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Newspapers as Political Instruments in Media Policy Debate

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Is press coverage of media issues self-interested? The short answer is yes, most of the time. There can be apparent exceptions. For example, a recent two page feature by Luke Collins in *The Australian Financial Review* ('The Hilmer Report — Downgrade adds to pressure', 23 March 2001) gives great prominence to Fairfax chief Fred Hilmer's announcement downgrading profit forecasts and, all in all, appears to give Fairfax a rather hard time. It duly notes that Fairfax shares had fallen some 43 per cent over the last twelve months and that its Internet arm lost $40 million in 1999-2000. It publicises criticisms of Hilmer's strategy by fund managers and even refers to a 'not warm and friendly' meeting between Hilmer and major Fairfax shareholder James Packer, discussion of which would, one might assume, embarrass Fred Hilmer. The piece is crafted with a keen sense of balance. Comments by Fairfax executives are carefully counterpointed by criticisms of Fairfax strategy and performance from various analysts. We are even told that the views of the chief executive of News Ltd, John Hartigan, were sought but that he declined to be interviewed. What could be fairer? Yet even in this admittedly highly professional piece the disinterestedness is more apparent than real. The crafted balance and tone of impartiality, worthy though they are, are themselves mobilised to give credibility to an article which is essentially a defence of Fairfax and of Hilmer's management.

Fairfax's recent performance and adverse comments on it were, after all, already on the public record. The article, while acknowledging them, is primarily a rebuttal with Hilmer given the dominant voice. The strategy is a subtle one, at least when compared with News Ltd's previous frontal attack on Fairfax in *The Daily Telegraph* which ran a story, including colour photographs of Fairfax executives playing golf during what *The Daily Telegraph* described as a 'crisis conference', that described Fairfax circulation as 'plummeting'. But *The Australian Financial Review* story is nevertheless a strategic intervention serving the interests of Fairfax management and shareholders.

You may suppose that when newspapers report on their own performance and that of their rivals, we can expect self-interest to colour editorial judgement both with respect to what is deemed worthy of coverage and how it is treated. Reports of audited circulation figures are interesting in this regard. Of 52 stories concerning newspaper circulation and readership published between 1997 and

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2000 by newspapers that can be checked via Dow Jones[1], 41 carried positive headlines, six were neutral and only five were negative. This is despite the fact that the per capita circulation of newspapers continues to steadily fall. Since 1951 the weekly circulation of Australian newspapers has declined from 2.5 to 1.2 per head of population (Dermott, 1998).

For *The Age* it took only a 1.84 per cent increase in weekday circulation over a particular accounting period in 2000 to warrant the headline 'Surge in weekday sales of the Age' while the information that its Saturday edition declined by 3.03 per cent is given well down in the story (*The Age*, 4 August, 2000). When, in the six months to March 30, 1999, the *Age's* weekday sales dropped by 5.05 per cent (admittedly, in a period of savage discounting by News Ltd's *The Australian*), the paper played down circulation figures instead turning to less precise estimates of 'readership' in order to claim growth ('Newspaper readership growing across all titles' *The Age*, 21 May 1999).

Between 1996 and 2000 the weekday circulation of *The Age* fell from 205,000 to 190,864, a fall of 9.3 per cent while its Saturday circulation fell from 350,000 to 309,478 or 8.8 per cent. Yet eleven of its eighteen stories about its circulation published between 1997 and 2000 featured headlines emphasising growth, via a selective highlighting of short-term variations. Of course *The Age* is not alone in this kind of positive spin. Sydney's *The Sun-Herald* proclaimed itself 'Australia's No 1' and 'Australia's greatest newspaper success story' when its circulation rose to over 600,000 in 1998 conveniently ignoring its rival *Sunday Telegraph's* circulation of over 700,000 (26 April, 1998). For its part News Ltd has been accused of 'mendacious propaganda' in its promulgation of circulation claims arising from its price cutting strategies (*The Sydney Morning Herald*, 29 April, 1998).

Conflict of Interest and Media Power

Criticising newspapers for reports on their own circulation may be somewhat carping. After all, in stories directly about themselves or their rivals the potential conflict of interest is evident to all and readers can make their own judgement. This is not the case in coverage of other aspects of the media and, in particular, of media policy. On the same day that *The Australian Financial Review* published its story about Fred Hilmer's management, *The Daily Telegraph* took a further editorial swipe against Government policy on the introduction of digital television, alleging that the Government had given between $5 billion and $10 billion worth of digital spectrum gratis to free-to-air broadcasters and introduced 'a host of restrictions to guarantee datacasters could not compete against existing networks'. Government policy was making Australia a 'digital backwater' and 'Prime Minister John Howard and Senator Richard Alston, his misinformed

[1] The Dow Jones database includes *The Age, The Australian, Financial Review, Canberra Times, Sun Herald, Sunday Age, Sydney Morning Herald, West Australian* and *The Newcastle Herald.*

Communications Minister, should hang their heads in shame' having 'robbed taxpayers of billions of dollars' ('High price for a last opportunity', 23 March, 2001).

The Daily Telegraph presents itself here as a fearless advocate of the public interest. Its strong language expresses outrage that Australian citizens are losing out because of Government ineptitude or worse. But whatever the cogency of this position, might it not have been fair for *The Daily Telegraph* to point out that News Ltd, as a would be broadcaster and datacaster, has a very strong direct interest in this particular Government policy? Should not readers be given the wherewithal to assess the range of motivations behind News Ltd's determined campaign to punish the Government for media policies it regards as detrimental to its interests? The Australian Press Council's Statement of Principles states that, 'A publication is justified in strongly advocating its own views on controversial topics provided that it treats its readers fairly by … disclosing any commercial or other interest which might be construed as influencing the publication's presentation of news or opinion' (Australian Press Council, 1999a:176). Surely some explicit disclosure of interest was appropriate in the case in point or do editors assume that readers are so savvy (or cynical) that they expect conflict of interest as 'par for the course', hence obviating the need for explicit disclosure?

Media bullying of Governments and Oppositions appears to be becoming ever more blatant. Consider, for example, the opening segment of a recent John Laws show, and the way it sets the agenda for that day's program. Laws disparagingly comments on a recent statement by Kim Beazley that corporate executive salaries in Australia needed to be kept in check. Laws' message is clear — butt out of this issue; executives deserve what the market is willing to pay and, besides, its private money unlike publicly funded Parliamentary superannuation. He follows up with this warning: 'So Kim while you're looking at the big end of town's salaries — that might sound good — might make you feel good — might make people who don't like tall poppies feel good too if you're going to start criticising it. But you start criticising that and we'll get back onto Parliamentary superannuation for you and we'll have a game with that' (2CC, 29 March, 2001).

The issue of how the media use their power to pursue their own interests and the extent to which this cuts across the public interest in fair and balanced reporting is a wide-ranging one. It goes beyond specific instances to the wider influence of commercial judgement on news values. Michelle Grattan has commented that in Australian newspapers 'commercialisation has come into the ascendant as a core value' and that 'this has far-reaching implications for how our papers are run, how they look and what they contain — or do not contain' (Grattan,1998:1). She goes on to note (p. 13), by way of example, that News Ltd's

> national and international interests are so vast that no day can pass when one bit of the empire is not faced with the task of reporting on other sections of the empire …. Newspapers fulminate about politicians' conflicts of interest. Yet a newspaper that is part of a

> conglomerate that runs a whole lot of other enterprises has perpetual conflicts of interest. The digital TV decision was a case in point where News' papers became weapons in the armoury. The coverage of Superleague was a particularly dramatic example.

Ewart (2000) reports that the problem is also severe in Australian regional newspapers noting that the convergence of newspapers' commercial and editorial sections means that 'journalistic independence and news sense are subsumed in favour of commercial imperatives' (p. 237) and that the media rarely make disclosures about commercial influences on news content (p. 239). The issue of commercial influence has, as Grattan and Ewart point out, enormous implications for the future of journalism.

Let us, however, return to the more specific case of press coverage of itself and of media policy. Assessing the quality of such coverage and the uses made of it has a particular importance since such assessment is germane to the efficacy of press self-regulation and of maintaining confidence in the processes of media policy development. Let us first turn to press self-regulation via the Australian Press Council.

The Australian Press Council

The Press Council, funded to the tune of $568,000 by major publishers in 1999-2000, is in the delicate position of having to balance its advocacy of a free press (which its benefactors characteristically identify with private ownership and freedom to pursue commercial interests without government interference) with its protection of the interests of individuals and groups whose rights might be infringed by the press. A former chair of the Press Council, Professor Pearce (Australian Press Council, 2000:11), has argued that there is no conflict between these two roles, commenting:

> The function of the Council of monitoring and reporting on freedom of the press issues may at first sight seem incompatible with its complaints role. I have found this not to be the case. The two functions complement each other as the freedom of the press issues can form the basis from which it is possible to judge whether a publication has acted improperly.

But, of course, the potential conflict only disappears if one accepts, as does Professor Pearce, that 'freedom of the press' (variously interpreted) is the prior concern and therefore appropriately provides the framework from which to view complaints. The position, though defensible in terms of broad concepts of public interest, is rather counter-intuitive when it comes to individuals or groups who feel wronged by the press. The conflict is evident when Press Council rulings clash with those of other jurisdictions. When the Head of the Australian Palestinian Delegation felt wronged by a 1998 article in *The Australian Financial Review* he

complained to both the Press Council and the NSW Administrative Appeals Tribunal. While the Press Council dismissed the complaint the Tribunal found that the article vilified Palestinians and contravened Australia's anti-discrimination laws. Despite the ruling the Press Council went on to criticise the Tribunal warning that its decision impeded press freedom.

The Press Council has recommended itself to government as a model of successful self-regulation. Its submission to the recent Inquiry into Media Regulation by the Senate Select Committee on Information Technologies was headed 'self-regulation works'. The Council 'expressed the view that its background and experience of the self-regulation of the print media would provide useful information to the committee. It asserted broadly that self-regulation had been shown to work for the print media and should be applied generally to the communications industries' (*Press Council News*, February, 1998). A cornerstone of the Press Council approach is a confidence in the willingness of newspapers to prominently publish findings critical of themselves. Furthermore the system is based on the view that the publication of an adverse finding constitutes an appropriate and sufficient remedy for the complainant. Underpinning all this is the traditional libertarian notion of a 'free market of ideas'. Another former Chairman of the Press Council, Professor David Flint (Australian Press Council, 1996:10), put the case in these terms:

> We strongly believe that the best remedy to a wronged complainant is the prominent publication of an adjudication. As Justice Holmes argued, echoing Milton, the best test of truth is the power of the thought to get itself accepted in the competition of the market. A Press Council adjudication…allows aggrieved complainants to be vindicated in the eyes of the public.

Let us leave aside the issue of whether complainants would agree that mere publications of an adverse funding is the 'best remedy'. The more immediate question is whether Press Council interventions (making adverse findings and insisting on having them published) effectively redress what one must assume had been a kind of 'market failure'. There is much evidence to suggest that they do not do this simply because it is the newspapers themselves who control this particular marketplace. While it is true that both major newspaper groups, News Ltd and Fairfax, have committed themselves to report Press Council findings, they do so very much on their own terms. Consider, for example, the positioning of reports of adverse findings on selected front-page stories[2]:

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[2] Press Council adjudications are published quarterly in *Press Council News* and republished in the Press Council's Annual Reports. The Reports also include data on the publication of adjudications in the press.

- Adjudication No 910 (February 1997) upholding a complaint against a front page story and photograph in *The Daily Telegraph* was published on page 20;
- Adjudication No 924 (May 1997) against a front page *Sunday Mail* (Brisbane) story appeared on page 58;
- Adjudication No 945 (September 1997) against a front page article in *The Sunday Telegraph* appeared on page 48;
- Adjudication No 960 (February 1999) against a front page article in *The Herald Sun* (Melbourne) appeared on page 26, and
- Adjudication No 1057 (November 1999) against Sydney's *Sun Herald* appeared on page 55.

The Press Council has emphasised that it 'reviews the publication of adjudications at each meeting to ensure they are published and published with appropriate prominence' (*Press Council News*, May 1998:3). One can assume, then, that the pattern indicated above is judged by the Press Council to meet its requirements. Even so, it has in recent years faced direct challenges to these rather minimalist requirements. *The Townsville Bulletin* republished a photograph, which the Council found irresponsible, next to the publication of the Council's adjudication and accompanied by editorial comment rejecting the Council's findings. *The Daily Telegraph* also republished 'sneak photographs' of the then Senator Bob Woods and his wife, which had been the subject of an adverse finding in 1997, in the context of publicising a merit award won by the press photographer who had taken the photo. In 1999 *The Australian* refused to publish an adverse adjudication on the grounds of alleged procedural unfairness and for a time refused to cooperate with the Council.

In condemning the republication of *The Townsville Bulletin* photograph the Council saw fit to remind editors that this kind of action risked undermining the principles of self-regulation. By challenging Press Council rulings the press could be its own worst enemy. Such challenges could be used as evidence of the failure of self-regulation and for the need for some form of statutory intervention. They are also a symptom of a deeper problem.

The Press Council makes a valuable contribution to debate on the media in Australia. Its adjudications thoughtfully articulate an important position derived from its primary concern with press freedom. It is not, however, well positioned to counter the power of the press when the press chooses to pursue its own interests. The former Chairman, Professor Pearce, noted that the Council had 'given careful consideration to its submissions on important issues so that it does not simply assume a lobbyist role but presents the case from the viewpoint of the public interest' (Australian Press Council, 2000:9). However, in order to maintain that the Council can effectively be both a lobbyist for existing newspapers and defend the public interest requires an unrealistically sanguine view of Australia's current press system (dominated, of course, by two corporations) and the imperatives that drive it. This is further evident if we look specifically at press reporting of media policy questions that affect it.

The Interdependence of Politics and the Media

As a preliminary point it should be noted that the interdependence of politics and the media renders media policy making a particularly fraught and contentious process. Governments and political parties have a much greater direct interest in the structure and day to day functioning of the media than they do in other industries, say tourism, manufacturing or mining — they are prime users of the media; they crave media support; and their political fortunes are influenced by media reporting. Individual politicians are dependent on the media to promote their status as public figures. At the same time, they can suffer at the hands of the media via encroachments on their privacy.

It is hardly surprising, then, that governments and politicians are not seen as disinterested parties when it comes to developing media policy. Bowman (1988) and Chadwick (1989) argued that in the 1980s the Labor government established mutually rewarding links with Rupert Murdoch and Kerry Packer whereby favourable media coverage was rewarded by cross media ownership rules that favoured the Murdoch and Packer camps. Barr (2000:10) comments that, 'the history of Australia's pattern of media ownership and control shows extraordinary political favouritism and pragmatism on the part of governments towards media corporations judged to best serve the party's interests.' Papandrea (2000:12) has noted that government decisions on digital television have illustrated the propensity of politicians to bow to media pressure: 'Our political system gives the ultimate power for the licensing of broadcasting to politicians whose own short-term interests are more likely to be better served by keeping powerful media proprietors friendly. Fearing a political payback, politicians have been reluctant to introduce policies potentially detrimental to the commercial interests of established players'. At the more personal level, politicians as public figures are more likely to have direct experience of media intrusion than the average person. Moreover, the political consequences for individual politicians publicly sullied in the media can be amplified. This arises because the strong party adherence characteristic of Australian politics leads to damnation by association and hence affects party standing as a whole. Recognition of such consequences might well colour attitudes to the efficacy of codes of practice and prompt calls for their review.

The threat of 'political payback' for the advocacy of policies seen by the media as detrimental to their interests is a quite palpable one. If politicians are interested parties in media policy development, so too, of course, are the media themselves. Large sections of the media are dependent on supportive government policies for their economic well being and are willing to fight to maintain that well being. Furthermore there is a long standing concern that governments inevitably tend to accumulate power in their own self-interest and that therefore any talk of media regulation (other than regulation which favours established players) should be treated with great suspicion. Most importantly, the media are uniquely positioned, as compared to other industries, to use their public reach and influence to intervene in policy debates directly affecting them. They can influence public

views (and if necessary foment dissent) on media policy and influence public respect for governments and politicians. When it suits them, the media can 'flex their muscles' to ward off unwelcome government attention by direct appeals to the public which also serve as a veiled political threat, demonstrating as they do, their power to the government of the day. Media commentator Dennis Shanahan (2000:30) has gone so far as to say that when it comes to media policy 'both sides of politics … have allowed a cringing culture towards media organisations and their related businesses to develop'. Other lobby groups need to hire PR professionals in order to obtain favourable media coverage. The media themselves have almost unlimited media resources at their disposal.

Proposed Media Complaints Commission

As argued by Ward (1995:126), while it may be generally true that 'the penchant of proprietors blatantly to use their newspapers as political instruments' has diminished 'under the weight of commercial pressures to build and maintain large heterogeneous audiences', this is not the case when media interests themselves are directly challenged by media policy proposals. Then, there are few holds barred. This can be seen if we examine media responses to the recent Senate Select Committee Report, *In the Public Interest: Monitoring Australia's Media* (2000, — hereafter referred to as 'Report') which recommended the establishment of a single statutory Media Complaints Commission (MCC) covering the press as well as broadcasting. Needless to say this proposal to bring broadcast and press regulation under the same umbrella sparked outrage amongst press interests who labelled it as an outrageous encroachment on press freedom. Somewhat paradoxically (and unfortunately) the extreme nature of the response seemed to provide further ammunition to those who see the need for more effective checks on media power, rather than providing an effective defence of press freedom.

The Report was tabled in the Senate on 13 April 2000. Its main recommendation was that the Government establish an 'independent statutory body, known as the Media Complaints Commission' in order to 'more effectively protect the right to privacy and empower individuals in lodging a complaint against Australia's information and communication industries' (Report:xii). The MCC would provide a one-stop shop for all complaints and would also function as a final adjudicatory body for complaints. It would work in conjunction with the existing industry-based complaints bodies and procedures.

The Committee found that self-regulation in the print media was 'failing the community' and that the community was confused by the different complaints procedures for different media and industries. In general it found that 'the complaints handling procedures and regulatory codes in [all media] sectors are inadequate, and need to be simplified and strengthened' (Report:128). It also found that 'the complexity involved in making a complaint and the perception of an inadequate outcome, may discourage individuals from engaging in existing complaints handling procedures' (Report:134).

Despite the majority Report's clear and forceful recommendations regarding the MCC, the Report was presented to Parliament by its Chair, Senator Jeannie Ferris (Liberal, South Australia), with something less than outright endorsement. Senator Ferris noted that the Report was about the protection of the media and the protection of consumers and that 'this Report seeks to put in place a means by which consumers can effectively complain about … breaches'. However she went on to say that she 'would be delighted if the recommendations in the Report … particularly for a Media Complaints Commission, were never used because the media itself improved the efficiency and effectiveness of the complaints regime that already exists'. She remarked, somewhat enigmatically given that statutory intervention was being recommended, that 'the Report provides an opportunity for improvements to be made to the self-regulation of Australia's media' (Commonwealth Parliamentary Debates, 2000). The tenor of this speech suggests that there was little expectation that the Government would actually proceed to establish a Media Complaints Commission. Rather it seemed to be sending the message that the media should improve its self-regulatory procedures so as to render such a commission unnecessary while at the same time waving (albeit somewhat weakly) the 'big stick' of government intervention. The vast majority of the press, however, saw no need whatsoever to take the hint.

It should be noted that there had been a measure of political self-interest in the setting up of this Inquiry. When the Committee began its deliberations in 1997 media/political relations were at a particularly low ebb. Unwritten codes of secrecy between politicians and gallery journalists that protected privacy of personal relationships had been challenged by the 'Woods affair'. The obsessive media tracking of Senator Colston had also raised political and public sensitivities.

One of the major political issues of 1996 and 1997 was the so-called 'travel rorts' affair in which a number of politicians on both sides of parliament were investigated for dishonest travel claims. The investigations and their reporting inevitably created tensions between politicians and the media. These came to a head when *The Daily Telegraph*, (7 February 1997) published the sneak photographs (noted earlier) of Liberal Senator Bob Woods (who as well as being investigated for 'travel rorts' was involved in a family crisis) and his wife Jane in private discussion in the backyard of their home with the headline: 'In the garden of their home, a Senator and his wife confront a scandal'. A complaint about the story was upheld by the Press Council (Australian Press Council, Adjudication No. 916, April 1997). While *The Daily Telegraph* published the adjudication (16 April 1997:22) it challenged it in an editorial on the same day, (p. 10) on the basis that both Senator Woods and his wife were public figures. *The Daily Telegraph*'s unrepentant stance would have irked Senators. Certainly this particular case featured prominently in the Report. Also noteworthy in this regard was the extensive quoting in the Report of the response by Lord Wakeham, Chair of the United Kingdom Press Complaints Commission, when informed by the Committee of the *The Daily Telegraph's* republishing of the photograph. Stating that no such blatant dismissal of the self regulatory adjudications had ever

happened in the United Kingdom, Wakeham's quoted response in the Report (p. 35) asserted:

> We are there to run a code that they ask us to. If they are not going to obey it, the system would break down and the government would have to act, and the newspaper industry does not want this to happen.

In the same period Senator Colston became the target of intense political scrutiny, especially over 'travel rorts', not least because his move from the ALP to Independent had made him a powerful player in the passing of Senate legislation. It is noteworthy that a submission from his wife, Mrs D. Colston, features prominently in the Report as evidence of unacceptable media intrusion.

Is it reasonable to infer that the media treatment of Senators Woods and Colston was a factor in the decision by the Senate Select Committee of Information Technology to launch an inquiry and that it was driven by specific political as well as more general public interest concerns. The political genesis of the Inquiry does not, however, negate the public interest importance of the issues of media accountability that it addressed.

The Press Council Response

The Press Council would not have been surprised by the Report's recommendation to establish a statutory Media Complaints Commission. It is clear from the Press Council's final submission to the inquiry that the Committee had canvassed with it the possibility of the Press Council extending its powers so that, in the Committee's view, it could become a more effective regulator. However the Press Council rejected this possibility commenting that it is 'established and funded by the print media' and that 'its power in relation to the receipt and determination of complaints is that which is given to it by the media which established it' and further that 'it is most improbable that the print media in Australia would agree to the extension of the Press Council's power' and any such suggestion 'is unlikely to result in any positive response'. The Press Council (Australian Press Council, 1999b:1459) went on to suggest a possible course of action for the Committee but at the same time warned it against taking such action:

> Accordingly, if the committee were to consider it desirable for additional power to be given to a body to deal with print media it would be necessary for the committee to recommend legislation to establish a statutory body and invest it with whatever are considered to be appropriate powers. It should be recognised that such a step would bring the status of the print media in this country to that in countries where there is no freedom of the press. In particular, it would place Australia at risk of being classed amongst those countries where the expression of critical opinion by the press may attract political or economic sanctions.

The message was clear: leave us alone or we will play our 'freedom of the press' card and we will play it hard. One can speculate that this Press Council response painted the Committee into something of a corner. The statutory Complaints Commission became a recommendation, albeit one presented by the Committee Chair to Parliament in a way tinged with regret that the press itself could not have been more responsive to the problems the Committee saw in its self-regulatory practices.

Press Response

Press response to the Report was swift, short, and sharp. Editorial response can be regarded as extraordinary in both its consistency and in the large number of leading national and state papers that chose to comment. Editorials on the Report appeared in the *Sydney Morning Herald*, *The Australian*, *The Daily Telegraph*, *The Herald Sun*, the *Courier Mail*, the *Adelaide Advertiser*, the *Canberra Times*, and the *Age*. Editorials, which unanimously condemned the Report's findings, in particular the concept of a statutory Media Complaint Commission, were a clear warning to Government that it interfered with the press at its own peril. The flippant and dismissive terminology that pervaded news reports and editorials detracted from press claims that their arguments were based on high principle, motivated by the defence of freedom of speech in 'the public interest'. Rather, they displayed a 'cockiness' born, one assumes, of a confidence that the Senate Report could be summarily dismissed with impunity and by a desire to send a clear message to Government about press prerogatives. Rather than accept the Report as a warning that it should get its house in order, a reading promoted by Senator Ferris in her speech presenting the Report to Parliament, the press chose (injudiciously, perhaps) to ridicule it.

The tenor of response was set by a press release from the Press Council (General Press Release No 238, 13 April 2000) which dismissed the Report as 'silly' though 'attractive to many politicians as it enables avoidance of public attention relating to their affairs'. These words were given great prominence as the headlines in *The Australian*, 'Media report a "silly" read' (14 April 2000:5), and in the *Sun Herald*, 'Gripes body "silly"' (18 April 2000:14) indicate. The AAP reports were also influential in developing the tone of news response, with all three of them describing the MCC as a 'one stop shop for media gripes, to be funded by taxpayers'. Although not technically an inaccurate term, 'gripes' carries an innuendo of unwarranted complaint and its use suggested a diminished respect for complainants, public and/or political. Its use in ostensibly 'straight reporting' suggests an unwillingness by the media to impartially report criticisms of itself even when made by a Senate Committee. 'Gripes' was repeatedly used in the many press reports based on the AAP story.

Editorial response to the Report was designed to send a clear and forceful message to Government: the recommendations of the Report should be shelved. *The Daily Telegraph* editorialised, 'put simply, in a democracy, government has

no role to play in media if this sector is to remain independent. This proposal is intrusive and a dangerous step along an authoritarian path' (19 April 2000).

The Australian talked of 'the slippery path to authoritarianism' and referred to the creation of a 'Ministry of Truth' and asserted that 'the authoritarian mind can always find reasons for wanting to "improve" methods of control' (14 April 2000). Political self-interest was a central theme of attack in editorials. Newspapers were openly contemptuous of Government interference. The only qualification offered in some was the acknowledgment that their arguments might read as 'self interest' but the assertion was that they were motivated by 'public interest'. *The Australian* noted that it was fortunate that 'the Committee's undemocratic recommendations faced some serious obstacles'. Firstly, the editor claimed, it was 'doubtful whether the Commonwealth has the power to control the print media', claiming incorrectly that this issue is not discussed in the majority report. Its second argument was even more disparaging, attacking the political intellect of the Committee while registering a division between its members and noting 'wiser heads more dedicated to preserving our freedoms'. Admitting to having had problems with the Prime Minister, John Howard, and the Communications Minister, Richard Alston, *The Australian* asserted that it doubted that either of these members of the executive would fail in their 'commitment to our fundamental democracy. We assume the Committee's Report will be dutifully read — and dutifully filed where it belongs'. The warning was specific, targeting those the paper or proprietors would hold responsible for acceptance of any of the Committee's recommendations.

Political–Press Stand-off

To date, there has been no formal Government response to the Report. Despite the general undertaking of Government to respond to committee reports within three months, the Government has not yet responded at the time of writing, one year later. The media response may preclude that eventuality. The publication of two letters from the Chair of the Committee represent one of the few indications of public recorded 'debate' on the Report. The fact that it represented debate between press and politician only further emphasises the difficulty for the public to see the link between their interests and this political/media scuffle. The letters were published in the *Canberra Times* (19 April 2000:10) where Ferris was once a journalist, and in the *Adelaide Advertiser* (22 April 2000:20). The *Adelaide Advertiser*'s editorial, like the editorials of other papers, had resorted to alarmist sensationalism in its response to the Report, describing the Report as 'ironic, sad and reprehensible' and its recommendation as 'the thin end of a mighty fat wedge, the first step on the descent to the Orwellian hell of Ministry of Truth' (15 April 2000:20). Ferris's reply used the categories 'ironic, sad and reprehensible' to criticise the response: 'These are very much the words that can be used to describe the Editorial' (*Adelaide Advertiser*, 19 April 2000:10). She also took the opportunity to attack the credibility of the Australian Press Council noting the funding it received from major publishers.

In the upshot it seems highly unlikely that the chief recommendation of the Report to establish a Media Complaints Commission will be acted upon by the current Government. The comments in editorials already cited clearly indicate that the expectation is that the Report will be 'shelved'. Whether this is a perspective based on inside information or a ploy to deflect or allow Government to ignore the Report is difficult to assess.

If the Report is unlikely to be implemented, as it appears, what is its significance? Its main importance is as a political threat, not to be acted upon now, but laid on the table as a warning to the media. The Inquiry, the Report and the media response to it are less significant with respect to immediate policy outcomes than for the insights they offer into media politics — its symbolic gestures, rhetorical positions, main actors and power plays. It is a politics where the press are far from dispassionate observers but are forceful players only too willing to use their ready access to electors to intimidate policy makers. But will the press eventually overreach? One suspects it will, given the arrogance it so often displays in response to criticism of its performance. If support grows for statutory intervention, surely an unwelcome development, the press will only have itself to blame. Certainly there is one ex-journalist, now a Liberal Senator, whose views on the press must surely have hardened considerably given her experience of chairing a committee which sought to make it more accountable.

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Reliability of Indigenous Employment Estimates

Boyd Hunter and John Taylor

Since 1971, the main vehicle for establishing a measure of the labour force status of Indigenous Australians has been the five-yearly Census. For the total population, census data are complemented by inter-censal estimates of labour force status derived from the Australian Bureau of Statistics (ABS) Labour Force Survey (LFS) first instituted in 1964. This long-standing commitment to data gathering reflects the importance of employment, unemployment, and labour force participation rates as key national indicators of social and economic wellbeing.

To the extent that Indigenous people have formed part of the sample for the LFS and have participated in the process, they have always been included in the ensuing statistical profile. However, it was not until 1994, in the March survey round, that a question was added to enable the separate identification of Indigenous people within the sample. This practice has subsequently been repeated annually in each February survey. Thus, for one month in each of the past six years, the ABS has gathered statistics that provide for the calculation of Indigenous labour force status, although they have only recently released these data as official, albeit experimental, estimates (ABS, 2000).

From the perspective of policy evaluation, considerable interest surrounds these latest available official measures of Indigenous economic status. As annual estimates, they offer the possibility of establishing trends in labour force status that are more aligned — at least more so than are census data — with identifiable policy shifts and macroeconomic shocks. The time series charted from the sequence of survey results is also suggestive, at least at face value, of a sizeable decline in the Indigenous unemployment rate since the mid 1990s, and a current upward trend in employment levels.

These apparently positive results are potentially significant indications for policy and raise a number of pertinent questions. They suggest, perhaps, that improvement is at long last emerging. They possibly reflect the success of the Indigenous Employment Policy. They may be a consequence of macroeconomic, or of microeconomic change. Previous research has found little if any link between macroeconomic change and Indigenous labour force status (Altman and Daly, 1993) — do the results of the LFS suggest otherwise?

It appears that policy-makers are already responding to this new source of data. For example, in its final submission to the Commonwealth Grants

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Commission's (CGC) Indigenous Funding Inquiry, the Department of Employment, Workplace Relations and Small Business proposes that key indicators of Indigenous labour force status should be calculated at national, State and regional levels using data from the LFS (CGC, 2000:9). This same submission also implies that previous estimates of labour force status based on projections from the 1996 Census, such as Taylor and Hunter (1998), should be superseded by the 'current' estimates provided by the LFS (CGC, 2000:10). Such a statement affords a degree of legitimacy to the LFS estimates that requires testing.

Accordingly, this paper aims to evaluate critically the estimates of Indigenous labour force status with a view to establishing their reliability, and hence their utility for policy analysis.

History of Official Measures

The lack of regular and accurate labour force estimates has been a long-standing and recurring concern of Indigenous affairs policy-makers (Altman, 1992:2-4). Lack of timeliness in the availability of information on the Indigenous population has been noted in a number of major reviews of Indigenous economic status including: the Miller Review of Aboriginal employment and training programs (Commonwealth of Australia, 1985); the *Royal Commission into Aboriginal Deaths in Custody* (Commonwealth of Australia, 1991); the Academy of Social Sciences workshop on Aboriginal employment equity (Altman, 1991:168-9); and the Council for Aboriginal Reconciliation (CAR) workshop on benchmarking service delivery for Indigenous Australians (CAR/CAEPR, 1997).

Indeed, it was the dearth of information with which to inform the Royal Commission into Aboriginal Deaths in Custody that caused the Commissioner to recommend a special national survey of the Indigenous population (Commonwealth of Australia, 1991, Vol. 2:62). This recommendation resulted in the 1994 National Aboriginal and Torres Strait Islander Survey (NATSIS) that provided the first inter-census estimates of Indigenous labour force characteristics. Coincidentally, in 1993, the ABS made a decision to include a question on Indigenous identity in the March 1994 LFS. Indigenous identity was also sought in the 1995 National Health Survey (NHS), which includes the standard question on labour force status.

Thus, there are now four ABS collections from which national statistics on Indigenous labour force status may be derived and charted — the Census, the NATSIS, the NHS and the LFS. Obviously, the greatest precision is associated with data from the census that provides a full enumeration of the self-identified Indigenous population.

Although the statistics available from the four collections are based on the same underlying standard International Labour Organisation definitions and concepts, there are differences in methodologies and definitions that affect the comparability of data (ABS, 2000:2).

Table 1: Indigenous Labour Force Status, 1971-2000

		Employment/ Population Ratio	Unemployment Rates	Participation Rates
Census	1971	41.4	9.3	45.6
	1976	40.7	17.8	49.5
	1981	35.7	24.6	47.3
	1986	31.3	35.3	48.3
	1991	37.1	30.8	51.4
	1996	40.1	22.7	50.3
NATSIS	1994	35.9	38.2	58.0
NHS[a]	1995	47.8	20.6	60.3
LFS	1994	38.3	27.8	53.1
	1995	44.7	20.9	56.5
	1996	42.5	22.9	55.2
	1997	38.9	23.3	50.7
	1998	39.1	25.0	52.2
	1999	39.8	21.9	50.9
	2000	43.6	17.6	52.9

Notes: a. The 1995 NHS data refers only to the 15 to 64 year-olds and is not strictly comparable to the other statistics in this table that refer to the population aged 15 years or more. Notwithstanding, NHS data are broadly consistent with the LFS results.

b. The 1996 Census estimate of participation rate increases to 52.7 per cent if the 'not stated' category is allocated proportionately across all labour force states (rather than assuming respondents who do not reply are outside the labour force). The LFS publications do not report a category for 'not stated' because respondents are always prompted for a response to this question.

Source: ABS (1995); ABS (1998); ABS (2000); and Daly (1995). The NHS estimates are based on unpublished data.

Despite these problems, Table 1 reveals an employment/population ratio that is remarkably consistent across all four collections. All fall within a range of about 7 percentage points around 40 per cent of Indigenous adults, for the period between 1971 and 2000 (excluding 1986). Thus, using Census and NATSIS data as benchmarks, the LFS estimates appear to be in line with expectations, although they exhibit considerable year-to-year fluctuation, with the most recent results suggesting a substantial improvement in the employment ratio.

As for unemployment rates among Indigenous people, census data are suggestive of an increase in the rate between 1971 and 1986 followed by a subsequent steady decline to 1996. This fall in unemployment rates appears to have continued (from the LFS results), especially considering the 1999 and 2000 survey results. In these estimates of unemployment, the effect of the different survey methodologies is clearly evident (Taylor and Hunter, 2001b). It is also apparent that the NATSIS labour force participation rate is notably above other

estimates. Notwithstanding, the participation rate appears to have risen and then stabilised at just over 50 per cent.

At face value, then, the LFS estimates look reasonable when benchmarked against other collections, and are thus suggestive of continuing positive trends in Indigenous labour force status as indicated by a rising employment rate and declining unemployment rate. How reliable is this estimation?

Reliability of the Estimates

As with the results of all sample surveys, estimates from the LFS cannot be accepted simply at face value. They require validation in the context of both sampling and non-sampling errors

Sample size

The fact that the Indigenous LFS estimates are not drawn from a sampling frame designed to be representative of the Indigenous population adds complexity to the assessment of reliability. For example, although the six-year average Indigenous sample size of 1,066 represents a sampling fraction of the Indigenous population which is roughly equivalent to that set by the LFS for the sample of the total Australian adult population (0.5%), the Indigenous sample size has varied each year, ranging from a low of 964 in 1998 to a high of 1,189 in 1997. Within this, the annual sample from sparsely settled areas (Statistical Local Areas with less than 0.057 dwellings per square kilometre) has been subject to greater fluctuation — from a high of 354 in 1994 to a low of 153 in 1998). With such small numbers and high annual variability, it is likely that the estimates will be highly variable at sub-national level.

Geographic distribution of the sample

A potential source of sampling error derives from the fact that the LFS sample is a multi-stage area sample of private dwellings designed to produce reliable estimates of labour force characteristics of the total population in each State and Territory. Another aim of area sampling is to spatially restrict the sampling frame in order to minimise survey costs.

In sparsely settled areas, the areas sampled are often synonymous with communities, and because of the great distances that exist between communities, the sample becomes geographically clustered with the result that Indigenous respondents in such areas are drawn from a relatively small number of localities. This has implications for the reliability of the sample in remote areas, in particular because high variability can exist between communities in terms of available employment opportunities, especially via the Community Development Employment Projects (CDEP) scheme (Altman and Daly, 1992; Altman, Gray and Sanders, 2000; Altman and Hunter, 1996). The CDEP scheme is a federal government program in which unemployed Indigenous people forgo their entitlements to Newstart Allowance payments but receive the equivalent from a

local community organisation in return for work. It is distinguished from the Work-for-the-Dole Scheme in having a much longer history (since 1977), in being specific to Indigenous communities and having a broader community-development component.

The multi-stage nature of the sample also means that annual Indigenous data are drawn each time from a different set of communities, thus adding to variability in the annual movement of the estimates. This point is illustrated by 1996 Census data from two adjacent Aboriginal communities in the Northern Territory. While Barunga had an unemployment rate of 46 per cent and no CDEP scheme, the neighbouring community of Wugularr, which has a CDEP scheme, reported no unemployment. Unfortunately, it is not possible to say which types of community (CDEP or non-CDEP) are included in the sample each year as the ABS does not provide such information.

The ABS's weighting procedure (based on Census counts) attempts to adjust for the probability of being sampled in a particular area, thus reducing the scope for bias. However, the weighting procedure might still produce predictable 'biases' in the point estimates of employment and unemployment (and possibly even labour force participation), if it failed to take into account the location of CDEP schemes. Over time this problem would manifest itself as volatility in the estimates of labour force status as the sample switched between communities with and without CDEP schemes. This volatility would depend on how many and which communities are being sampled rather than on the number of respondents.

Sample timing

Since 1995, the data on Indigenous labour force status has been drawn from the February LFS. February is a highly transitional month in labour market terms and therefore one of the most unstable months of the year to collect information on job seekers. Large numbers of youth, in particular, are about to alter their labour force status by entering the higher education sector, and this presents a severe problem for the interpretation of results. Centrelink data on unemployment indicate that unemployment is much higher in the first few months of the year with many ex-students claiming unemployment benefits before returning to education. It is not possible to seasonally adjust LFS data on Indigenous people since it is only available for one month each year.

Another timing-related issue is that while the estimates are currently based on a single month sample only, from 2002 it is proposed that they be based on a 12-months sample, thus producing 'annualised' estimates (ABS, 2000:2). The ABS calculates that this strategy will effectively increase the Indigenous sample size by 50 per cent with a corresponding reduction in standard errors of around 30 to 40 per cent. However, this methodology raises questions about how monthly data is combined over time to measure unemployment and employment at a particular point in time. For example, the LFS is a rolling sample that replaces one-eighth of the sample every month. Given that monthly data include different people in the various months, it is not clear how the methodology for combining

the data will address issues about the duration of employment and unemployment for various respondents. If people move in and out of employment, then this will also have to be taken into account. That is, in order to produce annualised estimates, one has to make crucial assumptions about the ongoing labour force status of respondents who are no longer in the sample.

Non-sampling errors

Non-sampling errors mainly relate to the incorrect or inaccurate reporting of information that inevitably occurs as a consequence of the interaction between respondents and interviewers administering household survey questionnaires. In surveying Indigenous households, ABS experience has highlighted the significance of non-sampling error for this population, especially in sparsely settled areas (ABS, 1999). One aspect of this, having particular relevance to the LFS results, is the difficulty of applying mainstream notions of work and unemployment in a cross-cultural setting. From the standpoint of the Indigenous domain, official indicators have been described as ethnocentric and consequently low in content validity, ambiguously defined and conceptually inadequate (Smith, 1995).

A related issue is the varying degree to which participants in the CDEP scheme may consider themselves employed according to the LFS definition. Following a review of the CDEP scheme in 1997 a series of administrative reforms were implemented that placed emphasis on the scheme as an employment program aimed at equipping participants for mainstream work (Spicer, 1997). Part of this reform involved shifting non-working participants from the scheme into the ambit of the social security system and their replacement by working participants (Sanders, 2000). Prior to this, participation in the scheme did not necessarily equate with employment according to LFS criteria and it is estimated that as many as 40 per cent of scheme participants were not employed (Taylor and Bell, 1998:44-5). According to the Aboriginal and Torres Strait Islander Commission (ATSIC), which administers the scheme, participation is now synonymous with paid employment and, in theory at least, all registered participants would be likely to be classified by the LFS as employed. Assuming this to be the case, the effect of administrative reforms nationally has been to raise estimated levels of Indigenous employment through the CDEP scheme from around 21,000 in 1998 to 31,000 in 1999 (Table 2).

As background to assist in the interpretation of its Indigenous LFS estimates, the ABS reports the number of CDEP scheme participants each year from 1994 to 2000 as at June 30 (ABS, 2000:13). These are shown in Table 2 alongside estimates of the number of CDEP participants who would be classified as employed according to ABS definitions (Taylor and Hunter, 2001a). Administrative data on CDEP are also reported for 1 February each year to maximise comparability with the labour force estimates in ABS (2000). Given that the ATSIC data and Table 4.1 in ABS (2000) are from the same administrative source, it is not surprising that there is little difference in their

participant numbers. However, compared to the adjusted estimates of those who might be classified as employed as a consequence of their participation in the scheme, the focus on participant numbers alone produces a misleading impression, suggesting low growth in employment due to CDEP in recent years. While some confusion may remain among CDEP participants regarding their labour force status (Altman and Johnson, 2000), it is likely that non-sampling error from this source will tend to decline in significance as participants are increasingly employed under 'no work, no pay' rules.

Table 2: Comparative CDEP Estimates, 1994-2000

	CDEP Employed	CDEP participants	
	Taylor and Hunter (2001a) (30 June)	ABS (2000) (30 June)	ATSIC (1 Feb)[a]
1994	NA	24,100	22,178
1995	NA	27,000	24,107
1996	18,656	28,400	26,217
1997	19,974	30,000	26,442
1998	21,228	30,300	30,007
1999	31,650	31,900	30,738
2000	32,220	30,600	31,050

Note: a. ATSIC figures for 1991-99 are from CDEP Finance spreadsheets, and show actual CDEP participation for February in each year. The figure for 2000 is from CDEPManager, and shows actual participation at 1 February 2000.

Sources: Taylor and Hunter (2001a); Table 4.1 in ABS (2000); ATSIC administrative data.

Confidence Intervals for Changes in Indigenous Unemployment Rates

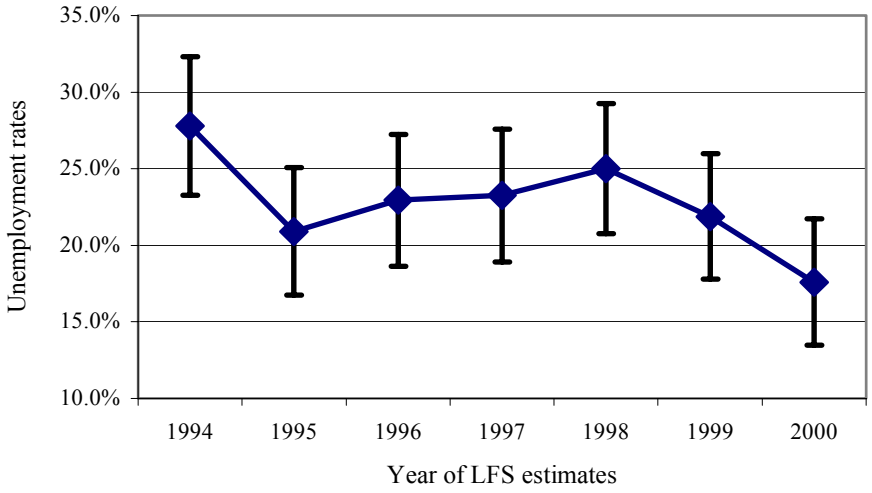
The standard errors reported in ABS (2000) are for the number in each labour force status for the Indigenous and non-Indigenous populations. Since most policy analysts are interested in the variability of unemployment rates, employment/population ratios and participation rates, the standard errors for the relevant ratios have to be manipulated to obtain appropriate measures of reliability. Taylor and Hunter (2001b) document this manipulation and provides the methodology for calculating standard errors of the difference or change between two rates.

Using these standard errors it is possible to calculate the 95 per cent confidence intervals for annual movements in unemployment rates (Figure 1). If an unemployment rate in an adjacent year is outside a confidence interval, then we can be 95 per cent confident that there was a significant change in the unemployment rate.

It is difficult to compare the 1994 estimate to other unemployment rates given that it was based on the March, rather than the February, round of the LFS. If one ignores the 1994 estimate, the only statistically significant change in unemployment rates was for the 1999-2000 period. That is, Indigenous

unemployment between 1995 and 1999 was about 22 per cent plus or minus about 4 percentage points. The lowest overall unemployment rate recorded was 17.6 per cent in February 2000. In effect, this means that no statistical significance can be attributed to any of the estimated changes in unemployment rates for most of the period for which Indigenous data are available from the LFS.

Figure 1: Reliability of LFS Estimates of Indigenous Unemployment



Source: ABS (2000) and Authors' calculations.

The standard errors for non-Indigenous labour force status tend to be much lower than those for the Indigenous population — with non-Indigenous unemployment rates having a relative standard error about five times less than those in the Indigenous data. Consequently, general improvements in Australian unemployment rates in the second half of the 1990s did not translate into significant improvements in Indigenous unemployment because of the unreliability of LFS estimates of the latter.

Benchmarking Indigenous Unemployment Rates

Another means of testing the reliability of the Indigenous estimates is to compare them to the number of unemployed registered at Centrelink offices. Table 3 facilitates this comparison by indicating the number of Centrelink clients who identified as Indigenous in February of 1999 and 2000 and who, as a result of their receipt of New Start Allowance (NSA) and certain Youth Allowances (YA), could be expected to declare as unemployed in the LFS.

Table 3: Comparative Levels of Indigenous Unemployment

	NSA/YA(o)[a]	ABS (2000)	Taylor and Hunter (2001a)
Feb-99	30,186	27,700	
Jun-99	29,106		30,200
Feb-00	31,866	23,700	
Jun-00	31,095		27,200

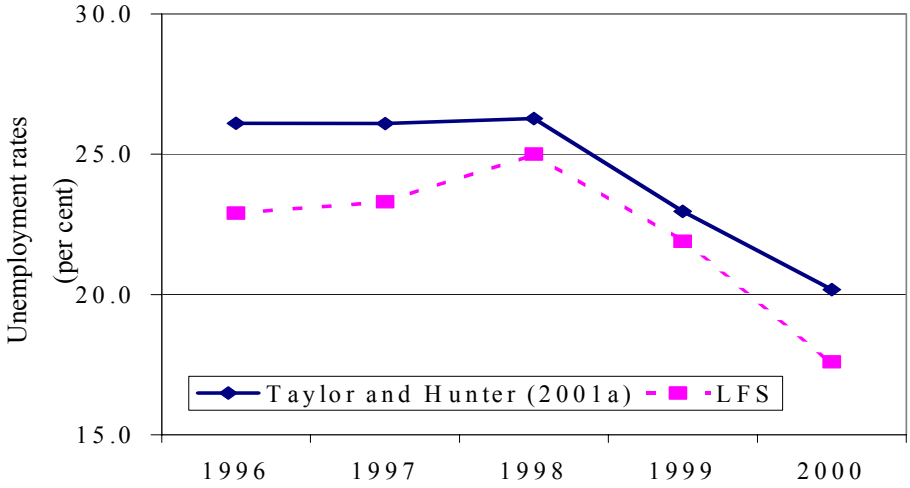
Note: a. The populations include customers who received NSA or Youth Allowance (other) YA(o). Customers on YA(o) are those who are unemployed and receiving YA (not full-time students on YA). The population for June 2000 excludes NSA/YA(o) customers who participate in CDEP programs. The populations are fortnightly populations for each of the periods. The quality of the data used to derive the Indigenous Indicator depends largely on the data that the customers provide (through self-identification). Prior to September 2000 customers on income support payments were not required to provide information on their Indigenous identification. Seasonal effects are usually prevalent from December to February in both Family and Community Services (FaCS) and ABS data (original series). FACS recommends that care should be taken when analysing the trends in the above populations.

Sources: Centrelink's Newstart SuperStar database; ABS (2000); Taylor and Hunter (2001a).

Against the Centrelink data, LFS estimates are lower — by about 2,500 in 1999 and by about 8,000 in 2000. The obvious conclusion is that the ABS definition of unemployment is more restrictive than that employed in the Centrelink administrative rules for unemployment entitlements, which allow eligible job seekers to also acquire some paid employment. However, since the activity test requires recipients to actively seek jobs in the previous two weeks (using ABS criteria), the Centrelink figures do at least provide a nominal count of the likely upper bound of Indigenous people who might be classified as unemployed by ABS criteria. Given that the only other estimates of Indigenous unemployment for this period (Taylor and Hunter, 2001a) are close to the Centrelink figures for June 1999 and between the LFS and Centrelink levels in June 2000, the LFS estimates appear to occupy the lower bounds of likely levels. To the extent that these sets of unemployment figures bear any relationship to each other, it is interesting to note that the substantial drop in the LFS estimates between 1999 and 2000 does not appear to be reflected in a similar decline in the Centrelink figures. It does, however, match the decline in unemployment levels simulated by Taylor and Hunter, who provide the only other available set of annual inter-censal estimates (Figure 2).

Although the LFS estimates are unreliable, the simulated unemployment rates are always within the 95 per cent confidence intervals presented in Figure 1. Clearly, the LFS estimates are consistent with the hypothesis advanced in Taylor and Hunter (2001a) that administrative changes in the CDEP scheme are the major factor behind recent changes in Indigenous labour force status.

Figure 2: Benchmarking LFS Estimates of Indigenous Unemployment Rates



The Taylor and Hunter simulation uses census data to control for demographic changes (that is, the large numbers of Indigenous youth entering the labour market), to make adjustments to account for recent CDEP scheme reforms and to hold employment growth at the 1991-96 rate. Therefore, despite the difference in timing of the ABS and the Taylor and Hunter estimates (in February and June respectively), the LFS results are explicable by recent changes in the labour market and CDEP policy. There is no need to resort to explanations that rely on the effect of active labour market policy or some form of trickle down of macroeconomic growth. Indeed, it could be argued that the Indigenous Employment Policy was implemented too recently to have had any impact as yet on unemployment rates. Equally, it has been shown empirically that Indigenous labour force status bears little relation to macroeconomic change (Altman and Daly, 1993).

Indigenous Labour Force Status Across Areas

The focus in the previous section was on unemployment rates; however, it is also possible to use the LFS to describe trends in employment/population ratios and participation rates. Furthermore, all three measures of labour force status can be examined separately for the three types of geographic areas used by the ABS (2000). This geographic breakdown is important because of concern about the reliability of LFS estimates for sparsely settled areas. Table 4 presents these labour force status indicators, while Table 5 (below) reports the annual movements in these indicators and the statistical significance of any changes.

Table 4: Indigenous Labour Force Status by Area, 1994-2000

	1994	1995	1996	1997	1998	1999	2000
				Employment/population ratios			
Capital city	48.2	46.5	42.8	38.4	45.0	46.4	48.2
Sparsely settled	29.1	50.1	47.3	40.9	28.0	34.8	26.5
Balance of State	35.8	41.7	40.7	38.5	39.6	37.6	46.9
Total Indigenous	38.3	44.7	42.5	38.9	39.2	39.8	43.6
				Unemployment rates			
Capital city	24.7	22.5	21.3	25.2	26.3	19.8	16.6
Sparsely settled	4.8	5.1	4.3	11.6	10.9	0.0	9.6
Balance of State	34.6	25.1	29.5	25.8	26.9	28.5	19.6
Total Indigenous	27.8	20.9	22.9	23.3	25.0	21.9	17.6
				Labour force participation rates			
Capital city	63.9	60.0	54.4	51.3	61.0	57.8	57.8
Sparsely settled	30.6	52.8	49.4	46.3	31.4	34.8	29.3
Balance of State	54.7	55.7	57.7	51.9	54.1	52.6	58.3
Total Indigenous	53.1	56.5	55.2	50.7	52.2	50.9	52.9

Source: ABS (2000).

Employment ratios have been reasonably stable in non-remote areas but are highly volatile in sparsely settled areas, where they fluctuated between 50.1 per cent and 26.5 per cent. For example, capital cities have had employment ratios hovering around 45 per cent, while the ratio was reasonably stable at around 40 per cent in the balance of State areas. There has been only a slight increase in overall Indigenous employment since 1999. Since employment did not improve substantially in capital cities and declined in sparsely settled areas, the increase can only be driven by changes in the balance of State areas, which includes regional and rural areas. Since many Indigenous communities in such areas are covered by the CDEP scheme, this observation is consistent with the Taylor and Hunter hypothesis reported above.

Unemployment rates in capital cities and 'balance of State' areas declined from a high base in a similar manner to that for the overall distribution (Figures 1 and 2). Much of the decline in unemployment rates appears to be generated outside capital cities, especially in the 1994 to 1995 period.

In contrast, unemployment rates in sparsely settled areas are very low and appear 'random'. They can be explained by the extensive participation in CDEP scheme across remote Australia. However, the fact that the unemployment rate rises, and then falls by 10 percentage points each year between 1998 and 2000 is particularly revealing of underlying problems with the measurement of LFS. Since employment demand is likely to be very weak in such areas, the fall of the unemployment rate to zero in 1999 means that the sample was probably taken exclusively from CDEP communities in that year. That is, the clustered nature of

the sample is likely to have generated particularly unreliable estimates, and some of their variability will not be picked up by the standard error provided by the ABS. In addition, the small sample of unemployed respondents in such areas, combined with widespread uncertainty among remote Indigenous people as to what constitutes being unemployed (that is, non-sampling errors), makes the unemployment rates particularly unreliable.

The LFS estimates of labour force participation are reasonably similar in capital cities and the balance of State. However, participation in sparsely settled areas in February 2000 appear remarkably low — approximately half that in capital cities (29.3 per cent compared to 57.8 per cent). In contrast, Altman and Gray (2000:7) derive an Indigenous participation rate of 58.3 per cent for areas where Special Indigenous Forms were deployed in the 1996 Census (an area roughly equivalent to the sparsely settled areas). This large disparity between the census-based participation rates and the LFS estimates after 1998 (or indeed the 1994 rates) raises further doubt about the accuracy of the latter, at least in sparsely settled areas. While it is not possible to discount the possibility that labour force participation in such areas fell by almost one-half between 1995 and 2000 (or rose by a similar amount between 1994 and 1995), it seems highly unlikely that this pattern was generated from a random sample, especially in the absence of a plausible hypothesis to explain large changes in both employment and participation in remote areas. For example, it is possible to discount the role of CDEP reforms in depressing the 1994 participation rates because these did not take effect until 1998. In any case, the internal expansion of the CDEP scheme would have a tendency to increase employment and reduce labour force participation simultaneously if non-working participants leave the labour force.

Table 5 provides data on the geography of annual changes in labour force status and indicates whether a change was statistically significant. For example, overall Indigenous employment/population ratios increased significantly in 1994-95 and 1999-2000, and fell significantly in 1996-97. Interestingly, none of these significant changes coincided with the only significant change in employment in capital cities (1997-98). In contrast, the balance of State areas registered significant increases in employment in the same years that overall Indigenous employment was buoyant. As expected, the changes in sparsely settled areas appear random, with equal numbers of significant increases and decreases in employment, and with the employment ratio in 2000 being roughly equal to that in 1994. It appears that the significance of these statistics is driven by the artificially low standard errors that fail to take account of the effect of 'clustering' and non-sampling errors.

There are no significant changes in Indigenous unemployment rates in capital cities. All the significant changes in unemployment rates have been generated in the balance of State areas, for which the significant changes in unemployment coincide with those in the overall Indigenous unemployment rates. As indicated above the changes in unemployment in sparsely settled areas appears to be generated by the nature of the LFS Indigenous sample.

Table 5: Significance of Annual Changes in Indigenous Labour Force Status by Area, 1994-2000

	Period over which change in labour force status is measured					
	1994-1995	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000
	Employment/population ratios					
Capital city	-1.7	-3.7	-4.4	6.6*	1.4	1.9
Sparsely settled	21.0*	-2.9	-6.4	-12.9*	6.8*	-8.3*
Balance of State	6.0*	-1.1	-2.1	1.0	-2.0	9.3*
Total Indigenous	6.4*	-2.2	-3.6*	0.2	0.6	3.8*
	Unemployment rates					
Capital city	-2.2	-1.2	3.9	1.1	-6.5	-3.2
Sparsely settled	0.2	-0.7	7.3*	-0.7	-10.9*	9.6*
Balance of State	-9.5*	4.4	-3.7	1.1	1.6	-8.8*
Total Indigenous	-6.9*	2.0	0.3	1.8	-3.1	-4.3*
	Labour force participation rates					
Capital city	-3.9	-5.6*	-3.1	9.7*	-3.2	0.0
Sparsely settled	22.2*	-3.4	-3.1	-14.9*	3.4	-5.5
Balance of State	1.0	2.0	-5.8*	2.2	-1.6	5.7*
Total Indigenous	3.4*	-1.3	-4.4*	1.5	-1.3	2.0

Note: An asterisk denotes that a change in labour force status was significant at the 95% level. Test statistics are calculated using the methodology in Taylor and Hunter (2001b).

Source: ABS (2000)

The annual movement in participation rates is roughly similar to that for employment ratios. One difference is that the significant increase in participation between 1994-95 is driven solely by the large apparent increase in participation in sparsely settled areas. Given the doubt that surrounds these estimates it would be unwise to overestimate their contribution to the overall picture. If one ignores the results for sparsely settled areas, one other difference is that an insignificant fall in participation in balance of State areas in 1996-97 translated into a significant decline in overall Indigenous participation. Also, the significant fall in participation in capital cities in 1995-96 is hidden in the annual changes in overall participation by the countervailing, but insignificant, increase in participation in the balance of State areas. While the inclusion of sparsely settled areas in the overall sample may hide important information on labour force trends, the changes in non-remote participation rates are very small in magnitude and appear to balance out in the medium term.

Policy and Methodological Implications

Recent publication by the ABS of annual estimates of Indigenous labour force status from the LFS represents an important development in the routine

monitoring of Indigenous economic status. As they stand, however, the estimates are of limited value for policy analysis. At best, they merely confirm existing understandings of recent labour force trends. At worst, they are unreliable due to high standard errors. In particular, movements of annual rates are statistically insignificant in all but the last two years, thus preventing the establishment of long-term trends. As in other ABS surveys, these results partly reflect sampling problems in sparsely settled areas. The inclusion of remote areas in estimates of overall Indigenous labour force status conceals significant trends in employment and participation rates and generates trends where probably none exist in reality.

Because of these limitations, policy makers should pay attention to the forthcoming Indigenous Social Survey. The ISS Indigenous sample will be much larger than that of the LFS and more regard will be given to Indigenous-specific issues, which will minimise non-sampling errors. It may therefore be prudent to give more weight to the ISS estimates, especially when assessing labour force status in remote Australia.

The key finding of significant decline in unemployment rates since 1998 resonates with an analysis of trends in increasing CDEP scheme employment and with the fact that purely administrative changes to the scheme are likely to have raised overall employment levels over the same period (Taylor and Hunter, 2001a). In other words, it is very unlikely that the recent decline in Indigenous unemployment has formed part of the general labour market trend, as has been demonstrated earlier (Altman and Daly, 1993). Also, the implementation of the Indigenous Employment policy would seem to have occurred too recently to have had any bearing on this result. While some program elements of the Indigenous Employment Policy commenced in July 1999, many of the programs were introduced progressively through the second half of 1999 and early 2000.

Technical issues such as the representativeness of the sample are important for interpreting the published ABS results. One means of ensuring that the sample is representative of the experience of Indigenous people is to augment the LFS with a stratified sample of the Indigenous population, as in the NHS. If the ABS were to deem that the expenditure this entails is not warranted, it would enhance the value of LFS data if more detail on the geographic composition of the sample were published. This would assist in understanding the process and effects of clustering in particular remote Indigenous communities. A nationally augmented sample might also open the possibility of increased use of Indigenous interviewers (Alphenaar, Majchrzak-Hamilton and Smith, 1999), although this would not, in itself, guarantee that response rates and data quality would be acceptable. Hunter and Smith (2000) provide a detailed analysis of the advantages and disadvantages of using Indigenous interviews in a 'longitudinal' context. While the LFS is based a rotating panel, rather than a strictly longitudinal survey, it attempts to collect information on respondents over time and hence will have to deal with a similar set of issues.

It would also aid the interpretation of estimates if more detail were provided for the accurate calculation of standard errors of annual movements in labour force rates. For example, the standard errors for unemployment rates used in this

paper are potentially inaccurate because no information was provided on the appropriate adjustment factors for the labour force (see Taylor and Hunter, 2001b). While a conservative adjustment was used, this tends to overstate the variability of the labour force and hence understates standard errors of unemployment rates.

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Agenda, Volume 8, Number 2, 2001, pages 129-140

The Battle for the Streets of NSW

Maged Ishak and Bert Groen

Proposals are floated from time to time to solve the perceived problem of a link between juveniles hanging out in public places such as streets, shopping centres, parks, and on public transport, and the incidence of juvenile crime. In 1994, the NSW Government proposed to solve this problem with Part 3 of the *Children (Parental Responsibility) Act 1994* (NSW). By virtue of this proposal police were given the ability to remove juveniles from public places if police believed, on reasonable grounds, that the person in question was under the age of sixteen and was not supervised or under the control of a responsible adult. The efficacy of the proposal was to be tested by way of operation of pilot schemes in the Local Government Areas of Orange and Gosford for a period of one year beginning on 13 March 1995. The Act (Section 16) provided for an evaluation of the pilot scheme to be done as soon as possible a year from the date of assent in order

> To ascertain whether the policy objectives of the Act remain valid and whether the terms of the Act remain appropriate for securing those objectives.

Consultants were appointed in June 1996 to evaluate the legislation and to report to the Parliamentary Evaluation Committee on the *Children (Parental Responsibility) Act 1994* (NSW) (Evaluation Committee).

In evaluating the pilot schemes the consultants bewailed the problem 'of having no reliable objective data to assist them in determining whether the Act works or is likely to work' (Evaluation Committee, 1997:11). Instead the consultants had to rely 'to a considerable extent upon the subjective views and experiences of individuals, organisations and groups who have their own interests in the Act and young people, as well as the limited research in this area' (Evaluation Committee, 1997:34). The consultants undertook extensive consultations with local police, local councillors, local community organisations, government organisations, parents and youths among many others before recommending that Part 3 of *Children (Parental Responsibility) Act 1994* (NSW) be repealed (see Evaluation Committee, 1997:Appendix C). However, it is suggested that without an examination of both subjective views and objective data, any evaluation lacks completeness.

This paper addresses the lack of objective data that bedevilled the consultants. This is done by analysing available juvenile crime data for Orange and Gosford before during and after the introduction of the pilot schemes.

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Background to the Passing of the Legislation

To understand the push for the passing of Part 3 of the *Children (Parental Responsibility) Act 1994* (NSW) is to understand the atmosphere that prevailed in NSW in the late 1980's into the early 1990's. Much legislation is driven by perception and in NSW there were a number of widely held community perceptions with regard to juvenile crime. As noted by the (Youth Justice Coalition, 1990:51), these perceptions included the beliefs that a juvenile crime wave was about to engulf the community, that juveniles committed disproportionately large numbers of serious personal and property offences, that new legislation and programs had resulted in an increase in juvenile crime, that society was getting soft on delinquents, and that tougher institutions and harsher penalties would help to curb juvenile crime. It did not matter that many of these perceptions could be debunked[1] or that juvenile crime was often invoked as an important signifier of a general malaise in morality, discipline, economy and freedom. What was more important was the flavour of the times, a flavour that can be encapsulated from this quote in *The Bulletin* (as quoted in Youth Justice Coalition, 1990:137):

> As street crime figures rocket, the spectre of a lawless society is looming with Australians increasingly at risk of being robbed, mugged or raped. Reporting from the front lines in city and country, Martin Warneminde describes how many people are planning to strike back — because they believe the police are tied down by politicians and pressure groups more concerned for the care of the villain than the victim.

The community of NSW felt something had to be done and it seemed that they might be prepared to take matters into their own hands. Recent studies had also drawn a causal link between family factors and juvenile involvement in crime. Baker (1998:3-4) reports that studies in the 1980's and early 1990's had shown that family factors such as poor parental supervision, parental rejection of the child, lack of involvement with the child, and inconsistent and erratic discipline were very strong predictors of a juvenile's involvement in crime. It was against this background that the NSW Coalition Government decided to act.

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[1] See, for example, Parliament of NSW (Legislative Council) (1992:12-13) and NSW Department of Juvenile Justice (1996:6).

The 1994 Legislation as it Related to the Pilot Schemes.

The *Children (Parental Responsibility) Act 1994* (NSW) was enacted to address the incidence of juvenile crime and the perceived failure of parents and guardians to take responsibility for their children. Specifically, as indicated by the Second Reading Speech, the legislation had five objectives:

- to prevent and reduce juvenile crime;
- to protect citizens from violence and interference with property;
- to make families responsible regarding the criminal behaviour of their children and to make them share the responsibility for their rehabilitation and punishment;
- to address the role of family dysfunction and inadequate and neglectful parenting in causing juvenile crime; and
- to protect children where there is a likelihood that they may commit a crime or be exposed to some risk (Evaluation Committee, 1997:18).

Part 3 of the Act, among other parts, was enacted in pursuit of these objectives. It was popularly conceived, and probably still is, that Part 3 introduced a youth curfew. This was a misconception. It is instructive, therefore to look at what, in fact, Part 3 of the Act provided for.

Section 12 of the *Children (Parental Responsibility) Act 1994* (NSW) allowed NSW police to do the following:

- to ask a person his or her name and age, and his or her parent's or carer's residential address;
- to remove and escort a person from any public place to the parent's or carer's residence but if such address was not known or it was not reasonably practicable to do so, to remove and escort a person from any public place to a place of refuge prescribed by the regulations; and
- to use reasonable force to remove and escort a person.

A police officer could not remove and escort a person from a public place unless the police officer could establish four things (Sections 11(1) and 12(4)), namely that:

- the person was in a public place;
- the police officer believed on reasonable grounds that the person was a child of or under 15 years of age and was not subject to the supervision or control of a responsible adult;
- the police officer knew or had requested the person's name and age and his or her parent's or carer's residential address; and

- the police officer considered that removing and escorting the person from a public place would reduce the likelihood of a crime being committed or of the person being exposed to some risk.

Section 12(3) stated that a police station could not be a prescribed place of refuge. Under section 12(7) a police officer had an obligation to notify the Director-General of any child that the police officer had reasonable grounds to suspect had been abused. These requirements, together with the requirement that the legislation be reviewed within one year of its assent, were conditions that the NSW Opposition insisted upon before giving their assent to the legislation. The legislation also provided that police officers had to notify parents or carers, if the parent or carer was known and notification was practicable, that the person had been removed and escorted to a place other than the parent's or carer's residence (Section 12(5)).

Part 3 of the Act was introduced in the Local Government Areas of Orange and Gosford for a one-year period commencing 13 March 1995.

Why Orange and Gosford Were Chosen for the Pilot Schemes

The city of Orange was selected as a pilot scheme area because there was a public perception of a problem with youth crime. According to the Evaluation Committee (1997:37 and Appendix C), elderly people had been complaining to police about an increased congregation of young people in the streets, particularly at night, and at so-called 'hot spots'. A community plan prepared for Orange detailed considerable community concern, particularly among older people and women, about personal safety in some public spaces, about young people menacing other people going about their normal business, about bag snatchers, and about young people 'hanging around' (pp. 18, 38 and Appendix C). There was also a general feeling that parents were disempowered by the law as it then stood in their dealings with children (pp. 19, 38 and Appendix C).

Police from the Gosford Local Government Area were perplexed about the selection of Gosford for the pilot study. While there had been a problem with youths hanging around in public places two and a half years prior to the institution of the pilot scheme, the problem had been at Wyoming shopping centre, not at Gosford. Police reported that there was no juvenile crime wave in Gosford (p. 49 and Appendix C). Gosford is, however, an area that is characterised by a relatively high proportion of people over the age of sixty. It may have been the fear expressed by people in this age category that led to the selection of Gosford as the subject for the pilot study. Again, parents reported that they felt disempowered with regard to their children by the prevailing law (p. 49 and Appendix C).

Evaluation the Impact of the Legislation

To evaluate whether Part 3 of the *Children (Parental Responsibility) Act 1994* (NSW) has achieved the Act's stated aim of reducing juvenile crime the authors have recently undertaken a study of the rate of juvenile crime in Gosford and Orange in NSW.

Two sets of statistics were examined in the study — statistics from the NSW Bureau of Crime Statistics (BCS) and statistics from the NSW Department of Juvenile Justice (DJJ). The statistics from the BCS proved to be more relevant than those from the DJJ in that they recorded all juvenile offences whether or not the offence resulted in a court appearance, whereas the statistics from the DJJ only recorded juvenile crime resulting in a court appearance. Nevertheless both sets of data were considered in the examination of, in particular, overall juvenile offence rates, juvenile offence rates by gender, and juvenile offence rates by age.

The data were analysed in twelve-month blocks, from April of one year to March of the next, to coincide with the twelve-month period of the pilot schemes. The study is a retrospective comparative study of changes in juvenile levels of crime following the application of the *Children (Parental Responsibility) Act 1994* (NSW) in 1995. The study compares juvenile offence rates in three non-overlapping periods:

- the pre-legislation period, 1992-1995;
- the period when the legislation was in force, 1995-1996;
- the post- legislation period, 1996-1998.

Three variables were considered:

- overall juvenile offence rates;
- juvenile offence rates by gender; and
- juvenile offence rates by age.

Juvenile rates of crime were computed by dividing the number of juvenile offences by the total number of juveniles from figures obtained from the Australian Bureau of Statistics relevant to the different variables and specific geographical areas. In addition to Gosford and Orange data NSW data as a whole were analysed to provide a comparison with an area where the legislation was not in force.

It is worth noting that in 1994 the method of recording crime by NSW police was changed from a manual process to a computer process. As a result statistics recorded for 1994, the transition period, are unreliable for research purposes. To overcome this problem a statistical time series technique was applied from 1992

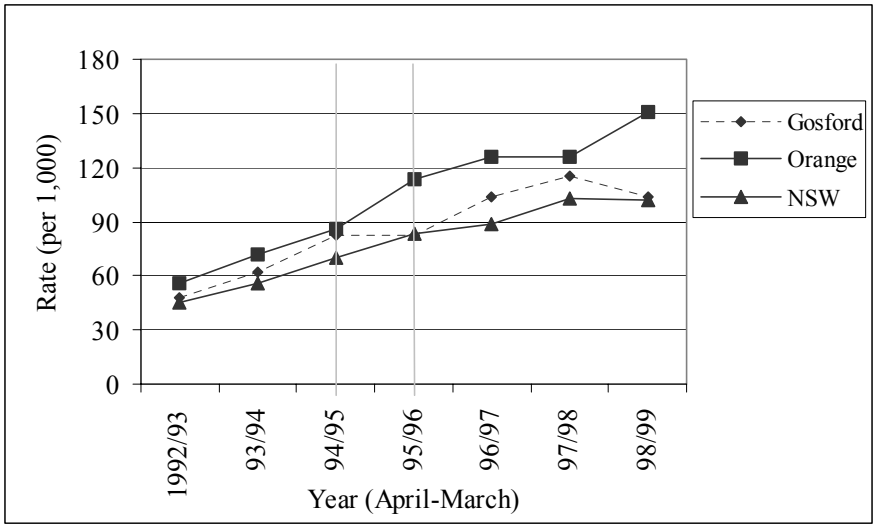
until 1999 in order to provide estimates for overall juvenile crime, juvenile offences by gender, and juvenile offences by age for 1994[2].

Results

Overall juvenile offence rates

The overall juvenile crime rates for NSW, Gosford and Orange from 1992 to 1999 using NSW Bureau of Crime Statistics figures is presented in Figure 1.

Figure 1: Juvenile Offences Rate (overall)



Source: BCS data.

The figures indicate that there was an overall steady increase in juvenile crime from 45.25 per thousand of juvenile population between the ages of 10 to 18 in 1992 to 101.64 per thousand in 1999 in NSW. The overall crime rate in Gosford and Orange showed a similar trend of increase over that time period. However, the trend in Gosford was characterised by a drop in the rate of crime in the period when the Act was in force (1994/95 - 1995/6). The difference in the rate of crime during this period was found to be significantly different than the rate in the periods before and after the Act was introduced.

The pattern in Orange indicated a generally higher level of juvenile crime rate when compared to the NSW and Gosford rates, especially from 1994/1995 onward. In contrast with the results from Gosford there was no drop in the rate of crime in 1995/6 in Orange or NSW. The results with regard to Orange, however,

[2] An interpolation using polynomial regression techniques was used. Further details of the research methodology used are available from the authors upon request. In this paper, the significance of differences in crime rates is determined at the five per cent level.

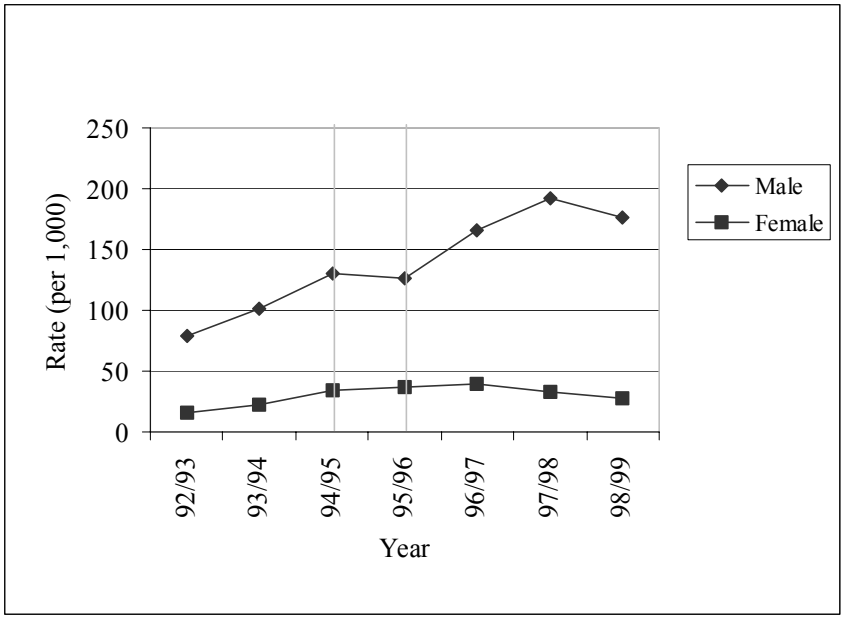
ought to be treated with caution, as the number of recorded incidents in Orange was small. The recording of one or two extra incidents in Orange in any one-year can affect the resulting pattern.

The conclusion that may be drawn from this analysis is that the pilot scheme seems to have been successful in Gosford but was not in Orange.

Juvenile offence rates by gender

Figure 2 shows juvenile offence rates by gender in Gosford from 1992 until 1999 using NSW Bureau of Crime Statistics data. The figure indicates a significant drop in the increasing trend of crime rates for males in 1995/6 as compared to the previous and following periods. However, there was no significant difference in crime rates for female juveniles during the 1995/6 period when compared to the prior and subsequent periods.

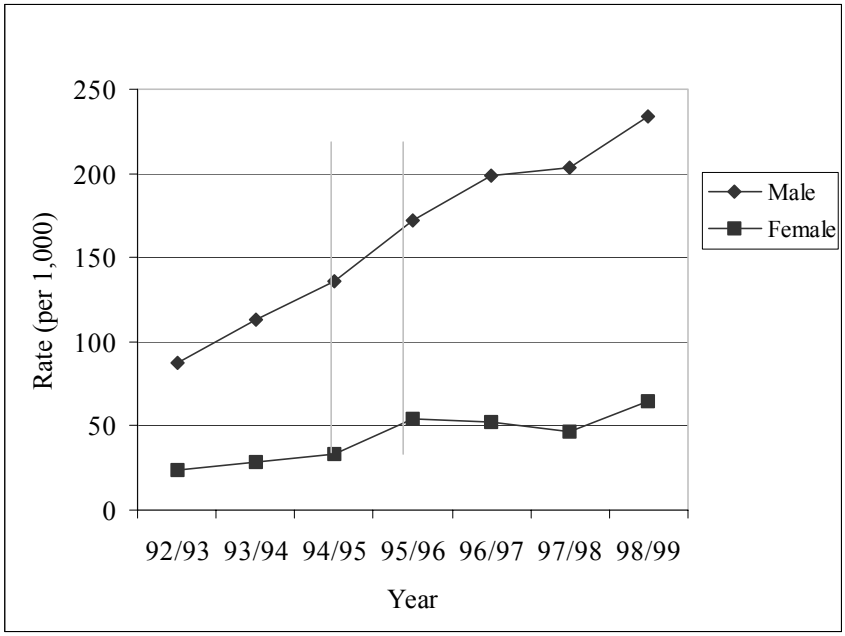
Figure 2: Juvenile Offence Rates by Gender in Gosford



Source: BCS data.

Figure 3 presents juvenile offence rates by gender in Orange for the same period using NSW Bureau of Crime Statistics data. This figure indicates a steady increase in the crime rate for males in Orange from 1992 until 1999 with no significant difference in the 1995/6 period when compared to the prior and subsequent periods. This is in direct contrast to the results for Gosford. Again, there was no significant difference in the juvenile crime rate for females during the 1995/6 period when compared to the prior and subsequent periods.

Figure3: Juvenile Offence Rates by Gender in Orange



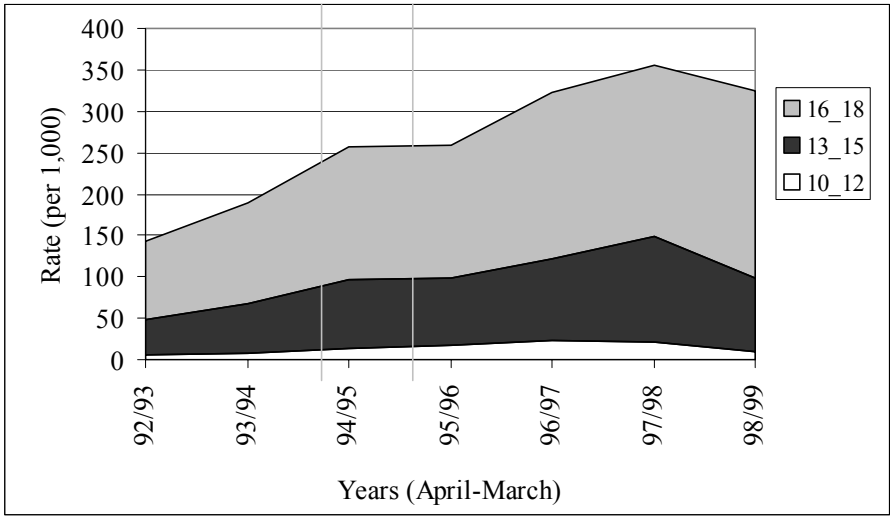
Source: BCS data.

On the basis of these results, the pilot scheme appears to have been successful in reducing the crime rate amongst the juvenile male population of Gosford but does not appear to have been a success amongst juvenile males in Orange.

Juvenile Offence Rates by Age Groups

Figure 4 represents juvenile offence rates by age groups in Gosford from 1992 until 1999 using NSW Bureau of Crime Statistics data. Three age groups were considered in the analysis: the 10-12 year age group, the 13-15 year age group and the 16-18 year age group. Figure 4 illustrates that in Orange for the year 1995/6, there was stability in crime rates for juveniles in the 13-15 year and the 16-18 year old categories when compared to the prior and subsequent periods. The change in the 10-12 year old category for the 1995/6 period was negligible when compared to prior and subsequent periods.

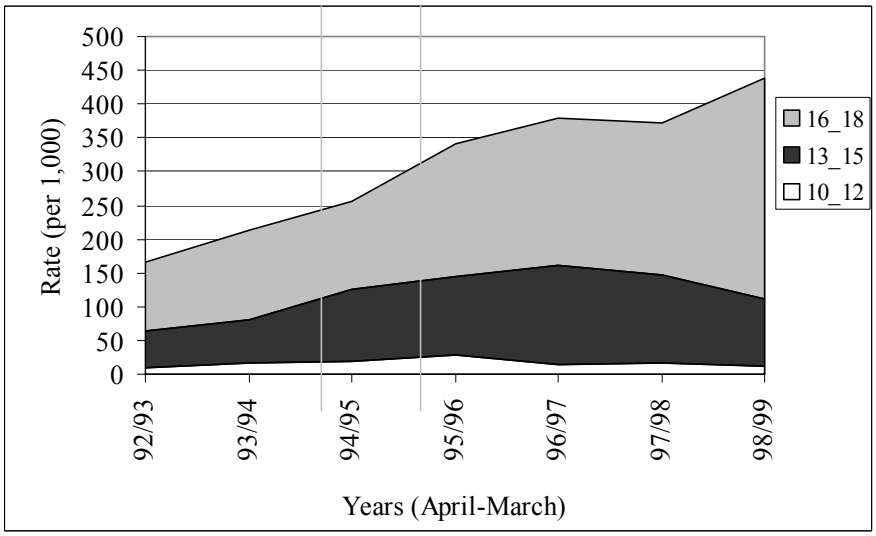
Figure 4: Juvenile Offence Rates by Age Groups-Gosford



Source: BCS data.

Figure 5 represents juvenile offence rates by age groups in Orange using NSW Bureau of Crime Statistics data. Figure 5 indicates that the growth rate of crime for juveniles in the 13-15 year old and the 16-18 year old categories did not slow down in the period 1995/6 when compared to the prior and subsequent periods. Again, the change in the 10-12 year old category was negligible.

Figure 5: Juvenile Offence Rates By Age Groups-Orange



Source: BCS data.

Data for NSW reflected similar patterns to that in Orange for all the three age groups.

On the basis of these results, the pilot scheme seems to have had an effect in decreasing the crime rates in the age groups 13-15 and 16-18 in Gosford, but did not have a noticeable effect on any age group in Orange.

Discussion and Recommendations

The perception after the pilot scheme was introduced into Orange and Gosford was that the scheme was a success in Orange (Evaluation Committee 1997:41-44 and Appendix C) but was not a success in Gosford (pp. 51-54 and Appendix C). The results of our analysis of the available statistical data support the opposite conclusion.

Why the pilot scheme can be claimed to be a success in Gosford and not in Orange on the basis of the available statistical data is open to conjecture. One or many of a number of factors might explain the reduction in juvenile crime rates in 1995/6 (Chan, 1994:35). One interesting anomaly, however, is that despite the pilot scheme having more support in Orange than in Gosford, our results would suggest this was not a significant factor in the scheme's success. We recommend that further research into the possible factors that reduced the rate of juvenile crime in Gosford needs to be done.

The pilot scheme as it operated in Gosford and Orange acted as the prototype for schemes that can now be introduced under new legislation, namely the *Children (Protection and Parental Responsibility) Act 1997* (NSW). The NSW Coalition Government enacted this new Act shortly after the report by the Evaluation Committee into the *Children (Parental Responsibility) Act 1994* (NSW) was handed down even though that Committee recommended that Part 3 of the 1994 Act not be re-enacted. Under the new legislation a local government area or part thereof can be declared an operational area by the NSW Attorney General upon that area's request (section 14(1,2)). The Attorney General cannot make such a declaration unless he or she is satisfied that adequate crime prevention or youth support initiatives are or will be available before the declaration takes effect (section 14(3)). Before making the declaration, the Attorney General should consider:

- whether the council has consulted with the local community, including young people and Aboriginals;
- the extent and nature of crime in the area;
- any crime prevention, youth support initiatives or safer community compacts;
- the impact on young people and availability of safe and appropriate recreational amenities for young people;
- the ability for police to carry out the scheme;
- the availability of appropriate refuge places; and
- whether the council has undertaken steps to include young people's needs in its local planning processes.

The Attorney General must also consult with the Minister for Community Services and Minister for Police (section 14(4,5)).

Once a declaration is in force the police have very similar powers to remove juveniles from public places to that which they had under the *Children (Parental Responsibility) Act 1994* (NSW) (sections 18, 19, 21 and 22). Both Orange and Gosford had the opportunity of becoming operational areas under the new Act without the need to seek a declaration by the Attorney General. Orange took up the option but Gosford declined.

Thus, despite the lack of objective evidence as to whether the pilot schemes were a success or not, the thrust of the schemes was re-enacted by the NSW government. The perception of the pilot scheme's success appears to have been relied on rather than any empirical evidence. As noted by the Australian Law Reform Commission quoted in Youth Justice Coalition (1990:98), community perceptions ought not to be the sole arbiter of what is the truth: 'It is impossible to understand the impact of legal measures without adequate statistical information' particularly when it comes to evaluating trial schemes for the reduction of crime.

Our study demonstrates the vital importance of proper and thorough evaluation of crime prevention schemes. The pilot scheme, unfortunately, fell into the normal situation about which the Australian Law Reform Commission commented (Youth Justice Coalition 1990:98):

> Legislators have enacted statutes without attaching adequate arrangements for collecting data from which to gauge the effect of those measures, or test whether the legislative aims have been realised.

This paper endorses the conclusion drawn by Chan (1994:58) that

> …rigorous evaluation of crime prevention programs is essential, but sadly lacking in many instances. Too often unrealistic claims or expectations are placed upon programs which have not been properly conceptualised, designed or implemented. Once implemented, programs are rarely carefully monitored and evaluated against their original claims. This 'routinisation of ignorance' allows the uncritical acceptance of impressionistic and emotive claims which are not substantiated by more carefully gathered evidence.

We recommend that whenever new crime prevention plans are instituted then proper evaluatory studies by which to judge the subjective and objective efficacy of that programme must be set up.

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Agenda, Volume 8, Number 2, 2001, pages 141-154

Alternative Measures of Australia's External Indebtedness

Scott Austin

Economics is fundamentally concerned with how people maximise their well being with limited resources. Economists are, therefore, interested in measuring these resource, or wealth, constraints. Some statistics are more useful for this purpose than others. GDP per capita is a commonly used measure of real living standards. With some qualifications, an increase in GDP per capita is generally regarded as a welfare improvement. It is also relatively uncontroversial that a rise in the unemployment rate represents a decline in aggregate welfare. By examining how these statistics impact on people's wealth constraints we are generally able to infer how welfare is affected.

As is well known, the current account deficit, which has featured prominently in Australian economic policymaking, provides no meaningful information about welfare changes. Australia's current account is a reflection of the underlying savings and investment decisions by individuals, companies and governments. These savings and investment decisions are determined by preferences, technology and wealth constraints.

Less well known is that the current account deficit may not be a good measure of changes in Australia's net external liabilities. In popular opinion, Australia's current account deficit represents the extent to which we are 'selling off the farm' and imposing a burden on future generations. However, the current account deficit represents only part of the change in net external liabilities over a given period. In particular, focussing only on the current account ignores any valuation effects on the existing stock of net external liabilities.

This paper considers two interrelated issues. First, it examines the extent to which the conventionally measured, current account, represents changes in net external indebtedness. This is largely a question about how to properly measure changes in net external liabilities. Second, it examines the relationship between a properly constructed measure of changes in net external liabilities and the welfare of the average Australian. This is a question about how data relating to net external liabilities should be interpreted.

This paper contributes to informed debate by providing an appropriate measure of changes in net external liabilities for Australia. As will become evident, the calculation underlying our measure involves a number of judgements on which there may be disagreement. One of the objectives of this paper is to expose these judgements for debate. Because it is the perceived link between the

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conventional current account and net external liabilities that has motivated much of the recent policy interest in the current account, a secondary objective of the paper is discuss the linkage (or lack thereof) between our current account measure (hereafter denoted the adjusted current account, or ACA) and changes in welfare.

Importance of Correct Measurement of the Current Account

In the popular conception, a current account deficit of, say, $100m is conceived of as an increase in net Australian liabilities of the same amount. This conception is flawed because it ignores:

- the effect of changes in the value of existing net debt because of exchange rate changes and interest rate changes;
- the effect of changes in the market value of assets owned by Australians offshore;
- changes in the present value of our foreign aid commitments; and
- changes in the present value of assets expected to be brought by migrants coming to Australia.

An individual's wealth is the accumulation of all past savings together with the present value of all anticipated future income. These represent the present value of all resources available to that individual over his or her lifetime. Taken together, net foreign assets at market value and the discounted value of future transfers represent the expected present value of all net resources currently available to a country from the rest of the world. An increase in the ACA will be shown to imply an increase in net external wealth for some domestic resident.

A conceptually correct measure of a country's net external wealth would therefore consist of two components. First, the market value of net external liabilities and, second, the present value of all expected net resource transfers from abroad. The second item is included because of the ability of countries to borrow against these transfers on international capital markets.

A current account deficit must be financed by foreign investment. Another way of saying this is that in a floating exchange rate regime, a current account deficit must be identically equal to the capital account surplus. The capital account measures all the transactions that add to the stock of foreign investment in Australia (FIA) or Australian investment abroad (AIA). A capital account surplus implies that purchases of Australian assets by foreigners exceeds purchases by Australians of offshore assets. These transactions are basically classified according to whether they are debt or equity investment[1]. The ABS also distinguishes between portfolio and direct investment.

Since the capital account focuses on transactions, it ignores valuation effects on the existing stock of net foreign liabilities. These valuation effects come about because of changes in financial markets. These include changes in interest rates,

[1] There is a third classification 'other' which refers to trade credits and debits.

share prices, or movements in the exchange rate since net foreign liabilities are converted into Australian dollar equivalents. Naturally, if the asset is denominated in Australian dollars, exchange rate movements are irrelevant for valuation in Australian dollars.

Calculating net foreign assets at market value

Exchange rate movements affect the Australian dollar value of debt denominated in foreign currency and equity investments by Australians in offshore markets. As at June 2000, 42 per cent of Australia's net foreign debt was denominated in local currency (down from almost 60 per cent three years previously). The Australian Bureau of Statistics converts external assets and liabilities into Australian dollar equivalents when compiling the international investment position, so exchange rate valuation effects will already be incorporated in official estimates of net external liabilities.

The treatment of other valuation effects is more problematic in trying to create a long time series. There are two major issues. First, prior to 1980, equity investments were not measured at current market value[2]. Second, the most important component of FIA, bearer debt securities (such as bonds), are also not marked to current market value. There is also an argument for valuing some debt instruments for which there is not a large secondary market (eg. term loans from banks) at book value. The major problems here are to revalue corporate equities at market value prior to 1980, and to change the value of bonds from face to market value to take into account (often volatile) movements in bond yields.

From 1979/80 official data on Australia's net external liabilities include changes in the value of foreigners' ownership of Australian equities arising from domestic share price movements. But if we are interested in changes in Australia's external net wealth (and any welfare changes which can be inferred from them), these valuation effects are, in themselves irrelevant, and are omitted from the ACA. If a foreigner owns a share in BHP, for example, and its value increases because productivity in the company has improved, this has no effect on the net worth of any domestic resident (although the productivity improvement obviously increases the wealth of domestic shareholders in BHP). The argument is not symmetrical, however. An increase in the market value of Australian equity holdings abroad is a welfare improvement for some domestic residents, since it implies an increased flow of resources from abroad to those residents.

Revaluation of offshore equity investments is achieved by calculating a composite share price index using data on AIA investment in portfolio corporate equities and direct corporate equities by country of destination. These country shares are used as weights and applied to movements in the relevant international

[2] The ABS does this using sharemarket prices or directors' valuations (in the case of direct equity investments).

share price index. The share price indices used are typically 'all industrial' prices[3].

The revaluation of net foreign debt to market requires some simplifying assumptions. Consider first offshore government debt. The Australian government budget papers provide data on Commonwealth government bonds domiciled offshore (typically denominated in foreign currencies) and those domiciled in Australia. To calculate the revaluation factor for interest rate changes, the interest rate on official sector debt domiciled offshore is substituted into a standard bond pricing formula. The weighted average term to maturity of non-official holdings of marketable government securities is taken from RBA data[4]. In the absence of information on the split between fixed and floating rate debt, a six-monthly coupon payment of 6.75 per cent is assumed.

Data on private sector offshore debt are harder to come by. By necessity, therefore, the debt revaluation factor calculated for the official sector is also applied to non-official borrowings. Prior to the 1980s, non-official portfolio debt was at negligible levels so the issue of revaluing non-official debt is a relatively minor one. However, during the 1980s, private sector offshore borrowing was the fastest growing component of Australia's external liabilities and revaluation of these liabilities takes on increasing importance. By applying an official sector revaluation to private debt we are assuming that private sector debt structure (yield, maturity structure and currency denomination) is the same as that of the public sector. This is obviously not the case. However, in calculating the intertemporal measure of the current account we use the *change* in net foreign assets at market value. The application of official bond prices to non-official debt will be a reasonable approximation in calculating the ACA if: movements in private yields have mirrored those of government bond yields (that is, if any private risk premium has been relatively constant); the currency composition and maturity structure of private debt is similar to that of public debt; and, the public/private split of net external debt has remained relatively stable. These assumptions are highly debatable (although more palatable than the assumption that the yields on private and public debt were the same). To the extent that private sector risk premia have been growing over time (and the gap between private and government bond yields has been rising) this will tend to overstate the rise in the market value of non-official external debt.

Other factors complicate the revaluation of private debt, since some of it is variable-rate. The extent to which this will bias the valuation depends on how the split between fixed and variable interest debt has evolved over time. Other potential complications flow from the growth of new offshore debt markets and use of derivatives. For example, from mid-1985 Euro-debt markets assumed an increasing importance as a source of private sector finance. Since these securities

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[3] Share price indices were used for the countries which received the bulk of AIA equity investment: the United States, Japan, West Germany, Japan, New Zealand, Hong Kong, South Korea, Taiwan and Papua New Guinea.

[4] Foster, R. A. and S.E.Stewart (1991). Table 2.21, Reserve Bank of Australia *Bulletin* Table E8.

are not denominated in Australian dollars, it is unlikely that their yields move with those on Australian dollar denominated securities. The difficulty in obtaining relevant Euro-rates precludes more detailed analysis.

Figure 1: Net Foreign Liabilities

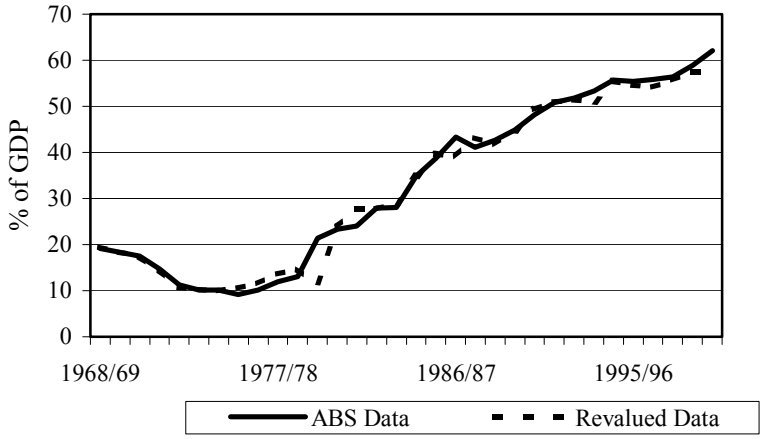


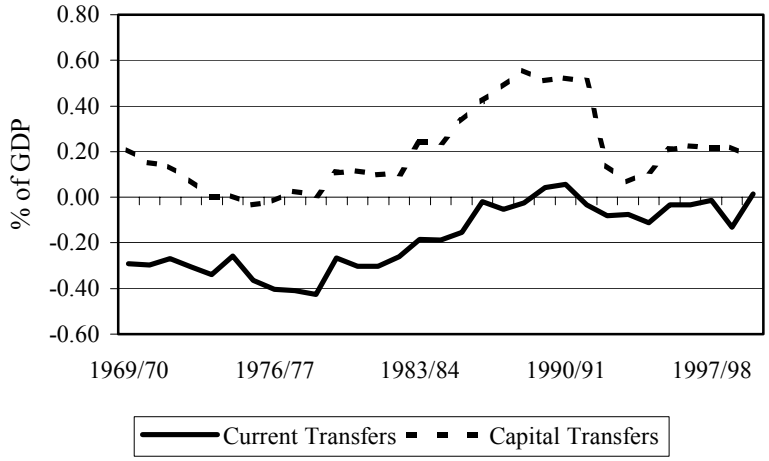
Figure 1 shows the revalued levels of Australia's net external liabilities, together with the official Australian Bureau of Statistics (ABS) data. The revalued series differs in two basic ways from the ABS series. First, it includes the revaluation of debt securities to market as discussed above. This debt revaluation tends to *increase* the value of Australia's net external liabilities. Second, it excludes movements in the value of foreigners' holdings of Australian equities caused by movements in the local share market. Removing these equity valuation effects tends to *reduce* the value of Australia's net external liabilities. For example, in 1999/00, equity valuations added the equivalent of 5 per cent of GDP to foreign investment in Australia. As Figure 1 shows, these effects have been roughly offsetting over time with the two series moving very closely together.

Calculating net expected transfers

As discussed earlier, the presence of transfers in the current account makes it an unreliable indicator of changes in net external liabilities. Consider the following example. Imagine a country has a commitment to provide financial aid to another country. It could choose to provide the aid in the form of on-going payments that would be reflected each year as a debit on its current account. Alternatively, it could choose to provide a once-only payment, equivalent in present value terms to its commitment to the other country. In the first case, there would be a relatively small, on-going impact on transfer payments (and therefore on the conventional current account). In the second case, the conventional current account balance would record a large fall initially, which would be subsequently unwound in the following year. In both cases, the implications for net resource transfers between

the two countries are identical. The conventional current account, however, gives a widely divergent view of the two policies.

Figure 2: Unrequited Transfers



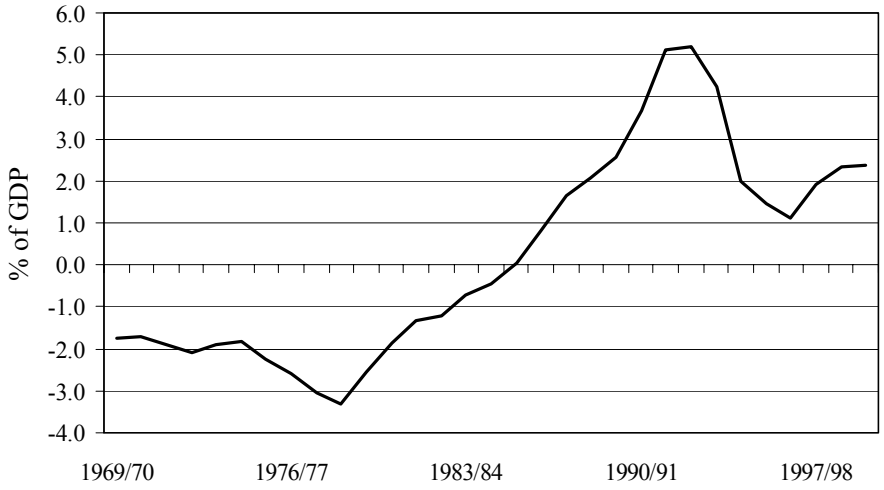
'Unrequited' transfers (plotted in Figure 2) are one-way resource flows that are unrelated to an underlying transaction in goods, services or financial assets. In 1997, the Australian Bureau of Statistics abandoned the use of the term 'unrequited transfers' and opted for a classification of transfers according to whether they were of a capital or current nature. Capital transfers basically consist of the movement of financial assets by immigrants from their country of origin to the new country of residency. These transfers have always been in surplus for Australia. Current transfers consist of items such as foreign aid[5] or contributions to international organisations. Capital transfers are now included by the ABS in the capital account; current transfers are measured as part of the current account. This relabelling of transfers (which, by removing the surplus on migrant capital inflows, added over $1 billion to the conventional current account deficit in 1996/97), highlights the potential dangers of relying on the conventional current account as an indicator of changes in net external liabilities.

In order to calculate the ACA, we can calculate expected values for these one-way transfers into an indefinite future and then discount them back to the present. In doing this, we are treating the capitalised value of expected inflows as an asset. The expectations mechanism that we assume people follow is obviously important here, and others may not wish to extrapolate the recent past into the future as we propose to do. But recall that expected income is relevant because it

[5] Foreign aid transfers that are deemed to be of a capital nature are included as capital transfer debits.

determines future spending (and hence current savings). Here we incorporate adaptive expectations by assuming that people extrapolate the average value of net transfers for the most recent five year period into the indefinite future, and this seems at least as reasonable as giving future transfers a zero value. It is this income stream which is discounted to give the values presented in Figure 3. As noted above, the major components of unrequited transfers are immigrant remittances and foreign aid. In addition to being influenced by government policy, net migration to Australia tends to be highly procyclical. Here, in an attempt to moderate the effects of the economic cycle, we assume that individuals expect that the average level of immigration-related transfers over the previous five years will continue into the indefinite future.

Figure 3: Present Value of Net Unrequited Transfers



As an alternative to simple adaptive expectations mechanism discussed above, the ACA was also calculated using the net immigration projections published by the Australian Bureau of Statistics (ABS 1998) together with recent data on average migrant capital inflow. There is only a negligible difference in the calculated ACA using these data.

In calculating estimates of wealth, the choice of a discount rate is often controversial. Typically a riskless rate is chosen. However, as Haveman (1994) notes, there may be an argument for discounting transfer credits at a higher rate than transfer debits. A risk averse individual is one who would pay to avoid volatility in income receipts. For such an individual, the certainty-equivalent present value of a stream of risky income (the amount he or she would accept as an upfront payment in lieu of the income stream) is less than that of an income stream that has no volatility. In the case of transfers from Australia, the argument

is reversed, since foreign residents bear the risk. Here the discount rate is assumed to be a 5 year average of the nominal yield on Commonwealth 10 year bonds. Within reasonable bounds, changes in the discount rate do not have a large impact on our calculations.

Figure 3 summarises the results of assuming that, at any point in time, people expect the average value of net transfers over the most recent five-year period to continue perpetually. As discussed above, this stream is discounted by the nominal government bond yield to give the values presented in Figure 3. As Figure 3 shows, these discounted values move from a negative value (ie., an expectation that there will be ongoing net transfers to foreigners) to a positive value in the mid-1980s. As Figure 2 shows, this is a combination of two factors. The first effect is the dramatic improvement in the surplus on capital transfers associated with the focussing of the immigration program on business migration (notwithstanding the fall in net migrant remittances to Australia following the recession of the early 1990s). Secondly, since the mid-1980s, there has been a steady decline in the deficit on current transfers to a position of approximate balance.

Trends in the Adjusted Current Account

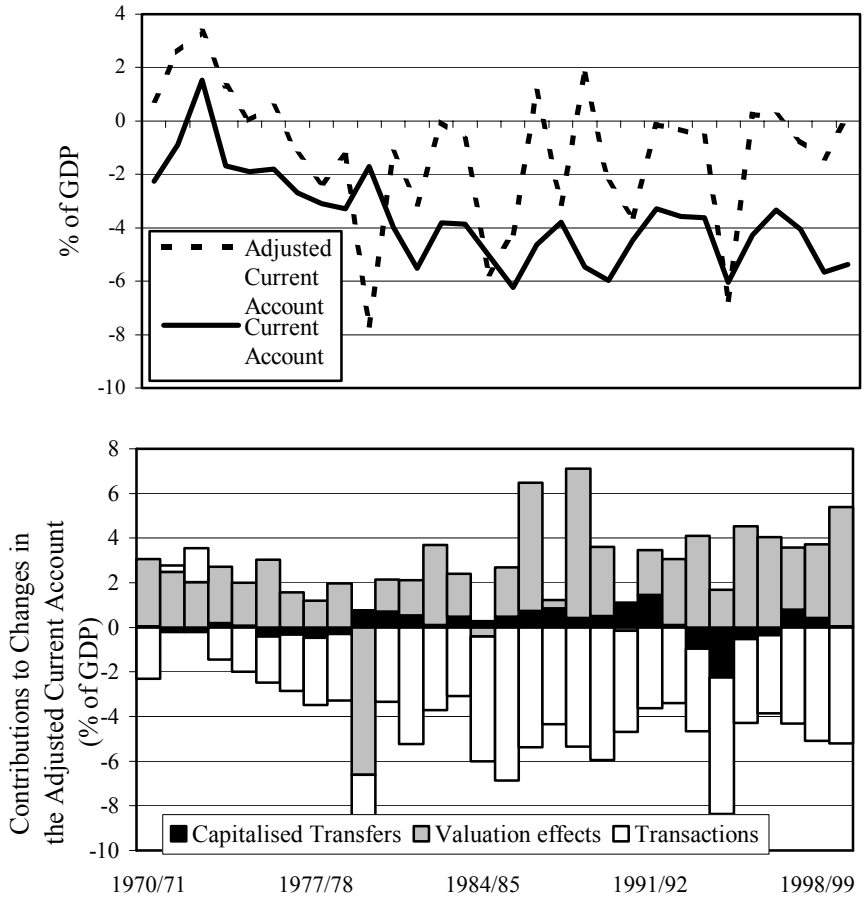
Figures 1 and 3 present our measure of two components of net external liabilities. The aggregate of these components represents a broadly defined measure of net foreign assets:

$$A_t = NFA_t + \sum_{s=1}^{\infty} \frac{E(I_{t+s})}{(1+i_E)^s} \qquad (1)$$

where NFA_t is the market value of net foreign assets at the end of period t, $E(I_t)$ are expected nominal income transfers during period t, and i_E is the expected nominal interest rate. The ACA is then the *change* in the stock defined in equation (1) and Figure 4 shows both the conventionally measured and the intertemporal current account (ACA), together with the component series of the latter.

The first point to note is that, although derived from different data sources, the two measures of the current account are positively correlated (with a correlation coefficient of 0.46). The second difference is that, with minor exceptions, the deficit on the ACA has been smaller than the conventionally measured current account deficit. In the 1990s, by traditional measures the current account deficit has fluctuated between 4 and 6 per cent of GDP. On the other hand the ACA has tended to be a deficit of around 2 per cent of GDP. Both measures of the current account deficit deteriorated somewhat from the mid-1970s, but appear to have levelled out in the mid-1980s. As the bottom panel of Figure 4 shows, new capital transactions (roughly corresponding to the conventional current account deficit) have consistently increased the deficit on the ACA.

Figure 4: Alternative Measures of the Current Account



With the exception of the early 1990s, capitalised net expected transfers have tended to reduce the ACA deficit. As Figure 3 shows, the discounted value of expected net unrequited transfers rose from minus 1.3 per cent of GDP in 1982/83 to over plus 5 per cent of GDP a decade later. This largely reflects the focus on the business migration program from the mid-1980s that considerably boosted the surplus from net migrant transfers. In 1998/99, net migration totalled 117,335. On average, the contribution of each immigrant was $13,719. This compares with net immigration of 128,117 in 1981/82 and an average net contribution of $5,167 (in 1998/99 dollars).

Valuation effects (shown in the bottom panel of Figure 4) have also tended to reduce the deficit on the ACA. The magnitude of the positive contribution from valuation effects has also increased markedly since the floating of the dollar in late 1983. As noted above, these valuation effects are caused by changes in the Australian dollar exchange rate and by movements in domestic and international

share prices and interest rates. There was a positive contribution from foreigners paying an inflation tax on holdings of Australian issued fixed interest securities. During the 1970s and 1980s, Australia ran consistently higher inflation rates than the countries that were the major suppliers of capital to Australia (the US, Japan and the United Kingdom). If purchasing power parity held it might be expected that exchange rates would move to somewhat offset these differentials. However, as noted above, not all external debt is denominated in foreign currency (over the 1980s and 1990s approximately 40 per cent was denominated in local currency). In this case, exchange rates will have no direct impact on whether or not foreigners pay the inflation tax.

It is not surprising that these valuation effects would tend to boost the ACA compared to the conventional current account. Recall that the ACA removes valuation effects from foreigners' holdings of Australian equities. In order to quantify the possible magnitude of this effect, the ACA was also calculated with valuation effects on FIA equity investments (as is the official practice). These equity valuation effects could either increase or decrease the deficit on the ACA. In recent years, this has led to a fall in the ACA deficit. Over the 1990s, the ACA with FIA equity revaluation averaged 2.0 per cent of GDP (compared to 1.4 per cent of GDP for the ACA as shown in Figure 4). Over the 1980s, removal of equity revaluation implied, on average, virtually no difference in the ACA deficit. Following the removal of capital controls in Australia, the private sector has been responsible for the overwhelming majority of capital inflow. Following deregulation, we would therefore expect capital from Australia to seek out the highest rate of return. For example, as Robertson (1990) notes, the accumulation of foreign debt over the 1980s was not only used to finance current account deficits but also to accumulate offshore equity investments. Reversing earlier trends, there was a net equity outflow by the mid-1980s. That is, Australians were accumulating offshore equity claims at a faster rate than foreigners were accumulating equity claims in Australia.

Interpreting Movements in the Intertemporal Current Account

Over the past fifty years, the current account has occupied a pre-eminent role in Australian macroeconomic policy making. In the period prior to the floating of the exchange rate in December 1983, the balance of payments was viewed with interest because it represented changes in the Reserve Bank's foreign exchange reserves. Policy makers were concerned about the current account because of its link to the sustainability of the exchange rate. Discussion about 'external balance' was primarily motivated by the concern to maintain a stable level of international reserves (Pitchford, 1995:6). More recently, concerns have been raised about the sustainability of Australia's current account deficit in the face of a rapid expansion in net external liabilities. The monetary policy tightening which lead to the 1990/91 recession was prompted in large part by these concerns.

In one sense, concern over developments in the current account might seem natural. Over the past two decades, net external liabilities have risen dramatically

from 21 per cent of GDP to 62 per cent of GDP. Within this total, net external debt has risen from 8.2 per cent of GDP to 42.5 per cent of GDP. However, from the mid-1980s, some economists, including John Pitchford (Pitchford 1990 and 1995), questioned the view that Australia's current account necessarily represented a policy dilemma. They noted that the overwhelming majority of net foreign liabilities were issued against the private sector. Net government foreign debt was a relatively small component of the total[6]. A large current account deficit might be a reflection of structural problems elsewhere in the economy (for example, the tax system). But, to target the current account as a policy objective was considered analogous to focussing on the symptoms of a disease rather than the cause.

The previous section of the paper has established that the conventional measure of the current account, which was the empirical basis for much of the Australian policy debate, may give a misleading picture of the change in Australia's net external liabilities. We now consider whether the welfare implications of changes in the current account are affected by the use of the ACA rather than the conventional current account deficit. According to Fisher[7] (1995),

> [i]n the open economy, what matters is a measure of the present value of net transfers from abroad…the annual change in the expected present value of net transfers from abroad, is an appropriate measure of the external deficit. If the [ACA] worsens, then some domestic resident will suffer lower utility. This simple fact is not true of the conventional current account.

Fisher (1998) and Fisher and Woo (1997) estimate this measure for Japan and for South Korea, respectively. However, when linking changes in external liabilities to national welfare changes, the position may not be as unambiguous as Fisher suggests in the above quote. Welfare changes may occur, after all, from domestically sourced changes in wealth (such as a productivity shock or the discovery of a new natural resource). As with the conventionally measured current account, linking a change in Fisher's measure of the current account to welfare will normally involve first identifying the factors which caused the change. Nonetheless, Fisher's measure represents a significant step in the right direction.

According to Fisher (1997) a lower deficit (correctly measured) unambiguously represents a welfare improvement for some domestic resident, either now or in the future. This is because such a deficit reduction 'shows that

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[6] In 1995/96, official gross external debt (incorporating the borrowings of all levels of government) was about a third of the total.

[7] The calculations made by Fisher were an important motivation for this paper. His calculation is based on an overlapping-generations model of the economy. He therefore called his adjusted current account measure the 'Aggregate Generational Current Account (AGCA)'. Except for some differences in the treatment of valuation effects, Fisher's AGCA is essentially the same as the ACA presented here.

some domestic resident has higher wealth abroad'. Hence Fisher links domestic welfare to changes in net external assets. However, this assumes that all welfare changes are externally sourced. A nation also derives wealth from domestically owned resources. The extent to which we utilise these resources will depend on a number of factors, primarily the cost of investment and technology. With this in mind, we can only make a qualified link between welfare and the ACA. For instance, the following three examples of wealth inducing shocks are potentially very important for a small open economy like Australia. In each case, relying on the ACA as an indicator of welfare change may give the wrong answer.

A productivity improvement is unambiguously a welfare improvement for a country. It increases domestic output of goods and services from the existing capital stock. This improvement in capital productivity will induce additional investment. The rise in permanent income induces an increase in consumption. It may be the case, that these increases in investment and consumption outweigh the permanent increase in income and lead to an increase in external indebtedness. (Forsyth 1990) makes a similar point for the conventional current account deficit.

A real interest rate fall is also an unambiguous welfare improvement for a small debtor nation. However, again, the implications for the ACA are unclear. The fall in interest rates induces an increase in current consumption and investment, thereby raising the current account deficit immediately. On the other hand, it also increases the present value of income transfers from abroad and reduces interest payments on existing debt. The overall impact on the ACA is ambiguous.

The removal of controls on capital flows in Australia in the late 1970s and early 1980s was followed by a dramatic surge in private offshore borrowing is indicative of a welfare improvement since the capital controls appeared to have restricted domestic below its optimal level. Yet, it is not clear that the ACA would show an increase following their removal since, initially, the removal of these controls would imply an increase in external liabilities. Indeed, from Figure (4), it appears that the deficit on the ACA increased along with the deficit on the conventionally measured current account in the period following the liberalisation of capital controls and the floating of the Australian dollar in December 1983.

Another potential point of ambiguity about how the ACA links to welfare changes is whether a decrease in the capitalised value of net unrequited transfers to Australia *necessarily* represents a welfare reduction. As noted previously, unrequited transfer debits include foreign aid payments. Here we are treating these payments, along with all other net transfer debits as a resource transfer away from Australia (which is exactly what they are). However, along with official aid programs, these transfers include donations from individual Australians who, presumably, derive utility from making them. In the same way that a permanent rise in consumption (for example, caused by a fall in interest rates) leads to a rise in welfare but may lead to a fall in the ACA, here an increase in private foreign aid donations would be welfare improving (since they are voluntary) but lead to a fall in the ACA. There is therefore a case for omitting these payments when

making welfare judgments. For Australia, however, these aid payments have made a negligible contribution to the ACA.

Conclusions

In the popular imagination, the current account deficit measures the extent to which Australia is 'selling off the farm'. However, since it ignores valuation effects on the stock of net external liabilities and expected future transfers, the conventionally measured current account deficit is flawed as an indication of the change in a country's net worth relative to the rest of the world. The above analysis suggests that the conventional current deficit might overstate the extent of future resource transfers by as much as 7 per cent of GDP. Measuring the current account deficit in a conceptually correct way, therefore, is quantitatively significant.

This is not to say that the conventional current account is irrelevant. Capital markets, concerned about the sustainability of Australia's net international investment position, focus on it as a readily available statistic that measures the accumulation of new net foreign liabilities. But it should be interpreted with caution. As we noted previously, the ACA has a heavy informational requirement. In both constructing net foreign liabilities at market value and forming estimates of expected future resource transfers, we have had to make some heroic assumptions. In contrast, the conventionally defined current account deficit is a reasonably well-measured statistic.

We have also argued that, contrary to the assertion in Fisher (1995), the correct measurement of net external liabilities does not, of itself, provide a means by which changes in the ACA can be associated with changes in welfare. Just as with the conventional current account, we need to know the source of the change in the ACA.

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Safeguards for Workers' Entitlements

Ian Bickerdyke, Ralph Lattimore and Alan Madge

While the employment impacts of business insolvencies in Australia are relatively modest, employees are seen as a particularly vulnerable group that often loses a significant share of its claims on the insolvent business. A number of high profile cases involving lost employee entitlements in the event of business insolvency has arisen in recent years. Examples include National Textiles at Rutherford (in 2000), Oakdale Colliery at Camden (in 1999), CSA Copper Mine at Cobar (in 1998) and Gilberton Abattoir in Grafton (in 1997).

Governments around the world use a variety of mechanisms to protect employee entitlements. In February 2000, the Commonwealth Government responded to community concerns by introducing a national insurance scheme to protect employees' entitlements. However, there has been significant debate over its merits. All state and territory governments — with the exception of the Northern Territory — have so far declined to participate in the scheme. In addition, employee organisations such as the ACTU have been critical of some of its characteristics.

In theory, there is a variety of possible employee protection schemes, involving different combinations of who pays (employers, governments, employees) and on what basis (flat rate, variable rate, risk rated, non-risk rated). This article outlines and analyses four of the principal approaches that might be adopted to protect employee entitlements, including the current Australian policy approach. It also discusses the merits of imposing limits on the amount of insurance payments made to employees — a common feature of employee protection schemes around the world.

Allocation of Liquidated Assets in the Event of Insolvency

A critical issue in the liquidation process is the allocation of available funds to the various stakeholders in the insolvent business. Because there are usually insufficient funds from the liquidation of assets to satisfy all stakeholders, a system has developed in Australia — under the Bankruptcy Act and the Corporations Law — to assign priorities to stakeholders' entitlements when funds are distributed.

Although employees are ranked relatively highly (near the top of the unsecured creditors), their position is subservient relative to most secured

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Ian Bickerdyke, Ralph Lattimore and Alan Madge are researchers with the Productivity Commission. The views expressed in the article do not necessarily reflect the views of the Productivity Commission.

creditors[1]. This can be very costly as employees often have substantial financial stakes tied up in insolvent businesses.

Many governments around the world have introduced arrangements to protect employee entitlements. Most of these arrangements appear to have been introduced on equity grounds to provide a 'safety net' for affected employees. However, efficiency rationale may also have been a factor — for example, due to an inability of workers to observe risk differences between firms (high search costs, inability to assess information).[2] Such employee entitlement protection mechanisms accept the current order of priority in legal terms, but recognise that employees are rarely able to access the proceeds of any liquidated assets in the event of insolvency. They represent an alternative policy option that places employees in a more secure position, without weakening the position of secured creditors.

What is at Stake in Australia

The employment impacts of business insolvencies in Australia are relatively modest. Direct job losses resulting from bankruptcies and liquidations in Australia in 1999-00 (see Table 1) are estimated at around 19,000 persons (or only around 1 per cent of total job losses in that year). Furthermore, these data include working proprietors. The employee component of this number is likely to be in the order of 12,000–13,000 persons.

While the number of employees affected by business insolvencies in recent years is low, it may be significantly higher during economic downturns — as it was in 1991-92, when the employment loss was around three times greater than in 1999-00.

Entitlements that may be due to employees of insolvent businesses include those accrued during service — annual leave, long service leave, unpaid wages and pay in lieu of notice — as well as any redundancy pay.

In researching its Employee Entitlements Support Scheme (see below), the Commonwealth Government (Reith, 2000) estimated that, on a long-term trend basis, around 19,000 employees annually might lose about $110 million in entitlements from insolvency (based on an average amount lost per employee of around $5,700). However, on the basis of actual data collected under the Employee Entitlements Support Scheme, this estimate of annual aggregate losses appears excessive. While the average amount lost per employee is currently higher than previously estimated ($7,200), the number of affected employees has been significantly lower than expected. Accordingly, the Commonwealth Government recently estimated that the total employee entitlements lost in 2000-2001 might be in the order of only $50–$60 million (DEWRSB, 2001).

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[1] For a discussion of the current order of priority and possible alternatives, see Bickerdyke, Lattimore and Madge (2000).

[2] A discussion of the economic and social justifications for government intervention to protect employee entitlements in the event of employer insolvency is beyond the scope of this paper.

Table 1: Employment Impacts of Enterprise Failures, 1991-92 to 1999-00

	Employment Loss (Number of persons)		
	Incorporated Enterprises[a]	Unincorporated Enterprises[b]	Total
1991-92	50 326	6 857	57 183
1992-93	40 231	6 105	46 336
1993-94	23 223	5 517	28 740
1994-95	19 584	5 088	24 672
1995-96	15 795	6 075	21 870
1996-97	11 242	6 607	17 848
1997-98	14 524	6 178	20 702
1998-99	14 524	7 516	22 040
1999-00	14 333	4 962	19 295

Notes: a. Comprises all employees plus working proprietors for small incorporated enterprises (less than 20 employees).

b. Comprises all employees and working proprietors.

Sources: ABS (Labour Force, Australia, Cat. No. 6203, various issues); ABS (Small Business in Australia, Cat. No. 1321.0, various issues; unpublished data); Annual reports of the Inspector-General in Bankruptcy; Australian Securities and Investments Commission (annual reports and unpublished data); Study estimates.

Current Australian Policy Approach

A ministerial discussion paper issued in August 1999 (Reith, 1999) canvassed two main options for the protection of employee entitlements in Australia — an employee protection fund and a compulsory insurance scheme. In February 2000, the Commonwealth Government established the Employee Entitlements Support Scheme (EESS) to provide a national safety net for the basic protection of employees' entitlements in the event of an employer's insolvency (Box 1). The model announced by the Commonwealth is a form of non-risk rated employee protection fund and is entirely government funded.

The Commonwealth originally committed $55 million of its own funds to the EESS for the 2000-01 financial year (DEWRSB, 2001). It proposed that the remaining $55 million of the expected $110 million annual cost be funded by the State/Territory Governments.[3] However, to date, only the Northern Territory Government has agreed to contribute. The main ramification of this lack of participation on the part of State/Territory Governments is that the vast majority of employees claiming EESS payments has only received compensation from the

[3] In fact, even if the outstanding entitlements lost by employees equalled $110 million per annum, the amount paid out under the EESS would be less than this figure — due to the capping arrangements that exist under the scheme. See the section on capping payments below.

Commonwealth. Had their relevant State/Territory Government been participating in the scheme, the employees would have been paid twice as much.

Box 1: The Employee Entitlements Support Scheme

The Commonwealth Government has established the Employee Entitlements Support Scheme (EESS), in order to provide a national safety net for the basic protection of employees' entitlements in the event of an employer's insolvency.

If workers had their employment terminated on, or after, 1 January 2000 because their employer has become insolvent or bankrupt, the EESS may advance them some money for the entitlements that they are owed. Depending on their employment conditions, former employees may be entitled to receive:

- up to 4 weeks unpaid wages;
- up to 4 weeks annual leave accrued in the last year;
- up to 5 weeks pay in lieu of notice;
- up to 4 weeks redundancy pay; and
- up to 12 weeks long service leave.

This assistance will be paid at ordinary time rates. The maximum rate of payment for each week's entitlements will be the rate corresponding to an annual wage of $40,000. There will be a $20,000 cap (based on combined funding) on the amount any individual may receive from the fund.

The EESS will seek to get back some or all of this money later, if funds become available (for example, from a distribution of the insolvent employer's assets).

Source: DEWRSB (2000).

At a cost initially expected to be $110 million per annum, the Australian employees' protection scheme would be the equivalent of around 0.06 per cent of total private sector employees' earnings. Under the revised estimates (DEWRSB, 2001), the cost of the scheme falls to around 0.03 per cent of earnings. Using either the original or revised estimate would make the EESS among the least costly of such schemes around the world (although the cost will increase during downturns in the business cycle). The following provide an indication of the cost of some overseas schemes:

- Benfield Greig (1999) found that comparable schemes cost between 0.1 and 0.3 per cent of wages, but reported that they have been as high as 1 per cent of wages in Spain during an economic recession.
- The Ministerial Discussion Paper (Reith, 1999) found that the basic contribution rates as a share of employee compensation were 0.43 per cent in Belgium, 0.05 per cent in Finland, 0.15 per cent in Greece and 0.2 per cent in Italy. Variations reflect the different scope of the insurance schemes.
- Contribution rates vary significantly over time. For example, in Austria, the scheme cost 0.1 per cent of wages in 1981, 0.8 per cent in 1983-84, 0.5 per

cent in 1985 and 0.2 per cent in 1986 — so that the annual cost has varied over the cycle by a factor of 8 times (ILO, 1991). Over a few years, the cost of similar schemes have varied by factors of over 2 in Belgium, 1.4 in Denmark, 5.5 in Spain, 2.3 in France and 2 in the UK (ILO, 1991; DTI, 2000).

The employee protection fund model adopted by the Commonwealth — along with other possible options for protecting employee entitlements — is described and analysed in the following section.

Mechanisms for Protection of Employee Entitlements

In the event of employer insolvency, governments have a variety of employee protection mechanisms at their disposal, including:

- *A non-risk rated employee protection fund*: A scheme to collectively insure employees (on a non-risk rated basis) for any lost entitlements. The existing employee protection fund in Australia is entirely government-funded, but this need not be the case.
- *Compulsory risk-rated employer insurance*: A system of compulsory risk-rated insurance whereby employers take out policies to ensure the payment of their employees' collective entitlements.
- *Voluntary employee insurance*: Private insurance policies taken out by employees, or voluntary arrangements between employers and employees, to protect employee entitlements.
- *Trust fund*: Accrued employees' entitlements held in trust so that other creditors could have no claim against them in case of insolvency.

A discussion of these options follows.

Option 1 — A non-risk rated employee protection fund

The idea of *collectively* insuring employees was first raised as a possibility in the Australian context by the Australian Law Commission in its inquiry into insolvency (ALRC, 1988). It recommended the creation of a 'wage-earner protection fund' to protect employee entitlements on insolvency. Twelve years on, the Commonwealth introduced such arrangements through the Employee Entitlements Support Scheme.

Arrangements of this kind are quite common overseas, where they are often referred to as 'wage guarantee funds' or 'basic payment schemes'. According to the ILO (1991), they originated in Europe, with the first being established in Belgium in 1967. Subsequently, over the next 20 years, similar schemes were established in the Netherlands, Sweden, Denmark, Finland, Norway, France, Germany, the United Kingdom, Spain, Austria, Greece, Switzerland, Ireland and Portugal.

The types of entitlements covered by the overseas schemes vary, as do the amounts covered and the caps on payments. The responsibility for paying the contributions to the schemes also varies, with the financing often being undertaken by employers and not only by governments — as is the case in Australia — or some combination of employers and governments. There are even rare cases where employees contribute to the financing of an employee protection fund.[4]

The essence of employee protection funds is to collectively insure private sector employees engaged by businesses that are forced into liquidation. Affected employees are able to claim lost entitlements against the fund. In turn, the fund seeks to get back some or all of this money later, if finances become available (for example, from a distribution of the insolvent employer's assets).

To the extent that employees are unaware of the relative risks of losses of entitlements when choosing jobs, then a government funded insurance policy is like a compulsory insurance scheme for all employees, albeit with a much more efficient collection method.

Government-funded universal coverage schemes have some significant advantages:

- by providing coverage for all employees, they avoid the adverse selection problem of voluntary schemes;
- they avoid new mechanisms for funding; and
- they are relatively simple and have low administrative costs.

However, these schemes also have some limitations. The most important of these is that they are not risk-rated. An advantage of risk rating is that it signals the areas of the economy where risks are inherently higher and shifts resources out of them. Government funding of these schemes means that riskier businesses face no penalty through insurance premiums. This might increase risk-taking behaviour — the problem of moral hazard.

On the other hand, the gains from signalling high risk areas through risk rating are likely to be small because the probability of default is low and the degree to which insurers could differentiate relative risks is likely to be highly imperfect. Moreover, there are other ways of addressing excessive risk taking than risk rating (for example, by imposing excesses on claims).

Another possible weakness of employee protection funds is that budget funding exposes governments to unknown future liabilities. It would be expected that unpaid liabilities would increase significantly during downturns in the business cycle — when government budgets are already under severe pressure.

[4] For a discussion of the operation of employee protection funds in other countries, see for example, Reith (1999), ILO (1991) and Bronstein (1987).

Option 2 — Compulsory risk-rated employer insurance

Prior to announcing the Employee Entitlements Support Scheme in 2000, the Commonwealth had also considered the relative merits of adopting compulsory employer insurance to protect employee entitlements (Reith, 1999).

Under such a scheme, employers would insure (pay a premium) to protect employee entitlements in case of their insolvency and there being insufficient funds to pay such entitlements. The existing commercial insurance market would be utilised (insurance companies already write policies for trade creditors in case of a customer's insolvency).

While premiums could potentially be either variable risk-rated or a flat percentage rate (both have been proposed), a flat rate policy is essentially identical to a government-funded scheme funded from labour taxes (option 1 above). Accordingly this is not discussed further here.

A variable risk-rated policy would take into account any factor that might increase the risk of insolvency (such as the size of the business, the extent to which assets are earmarked for employee entitlements, leverage, current profits to assets, and existing credit ratings). The premium would change periodically with the changing risk exposure of the business. However, the information underlying risk rating is costly. Accordingly, insurers would trade-off the gains from finer gradations of risk rating against the transaction costs of writing made-to-measure policies and information gathering. In practice, it is likely that a few simply monitored variables would be used as the basis for risk rating.

Risk-rated employer insurance implies that the risky part of the economy would contract somewhat in response to the higher premium rates. The use of price signals in the form of risk-rated premiums might have some impact on reducing the risk of insolvency — through employers putting greater effort into financial planning, risk management and other preventive measures to reduce the at-risk amount of outstanding employee entitlements. Under a flat rate insurance scheme (or other protection schemes where employers do not contribute), high-risk employers are no worse off financially than employers who take steps to reduce the risk of insolvency.

The additional cost of insurance to high-risk businesses could precipitate early insolvency. If the risk rating employed by the insurer was accurate, this may be a desirable outcome since it allows greater recovery for all creditors, including employees.

A potential difficulty with a risk-rated insurance scheme is its administrative complexity. To be effective, premiums would somehow have to be commensurate with the likelihood of failure — and that could be difficult for commercial insurers to assess. A significant amount of red tape and administrative hurdles would also imply significant costs. Benfield Greig (1999:paragraph 5.6) noted that variable premiums would require costly underwriting and administration by insurers:

> This additional expense would be incurred prior to the commencement of the scheme (in collating segmented historical data) and in managing

the ongoing scheme (in actuarial pricing adjustments and decision-making regarding the appropriate classification for each policyholder).

To date, a compulsory risk-rated insurance scheme for employee entitlements does not appear to have been introduced in any country.

Option 3 — Voluntary employee insurance

Given that employees are the potential losers, it may be thought appropriate to enable them to enter into insurance arrangements if they wish. This is analogous to a range of other voluntary insurance services. These include insurance for life, house and contents, travel, income protection and a range of other insurance services. Many of these have greater value than employee entitlements.

The prime advantages of voluntary personal insurance are that it can allow individuals to cover their risk according to their preferences and it would distinguish high from low risk businesses. In addition, employees with low leave entitlements (for example, new workers) would pay lower premiums than employees with large leave entitlements.

There are, however, a number of potential problems with *voluntary* arrangements as a solution to lost entitlements.

- Many employees may not seek cover because of ignorance about the risks.
- Participation could also be low because employees feel they have a right to expect their legal entitlements to be paid to them (and that they should not have to insure at their own expense).
- The cost associated with monitoring and administration of a large number of policies is likely to be significant, even if only a small proportion of employees seeks cover.
- There is likely to be adverse selection problems. Insurers may not know as much about an employer's risk of insolvency as an employee — especially in smaller enterprises. This means that premiums will be set for general risk categories that include a mixture of high and low risks. Employees in the low risk category will not generally want to pay the premium, while those who perceive themselves to be in the high-risk category will. If the low risks drop out, premiums rise, sparking others to give up insurance — resulting in a vicious circle that can lead to only the highest risks (or indeed no one) being insured. Some of these adverse selection problems could be dealt with by having different insurance products with different excesses. High-risk employees will prefer smaller excesses. But this reduces, rather than eliminates, adverse selection.

Option 4 — Trust fund

Instead of insurance schemes or government-financed funds, the same outcome — protecting employee entitlements — could potentially be achieved by the secured

pooling of entitlements. This would oblige employers to hold accrued employee entitlements in a trust fund, or another earmarked secure asset, to protect them in the event of insolvency.

Such a scheme has apparently been used in Venezuela and Japan for certain employee entitlements (ILO, 1991). The ACTU has previously supported the concept (ACTU, 1999) and the NSW Government also considered it as an option for guaranteeing wage payments (Carr, 2000).

Businesses might hold the assets themselves or deposit them with another body — but the employee would retain title to the assets and could assert title against the business, or the business's creditors, in case of insolvency. Such a scheme has been likened to lawyers holding clients' money in trust accounts, or indeed to the current superannuation system.

New trusts could be established or existing trusts (such as superannuation) could possibly be utilised. They could be employer-based, industry-based or economy-based. However, the administrative costs for employer-based funds could be high and there would be economies from industry or national trust funds. Further efficiencies could be obtained if the initiative could be tacked onto an existing scheme.

As well as covering accrued entitlements such as annual leave and long service leave, trust funds could potentially have a contingent liability element to cover potential expenses which may only eventuate in the event of insolvency (such as pay in lieu of notice, unpaid wages and redundancy payments). Although there would be difficulties in including such unspecified amounts in advance, some formula could probably be developed.

The major drawbacks of a trust fund scheme would be the administrative complexities and its impact on the working capital of businesses. On the administrative side, a few challenges might arise:

- One problem would be the provision of a mechanism to ensure payments by employers are actually paid to the trust fund at regular intervals. Random audits and substantial penalties may be an adequate method.
- Another administrative problem relates to the ability of employers to accurately provide for future entitlements, some of which may never eventuate. Pay in lieu and redundancy pay are contingent liabilities. If the maximum potential value of these liabilities were set aside, this would represent considerable excess provision across the economy as a whole — with implications for working capital. However, if incomplete provision is made, there may be insufficient funds to acquit employee entitlements for those businesses that actually become insolvent.
- Provisions for annual and long service leave, while ostensibly straightforward, involve administrative complications. For example employees' leave payments are based on current wage levels, but employers' contributions may have been made one or two years prior (and even longer in the case of long service leave). This inter-temporal problem applies to other similar mechanisms (such as superannuation) and, in part, relies on fund

earnings to assist the process. However, it could be particularly problematic for small trust funds if employer-based funds were the favoured option.

The impact of trust funds on working/operating capital could be significant. While prudent employers already make provision for leave entitlements, it is not clear how many businesses do, in fact, observe such practices. To the extent they do not, mandated trusts would significantly reduce liquidity.

The loss of working capital suggests that some businesses would be unable to pay trade creditors or bank loans. Ironically, a mechanism to protect employee entitlements in case of insolvency might actually be instrumental in triggering such an event (and costing employees their jobs).

As well, bringing forward future liabilities into a trust fund acts like a wage increase to the employer — because, in effect, more money has to be found now to pay for each employee. This would tend to discourage recruitment, increasing unemployment temporarily.

It is important to note that such problems would mainly affect existing businesses that had not already made adequate provisions and be of short-term duration. If a trust fund scheme were a preferred policy option, it would probably require a transition period for existing businesses to build up their full trust fund quotas and to allow wage adjustment. Otherwise, the measure would precipitate higher rates of business failure and unemployment in the short run.

Comparisons

The characteristics and impacts of the various options are set out in Table 2. There is clearly considerable uncertainty over the relative monetary costs of the alternative arrangements. A compulsory risk-rated insurance scheme is assumed to cost more than a non-risk rated fund because of its additional administrative complexity. Trust funds would also involve significant administrative complexities and have an additional cost to business arising from bringing forward future liabilities (which would act like a wage increase to employers).

The comparison of overall monetary costs in Table 2 is made on the basis there are no capping arrangements involved with the non-risk rated employee protection fund (option 1). In fact, payments are capped in Australia (see below). In practice, the existence of capping arrangements reduces even further the comparative monetary cost of the current Australian scheme. However, the existing arrangements also provide fewer benefits — assuming that the compulsory insurance and trust fund schemes would pay out employee entitlements in full.

More broadly, the comparisons suggest that voluntary insurance and trust funds have significant drawbacks. Voluntary schemes would be undermined by adverse selection. Trusts, which do not pool risks, would be relatively costly and require phasing in to avoid large transitional impacts on employment.

Table 2: Nature and Impacts of Measures for the Protection of Employee Entitlements in Australia

	Non Risk-rated Employee Protection Fund	Compulsory Risk-rated Employer Insurance	Voluntary Employee Insurance	Trusts
Overall monetary cost	Total entitlements lost annually currently estimated at between $50-60 million per annum	Unknown but likely to be higher than option 1	Cost per employee very high	Unknown but likely to be higher than options 1 and 2
Administrative costs	Low	High	High	High
Transitional requirements	None	None	None	Large
Adjustment costs	None	Moderate	None	High
Who pays?	Payroll tax and general revenue	Business	Employees	Business
Long run incidence	Probably employees (but depends on how revenue is raised)	Employees and consumers	Employees	Employees
Intermediaries	Government	Insurers	Insurers	Trusts
Who typically makes choice of coverage?	Government	Government	Employee	Government
Adverse selection	None	None	High	None
Deters risky businesses	No	Yes	Uncertain	Yes
Coverage of employees	Full	Full	Very partial	Full

The choice between the universal insurance mechanisms — a non-risk rated employee protection fund or a risk-rated employer scheme — depends on the trade-offs between administrative simplicity, government budget constraints and deterring higher risk business behaviour. Employee protection funds have some advantages — they are easy to implement, administratively simple, involve no adjustment costs and have relatively low ongoing costs (although liabilities may be significantly higher during economic downturns).

While taxpayers pay for the employee protection fund in Australia, employers would pay for a compulsory insurance scheme. However, this apparent difference in the source of funding is an illusion. It is likely that, in the long run, employees bear the burden under both financing methods.

The Commonwealth contribution to the Employee Entitlements Support Scheme is funded from general revenue, mainly taxes on labour. Indeed, the Commonwealth has explicitly signalled payroll tax as the funding source for any State contribution to the scheme. Payroll taxes are *paid* by businesses, but their true *incidence* and ultimate burden is on employees through lower wages (Stiglitz, 1988; Nickell and Bell, 1996).

In this regard, the relatively popular idea that a flat rate tax on employers is superior to taxpayers 'subsidising' failed businesses misses the point. A flat rate policy would be essentially identical to a government-funded scheme funded from labour taxes.

Moreover, regardless of where the money comes from, any insurance system that is not explicitly risk-rated implies that higher-risk businesses are subsidised.

Overall, a simple government-funded employee protection fund might be favoured over compulsory risk-rated insurance on the basis that:

- the overall default risk is very low; and
- the transaction costs of writing a large number of individual insurance contracts are high relative to the actuarially fair insurance premium.

Although preferable, employee protection funds also have some limitations. First, as the premiums are funded by government, riskier businesses face no penalty through insurance premiums. This might increase risk-taking behaviour — the problem of 'moral hazard'. Second, the future liabilities associated with a budget-funded scheme are unknown, but are likely to be significant during downturns.

However, their major weakness is not inherent. Rather it tends to be the effects of the capping practices that are commonly associated with such mechanisms.

Capping of Payments to Employees

A common feature of employee protection funds around the world is the imposition of a cap on the amount payable to an individual employee. The Australian Employee Entitlements Support Scheme caps entitlements as follows:

- a maximum of 29 weeks pay;
- a maximum payment for each week's entitlements corresponding to an annual wage of $40,000; and
- a maximum payment to any individual employee of $20,000.

The capping of payments under the Australian scheme has been criticised by Industrial Relations Ministers from the Labor States of NSW, Queensland, Victoria and Tasmania (AFR, 2000). Capping is also one of the major criticisms that the ACTU has of the Australian scheme (ACTU, 2000).

Capping may perhaps be regarded as acceptable if employee entitlement protection schemes are viewed as being part of a wider government 'safety net' to protect the less fortunate in society. In this context, the employee insurance system is not meant to provide 100 per cent coverage for all claims. Rather it is designed to provide the majority of workers caught up in insolvencies with the expectation of receiving a reasonable proportion of their accrued entitlements.

The most common justification used for capping payments though is to reduce the overall cost of employee protection schemes.[5] In the case of the Australian budget-funded model, it can be argued that it is a legitimate and responsible policy option for a government to impose caps as a means of limiting its budget exposure (particularly in the absence of comprehensive data on the extent of the problem).

A measure of the possible budget savings from capping under the Australian scheme is provided by the Commonwealth in its EESS Year One Activity Report (DEWRSB, 2001). In detailing the claims under the EESS between July-December 2000, the report notes that in some cases the scheme caps have been applied for the weekly wage and/or each of the five entitlements, namely, annual leave, long service leave, unpaid wages, pay in lieu of notice and redundancy pay. Thus, while the average amount outstanding for components covered by the EESS has been $7,203 per eligible claimant, the average EESS payment per employee if the States had contributed would have been $4,354 (in practice it has been only half of this amount ie $2,177). In aggregate terms, DEWRSB estimates that the total employee entitlements lost annually for the components covered by the EESS will be around $50–$60 million. However, because of the capping arrangements, DEWRSB indicates that the likely cost of payments eligible to be made through the EESS will be considerably lower at $30–40 million (of which the Commonwealth will pay half).

Although capping may reduce budget outlays, cost reduction is not, by itself, a good economic or social rationale for imposing limits on the amount of insurance payments made to employees:

- The capping of *individual* employee payments does not cap the *aggregate* budget outlay, the size of which is determined principally by the number of insolvent firms.
- As an instrument for constraining outlays, capping of individual entitlements places all the burden on a few individuals.
- Even when a government-funded scheme comes well under budget in a particular year, there may still be some individuals who do not receive their full entitlement.

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[5] Another possible (but less significant) rationale for capping is that it might conceivably reduce moral hazard on the part of both employers and employees. For a discussion of the issues, see Bickerdyke, Lattimore and Madge (2000).

In fact, with respect to the last point, this appears likely in the EESS's first year of operation in Australia. As noted above, the Commonwealth has estimated (DEWRSB, 2001) that the annual aggregate loss of employee entitlements due to employer insolvency might be in the order of one-half of its original estimate. However, due to capping arrangements, the EESS would still pay affected employees, on average, only 60 per cent ($4,354 instead of $ 7,200) of the amount outstanding for the components covered by the scheme.

There are some other issues relevant to the desirable extent and nature of capping.

First, caps may provide less insurance than employees would wish to buy in a properly functioning insurance market. Insurance is most valued by people when it insulates them against rare adverse events that would have a significant impact. In effect, caps force some employees to take out only partial insurance.[6] If the primary intention of the government-funded insurance policy were to try to maximise the welfare gains for employees, taking into account their likely preferences for avoiding risk, no or little cap would be the most appropriate outcome.

Second, a cap may affect the distribution of claims among competing creditors that would have proceeded under insolvency law. Take, for example, a business in which the only creditors are two employees with $120,000 of claims — employee 1 is owed $100,000 and employee 2 is owed $20,000. However, the business assets can only realise $60,000. Under normal insolvency law, both employees would get 50 cents in the dollar, based on the principle of equal treatment of creditors. However, supposing there is a $20,000 cap, then under the insurance arrangements, both employees initially get $20,000 each. The government, in turn, claims this money back from the administrator, leaving $20,000 to be disbursed. Since employee 2 has had all of his or her claims met, only employee 1 can claim these assets. Accordingly, combining the effects of insurance and disbursement of the residual assets, one employee (employee 1) gets 40 cents in the dollar, while another gets 100 cents in the dollar. Capping has thus reduced the pay-off ratio by 10 cents in the dollar for one creditor and increased it by 50 cents in the dollar for another.

Conclusion

The employment impacts of business insolvencies are relatively modest. Direct job losses resulting from bankruptcies and liquidations in Australia in 1999-00 are estimated to have accounted for less than 1 per cent of total job losses in that year.

Nevertheless, in the event of business insolvency, employees are seen as a particularly vulnerable group that often loses a significant share of its claims on the insolvent business.

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[6] In principle, employees could voluntarily take out their own insurance against loss over and above the capped amount. However, there may be a number of potential problems, as described under option 3 above.

Governments around the world use a variety of mechanisms to protect employee entitlements in the event of business insolvency. These mechanisms generally consist of an employee protection fund made up of contributions from governments, employers or employees. A government-funded national employee protection fund was introduced in Australia in early 2000.

Employee protection funds have some significant advantages. They are easy to implement, are administratively simple and have low costs (although liabilities may be significantly higher during economic downturns). However, employee protection funds also have some limitations.

As the funds are provided by government, riskier businesses face no penalty through insurance premiums. This might increase risk-taking behaviour — the problem of 'moral hazard'. The capping practices associated with employee protection funds mean that some employees can receive relatively low levels of insurance cover. In the case of the Australian employee protection fund, the effect of capping arrangements, combined with the failure of the States to contribute their half share, means that eligible claimants are, on average, only receiving around 30 per cent of their lost employee entitlements through the scheme.

Other forms of employee protection mechanisms that are potentially available include compulsory risk-rated employer insurance, voluntary employee insurance and accrued employee entitlements held in trust. While these have some benefits — particularly in addressing the relative risks of different businesses — they are likely to involve some transaction costs and implementation problems.

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Agenda, Volume 8, Number 2, 2001, pages 171-175

REVIEWS

Anatomy of a Radical (?) Government

Gwynneth Singleton (ed.), ***The Howard Government: Australian Commonwealth Administration 1996-1998,*** *UNSW Press, Sydney, 2000*

Reviewed by ***Peter Hay***

This volume is the second in what promises to be an ongoing series of studies of Australian federal governments, and a very timely and valuable series it should prove to be. Though the back cover blurb promises 'the first comprehensive overview of the issues of the period', as the book's sub-title indicates, the emphasis is upon the institutional and processual reforms to Australian government administration rather than achievements and failures of policy. Even the chapters collected as 'policy issues' tend to be concerned more with institutions and processes than substantive policy, and of the three policy domains that characterised the first Howard Government in popular perception – indigenous issues and the complicating advent of American style backwoods populism, gun control, and workplace relations reform, only the latter is accorded a chapter in its own right. The turbulent issues of gun control and Hansonism are curiously marginalised concerns within the themes discussed here, whilst the chapter devoted to indigenous issues focuses upon the budgetary and institutional changes to ATSIC rather than the broader policy environment.

This is not to be entirely construed as criticism – indeed, given a caveat to be introduced below, it may not be a legitimate criticism at all. There is certainly a sense in which this is the book's great strength. We are reminded that some of the most profound, the most permanent and the most significant changes are not necessarily reflected in the mass media's selection of 'news' priorities. For those wanting succinct and insightful overviews of the structural legacy of the first Howard Government this is an invaluable source. None of the essays free-ride on its fellows; all provide excellent descriptive data, to which the best contributions add outstanding analysis of short and long-term significances.

Most contributors to *The Howard Government* are academics from the University of Canberra. Just two are practitioners. Centrelink's CEO, Sue Vardon, provides a clear account of her organisation's genesis, structure and operational norms. Given her position, it is not to be expected that this contribution would offer much in the way of critical analysis, and none is forthcoming. On the other hand, the one-stop-shop idea embodied in Centrelink also had currency in the Whitlam years, and is not likely to figure high on the objections list of even the most implacable critic of the Howard government. The other practitioner is Harry Evans, Clerk of the Australian Senate. Writing on the

Howard government's relationship with and treatment of the Commonwealth Parliament, his contribution *is* strong on critical analysis, and is one of the best pieces in the book. Employing an edgy, sometimes acerbic, prose, Evans renders painfully apparent the contrast between John Howard's pre-government rhetoric on the need to preserve the strength and integrity of Parliament and the reality. As with its predecessor, the Howard government's 'actual performance in relations with Parliament… reinforces the universal truth: governments prefer to control parliaments rather than answer to them' (p. 35). A two-page demolition of the notion of governmental 'mandate' is brilliant, and should be tacked to the wall, a stern corrective, of anyone misguided enough to invoke it.

The book's essays are arranged in two sections, 'Part One: The Institutions of Government' (seven essays) and 'Part Two: Policy Issues' (five essays) – though, as noted above, several of the 'Policy Issues' essays could as readily have been classified under Part One. The Varden and Evans essays are both in the first section. Also in Part One are strongly detailed accounts by John Halligan and Roger Wettenhall of the government's revolutionary approach to public sector management, Haig Patapan's perceptive description of the frequently uneasy relationship between a moderately activist post-Mason High Court and the government, and Christine Fletcher's similarly perceptive account of ATSIC's faring under a hostile government.

Also in Part One, the volume's lead essay in fact, is a beautifully written assessment of John Howard, Prime Minister, by David Adams. But I want to set this essay aside for the moment, and return to the analyses – by Halligan and Wettenhall - of the 'revolution' in public sector management. Halligan takes the Howard reforms of the public service proper for his subject matter, whilst Wettenhall's concerns are with the non-departmental organisation (NDO) sub-sector. Each contribution partakes of the high standards we have come to anticipate from these fine scholars. Halligan's essay should quickly become compulsory reading in courses in Australian public sector management. He notes that the agenda of privatising, downsizing, colonising public administratiove theory with concepts taken from 'best practice' in the private sector, and reducing the scope of the public service's ambit of operation, was in place by 1983, and received powerful impetus in the early 1990s from the Hilmer Report on National Competition Policy. In this sense the Howard reform agenda was partly a continuation of a process of change already in place, though Halligan makes it clear that, even though they were somewhat slow to materialise, when they did 'the directions that emerged during the first term of the Howard government were fundamentally different from the initial decade of reform in important respects' (p. 60), particularly in the government's determined relegation of the public sector to the status of 'an adjunct to the private sector' (p. 60).

Halligan is impeccably detached; Wettenhall, by contrast, locates himself squarely within the debate: he laments, in his opening paragraph, the globalisation of the Thatcherite 'model', a model historically devised in response to failures specific to British public enterprise. Few other countries, he notes, have adopted Thatcher's inappropriately universalised 'model' in such 'gung-ho' fashion as

Australia (p. 65). Much of his essay (and it is the longest in the book) is devoted to defending the now unfashionable statutory authority form of NDO against the company form so enthusiastically embraced by the government in the wake of its enthusiastic endorsement in the 1997 Humphry Report. I think Wettenhall succeeds very well. He makes it clear, too, that the larger part of the preference for the company form is ideologically sourced, for 'things public are denigrated, things private adored' (p. 87).

Of the five papers grouped in 'Part Two: Policy Issues', three, Jenny Stewart's account of the faring of federalism under Howard; Chris Aulich's reprise of privatisation and outsourcing, and Don Fleming's piece on new theories and regulatory regimes of administrative law, could all have fitted within Part One. All three papers are cogent and intelligent. I was much taken with the force of Aulich's closing observation: that neither detractors nor defenders of privatisation have shown much stomach for moving beyond argument-from-assertion to rigorous analysis of the record. Stewart makes it plain that federalism has fared surprisingly badly under Howard, the conservative side of politics' longstanding commitment to federalism notwithstanding. Only when it has been in its clear political interests to do so – in the environment policy domain in particular – has Howard 'federalised' functional relationships. Elsewhere – in education, say - the shift has been *from* the states *to* Canberra. This should not surprise us. If, as I shall argue shortly, Howard's is the most radical government since Whitlam's (at least - possibly since Chifley's), it is to be expected that an inherited and potentially obstructive commitment to functional devolution to the states would be deemed dispensable.

In Stewart's chapter we are given a survey of the Howard record in certain prominent policy areas – albeit they are chosen instrumentally for their relevance to her focus upon federalism. We are left with two 'pure' policy chapters. One is a thorough, methodical account of workplace relations, with a concentration upon the debacle of the waterfront dispute, by the book's editor, Gwynneth Singleton. 'The word 'debacle' is not ill-chosen - it is apparent from this account that the outcome gave cold comfort for the Maritime Union of Australia, the apparent victor in the dispute (and there can be no doubt, of course, that the word 'debacle' accurately describes the outcome for the government).

The other is a curious piece by Greg Barrett on John Howard as economic manager. Barrett determinedly seeks to prove that Howard 'inherited' his 'market-oriented policies' from the Keating government, and that he 'did not produce a fundamental change in policy direction' (p. 133). The other piece that focuses upon Howard personally, the essay by David Adams that leads the collection off, and concerning which, it will be remembered, I earlier postponed consideration, also downplays the extent to which Howard can be said to represent a dramatic new future, a plunge into uncharted waters, to be a leader of a quintessentially *radical* government. For Adams, Howard is a 'formidable politician' (p. 13), but essentially one who dodges along approximately in tune with the public mood, sometimes misjudging it and falling behind or straying

ahead, but not a great definer of his times, a 'skilful' but 'prosaic' prime minister, 'never great but ever adequate' (p. 24).

This stress upon the Howard government's degree of continuity with its predecessor, and upon Howard's personal ordinariness, is misleading, in my view. It masks the real character of the 'Howard revolution'. Admittedly there is some tension over this portrayal within the book. Thus Singleton, in her Introduction, notes 'how close the [major] parties have become on significant policy issues' (p. 9), but on the question of Howard's political persona she appears to take a somewhat different position from Adams, noting 'the strength of purpose and tenacity with which Howard factored his philosophy to the policies of his government', and that 'he led his government down the pathway to significant reform in a range of policy areas in which he had a personal interest and philosophical view' (p. 4). Tension then – but the general mood of the book militates against a characterisation of the government as radically discontinuous with what has gone before. Personally, I am not much interested in the question of whether the government's radicalism carries John Howard's personal signature or whether it is the collective creation of his powerful senior ministers. What is significant is that this is a government that has generated a degree of passion and abhorrence not seen since the Whitlam years – over its approach to Aboriginal reconciliation, over its seemingly blatant class partisanship at the time of the waterfront dispute (and workplace relations generally): and more generally, but most appositely, over the change it represents to hitherto ingrained and esteemed elements of the national political culture, values such as fairness, compassion and the social virtues, all scrapped in favour of the claims of individual self-reliance, enlightened self-interest and the private life. It is in this territory that a strong case can be made for characterising the Howard government as one of the most radical in Australia's history.

I have said that the strength of this book resides in its focus upon little-understood changes in structures and processes of government. But this is simultaneously a weakness, for it promotes a mistaken 'sense' of the government. This would have been apparent had more attention been paid to the wider policy environment in 1996-1998. But here I must introduce that caveat foreshadowed in my second paragraph. It is this: it is not legitimate to criticise a book for not being some other book one would rather have read. A book should only be reviewed within the terms of its own intent. I have already said that, as an assessment of the impact of the first Howard government on the structures and machinery of government, this book does outstandingly well.

But a different sort of book would, I think, have given a different overall picture of the first Howard government, one less concerned with continuity and placing more stress upon difference. The book I would like to see would include, along with much that is in the present volume, a more forthright assessment than Singleton provides of whether, and if so, the extent to which, in the waterfront dispute, the government did conspire with its favoured party to the dispute, and to what extent it was driven in its actions by ideological consideration. It would consider the reconciliation process in broader context. It would test the reality of

the Howard government's much-vaunted commitment to family values, looking at the extent to which added work stress stemming from the loss of job security, and added physical and psychological exhaustion stemming from the job productivity targets built into workplace contracts, contributes crucially to the strains within families. I would like a chapter on environmental policy, and a consideration of the extent to which the hot-spot 'bandaiding' approach, as represented by the National Heritage Trust, is an adequate policy response as against an approach that starts from identification of the structural causes of environmental degradation. I would like Aulich to expand upon his tantalising hint (pp. 170-171) at the expanded potentially for patronage and outright corruption entailed in contracting out government services, particularly when lucrative multi-department, ('cluster') contracts are involved, as has been the case, most controversially, with IT services. I would like more detailed consideration of the portentous questions to which Halligan merely alludes in his conclusion on 'the future of the public service': the devaluation of professional skills, the loss of corporate memory, the loss of a public service culture (for example). And I would like a chapter on the issue of gun control, an issue, in my opinion, of unsurpassed importance, an issue which would have been beyond Labor's capacity (because it could not have taken the conservative states with it) and one upon which Howard delivered spectacularly well.

But most of all I would like to see consideration of the impact Howard's changes have had on Australia's political culture, and, via consideration of the clash of values between the politically adept and the politically alienated - the latter embodied in the bizarre phenomenon of Pauline Hanson, concerning which only this specific manifestation has now been eclipsed, not the conditions that created it in the first place - an assessment of the legacy of the first Howard government in terms of what it means for the very future of the democratic consensus.

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Asian Financial Crisis

Gregory W. Noble and John Ravenhill (eds), ***The Asian Financial Crisis and the Architecture of Global Finance,*** *Cambridge University Press, Melbourne, 2000*

Reviewed by ***George Fane***

The distinctive feature of this study of the Asian financial crisis is that both of the editors and most of the contributors are political scientists. Seven out of 11 chapters focus on why countries chose the policies they did choose, and most of these chapters deal with particular countries, or comparisons between pairs of countries. The remaining four chapters, which deal mainly with general economic issues from a regional perspective, are the editors' introduction, Stephen Grenville's chapter on capital flows, a partial defence of the role of the IMF by Barry Eichengreen (who was director of research at the IMF during the crisis), and Benjamin Cohen's study of monetary and exchange rate policies.

The political science focus gives the book a different flavour from those written by economists, who usually try to explain why chosen policies had the effects that they did, rather than on why they were chosen. As a result, this book fills a gap left by the more numerous economic studies. My main criticisms are that the quality of the chapters is uneven, and that the editors should have gone even further than they did to make their political science contributors focus on their area of comparative advantage: explaining policy choice by governments. Overall, however, it is one of the more useful books to be written on this very popular topic.

The editors' introductory chapter provides a useful overview of the (mainly economic) literature on financial crises and policy responses to them. Several chapters, including this one, note that there has been a long-running debate between those who argue that the 1997-98 Asian crisis resulted from fundamental weaknesses in the crisis countries and those who argue that it resulted from self-fulfilling panic by foreign and domestic investors. The two positions are reconciled in Goldstein's 'wake-up call' hypothesis: a crisis in one country provoked panics among investors in countries believed to have similar weaknesses, but panics were only self-fulfilling in countries with fundamental weaknesses. Countries like Hong Kong, which had sound banks and credible macroeconomic policies, successfully resisted speculative attacks. Noble and Ravenhill argue that the main weaknesses that distinguished the countries whose financial systems collapsed from those that survived were large foreign debts, relatively small foreign exchange reserves, the absence of capital and exchange controls, the absence of financial repression and the absence of effective prudential supervision and regulation. Of course the correlation between these

factors and the occurrence of crises was imperfect, and in some cases, the medicine – even if it is effective – may be worse than the disease. Noble and Ravenhill do not suggest that financial repression is desirable, and in my view capital and exchange controls are also an excessively blunt way of trying to prevent crises. I would add to the editors' list of factors that contribute to vulnerability, the absence of an effective system for resolving bankruptcies.

Stephan Haggard and Andrew MacIntyre argue that political constraints that limit the ability of governments to respond to crises are an important source of the fundamental weaknesses that can lead investors to panic and make panics self-fulfilling. They set out to apply this thesis to policy making in Thailand and Korea. They argue that in Thailand's case, governments based on coalitions of weak political parties were unable to take decisive actions, while in Korea's case, similar effects resulted from internal divisions within the ruling party. Haggard and MacIntyre's argument would be more powerful if they–or anyone else–could be sure which policies would be effective in restoring investor confidence once a crisis has begun. Promising to bail out banks helps in the short run, but generates increased moral hazard in the long run; tight monetary and fiscal policies risk being counterproductive, while expansionary policies might lead to hyperinflation. A second problem with the 'political weakness' theory of crises is that it is very hard to obtain objective measures of political weakness. After the event it is always possible to point to weaknesses in any government. If, for example, Indonesia had resisted the crisis and Soeharto had remained in power, many people would have seen this as further evidence of the advantages of his firm hand. Instead, Soeharto's fall and Indonesia's collapse have become the main evidence used to demonstrate the ill effects of crony capitalism.

The chapter that focuses mostly clearly on policy choices is also the one I found most interesting. This is Noble and Ravenhill's study of Korea and Taiwan. These countries provide a better basis than Thailand and Korea for testing the importance of political factors because their performances were so different: Korea's financial system collapsed, while Taiwan's did not. It also helps that the authors focus more on policies that contributed to vulnerability or strength in the decades before the crisis, rather than on the more difficult question of how to contain a crisis that has begun. Their thesis is that the Korean government's adoption of relatively risky economic policies and the Taiwanese government's preference for very cautious economic policies arose from differences in government-business relations in each. The Korean government opted for 'big push capitalism', i.e. rapid industrialisation on a broad front. Beginning with the heavy and chemical industries drive in 1973, it tried to pick winners by licensing monopolies, or oligopolies, in each industrial sector. As a result of this strategy, the economy was dominated by business conglomerates ('chaebol'). Because the government channelled resources to favoured enterprises by directing banks to lend to them at low (and often negative) real interest rates, the conglomerates were financed mainly by debt, rather than equity. Because the conglomerates were highly leveraged, and because the banks had had to lend to them at low interest rates, Korea was highly vulnerable to a rise in world interest rates. In addition, the

policy of holding down domestic interest rates encouraged the build-up of foreign debt, by discouraging savings and raising investment. When capital controls were partially eased in the 1990s, the government kept tighter controls on long-term borrowing and inward foreign direct investment than on short-term borrowing. As a result, Korea's foreign debts were mainly short-term, and were therefore not renewed when the crisis occurred.

The Taiwanese government never encouraged the growth of large private conglomerates. Relative to Korea, the state owned sector in Taiwan was larger and private firms were smaller and more numerous. The banking sector in particular was dominated by state owned banks. Small firms were able to play a large role in Taiwan partly because technological know-how was provided by quasi-public research organisations. Noble and Ravenhill attribute the decision to maintain a relatively large state sector and a private sector dominated by small and medium firms to the strong party discipline and dominance in domestic politics of the ruling Kuomintang party, which was strong enough not to need a partnership with the private sector. They attribute Taiwan's cautious macroeconomic policies, and its decision to hold foreign exchange reserves of almost $100 billion, to its vulnerable external situation: 'its diplomatic isolation meant that it could not hope for aid from the IMF, Japan or the United States' (p. 102). They do not comment on the irony in this explanation for Taiwan's ability to resist the crisis, given the discussions in other chapters of the alleged need for a new global financial architecture to ensure that other emerging markets can count on external aid.

The chapter by Thomas Callaghy describes how the US government pressured the international (but mainly American) banks that were Korea's major creditors, to renegotiate (i.e. partially forgive) their loans to Korea in late 1997 and early 1998. It then deals with the Japanese government's reluctance to force analogous debt forgiveness on the international (but mainly Japanese) banks that were Indonesia's main creditors. This is one of the most interesting chapters because Callaghy appears to have contacts that allow him to give what seems to be an insider's account of the negotiations. According to Callaghy, the Paris Club of official creditors rescheduled Indonesia's official debts in September 1998, but to avoid embarrassing the Indonesian government, it agreed to a half hearted pretence that the negotiations did not involve the full Paris Club, but rather the 'Group of Creditor Countries to Indonesia'. Callaghy notes (p. 228) that 'all the press coverage referred to it as a Paris Club rescheduling, which it was'. It is a pity that this chapter is marred by repetition and careless inconsistencies: the data on external debts on pages. 215-6 are contradicted by the data in Figure 10.1, which itself involves glaring inconsistencies that any reader will be able to spot at once.

Among the chapters by the economists, I found Grenville's wholesale rejection of conventional economics too negative to be useful. He asserts that the massive capital flows in the lead-up to the crisis cannot be understood in terms of conventional equilibrium adjustment processes, but does not provide a theory of disequilibrium adjustment. He also rejects the portfolio model of exchange rates, the efficient markets hypothesis and the uncovered interest parity principle,

without suggesting what should replace them. He scorns the idea that interest rate differentials are the best predictor of exchange rate movements, but does not say what is.

The 'new architecture of international finance' is the subject of the chapter by Miles Kahler. Kahler lists what the former managing director of the IMF, Michel Camdessus, called its five core features: transparency, prudential regulation of the financial sector, 'involvement of the private sector' in the cost of crises, cautious and orderly liberalization of capital flows, and the implementation of codes of international best practice. In my view, Kahler is not sufficiently critical of the alleged economic benefits of the proposed new architecture. For example, 'cautious and orderly liberalization' looks like a formula designed to cover up the fact that those using it have avoided analyzing the difficult question of what capital controls, if any, are optimal. If, as Kahler seems to believe, some controls are desirable, then liberalization is only desirable if existing controls are excessive and even 'cautious and orderly' liberalization is undesirable once existing controls have been reduced to those that are optimal. The question for Kahler and the IMF is what controls are optimal.

The new architecture is also discussed by Callaghy and by Eichengreen. Callaghy notes that in 1999 the IMF was 'encouraging' Ecuador to default on its bond debt service as a condition for continuing assistance. It is easy to see that this way of 'involving the private sector' in the cost of crises has short-term benefits to the IMF and the governments of the G-7 countries. It is much harder to see how such official encouragement of default could be part of an optimal international financial structure, and it is a pity that none of the contributors tackled this question head-on.

Kahler's chapter focuses on the political implications of the new international architecture. He argues that, if fully implemented, fiscal and financial transparency would revolutionise politics and government in developing countries. He is therefore sceptical about the likelihood that it ever will be fully implemented. Of course, governments might implement the new architecture if they thought that it would work, or in Kahler's terms that it would provide 'insurance' against potential future crises. Kahler seems not to notice the irony in his dismissal of this possibility: 'Unfortunately, any benefit from insurance is both uncertain and distant'. So much for the new international architecture!

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An Assessment of the 1990s

David Gruen and Sona Shrestha (eds), ***The Australian Economy in the 1990s****, Reserve Bank of Australia, Sydney, 2000*

Reviewed by ***Graeme Wells***

Each year the Reserve Bank of Australia invites a group of economists to a conference organised around a theme of topical interest. The volume presently under review records proceedings of the third in a sequence of conferences, held in 1979, 1990 and 2000, that provides an overview and analysis of the main developments in the Australian economy and economic policy over the previous decade. Taken as a whole the papers in this volume succeed in providing a very useful and accessible overview of the Australian economy in the 1990s. Its non-technical style will ensure a wide readership.

As in earlier conferences, contributors are drawn from the staff of the Bank and a wide variety of other sources, with about half of the papers being commissioned from economists outside the Bank. Three contributions from the Bank survey decade-long developments in macro performance and policies (David Gruen and Glenn Stevens); the Australian financial system (Marianne Gizycki and Philip Lowe); and national saving (Malcolm Edey and Luke Gower). Other contributions include an analysis of microeconomic policies and structural change (Peter Forsyth), the politics of economic change (Paul Kelly), developments in the Australian labour market (Peter Dawkins), the historical interaction between theory and advocacy in the development of policy (Robert Leeson), and perspectives from the UK and the US on Australia's economic performance (Charles Bean and Bradford DeLong). Discussant's comments and a brief record of general discussion follow each of the papers.

A brief review cannot do justice to these varied contributions - a more useful approach, perhaps, is to highlight a small number of themes running through the conference. Consider first the evolution of the policy debate. Two good examples are the evolution of monetary policy towards inflation targeting, and the policy significance of the current account and foreign debt position.

Leaving aside the difficulties engendered by instability in relationships between broader monetary aggregates and nominal income the attempt to target monetary aggregates, interest rates, and the exchange rate was always likely to end in failure in a world of increasing capital mobility. So was the 'checklist' approach which replaced it in the second half of the 1980s, after the float of the dollar. This volume has scant discussion of the role of monetary policy in precipitating the recession, but some of the outside participants don't pull their punches. As Kelly puts it '... the 1980s ended in failure, a monetary policy failure – a deep recession

provoked by interest rates of 18 per cent resulting in unemployment above 11 per cent' (p. 225).

Little wonder, then, that in the early 1990s the search was on for a new policy framework. Many of the proposals under discussion outside the Bank, including the inflation targeting approach that eventually emerged, shared common characteristics. Having a clearly defined nominal anchor, whether it be the monetary base, the US dollar, or the rate of inflation, was important. Increased transparency in monetary policy was important. So too was the independence of monetary policy. As Gruen and Stevens describe the approach in Australian policy-making circles, 'more attention began to be given to the model which combined an inflation target and clear central bank independence. Both [in New Zealand] and in Canada the idea of an explicit, numerical inflation target took shape, and was implemented' (p.54). In the view of this reviewer, the Australian definition of the inflation target is an improvement on the New Zealand practice of a narrow band with 'hard edges'. It is also to the Bank's great credit that it eschewed the Canadian and New Zealand practice of paying attention to a 'monetary conditions index' in setting monetary policy.

Gruen and Stevens also discuss changing policy perceptions regarding the current account and foreign debt. At the beginning of the decade the 'consenting adults' view – that, in the absence of externalities, saving, investment and financial market decisions are best left to persons in the private sector – was thought to be contentious. But as the decade progressed current account deficits continued, net foreign liabilities rose from the low 40s as a percentage of GDP to the low 60s, and the foreign debt position proved to be 'the dog that didn't bite'. For this reason, and the force of the underlying logic, the 'consenting adults' view gained ascendancy.

But Gruen and Stevens (and, more directly, other contributors such as Bean and Edwards) point out that it cannot be taken for granted that the rest of the world will wish to accumulate our foreign liabilities at the same rate, and at current exchange and interest rates. Surprisingly, they fail to indicate a possible qualification of the 'consenting adults' view. Over the 1990s the proportion of foreign debt intermediated through the banking system has grown significantly, to the point that the gross foreign debt of depository institutions is now more than one third of annual GDP. To the extent that foreign lenders perceive these institutions to have an implicit government guarantee, an externality is lurking in the background which may encourage more foreign borrowing than would otherwise be warranted.

Now turn to other contributors whose main focus is on the evolution of policy ideas. At first glance the chapter by Leeson appears to be a rambling exercise in self-citation. It is replete with irritating acronyms such as DAFF-O-DILS (Dynamically Alliterate (sic) Flatlandia Formalists). The important issue buried in the paper is a variation on the aphorism that those who do not understand history are condemned to repeat it. Leeson argues that understanding the origins and development of economic ideas, and the process by which they gain acceptance in policy circles, would have had a salutary effect on recent policy debates.

Important as that argument is, it would have more force if it were developed, not in the context of the policy debates of the 1960s, 1970s and 1980s, but in terms of current policy issues.

Kelly also examines the evolution of policy, comparing the reform agendas of Commonwealth governments of the 1980s and 1990s. He argues that, with the exception of the tax package, Prime Minister Howard's economic reform agenda has been modest by comparison with the Hawke-Keating years. For Hawke and Keating the groundwork for some of the reforms was laid earlier — the Campbell Inquiry that underpinned deregulation of financial markets, for instance. They were also able to use the Accord and the tax and transfer system to offset most of the income inequity that would otherwise have resulted. Kelly refers to changes in the role of the Senate and respective Opposition parties between the two periods, and also makes the case that the political cost of reform has been raised. Howard's draw down of the fiscal surplus to over-compensate groups affected by the introduction of the GST is offered as one example of the latter effect. While Kelly offers an intriguing analysis, this reviewer would put more emphasis on the role of the States in any overall analysis of the political economy of economic reform. For example, the States played an important part in the move to overall fiscal surplus during the 1990s. In many of the areas not yet subject to significant reform such as health, education and urban transport infrastructure, political difficulties are increased because it is necessary to gain the cooperation of the States.

Many of the contributors explore aspects of the long Australian expansion that began in the second quarter of 1991, and this is a second major theme of the conference. A recurring, and ultimately unanswered question, concerns our strong productivity performance over the decade. Does it reflect, as Forsyth suggests, a transitional increase resulting from the reforms of the 1980s? What are the effects of the information technology revolution, or the removal of distortions to investment engendered by high inflation? For Bean, Australia's performance in the 1990s looks very much like Thatcher's productivity boom of the 1980s. In the British case it all ended in tears, largely because monetary mismanagement (in the form of an exchange-rate peg which implied a fall in competitiveness) coincided with the recession that affected most OECD economies at the time of the war against Iraq. He is cautiously optimistic that Australia's long growth cycle will avoid the same ending.

Whether measured by labour productivity or multifactor productivity, the pickup in Australian productivity growth in the 1990s began several years earlier than the much-remarked upsurge in productivity in the United States. Arithmetically, the counterpart to this is that, although the track of GDP growth rates in the two countries over their 1989-91 recessions was similar, labour market outcomes were significantly different. Australian unemployment rose from under 6 per cent in mid-1989 to over 11 per cent in early 1992, while in the United States the corresponding figures are 5.2 per cent and 7.8 per cent. Another point of reference is the Australian growth cycle in the 1980s. In the 1990s, the Australian labour market delivered higher real wage growth and lower employment growth - particularly, as Gregory notes, relatively low growth in full-time jobs. In its early

stages, the Australian growth cycle of the 1990s was characterised as the 'jobless recovery'. Contributions by Gruen and Stevens, Bean, and Dawkins, all analyse aspects of the Australian labour market. Evidently disentangling the effects of productivity change, recovery from recession, and industrial relations reform, is a difficult and unfinished task. But these papers offer a good summary of the state of play.

In Australian financial markets, the 1990s were characterised by a number of clear trends. The increasing impact of compulsory superannuation and a number of privatisations and demutualisations meant that, for an increasing number of Australians, savings were mediated through equity markets rather than banks. As Edey and Gower tell it, there has been something of a recovery in the national saving rate over the course of the 1990s with both the private and public sector contributing to this trend. Gizycki and Lowe trace through the impact of changes in savings patterns on the banking system, and how it has led to banks becoming large borrowers on overseas financial markets, and expanding into the funds management business. Their contribution also discusses prudential supervision of banks and the way in which changing financial markets are leading to changes in the risks facing the banking industry.

It has become rather common for the resilience of the Australian financial system during the Asian crisis to be attributed to recent reforms. Gizycki and Lowe do not make this claim and, for this reviewer, a more prosaic explanation is to be found in the recession of the early 1990s. The Australian banking system spent the early part of the 1990s recovering from the lax credit standards they had applied in the 1980s, the results of which came to roost in 1990, 1991 and 1992. It was too soon, in 1997, for these lessons to have been forgotten by Australian bankers. As to the future, Gizycki and Lowe would, I think, argue that arrangements flowing the Wallis inquiry have yet to be tested. They refrain from revisiting old arguments as to whether the Reserve Bank or an independent regulator should have primary responsibility for prudential supervision, but they do make an argument for deposit insurance.

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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.
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> —*Jeremy Bentham* (c.1801)

Examine Them Until They Pass!

Robert Albon

Examinations are an important part of the tertiary education process. They act as a screening device for enrolment in higher-level units and for the award of degrees, and they provide a reason to learn for students not otherwise motivated by the desire to gain income-earning skills or driven by the thirst for knowledge. Many changes have occurred over the years to the way that students are examined. For example, students tend to be examined at more frequent intervals and in smaller doses, as continuing assessment has become more widespread. Further, 'follow-up' examinations have become more common, to the extent that supplementary examinations on a comprehensive basis and as a right are offered by many of the government owned and regulated Australian universities. These allow students with 'near passes' (usually 45-49) to have another examination, enabling them the possibility of achieving at best a pass grade. Supplementary examinations should not be confused with 'special examinations' which are granted to students who are unable or unprepared to sit examinations at the usual time, usually through illness or accident but sometimes through work commitments. Policies on granting special examinations vary across and even within institutions.

The purpose of this article is to consider the case for and against using resources to conduct supplementary examinations. This is based on in-principle

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argument and the experience of the Australian National University (ANU) with introducing and operating supplementary examinations.

The Origins of Supplementary Examinations

While most Australian universities apparently have at least some availability of supplementary examinations, the extent of this availability within some institutions is limited to one or both of particular faculties and years of study. For example, at the University of Adelaide they are not available in Economics and Commerce and at the University of Queensland they are only available for students failing a unit in their final year that would prevent them from attaining their degree. Similarly the ANU had limited supplementaries in two areas (the Institute of the Arts and the Law Faculty) prior to the introduction of a comprehensive system.

The 'Dawkins era' of the late 1980s and early 1990s was one of big changes to the tertiary education sector that provided the stimulus to comprehensive supplementary examinations in many institutions. The White and Green Papers on Higher Education emphasised the need for universities to increase expedition of students' progress and 'productivity', and did not seem to care whether this was 'artificial'. A 1990 ANU Sub-Committee on supplementary examinations mentioned these productivity improvements as advantages of supplementary examinations.

The ANU joined the 'supplementary examinations club' effective from 1998 after a decision made in 1996. In the case of the ANU the introduction of comprehensive supplementary examinations followed years of activity from radical students with support from the various offices in the University that depend for their existence on students that are 'abnormal' in some way. There were major pushes in the late 1980s and in 1992-93. Both were unsuccessful. The successful campaign was relatively low-key.

In late 1992 the President of the Students' Association announced as part of her agenda the achieving of 'Supplementary examinations for all students' (Howe, 1992). The Students Association was joined by the Dean of Students, the Study Skills Centre, the Educational Services Advisory Committee, some in the Arts Faculty, and, according to the President of the Students' Association, 'The ANU administration is in favour of the proposal in principle'. Indeed this statement proved to be correct. When supplementary examinations were finally legislated in 1996 the then Vice Chancellor welcomed them warmly.

The role of the student support services was extraordinary in all three campaigns. For example, a staff member from the Study Skills Centre initiated the 1989 inquiry by the Board of the Faculties and was an important player in the 1992-93 round. In a paper to the Working Party (Clanchy, 1993) he ran through the standard arguments made in favour of supplementary examinations and concluded from this that supplementary examinations 'provide a flexible, educationally sound, equitable and efficient instrument for counteracting some of the inadequacies and burdens on students imposed by the current structures of

Higher Education.' The Dean of Students (Cornish, 1993) felt that this paper 'raises a number of persuasive arguments'.

The Benefits Claimed

Proponents of supplementary examinations have claimed a number of benefits from them, and these were all rehearsed during the ANU debates. These arguments are considered, beginning with the more plausible, and ending with those that are either illusory or are arguments for other things.

Examiners are unsure

It is often claimed that examiners may be unsure whether a student has passed or failed. In my experience, examiners place greater weight on avoiding failing a student who has actually passed than the opposite error of passing a student who has actually failed, and have devoted considerable effort (including examiner-initiated further examination) to the consideration of marginal cases. While a supplementary examination may help in deciding whether a student has passed or failed, compulsion is neither necessary nor desirable. There are other ways of ensuring that examiners do their job properly, including the (re)introduction of external examiners.

Resource savings

Supplementary examinations at ANU followed a period where the number of students being granted special examinations had been increasing rapidly and was a matter of some concern because of the associated administrative burden. Suggestions made at the Working Party that specials and supplementaries could be integrated showed little understanding of the role and nature of special examinations. The timing requirements of specials (in the interests of students and staff, usually held before or very soon after results are finalised) and the nature of the assessment being made under specials (students concerned are being tested for the full range of grades, not just pass/fail) are different from those of supplementary examinations. The suggestion that a combined 'special-supplementary' examination could be held in September and February has proved unworkable.

Inadequate preparation and declining educational quality

The 1990 ANU sub-committee report pointed to the 'inadequate preparation for or slow settling into university study' by many students, and declines in the quality of advice and teaching. Making supplementary examinations available is an inappropriate approach to these problems for three main reasons.

First, these problems should be — and are — attacked in other ways. Admission criteria and opportunities for students to prepare in advance for university studies are the important considerations for dealing with

unpreparedness. Where a student has learning or other difficulties throughout the semester or year, s/he has access to expert advice. If the problem is with a specific unit, advice can be sought from tutorial and lecturing staff in that unit. Where the difficulties relate to study skills or library use, students have access to specialist facilities for advice available at the ANU and other universities. Information about these facilities is disseminated widely; including prior to and during orientation presentations. If the difficulty lies with course advice, the Sub-Deans and Faculty Secretaries provide the support structure. Similarly, if the difficulties relate to personal and/or adjustment problems, counsellors provide assistance.

Second, if there are concerns about quality of teaching and advice then it is looking in the wrong place to suggest that the problems can be attacked by a change that will result in the diversion of resources away from teaching and advisory activities.

Third, it is difficult to see how the availability of supplementary examinations can enhance the settling-in process and the solution of learning difficulties. If anything, the existence of a 'safety net' will act as a disincentive to the early development of responsible and productive work habits. This aspect is further considered later.

Increasing costs of failure

Claims were made in the ANU debates that 'the penalties for students (of poorly informed choice, of poorer teaching and learning) are actually rising', the introduction of the Higher Education Charge and changes to the Overseas Student Scheme mean that 'failure and withdrawal suddenly cost in a way they haven't before', and that 'problems of "blockage" arise when students fail first semester units'. All these points relate to the rising cost of failure, which, in the minds of the proponents, somehow constitute a case for a radical change to the examination system.

Let us accept for the sake of argument the implicit proposition that the higher the cost of failure for a particular student, the more 'consideration' and chances that student should be given. The implications of accepting such an argument are disturbing. For example, the pecuniary costs of failing for a person not intending to enter the work-force are minimal as no HECS will ever be paid and there is no opportunity cost of being at university. The 'principle' would dictate that no second chance be given; the Dean of Students could be imagined to say — 'Off you go, the costs of failure for you are zero. Try again next year'.

In the middle of the costs spectrum we have the typical Australian school-leaver who probably will get a sufficiently well-paying job as to require repayment of a HECS liability. Here a single supplementary examination may be reasonable under this principle. Then, at the other extreme, there are the full-paying students from overseas for whom the costs of failing are often much higher than they are for Australian students. For them the 'principle' might dictate a supplementary 'supplementary' examination (that is, a third attempt at passing) or at least that they be given an easier first examination and the opportunity for a

supplementary examination. The implications of accepting this principle are neither fair nor conducive to educational attainment.

Increase in 'productivity'

Two of the hallmarks of the Dawkins era are the White and Green Papers on Higher Education. These emphasised the need for universities to increase expedition of students' progress and 'productivity'. But what is academic progress? Unfortunately the authors of these papers in the Department of Employment, Education and Training (DEET) did not mean 'real' progress; rather the process of just crossing out some Ns and replacing them with Ps on the result sheets. There is no real productivity or academic progress improvement from doing this. For those who do not clear the hurdle and who attempt the supplementary examination, a week of 'cramming' is probably the most that could be expected from most students granted a supplementary examination, and this does not constitute quality work time of lasting value. There is no real productivity or academic progress improvement.

Pervasiveness

It was claimed in the ANU debates that supplementary examinations are 'available at almost every other Australian university'. This is neither an argument for supplementary examinations at any particular university; nor — at the time — was the statement correct in any meaningful sense. The principal criterion of evaluation of any educational innovation should be, in some sense, 'educational attainment', not what others are doing.

The Costs

Disincentives to industry and responsibility

Educators in tertiary institutions are constantly trying to find ways of motivating students to industrious and responsible work habits. Unfortunately there is a substantial minority of students who attempt to get through with the minimum amount of work. It is this group that will perceive an advantage from the availability of supplementary examinations in that they have a safety net. The unequivocal message from theoretical and empirical research in educational psychology is that some degree of pressure is necessary as a motivational force (see, for example, Mouly, 1968, Ch. 12). Within reason, pressures to do well should manifest themselves in diligent work habits, acting as a stimulus to educational attainment. Anxiety always seems to increase around examination time for all students — and staff — but especially so for those students who have not worked consistently throughout the semester. Supplementary examinations will reduce the pressure on, and effort of, these students — as Mouly puts it, a 'complete lack of tension ... [will be] reflected in indifference to schoolwork and in irresponsible behaviour.' (p. 335).

This also has implications for the 'increasing cost of failure' argument for supplementary examinations. If the cost of failure is high for a particular student, then that student has an incentive to work harder to ensure success. Lowering the cost of failure by allowing a supplementary examination reduces the incentive to work.

Direct resource costs

Compulsory supplementary examinations have resulted in increased costs to academic and general staff which, in turn, impacts adversely on the majority of students. Staff has been diverted from its primary task to that of examining and advising students who, in many if not most cases, are not devoting enough time and effort into their studies. Teaching staff is unable to devote as much time to preparation of lectures and course materials. Research also suffers. This contributes to what has been called elsewhere the 'dumbing down' of the universities.

Unfairness

Compulsory supplementary examinations are inequitable under common notions of fairness. In particular it is unfair to the majority of students who do sufficient work throughout the semester and it is inequitable for those students concerned about the lack of opportunity to have a second chance at grades above the pass level (for example, those on a 'near distinction').

Conclusion

There are no compelling arguments on either educational or practical grounds for the existence of supplementary examinations as a right. The arguments put either are irrelevant, refer to problems with other solutions, or refer to situations where supplementary examinations actually cause damage. Indeed, there are clear costs from compulsory supplementary examinations, especially through disincentives to industry and responsibility and the diversion of staff from activities with positive educational value. As there are no credible arguments for compelling examiners to offer supplementary examinations and there are compelling arguments against them, supplementary examinations should be non-agenda for Australia's government owned and regulated universities.

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