say categorically that one leadership style is better than another. It depends upon the circumstances. For example, surveys tell us that popular opinion has always opposed tariff cuts, but did it really help anyone in the long-run when Howard bowed to this opinion and postponed the previously announced tariff cuts for the motor vehicle and textile, clothing and footwear industries? This policy reversal inevitably reduced the certainty of future industry planning and encouraged future action by similar pressure groups. On the other hand, Howard has been prepared to lead from the front when he introduced the politically unpopular GST, and there is now considerable evidence that public opinion is coming around to accept this new tax system.
Overall there is much to admire in Terrill’s analysis of The Australians. This book is very well written and is entertaining. Most of us will empathise with Terrill’s sympathetic portrait of we Australians that mainly rings true. I agree with his optimism about our future and the quality of our society, but I also think we must avoid becoming complacent. In particular I think the divides in our society and the degree of uncertainty that accompanies those divides are more serious than Terrill has observed. A focus on political leadership and a comparison of our major cities is probably not the way to spot what troubles many Australians.

The picture that emerges from numerous other studies is somewhat less reassuring. Instead we are told that many Australians are worried at what they see as a loss of control over their lives. They no longer feel able to trust the boss when he says that their jobs are safe, not least because they doubt his capacity to make them so. Ditto for the government, only more so! Worst of all they are losing confidence in the family as the basic building block for a stable society. As Hugh Mackay has found, feminism has succeeded in giving women a desirable degree of independence, but it has also left both sexes uncertain about their respective roles as they try to balance career and family responsibilities. Equally tensions arise as adolescent children demand more independence over their lifestyle earlier, while staying financially dependent longer. Family breakdown, drug abuse, suicide and violent behaviour are some of the possible results as family ties and obligations weaken.

Society is also being increasingly organised along more individualistic lines. Loneliness afflicts many people. Even those who have contact with friends and relations complain about a scarcity of ‘quality time’. Individual freedom has increased, with people being offered a greater range of choices and more independence. But many miss the spirit of community and the opportunity to participate as a member of a community. Rural communities have still retained that sense of group identity and that is helping many of them survive as attractive places to live. On special occasions that community spirit is also recaptured by our urban society and that is what makes events like the Olympic Games such a success.

Other divides that are confronting policy makers are the increasing gap between the knowledge rich and the knowledge poor, and the accompanying dispersion of work opportunities and earnings. Sometimes this is expressed in attitudes to information technology and globalisation. In both cases some people see these developments as an opportunity, while others see them as a threat. Many of those who feel most insecure feel they are on some sort of treadmill as they struggle to keep up with their material expectations. By contrast the material goods on offer are unable to satisfy all the needs of many of those who are able to command the new technologies and feel relatively secure. Their post material values put more emphasis on the quality of life, through a concern for the environment and the development of a broader range of cultural experience. Terrill’s derogatory description of such concerns as part of the ‘new dispossessed’, while it might apply to some, is hardly fair nor effective if it is intended to apply
to the broad range of these different people. What Terrill fails to recognise, but which politicians ignore at their peril, is that those Australians who say they think life is getting better are slightly outnumbered by those who think it is getting worse. In addition, Newspoll found an overwhelming preference for reducing inequality even at a cost to economic growth. Of course perceptions are not necessarily matched by reality, but if we want to understand our fellow Australians perceptions are sometimes at least as important.

Terrill may be right that we are more united politically than we have been for some time, but in other respects we are more diverse and share less common experiences than we used to. Moreover even the apparent political unity may not be all that deep – a unity among a political elite, but with less grass roots support than ever before. As the Republic debate reminded us most people are turned off by our political parties which increasingly are seen as unrepresentative. Today the major political parties gather their votes from force of habit and the lack of an alternative rather than from commitment.

In addition, the adversarial style of Australian political debate has now been taken to extremes that arguably makes our system ill-equipped to respond to major policy challenges. For example, we took years to achieve tax reform as there was a natural tendency for one party to oppose whatever the other supported. And most recently Cabinet could not even discuss the reform of higher education once the Minister’s Cabinet Submission was leaked, despite the universal agreement that continuation of the status quo is heading for disaster.

To my mind although there is evidence that many of Australia’s institutions have adapted well to the challenges from technology, globalisation and the changing nature of our society, Australia does need to find a less confrontational method of solving its policy disputes. The future good governance of Australia demands that we repudiate the attitude that is currently held in some quarters that the spoils belong to the victor. Instead we need to more actively explore the opportunities for power sharing, and in that way each government may actually find that it is able to achieve more.

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Democratic Devices and Desires


Reviewed by Perry Shapiro

Professors Brennan and Hamlin have produced a commendably ambitious book. Democratic Devices and Desires (3D) is, simultaneously, a critique of selfish actor public choice theory and a proposal for a new direction. While I take exception to various aspects, it is an important contribution to public choice theory. It is a challenge to all scholars who hope to push forward understanding of democratic societies.

In the words of the authors, 3D ‘... is an exercise in ... “public choice” theory’. However their characterisation is both overmodest and misleading. With varying success the book aims to overturn the most traditional basis of public choice theory, namely the self-interested rational economic person. The replacement is a model of public choice that has at its core, political representatives of uncommon virtue and voters motivated by expressive, rather than instrumental preferences.

Traditional public choice theory starts with the selfish and self-serving individuals acting in the public sphere. The theory concludes that public outcomes, unlike those of the competitive market for private goods, are neither stable nor efficient. While 3D is unconcerned about the inefficiencies, instability is a major focus of the book. It seems to me that the preoccupation of public choice with these, so called, failures is overdone.

Efficiency appears to be a natural consequence of a public choice process in which the public decision-makers have any concern for citizen approbation — the decision-maker either is concerned about re-election or the general good feeling of the public. There is no reason why an inefficient public goods choice should be chosen by a fully informed decision-maker (except, perhaps, for malevolent motives). An efficient outcome requires that there is no redistribution of resources or product that could make some person better off without diminishing the welfare of any other individual. No matter how selfish is a public decision-maker, there is no reason to withhold benefits from others, as long as personal welfare is unaffected. In fact, if voter approval is important, there is every reason to make sure that there is no unused surplus to distribute.

Even if public choice outcomes are efficient, the stability problem remains. Brennan and Hamlin focus on the Arrow Impossibility Theorem as it is a rigorous and familiar representation of public choice instability. Their critique of Arrow is familiar, and certainly correct. It is that the restrictions that Arrow imposes are much too severe for any workable social system. We really should not expect a
well-behaved social outcome for any potential aggregation of people, no matter how heterogeneous it is. The relationship between a male and female, for instance, is unstable if their preferences are too different. The same must be true for any aggregation of individuals attempting to agree on a common policy. An important moral of the Arrow Theorem is that stability requires a degree of homogeneity. Brennan and Hamlin, following the noble tradition of political theorist, tell us how a stable (and righteous) democratic society can be built for a heterogeneous aggregation of people.

First they reject the notion of public choices based on the simple calculus of the individual rational net benefit maximiser. In their view citizens are not instrumental voters, thinking only of the personal net gains from voting, for if that were the case, voting would never be rational. Voters are, instead, motivated to 'express' their approval of the option that most closely matches their own perception of what is best. Furthermore, their motivation is not simple economic self-interest, but rather the desire that the socially virtuous outcome prevail. Citizens abstain from voting when there is no alternative that sufficiently matches their ideal. Thus voters do not perform a cost benefit calculus, rather, they vote to express approval of an alternative, regardless of the cost of voting.

This is a plausible theory, but disturbing. The theory of expressive voting, as presented in 3D, has no practical implications. Indisputably, individuals are motivated by a number of influences, expressive as well as instrumental. Brennan and Hamlin might have chosen the expedient course and offered the possibility of multiple motivations and the compromise of expressiveness as random noise in the model of instrumental voting. This position is strongly rejected by the authors on page 176:

...expressive voting undermines the normative credibility of direct democracy in a manner much more radical than that threatened by the more standard idea of rational ignorance. Rational ignorance might be conceived as adding statistical noise to an otherwise essentially deterministic system. In this interpretation, although the vote is not a perfect reflection of voter interest, it is at least still correlated with interests; and this correlation might be sufficient to ground the normative status of direct democracy. The expressive voting idea, when applied to direct democracy, removes the prospect of any reliable, consistent relation between voting behaviour and either private or public interest.

From both a practical and empirical perspective, this seems indefensible.

Clearly, voters, and their elected representatives, are strongly motivated by perceived self-interest. Representatives work hard to secure public work projects for their districts, and when successful, they make sure that the success is touted widely. For instance, numerous studies find a strong correlation between parenthood and support for educational expenditures. The same (consistent with the 3D perspective) find that political affiliation is a strong predictor of public expenditure support as well. The question is not whether voters are motivated by
expressive, as well as self, interest, because unquestionably they are. The practical concern is whether these other motives can be treated as random noise. What this means for the design of an econometric study is that the researcher should be concerned that the excluded expressive concerns are uncorrelated with the included indicators of self-interest. While they may be correlated, there is no empirical evidence that they are. If there is importance to estimating public good preferences, then the maintained hypothesis of no correlation is reasonable until otherwise demonstrated.

The question is, is there value to estimating the demand for public goods? The estimates are useful in determining the allocation of public expenditures. Commonly, in cost benefit analysis estimated consumer surplus is used as the benefit measure. Does consumer surplus, even if it is applied to purely private consumption, truly represent social welfare? Clearly, it does not. Nonetheless, it is a useful attainable approximation of a desired value. Interpreting voting as an expression of private interests, and thus, personal preferences, is an economical way to estimate and important policy values.

3D confronts one of the most interesting aspects of political theory, namely, the importance of civic virtue. If, as the ‘Federalists’¹ recognised, all men were angels, no government would be necessary, but government can not succeed if all men were scoundrels either. Political leaders and public servants must possess a degree of public morality. The Federalists specifically recognised the principal-agent problem of the self-interested public servant, and their government design, in which ambition is made to counteract ambition, provides a degree of self-enforcing regulation. Nonetheless, even that clever construction would be unsuccessful without some degree of public virtue. Brennan and Hamlin bravely attempt to incorporate the aspect of morality into the framework of the rational actor tradition of economics. This is a difficult task and they are partially successful in its implementation.

Central to their story is something they label screening. As with many explanations in the book, it is a bit difficult to tie down exactly what is meant by the term. I think a fair representation of it is that the public job market holds out higher reward to virtuous people than those without virtue.² Because of this, the virtuous are attracted to the public sector, while the self-serving are attracted to private sector employment. An evolutionary argument is used to show that in equilibrium there will be a stable fraction of the population that is virtuous and will choose the public service as a life career. This is a very clever device. However, while morality is important to the success of a public life, observation of the world convinces me that the people who choose public careers do not have a monopoly on virtue. There may be a \( V \) attribute, as Brennan and Hamlin label virtue, but something more convincing than a simple mixed strategy equilibrium

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¹ By this I mean the authors of the Federalist Papers, Alexander Hamilton, James Madison and John Jay.

² It seems that virtue, as used in the book, is indistinguishable from a predisposition to do well at public employment. While it appears that the authors have a much more ethically based notion of virtue, as modelled it is a job-specific skill.
argument, as given in $3D$, is needed to conclude that $V$ has a higher ethical value than a simple comparative advantage in public sector employment.

*Democratic Devices and Desires* is an important and radical contribution to the theory of public choice. Undoubtedly its challenge will draw much critical fire. But all serious students of political economy and institutional design should read this admirably original and scholarly work.

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NON-AGENDA

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

—Jeremy Bentham (c.1801)

MONEY AND THE ENVIRONMENT

Alistair Watson

Environmentalism is a potent political force in Australia. The most recent response to widespread community concern with adverse effects of agricultural production on the environment is the decision by the Council of Australian Governments (COAG) in November 2000 to embark on a seven-year $1.4 billion plan to combat salinity, jointly funded by the States and the Commonwealth. The Prime Minister has described salinity as Australia’s ‘greatest environmental crisis’. Despite this acknowledgement and the planned expenditure, both farmers’ organisations and environmental groups are not satisfied. Earlier in 2000, the Australian Conservation Foundation (ACF) and the National Farmers’ Federation (NFF) claimed that expenditure of $65 billion over ten years was required to combat land and water degradation. The ACF and NFF also collaborated in the creation of Landcare over a decade ago.

Modern environmentalism in Australia has led to administrative changes as well as substantial reordering of political priorities. A favoured administrative unit is now the ‘catchment’ or ‘region’ rather than established political boundaries. Together with Commonwealth control of grants-based funding, this has eroded the traditional and constitutional role of the States in land management. The fashion for community involvement and extensive consultation has diminished the role of science-based professionals in environmental and agricultural bureaucracies. This is more intentional than accidental. The philosophical basis of environmentalism is different from traditional approaches to environmental problems. A voluntarist

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philosophy widespread in the conservation movement sees solution of environmental problems as dependent on consciousness raising and an attitude test for the community as a whole, whereas traditionally the solution has been seen as the resolution of a complex problem in public administration involving interaction of physical, biological, hydrological, political, social and economic factors. The measurement, hypothesis testing and reductionism of science is rejected in favour of holism, with ill-defined slogans and catchphrases like ‘sustainability’ and ‘triple bottom lines’ (environmental, social and economic). As is also the case with other complex political and technical problems, environmentalists confront a choice between telling the full story and losing the audience or oversimplifying the message and achieving short-term political results. Unfortunately, the majority view of the organised Australian conservation movement is to prefer the latter.

There is no point in being nostalgic about these changes. Increasing emphasis on the benefits of the amenity provided by land and water resources and the costs associated with modern agricultural production is predictable in an affluent society. Concern with environmental damage in agriculture is also an ingredient of the widespread pessimism surrounding Australian agriculture. The moral panic encouraged by the environmental movement and some farmers strikes a more receptive chord amongst urban dwellers and politicians than recondite arguments concerning the relative decline of the agricultural sector in a developed economy and Australia’s intractable problems in agricultural trade. Nevertheless, the inherent characteristics of environmental problems and the magnitude of actual and proposed expenditure require that institutional arrangements and the content of environmental policy be subjected to greater scrutiny. Public policy should be judged by its effects not its intentions.

There are difficulties with the current direction of environmental policy and administration. The size and diversity of landscape and land use in Australia mean that central control of funding and program management is expensive and seldom appropriate to local circumstances and preferences. The hydrogeology of dryland salinity is different in Western Australia from the eastern States. Moreover, the land is flatter and the farms much larger. The relative importance of off-site and on-site effects is different (Pannell 2000a). Western Australia has the expertise and resources to organise its own salinity abatement effort without imposition of costly and unwieldy Commonwealth programs. Without considerable care and far-sighted leadership, there is a danger of chequebook environmentalism with progress measured by the number of grants, press releases and column-inches rather than results on the ground and in farmers’ pockets. Regional programs are vulnerable to interference with a political system based on single member electorates dominated by marginal seats’ strategies.

The usefulness of catchment management as an organising principle is problematic in large parts of Australia. Where most of Australia’s agriculture is practised, catchment management is based on little more than the observation that water flows downhill. (Except that in earlier pro-irrigation phases of Australia’s agricultural history, water flowed uphill to votes and money.) Catchment
management neglects other important dimensions of environmental problems — settlement history and its relationship to production systems and the profitability of farming, soil types and climate, for example. Most importantly, catchment management in Australia, most often styled ‘integrated’ catchment management, has not resolved difficult funding and cost sharing issues between private landholders and different tiers of government. Pannell (2000b:2) has pointed out that ‘advocates of catchment planning also seem to neglect the reality that real decisions about farm management are made by individual farmers, not by catchment groups or regional [natural resource management] bodies.’

In principle, the rhetoric of local participation in catchment management should be matched by local contributions. Significantly, the attempt to introduce extremely modest catchment levies in Victoria failed and the resultant adverse reaction in country areas was partly responsible for the defeat of the Kennett Government. Catchment levies might have justified the ambitious hopes for catchment management, as well as the degree of autonomy promised to catchment management authorities, in Victoria. Instead, the Victorian Government is now taking total financial responsibility for funding catchment management. Eventually, the Victorian Government will want greater control of catchment authorities to ensure accountability and, in the process, will be likely to alienate local people involved in the management of catchment authorities.

Landcare and similar programs have other conceptual problems. Landcare is based on a narrow approach that promotes group activity as the organisational basis of environmental remediation. By default or design, this is at the expense of scientific information, careful economic analysis and calculation, and patient public administration. In fact, as revealed by the National Commission of Audit in 1996, and the 1997 report of the Australian National Audit Office (ANAO) on Commonwealth Natural Resource Management and Environment Programs, Landcare has suffered from flawed administration with its convoluted funding procedures. Despite protestations of greater participation, consultation and empowerment of farmers, Landcare has resulted in transfer of control to officials in Canberra. These officials are seldom trained in technical aspects of farming and have limited capacity to assess submissions on reasonable criteria. The environment has become another area of administration where imbalance of powers and responsibilities for taxing and spending is played out between different agencies and tiers of government.

Environmental policies and administrative responsibilities are so confused that separate Commonwealth and state agencies are often competing for the same funds, that could be allocated directly. Grants-based funding is a poor substitute for strong public research agencies with properly-defined responsibilities and appropriate systems of quality control and accountability. Uncertainty over the continuity of funding is diverting researchers from the important tasks of narrowing down the most significant environmental problems and developing options to handle those problems. Funding almost exclusively on the basis of submissions is at best likely to produce random results; at worst, it will institutionalise make-work activities and encourages laxity and favouritism.
Group activity is most sensible when there are significant local off-site effects of farming practices. To date, the importance of externalities has generally been asserted rather than established on the basis of measurement and technical analysis. In the case of dryland salinity in particular, recent hydrological and hydrogeological investigations have revealed that on-site phenomena are far more significant than previously thought. These should be the responsibility of private landholders not governments. Access to useful technical knowledge and the acceptability and profitability of salinity control measures are more important in the adoption of innovations by farmers than group activity. Encouraging group activity without thinking through, and dealing with, difficult issues concerning the distribution of private and public benefits from private and public expenditure is abdicating responsibility, not empowering local communities. Group activity *per se* is not really the problem. The problem is that groups become a vehicle for interest group politics, when what should be encouraged is diversity of views in the policy debate. These difficult issues in public administration were elaborated in a recent contribution to this *Journal* (Kerley and Starr, 2000).

A further weakness of group activity at the local level and excessive involvement by ‘pique’ organisations like the NFF and ACF in formulation of environmental policy is that the option of land retirement is downplayed. The promise of environmental and economic sustainability is held out to all farmers when that is impossible in many areas of Australia for technical and economic reasons. The NFF is hardly in a position to tell some of its constituents that their prospects are poor, with or without environmental problems. Moreover, direct (and often unpopular) regulation by government will be necessary to achieve some environmental objectives. This is made more difficult when government has passed responsibility to local groups. Buy-back of irrigation entitlements is a practical and potentially lower cost solution to some environmental problems. The knee-jerk opposition of the ACF and NFF to market-based instruments effectively precludes this option. Finally, group activity loses its momentum because it is so time-consuming and frustrating for the farmers who are expected to develop the ‘community-based solutions’ to environmental problems.

Concerns with the capacity of the natural environment to sustain agricultural production and any damaging off-site effects of farming are not new in Australia and other countries. Following the experiences of the 1930s, all States embarked on programs directed at reducing soil erosion. In that case, there was explicit recognition that economic and environmental problems were entwined. Professional organisations worked closely with farmers and considerable progress was achieved in reducing soil erosion in an (admittedly easier) era of agricultural expansion and profitable farming. Widespread soil erosion in the 1930s was the consequence of low prices and low farm incomes, deficiencies in farming knowledge and practice, and chronic structural weakness of the agricultural sector occasioned by over-enthusiastic official settlement policies. In irrigated areas, small farms with excessive hydraulic loads on unsuitable soils and inadequate investment in drainage are still the major sources of environmental damage. These problems can obviously be sheeted home to previous government actions.
Environmental problems associated with reduced river flows are also the result of past ill-conceived enthusiasm for irrigation. A similar story could be told about land clearing. Until very recently, governments actively encouraged land clearing with taxation and other substantial incentives. No wonder farmers are confused, especially in states like Queensland and Western Australia where the ethos of agricultural expansionism persists most strongly.

To be effective, environmental policy:

- requires a rigorous approach that gives primacy to generation and dissemination of credible scientific information;
- recognises the economic difference between reversible and irreversible environmental damage;
- separates on-site and off-site effects; carefully distinguishes public and private responsibilities for the environment; and,
- considers the appropriate division of public responsibilities between Commonwealth, state and local governments.

Environmental problems would be difficult to resolve at any time, even without the recent fickle behaviour of the rural electorate most obviously demonstrated in the Hanson episode of the late 1990s. Mainstream politicians are at pains to recover lost ground in rural and regional Australia, frequently — and just as loosely — described as ‘the bush’. Current spending on the environment should be seen as part vehicle for effecting income transfers to farmers and rural communities and part response to environmental problems per se. In a supposed era of economic rationalism, it is salutary to observe that a useful principle for public policymaking is now almost completely ignored. There is scant attention to matching objectives of policy with the instruments of policy. For example, the Natural Heritage Trust was established from the proceeds of part-privatisation of Telstra, breaking every rule in the public finance book. Environmental expenditure is a blunt tool for increasing the welfare of farmers. In some cases, farmers’ welfare will be reduced if they are encouraged to spend their own funds on worthless initiatives by the lure of government grants. If the objective is improvement in the natural environment, expenditure needs to be directed to environmental problems on criteria other than the location of swinging seats.

The NFF and ACF have been vigorous in advocacy of greater expenditure on the environment. For different reasons, the NFF and ACF are prepared to paint a grim picture of Australian agriculture and exaggerate environmental problems. Both organisations have interests in promoting environmental programs and obtaining funds for their constituencies. The campaign to increase expenditure on salinity reached its zenith in mid-2000 with the release of documents by the NFF and ACF supporting expenditure of $6.5 billion per year for ten years (NFF/ACF 2000) and subsequent advocacy by two former officials of the NFF and ACF (Rick Farley and Philip Toyne) of a one per cent taxation levy to fund salinity control. The difficulties of the latter are more straightforward than the NFF/ACF proposal. Only the Commonwealth has the power to raise environmental levies.
The Commonwealth would be more firmly in the driver’s seat. Cost sharing and user charges will be neglected. Some public responsibilities with respect to the environment should be paid for directly by state governments and/or from local government rates. A hypothecated levy of the size suggested would make environmental agencies so flush with funds that insufficient care would be taken in developing a program of environmental remediation than would occur if it were paid for from general revenue, partially reliant on farmers’ contributions.

What is lacking in much of the popular environmental literature is recognition that the sequence of actions in the program is just as important as its content. There is inadequate acceptance that both resources and knowledge are insufficient to satisfy the utopian visions of environmentalism. The future is contemplated with the same confidence, almost insouciance, as the various constraints imposed by the past.

The earlier NFF/ACF proposal was based on consultants’ reports by Virtual Consulting Group & Griffin nrm Pty Ltd (2000). The Land and Water Resources Research and Development Corporation, a Commonwealth-funded body, paid half the (modest) cost of this work. In other words, taxpayers are paying part of the cost of lobbying for taxpayer funds. Hopefully, this will attract the attention of ANAO, which previously took Greening Australia to task for using government funds to lobby for more government funds. Irrespective of the legitimate interests of the NFF and ACF, there are serious issues for public administration when lobby groups are that close to government agencies.

Three-quarters of the investment proposed by NFF and ACF is for the redressing of salinity mainly through reforestation. Not only has recent research questioned the association of dryland salinity with off-site or externality effects (Pannell 2000a), but also the hydrogeology of dryland salinity needs more refinement before all those trees are planted. There are insufficient commercial markets for wood products with planting on this scale. In any case, large parts of Australia affected by dryland salinity have insufficient rainfall for plantation forestry. Where reforestation is profitable, the benefits accrue to private individuals. How this fits into the cost-benefit calculus and ambit claims for government assistance is not made clear in the NFF/ACF documents. Moreover, tree planting on the scale envisaged would have drastic effects on surface run-off and water supply in some areas. In effect, this would concentrate salt in streams and rivers rather than improve water quality (Heaney, Beare and Bell, 2000). Barr and Cary (1992) correctly identified ‘Symbolic Trees and Salinity’ as one of the shibboleths of modern Australian environmentalism.

The NFF and ACF face numerous dilemmas in their political activities. The overriding problem for the strategy articulated in their recent joint exercise is that Australian agriculture is overwhelmingly export-dependent. Commercial farms have to compete on international markets. While the idea of retaining people on the land as caretakers has some currency in parts of the Australian environmental movement, how this is to be financed and maintained is not spelt out. The concepts of ‘multifunctionality’ and ‘stewardship’ were invented in Europe to describe the multiplicity of benefits provided by agricultural land and the dual role
of farmers as food producers and as custodians of the land and the environment. This has led to greater creativity in reconfiguring agricultural support. The ideas might just about have some legitimacy in densely populated Europe, where there are obvious links between intensification of production associated with modern farming methods, off-site environmental damage and loss of amenity to the non-farming population. Indeed, these unfavourable effects are exacerbated by agricultural protectionism in Europe at considerable cost to Australian farmers. The situation is altogether different in Australia. Subsidising Australian agriculture under the guise of environmental programs is not a long-term political proposition, even if it were financially possible. Taxpayers are unlikely to maintain their support for environmental subsidies when most of the output is exported. In any case, independent Australian farmers are unlikely to be interested in a new role as caretakers, living as many of them do in remote and harsh locations.

The Commonwealth and States were prudent in watering down the NFF/ACF proposals to a scale potentially manageable by responsible agencies. However, environmental policy is now compromised by:

- its emphasis on public relations;
- the mendicant status and consequent opportunism of research organisations dependent on grants-based funding;
- centralisation; and,
- the political desire for quick results when that is manifestly impossible.

Economists such as Corden and Krugman successfully disposed of the sporting metaphor in their writings on the spurious notion of national competitiveness, even though the idea lingers on in the down-market world of politics and popular discussion. The same intellectual effort is required of economists and scientists to dispose of an equally unproductive military metaphor in environmental discussion with its emphasis on campaigns and battles.

Spending more money on dryland salinity before there is appropriate understanding of economic and technical possibilities for ameliorating salinity will create new problems rather than solve existing problems. As observed by Pannell (2000b:3), ‘the momentum behind ever increasing salinity budgets appears to be irresistible. We need to start spending the money sensibly, so that the new money is not spent as unproductively as the old money.’

References


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