From Work-fare to Welfare: The Budgetary Imperatives.

After Whitlam: George Reid's revenge and the Fall of the Deakinite Settlement

Paper to H.R. Nicholls Conference

Melbourne, Saturday, August 28 1999

Paul Kelly, in his book *The End of Certainty*, refers to what he calls Australia's 'Federation Settlement' as a set of five fundamental principles of policy:

- *Imperial Benevolence*—postulated a latently hostile international environment in which Australia needed a Great and Powerful Friend;
- *White Australia*—explicitly aimed at stopping labour competition from non-whites;
- *State Paternalism*—the use of state power to provide services and protect people from the vagaries of the market;
- *Wage Arbitration*—the use of state power to set wages and conditions; and
- *Trade Protection*—the deliberate insulation of Australian manufacturers from international competition.

Kelly described the underlying story of politics in the 1980s as being the dismantling of this Settlement.

This theme of a change of direction was also picked up in Michael Pusey's 1991 book *Economic Rationalism in Canberra* which kicked off the so-called 'economic rationalism' debate. Pusey's work had the subtitle of *A Nation-Building State Changes Its Mind*.

The change of direction of Australian policy both writers refer to is best described as the unravelling of this Settlement. This unravelling is still going on, sometimes with great public drama, as with last year's waterfront dispute. The move to greater use of market mechanisms in some areas of public policy came primarily came from problems within the mix of state policy. In particular, the consequences of change in one part of the Settlement—State Paternalism—under the Whitlam Government. Yet, despite the extent of the economic reforms, we have not really dealt with the underlying problems, we have merely ameliorated them.

1905 to 1972

The term 'Federation Settlement' is something of a misnomer. While White Australia was speedily installed as part of Commonwealth policy and Imperial Benevolence was inherent in the entire structure of federating colonies under the aegis of the British Crown in a Constitution whose original legal power came from being an Act of the Imperial Parliament, State Paternalism, Arbitration and Trade Protection were not firmly established as Commonwealth policy until the Deakin Government of 1905-8. Due to the agnostic position of the cross-bench party—the ALP—the first Parliament had a narrow protectionist majority in the Representatives and a narrow free trade one in the Senate. It was not until Arbitration was accepted as intimately tied to Protection that the tariff moved beyond being a 'revenue' tariff to being a genuinely protective instrument. It was also the Deakin Government which founded the Commonwealth welfare state.

The Deakinite settlement had been first tried in Victoria, urged on by David Syme, maker and breaker of governments. Protection, wages boards and labour market regulation, massive government borrowings, all came to grief with the 1893 crash, the effects of which were much worse in protectionist Victoria than in free-trading NSW, not least because a run on the banks was mishandled by the local authorities. Between 1891 and 1901, the Victorian male workforce fell by 1 per cent while NSW's grew by 19 per cent.[1] NSW had far less of the borrowing-financed railway development, and accompanying land speculation, that had blighted Victoria. Many thousands of unemployed Victorian men went to the WA gold rushes to support their families, where they voted in due course for Federation. (The general pattern was to be repeated in the 1990s recession, with the VEDC, Tricontinental and migration to Queensland.) NSW was a bit apprehensive about Federation in part because it sensed that Victoria was going to share its debts with NSW. That apprehension was wholly justified.

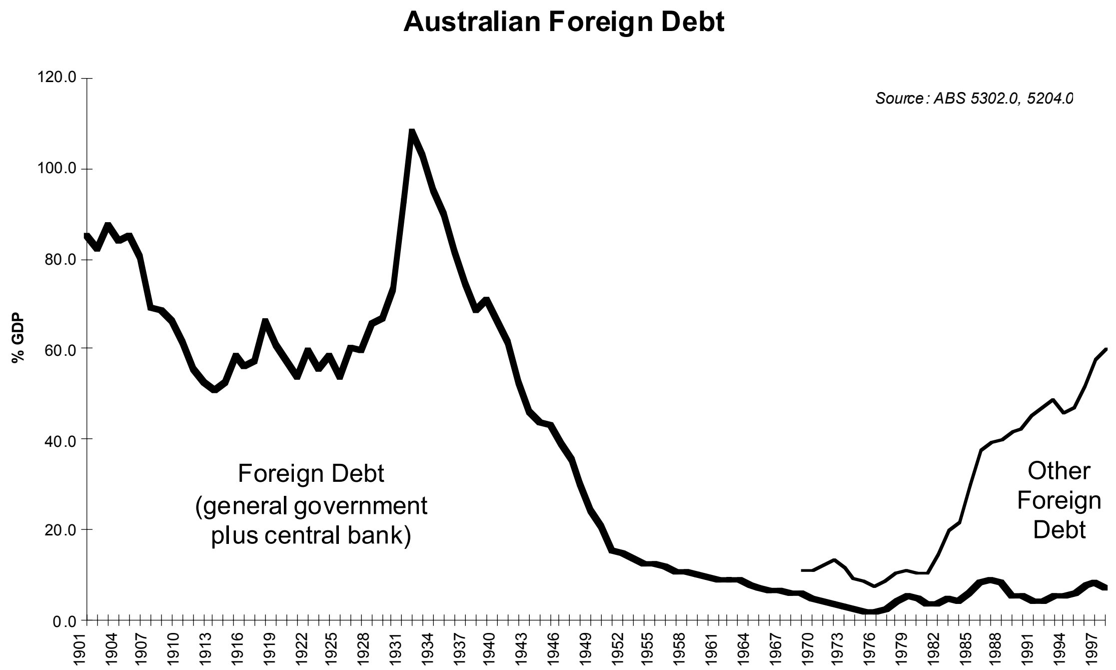
The first signs of revolt against the Deakinite Settlement came early, with the election of farmer candidates from rural seats, coalescing together as the Country Party in 1920. The net costs of the system were being paid by exporting industries—the Deakinite Settlement in its pure form being based on extraction of rents from the rural-based export industries of agriculture and mining by urban-based groups through the operation of public policy. This was an obvious route for Australian policy to go. Urban voters dominated the national electorate while Australia's status as the wealthiest society in the world at the end of the nineteenth century rested in large part on the resource base of an entire continent being efficiently extracted and exported and the returns then being distributed across a very small national population.

The rural revolt was 'bought off' by the Earle Page-led Country Party being incorporated in an expansion of Deakin's system through marketing boards, agricultural tariffs, subsidies and rural infrastructure. The costs of the expanded system were supported by government borrowing,[2] leaving a highly indebted Australian state extremely vulnerable to the savage impact of the Depression and the destruction of international trade that followed the 'beggar-thy-neighbour' protectionism triggered by the Smoot-Hawley tariff in the US.

[1] The female work force was much less affected, growing by 42 per cent in Victoria and 46 per cent in New South Wales, leading to an 8 per cent growth in the total Victorian work force and a 24 per cent growth in the total New South Wales work force. Vamplew, W. (ed.), *Australian Historical Statistics*, Fairfax, Syme & Weldon Associates, 1987, Sydney, P.147.

[2] The term 'general government' is a statistical definition used in the national accounts system to refer to government departments and authorities not classed as government business enterprises (themselves divided into public trading enterprises and public financial enterprises).

Graph 1



This is why Australian politics of the Depression were so dominated by issues of public debt—Australian level of foreign indebtedness being, in proportion to the economy and asset base, far higher in the 1930s than any time since. This foreign debt was overwhelmingly government debt.

The long postwar boom saw public debt recede as an issue. This postwar boom is now seen as something of an economic ‘golden age’, a period of low inflation and low unemployment. It was the period where the Deakinite Settlement seemed to have achieved status as settled policy, particularly in economic policy.

Yet, even here Australia under-performed: Australia’s rate of per capita GDP growth from 1960 to 1972 was 70 per cent lower than the industrial country average. Where, on average, per capita GDP increased by more than half in those years in industrial countries, in Australia it increased by less than a third.[3]

But such relative under-performance is not the stuff of policy crises. Australian public policy continued on its way. 'Black Jack' McEwan sought a similar rural inclusion as the Bruce-Page expansion of Deakin’s 'New Protection'—though, to be fair to McEwan, his policies also rested on moderately sophisticated exchange rate policies and aggressive seeking of export opportunities (in particular, early recognition and exploitation of Japanese trading opportunities). The minerals boom of the late sixties put off the day of reckoning for at least a decade.

[3] Other factors included Australia being relatively undamaged by the War (so not getting ‘easy’ high growth from recovery) plus high population growth diluting returns from Australia’s resource base.

Just as it had in the 1920s, all seemed sunny in the 1960s. There was no sense that the general framework could not continue to deal with any new problems that might arise. The program of the incoming Whitlam Government encapsulated the mood that what was needed was better management of the fruits of growth. So the Whitlam Government undertook a massive expansion of State Paternalism—just as the 1973 Oil Shock and global recession of 1973-74 hit.

The Workfare State

By the post-war period, the Deakinite Settlement had created what is best described as the 'workfare state'. At the time of the election of the Whitlam Government, Australia had a somewhat different balance of government activities compared to other OECD countries. The Australian welfare state was smaller than most OECD countries. Yet this was combined with very extensive government ownership of major utilities without, however, much government ownership of non-utilities. There were some exceptions—government-owned printing business, State butcher shops, brickworks and so on—but Australia lacked the 'commanding heights' ownership of coal mines, steel works and other manufacturing enterprises that was common in Europe.

The extensive government ownership of utilities distinguished Australia from the US. The more modest scale of the welfare state, as well as the lack of extensive ownership of resource and manufacturing industries, distinguished Australia from Western Europe.

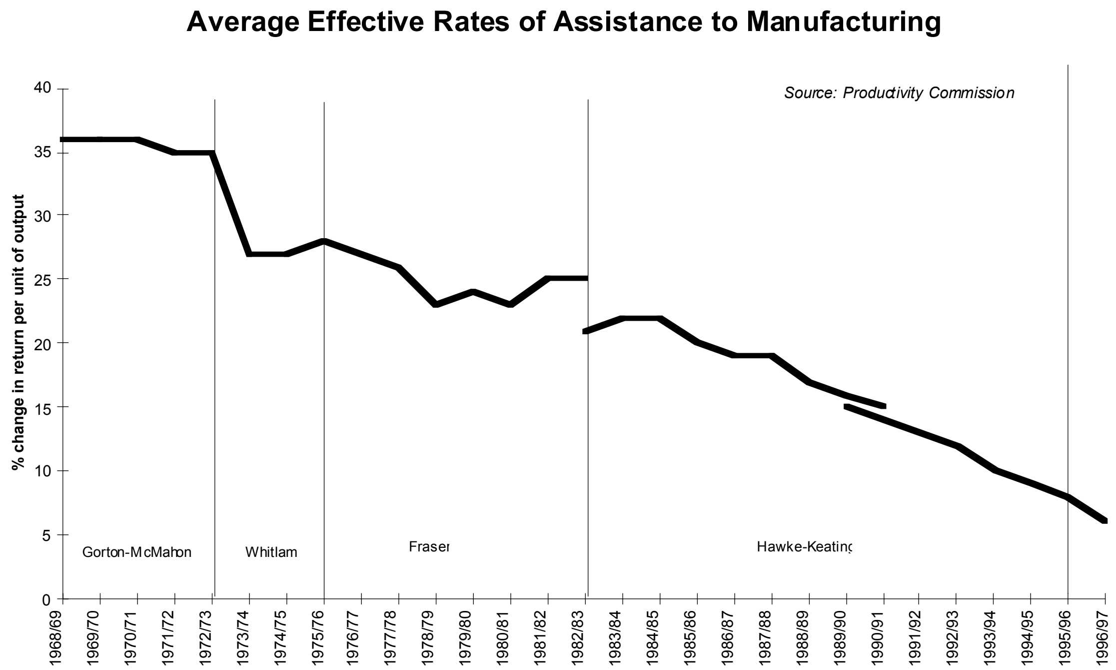
The Australian 'workfare' state employed a very large proportion of the workforce—22 per cent of employment was in the public sector at the time of the election of the Whitlam Government. The expenditure on the 'workfare sector'—government business enterprise outlays plus investment by the general government sector—was, at almost 11 per cent of GDP, about equal to recurrent government expenditure on health, education and welfare services plus income transfers.

This workfare state was, very consciously, about nation-building. Public investment was seen as the best available means, perhaps the only means, of getting the infrastructure investment a young, growing nation needed. And its positive impact on provincial employment was no small point.

Furthermore, with Protection and Wage Arbitration, the ambit of government action extended far into the commercial life of the country, particularly the labour market. Ever since Mr Justice Higgins' 1907 *Harvester* judgement, the operation of labour market regulation had been explicitly focused on achieving welfare objectives.

Similarly, a situation where manufacturers typically relied for 35 per cent of their unit return on tariff and other protective policies, was one where much of the focus of firms was displaced from making commercial judgements to lobbying Canberra. The idea of using Australia as a base for a global enterprise was confined entirely to the resource industries, and not common there.

Graph 2



The Deakinite system was 'formalised risk-transference capitalism' with underlying similarities to what has become known as 'crony capitalism'. In the case of 'crony capitalism', commercial risk is replaced by political guarantees through corruption and political connection. In the case of the Deakinite system, commercial risk was displaced by political guarantees in the form of legislated privileges delivered through political networks ratified by formal inquiry processes.[4] Explicit corruption was largely avoided, the building up of systemic risk was not. In either case, risk was transferred to political mechanisms not well able to manage them, particularly if circumstances changed substantially.[5]

As one wit remarked, Australian free enterprise was only formally free and only notionally enterprising.

The Fatal Blow

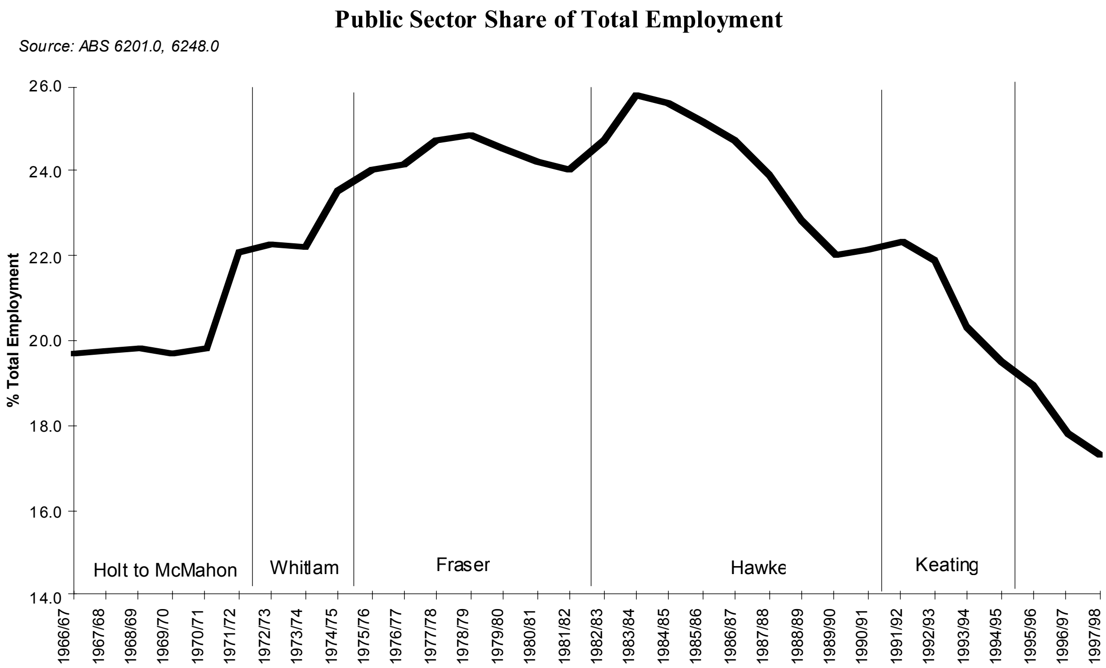
It was not the intent of the Whitlam Government to undermine this workfare state. Indeed, the workfare sector expanded. The 'workfare' sector of government outlays peaked at 14 per cent of

[4] As a device to increase capital formation in a society felt to suffer from certain inherent deficiencies in capital formation it has some similarities to the 'Asian' model of development. See Deepak, L. *Renewing the Miracle: Economic Development in Asia*, IPA, February 1999, particularly pages 2-5.

[5] As with the '1940 system' in Japan (see Peter Hartcher's excellent article in the *National Interest* 'Can Japan Come Back?', Winter 1998/99), the Deakinite system failed to cope well with significant change in circumstances. In fact, it proved less resilient to the pressures of the 1970s than the Japanese variety of corporatism, which did not fail until the late 1980s. Conversely, Australia's willingness to engage in real reform actually spared Australia the level of failure Japan has since experienced—it has been estimated that the loss of wealth inflicted on Japan by the failures of the 1940 system are, in real terms, twice the value of the wealth destroyed by American bombing in World War Two. Moreover, the loss was accompanied by a massive wealth transfer to the United States, as Americans bought back at much less cost assets they had previously sold to the Japanese (a process that also occurred to some extent in Australia).

GDP in 1985/86 and 1986/87. The public sector share of employment peaked at 26 per cent of total employment in 1983-84 and 1984-85.

Graph 3

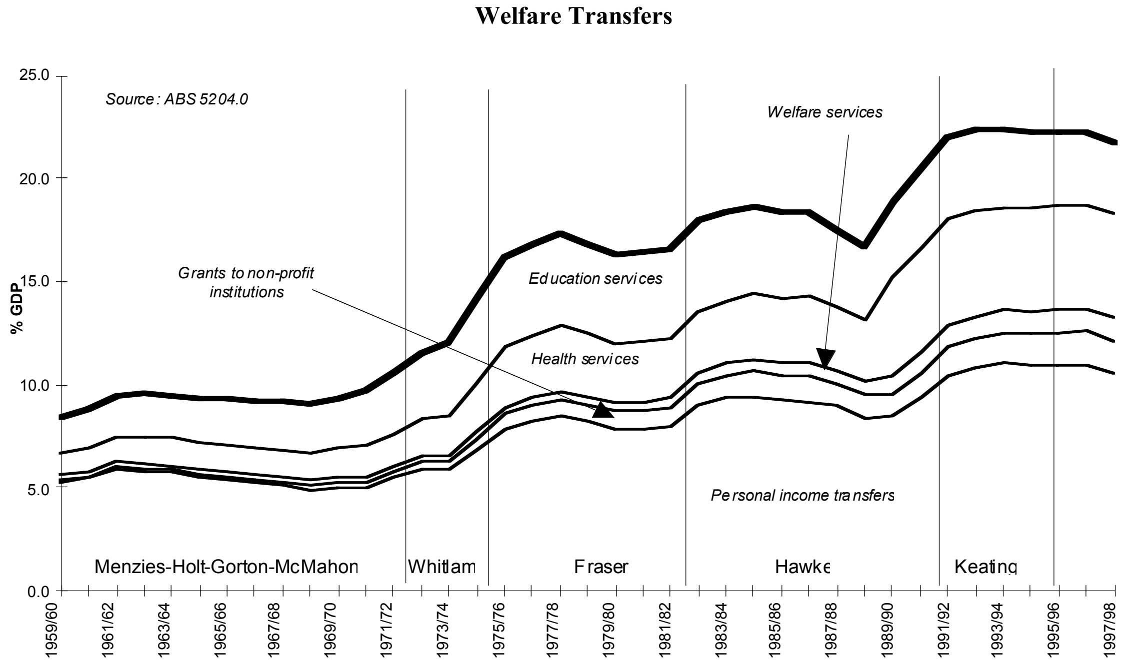


The Whitlam Government's 25 per cent tariff cut—a response to the economic crisis of the time—increased competitive pressures within the system. The Whitlam Government also ostentatiously completed the process of abolishing White Australia begun by the Holt Government.[6] But it was the dramatic increase in welfare expenditure which was to have the greatest long-term consequences on public policy.

In 1971-72, expenditure on health, education and welfare totalled 11 per cent of GDP, out of total recurrent government expenditure of almost 24 per cent of GDP. By 1975-76, expenditure on health, education and welfare totalled almost 17 per cent of GDP out of total recurrent government expenditure of 29 per cent of GDP. This sudden upward shift was followed by continuing increases. Health, education and welfare expenditure now reaches almost 22 per cent of GDP, with total recurrent general government expenditure being over 33 per cent of GDP.

[6] The Whitlam Government marked the end of the protection of Anglo-Celtic identity via public policy.

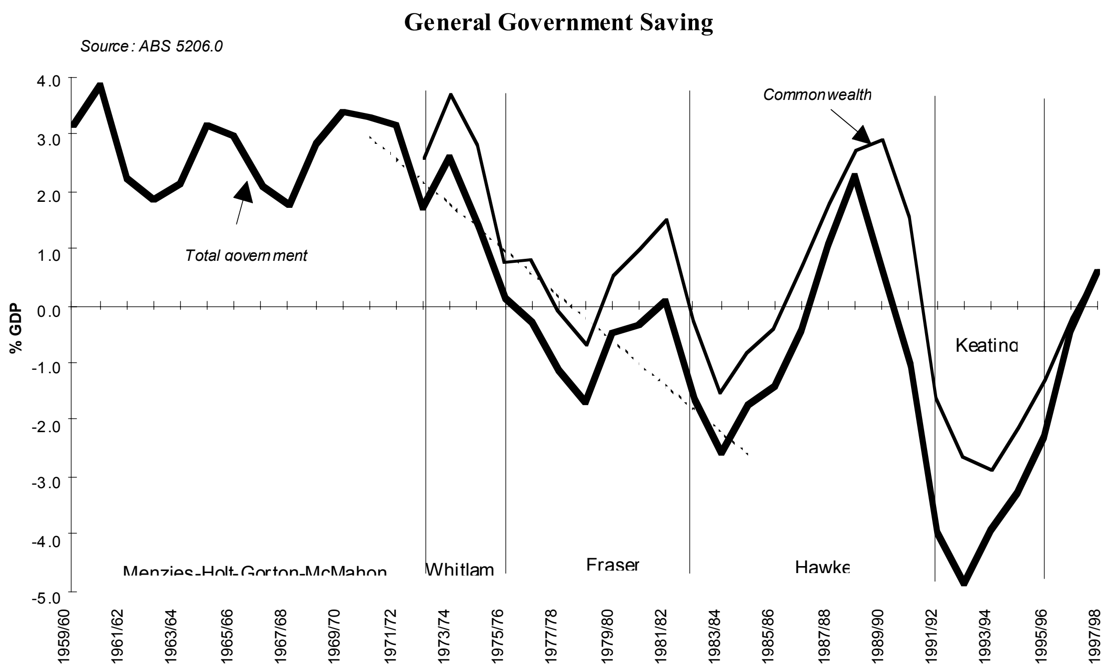
Graph 4



Given that the workfare sector continued to expand until the early to mid-1980s, how did the Whitlam Government deal a fatal blow to the traditional workfare state?

Well, the effect was delayed, but the blow was fatal nonetheless. The first effect was that the expansion of the Australian welfare state saw a collapse in general government saving.

Graph 5



By the end of the Whitlam government, the Australian general government sector had gone from a saving rate of about 2-4 per cent of GDP to barely saving in 1975-76 to a pattern of negative saving—that is, the financing of non-capital expenditure by borrowing or selling assets—more often than not. The expenditure received being more popular than the taxes to pay for such, the extra welfare expenditure was accommodated by eliminating government saving, later by outright borrowing and sale of assets.

Enterprises only have three possible sources of capital accumulation. One is from retained earnings, one is from borrowing, one is from equity injections. General government saving was the workfare sector's equivalent of an equity market. It was now effectively eliminated. This left government business enterprises reliant either on retained earnings or increased borrowing for their required capital. The increasing revenue demands of government largely eliminated the former, leading to increased reliance on borrowing. From there, given the governance problems which riddled the sector, it was an easy path to the debt-disasters of SA State Bank, VEDC, WA Inc, the undermining of public ownership and the forced sale of government assets.[7]

Politicians put off facing hard choices as long as possible. While the Fraser Government did manage to slow the expansion of the welfare sector, the choice between workfare state and welfare state was not faced. Cutting welfare seriously was seen as politically too hard, while painful economic reforms seemed unnecessary.[8] This was the era of 'resource scarcity' *a la* Club of Rome and Oil Shocks, where a resource-rich Australia had the prospect of 'resources booms'. We could become 'the blue-eyed sheiks of the South Pacific' in Doug Anthony's words. We could have our workfare cake and eat welfare too.

Except we couldn't. The Club of Rome had blithely extrapolated demand lines without serious consideration of price effects (either short term or long term). The sudden rise in oil prices had predictable effects in drops in energy intensity of production and stimulation of exploration and extra energy supplies. Resource scarcity and booms turned with extraordinary speed into resource gluts and busts. Predictions made in the early 1970s of oil reaching the equivalent of US$100 to US$150 by the end of the century turned out to be ludicrously off the mark—oil is currently $US21-23 a barrel, having recently been as low as US$12 a barrel: in real terms, it is only about two-thirds the price it was after the first Oil Shock of 1973.

Australia's terms of trade—the price of its imports in terms of its exports—deteriorated steadily during this period.

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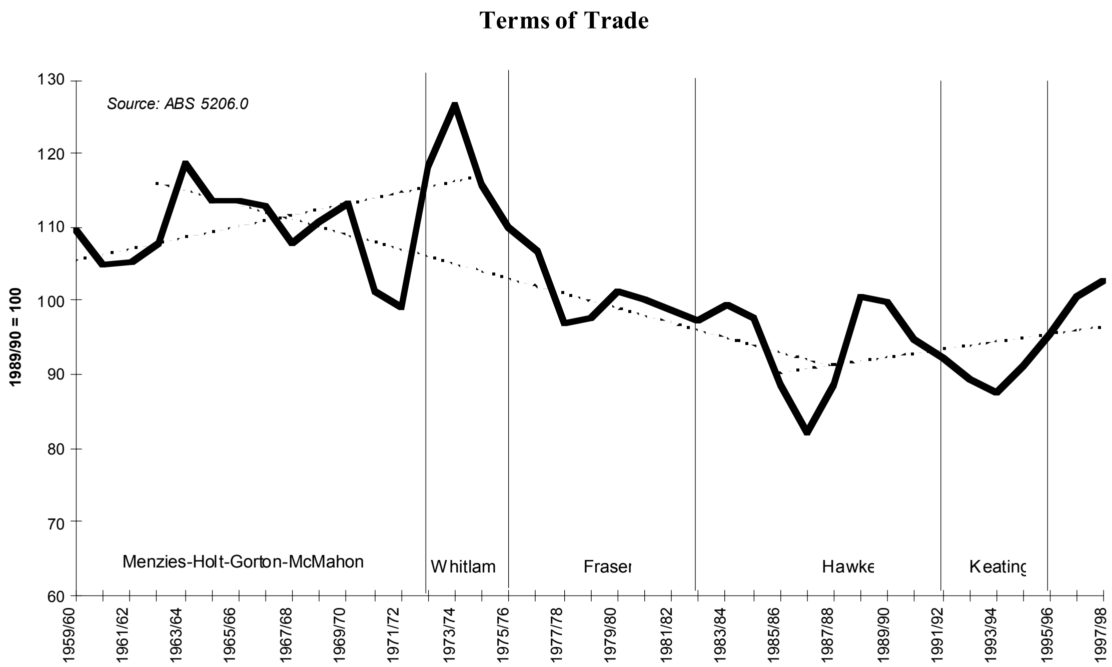
[7] When a public enterprise was faced with a bad debt, it was easier to cover up the problem and hope it would go away rather than writing debts off (embarrassing) and changing commercial practices. As a result, bad debts snowballed as poor practices were not terminated early. See footnote 12 for references on government ownership as being one of 'unowned capital' and thus insufficient incentives for concern with efficiency of resource use.

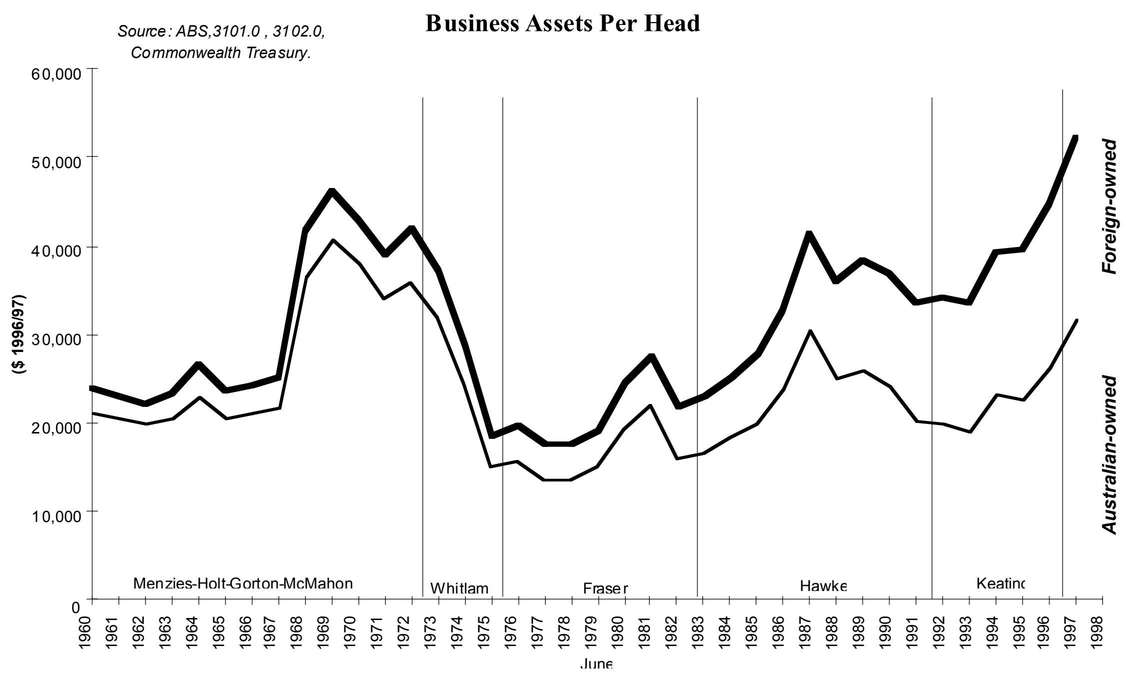
[8] That the low-return on capital workfare state was unable to provide sufficient employment was clear enough: that it had longer term problems was not.

Graph 6



While the Oil Shock helped trigger an asset price collapse in Australia and the US comparable in scale to the stock market crash of 1929,

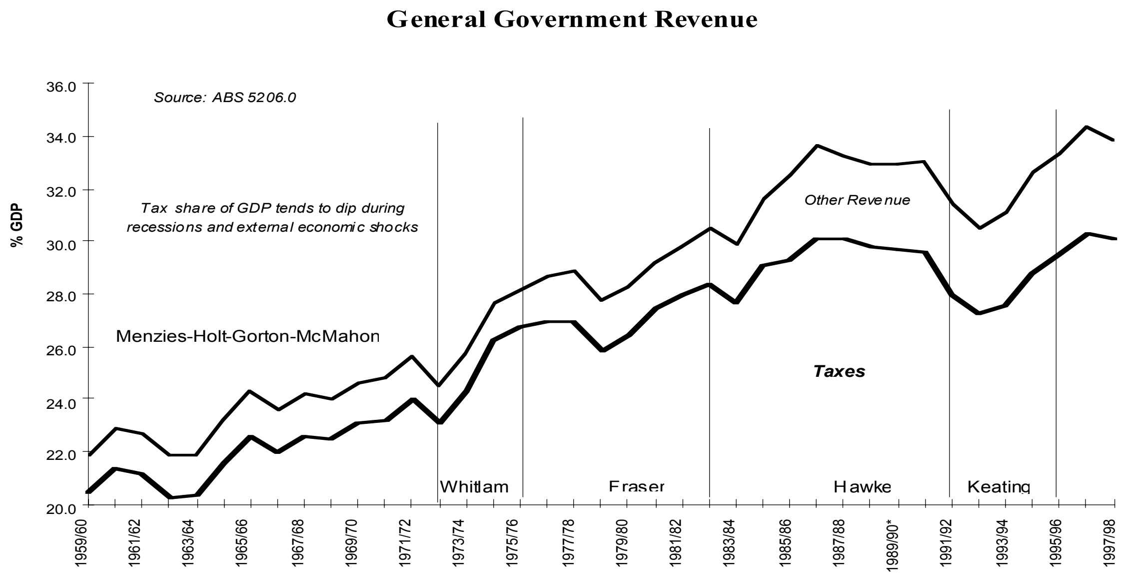
Graph 7



a world Depression was avoided: perhaps because memories of the Depression, expressed institutionally in the General Agreement on Tariffs and Trade, stopped a catastrophic collapse in world trade through 'beggar thy neighbour' protectionism.[9]

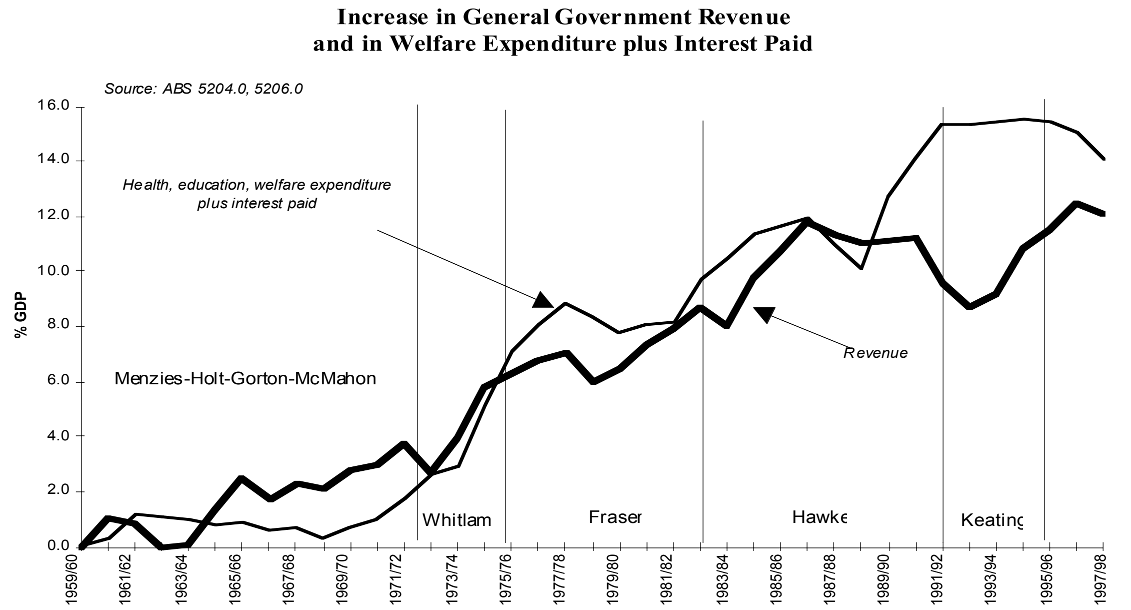
The fiscal pressure on government has been relentless. Government revenue has increased:

Graph 8



but the increase in welfare expenditure has outpaced it

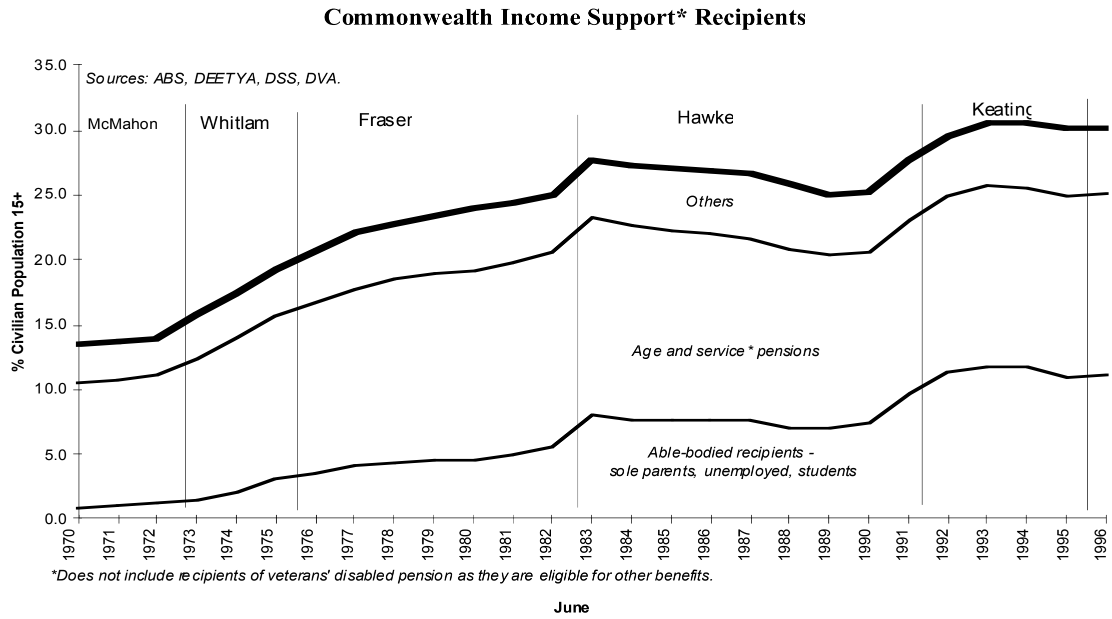
Graph 9



[9] That monetary authorities did not respond to an asset collapse with contractionary policies, unlike 1929-30, certainly

The growth of income transfers in particular did not primarily come from the ageing of the population, but from growth in able-bodied welfare recipients—sole parents, unemployed, students.

Graph 10

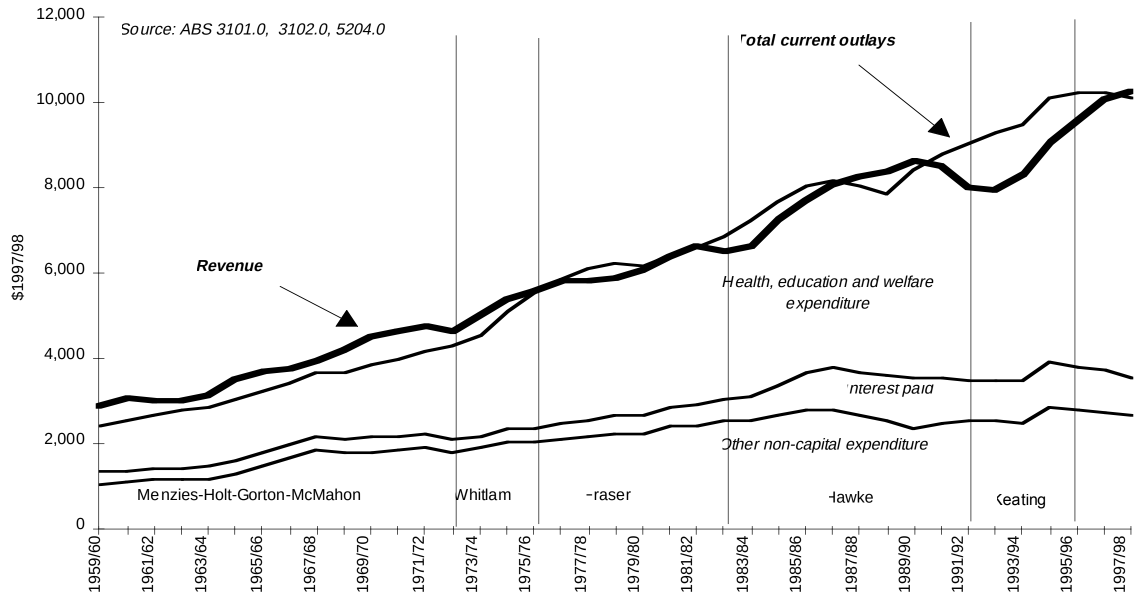


Let us be clear about this. The welfare sector has been steadily growing, not shrinking. Government resources per Australian have been increasing.

Graph 11

helped, as did the fact that the economic down-turn was not centred in the US, again unlike the case in 1929.

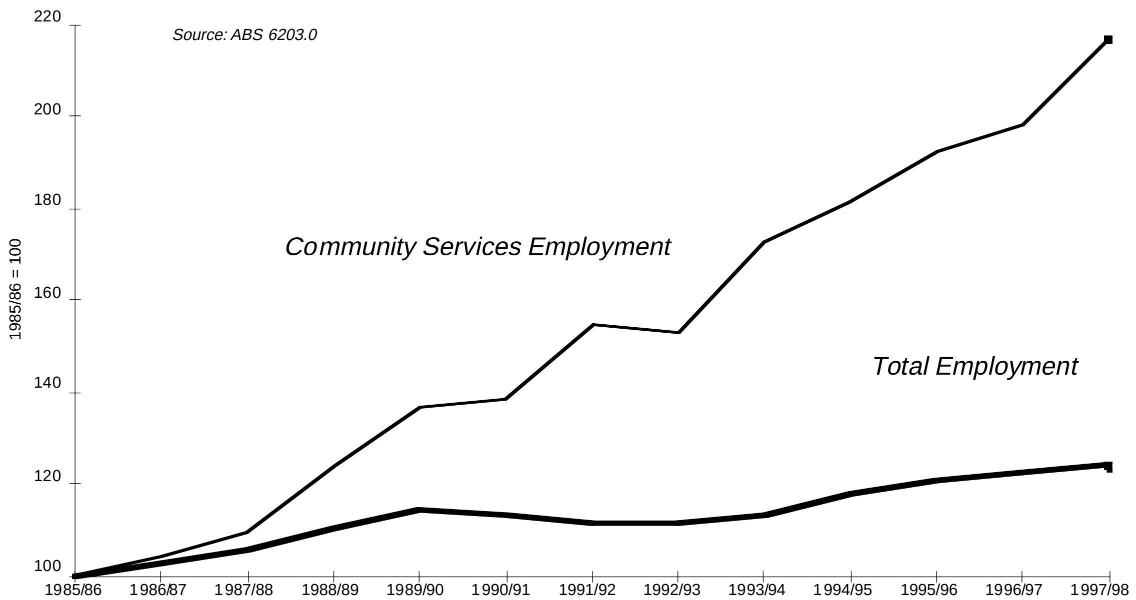
General Government Revenue and Current Outlays Per Head



The growth in community services jobs (child care, nursing homes, etc), for example, has dramatically outstripped general employment growth:

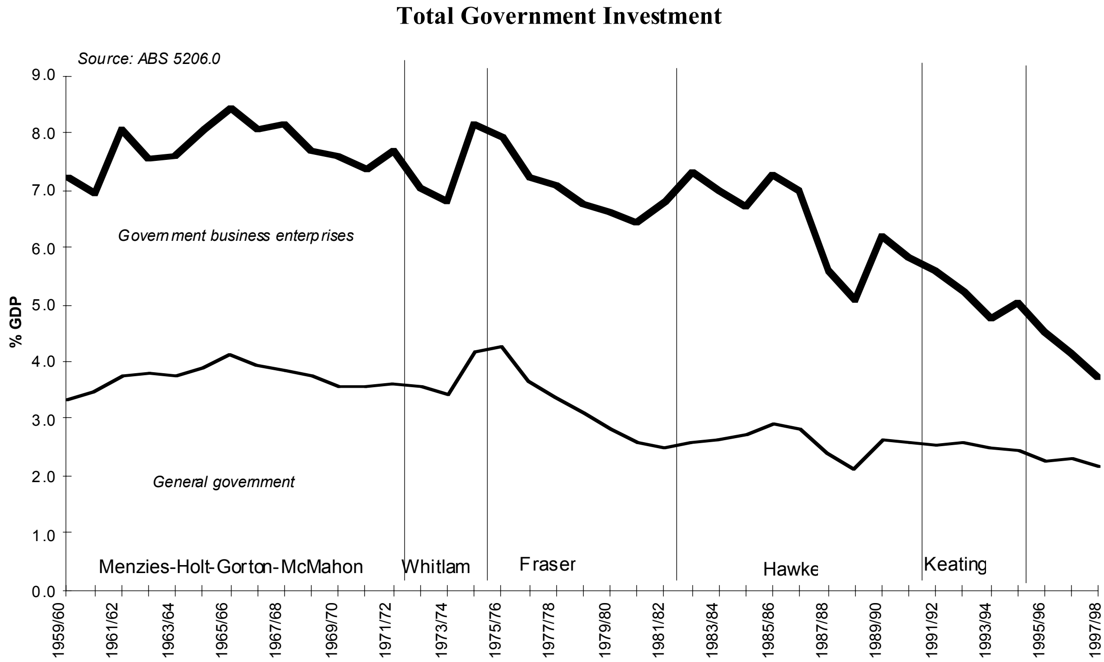
Graph 12

Growth in Community Services and in Total Employment



The collapse in government saving was part of the response to this fiscal pressure. Another was a winding back in government investment

Graph 13



which meant a further movement away from the workfare state. But there has certainly be no real lack of government resources: just an expansion of ambition in excess of revenue, and in excess of any full examination of the costs and benefits.[10]

Facing the Choice

Coming to office in the tail end of the 1982-83 recession where, true to its twentieth century form, Australia had performed worse than comparable countries, the Hawke Government faced the choice between workfare state and welfare state and chose the welfare state. The Hawke government's policies of floating the exchange rate, freeing capital markets, corporatising and privatising government activities, reducing tariffs and selective other deregulation of markets—a program of reform enacted to varying degrees by State governments as well—became known as 'economic rationalism'. Those reacting against the program—such as Professor Pusey—typically saw it as some weird 'economic fundamentalism' that had invaded Canberra/Australia/Anglo-Saxon countries: a free-floating delusion completely unanchored in any real policy problems or issues.

[10] There are many reasons to suspect that the full costs of government are not taken into account. The displacement costs of taxation and regulation (all the mutually-beneficial transactions that do not take place because of taxation and regulation) are things which do not happen, so do not get accounted for. (The central difference between poor societies and rich ones is the things which do not happen in poor ones, but do in rich ones). The compliance costs of taxation and regulation are borne by citizens and firms, not the political process and political actors. There is little or no systematic examination of the benefits of government expenditure and regulation, much of which takes place on a basis where there is no systematic feedback or incentive structure connecting what is done to benefit delivered. Appearing to do the right thing (often on what is implicitly a very simplistic basis of outcome=intentions+resources) is much more important than actual effects. Expenditure on indigenous policy shows this particularly invidiously, not least because debate on indigenous issues have been highly restricted due to the very narrow range of views which have been deemed acceptable by the media, though there have been some signs of a broadening of the debate recently.

In reality, similar choices were being confronted by governments all over the world. Between January 1984 and September 1995, in the area of infrastructure alone, 547 firms in 86 countries were privatised for a total value of $US357 billion. Corporatisation and marketisation also occurred on a large scale around the globe. The global scale of privatisation on its own makes a complete nonsense of the view that the move to privatisation and market reforms is some specific Australian or Anglo-Saxon madness.[11]

Indeed, fiscal crisis leading to liberal reforms is a very old pattern in Western history, reaching back into the late Medieval period. The public sector is more tolerant of waste and failure than the commercial sector, for reasons which are quite straightforward. Businesses have to build their income out of continual dispersed acts of consent. People can just withdraw, or not give, their support as easy, individual decisions in situations where they directly feel the benefits, or not, of a service. By contrast, public sector incomes are based on centralised coercion. Once the decision to fund something is in place, it is hard to reverse beyond periodic pruning, particularly against entrenched interests, as the taxpayer is so distant from decisions and their effects. This is why, down the centuries, liberal reforms have typically been driven by fiscal crisis—it takes a general funding crunch to break through the logjam of special interests.

As Milton Friedman has said, capitalism is a profit and loss system and, of the two, loss is by far the more important. It is the elimination of what doesn't work. All societies accumulate 'barnacles'—social formations which consume more value than they provide and impede the general operation of society. The trick is to have effective systems which regularly eliminate such 'barnacles'. Market economies do: command economies, for example, don't. Democratic states, being more accountable, also have advantages in 'barnacle removal' over authoritarian states, though these are not as pronounced as that of market economies over command economies. (Democracy is the political form most like a market, but still represents the operation of centralised coercion.)[12]

If one is going to pay for a growing welfare state, one needs a growing economy. The 'policy alliance' which later became known as 'economic rationalism' brought together economic liberals with those who wanted to ensure the welfare state could be paid for. We have recently seen the same alliance come together for tax reform. The welfare lobby now understands that without adding the 'S' to the current GT, the capacity to maintain and extend the current welfare state, as services increasingly dominate economic activity, will decline.

Freeing up of capital markets and the exchange rate was part of this process of increasing the general efficiency of the economy to ensure an affordable welfare state. The reform and

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[11] David Henderson's study *The Changing Fortunes of Economic Liberalism: Yesterday, Today and Tomorrow* (IPA, NZBR, 1999) and Lord Skidelsky's brilliant essay *The Road From Serfdom: The Economic and Political Consequences of the End of Communism* (Penguin, 1995) demonstrate the vacuousness of this view.

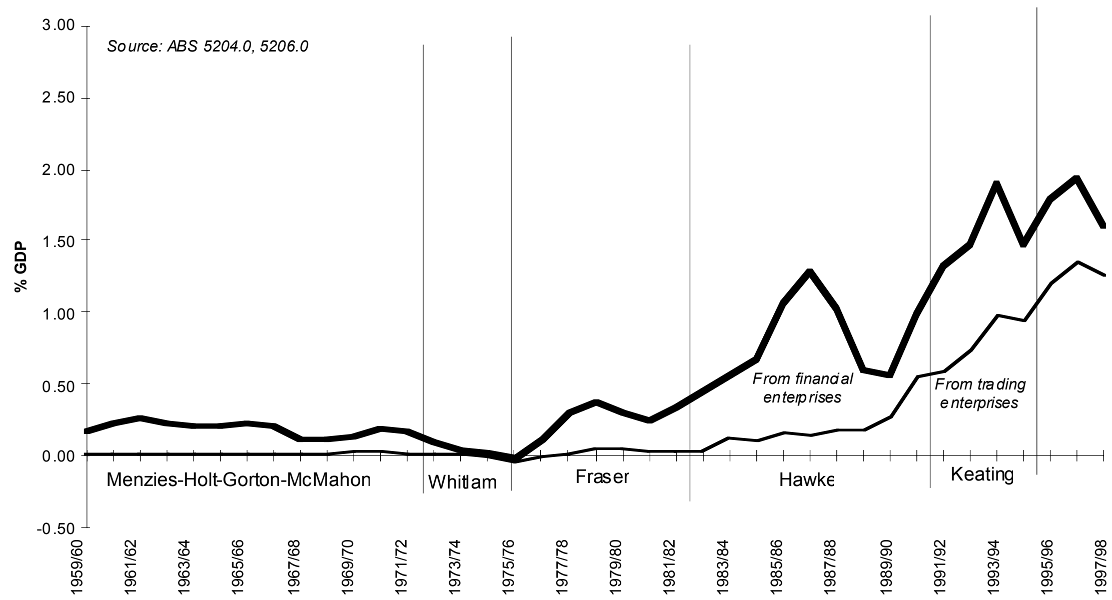
[12] The central difference between the US and the old Soviet Union was the difference between a society with a huge and vibrant commercial sector which rewarded success and punished failure, and where the public sector is and was more accountable than is the rule even in most Western societies, and a society where public sector waste and failure dominated everything and suffered under a government which was completely unaccountable. The delusion that there is something inherently ennobling about government activity has been amply demolished by the corruption, violence and rapacity of post-Soviet Russia, where the effects of 70 years of socialism (i.e. the operation of centralised coercion as the principle of action) on social morality have become abundantly clear.

privatisation of government-owned utilities and the abandonment of Trade Protection likewise delivered major efficiency gains, which are now compounding, year by year.

The 1980s saw the start of major reform in the government business sector. Even without the massive commercial failures previously alluded to, faced with the relentless upward pressure on revenue of the ever-growing welfare sector, governments looked to government business enterprises for income and as assets to be sold for debt relief and the cutting of interest bills. It is no accident that the government business sector became a centre of economic reform, leading to increases in efficiency of capital use, through ‘corporatisation’, exposure to competition and privatisation.

Graph 14

Income to General Government from Government Business Enterprises



The relatively low return on capital that government business enterprises had provided became an issue only under fiscal stress. That low return was a natural result of the lack of an effective owner of capital government ownership entails: the problem of 'unowned capital'.[13] But it is precisely because government ownership provides poor incentives to attend to the efficiency of capital use that it is capable of tolerating low returns almost indefinitely.

One of the major supports for the old workfare sector had been use of its monopoly or otherwise privileged position to extract economic rents from consumers. Under the pressure of falling tariffs and adverse terms-of-trade, the costs this imposed on business became increasingly unacceptable, turning the issue back to reform of the government business sector. Thus the processes of reform tended to reinforce each other.

Consequences

One has to say that the reform program has only been a partial success. It has achieved greater economic efficiency. The Australian economy is more adaptive than it was—the 'Asian' crisis is

[13] The analysis of government ownership as creating 'unowned capital' is based on the extension of Jensen, Fama and Mecklin's analysis of agency problems in firms (see .Jensen, M.C. & Meckling, W.H. [1976], 'Theory of the firm: managerial behaviour, agency costs and ownership structure, *Journal of Financial Economics*, 3, pages 305–360; Fama, E.F. [1980], Agency problems and the theory of the firm', *Journal of Political Economy,* 88, pages 228–307; Jensen, M.C. & Fama, E.F. [1982], *Separation of ownership and control*, University of Rochester, Managerial Economics Research Center, Working Paper No. 82-14, Rochester) to publicly-owned enterprises by Peter Hartley and Chris Trengove while they were at the Centre of Policy Studies, Monash University (see Trengove, Chris, *Improving the Performance of State Enterprises*, paper prepared for EPAC, Research Paper B10, Centre of Policy Studies, November 1984, Hartley, Peter & Trengove, Chris, 'Who Benefits from Public Utilities?' *The Economic Record*, 1986, pages 163–179). The argument is further developed in Hartley, Peter; Warby, Michael, *et al*., *Public or Private?: Setting the Boundaries*, a paper for The Infrastructure Forum, Tasman Asia Pacific, August 1998.

the first global economic crisis this century in which the Australian economy has performed better than comparable countries. Indeed, it has done spectacularly better, Australia and the US being the only major economies currently growing above long-term trend. The floating exchange rate worked as it is supposed to, cushioning the external shock of the collapse of many of our Asian trading partners. Our exporters, focused on market realities rather than Canberra's subsidies and legislated privileges, re-directed sales to the US and Europe, the lower $A making our exports suddenly much more competitive in those markets.[14]

This success has exposed a central weakness of the Deakinite Settlement. The Deakinite system reduced individual risk—security being the reduction of risk—at considerable cost, by increasing the risks faced by those on the margins of society, and by increasing overall systemic risk. In each external economic crisis faced by Australia while the Deakinite system was operating, Australia fared more poorly than comparable economies.[15] The inbuilt rigidities of the Deakinite system made it very difficult for Australians to respond successfully to sudden crisis, or indeed to change generally. Every time we have attempted to extend the Deakinite Settlement, the economy has suffered a crisis. A system which was supposed to make Australia and Australians less vulnerable to external pressures, made them more so when circumstances changed dramatically.

The reality is, however, that none of the problems which lead to the dismantling of the Deakinite Settlement have been solved. The demands of the welfare state continue to increase faster than the economy. No real structural halts on those demands have been put in place.

A further sign of fiscal stress was government resorting to the 'inflation tax' where government prints money beyond the demand for it, thereby creating exchange-value available for its own expenditure but reducing the value of holdings of money.[16]

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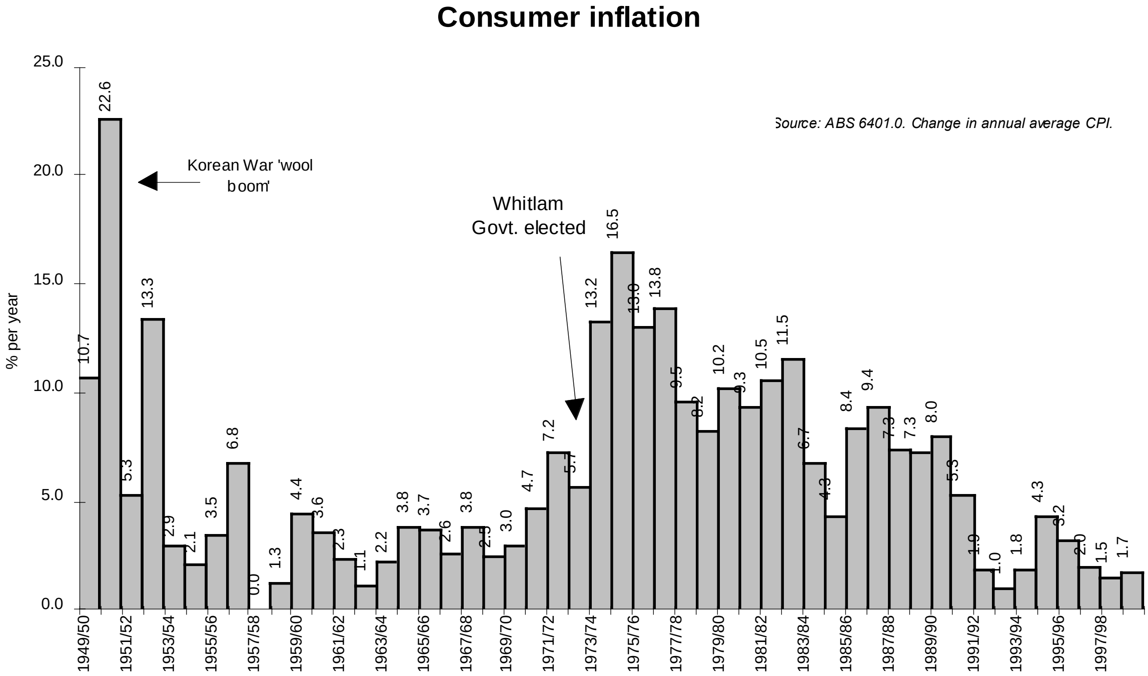
[14] Privatisation and competition policy also led to a boom in private investment in infrastructure investment which had positive demand effects at a fortuitous time.

[15] While Australia was, under the operation of the highly economically-orthodox Premier's Plan, one of the first countries to begin to come out of the Great Depression, its initial experience was very severe.

[16] With government taking (through taxes, transfers and regulatory intervention) increased responsibility for social outcomes, interest groups' claims on incomes could not be effectively adjudicated through consensual exchanges in the (increasingly constrained) marketplace, and as the political system is heavily biased against being seen to deny interest groups, this led to intense inflationary pressures.

Graph 15

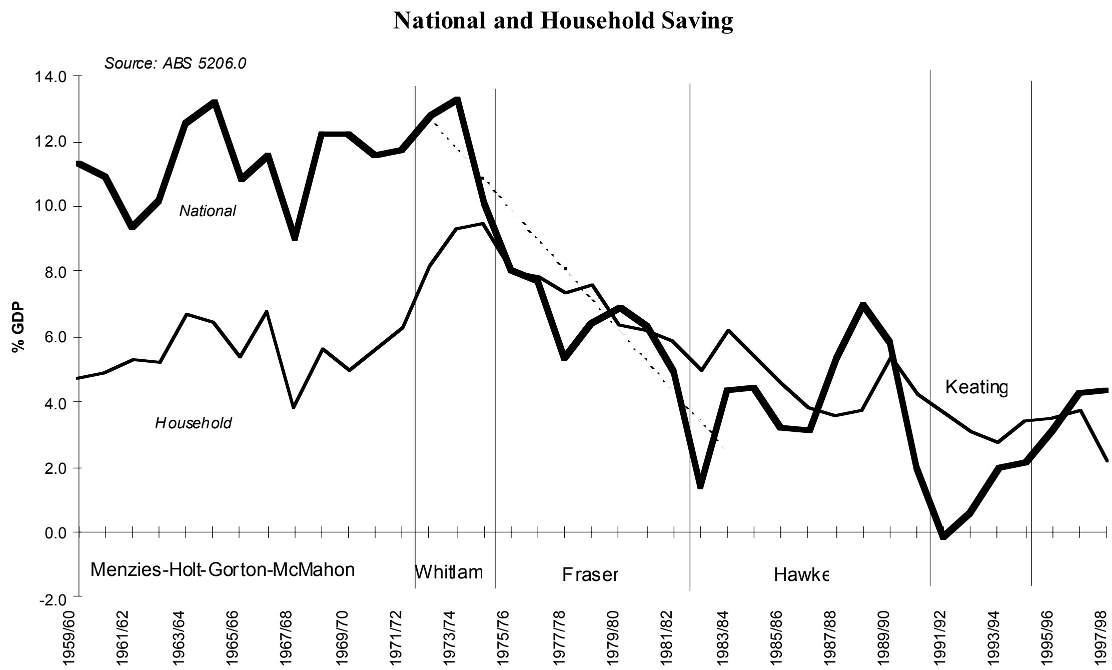


A settled regime of inflation discourages the holding of money (such as bank deposits) as assets, because inflation constantly devalues the value of the money in terms of the goods and services it buys. In Australia, with high reliance on income tax which treated interest income as ordinary income, the 'deferred consumption' which saving consists of was taxed twice. The income earned from which any saving would be made had already been taxed: then the interest income on the deferred consumption was also taxed and the value of the money was taxed by inflation. This decreased the value of future consumption compared to current consumption, discouraging saving. Given the expanded role of the state in guaranteeing people against ill-fortune, the insurance role of saving was also reduced.

It is therefore no surprise that national saving has not recovered, with the collapse in government saving being accompanied by a (less precipitous) fall in private saving.[17]

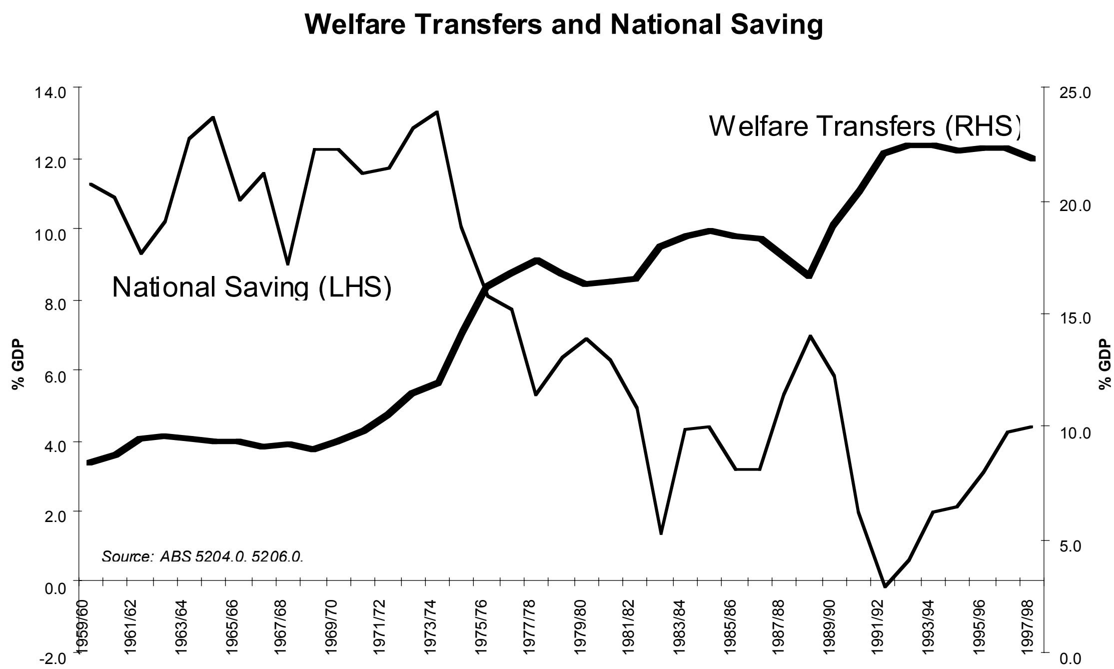
[17] Some of the fall in private saving may be benign, such as higher gearing in response to financial de-regulation and lower interest rates.

Graph 16



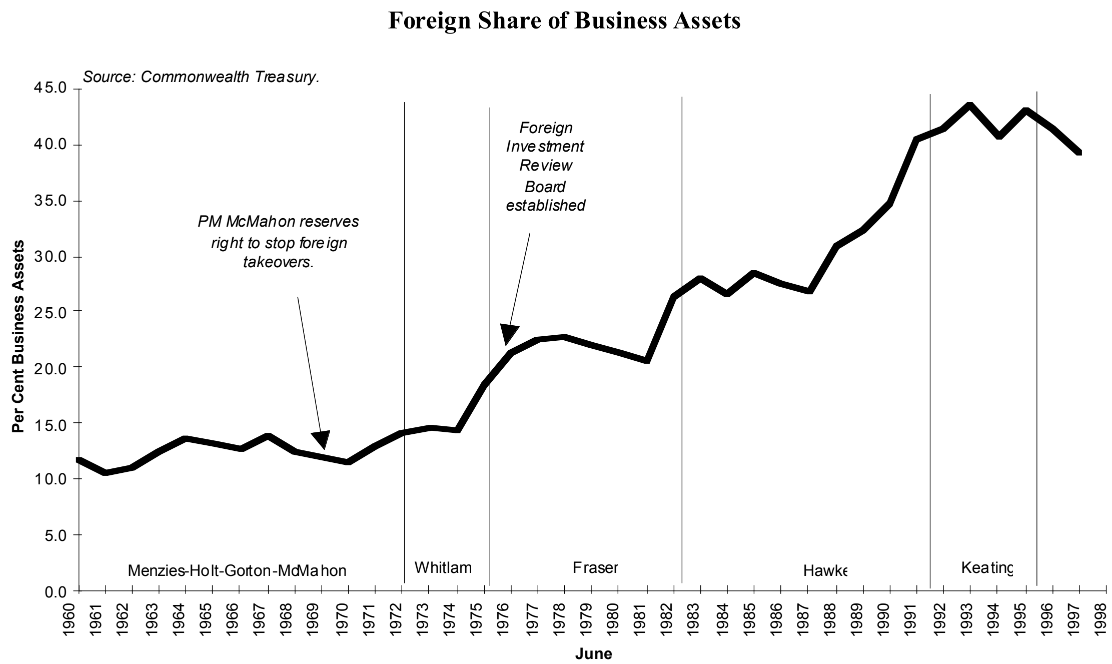
In fact, we have been transferring resources more or less directly from national saving to welfare transfers. The correlation between the two series is -0.92, almost perfect.

Graph 17



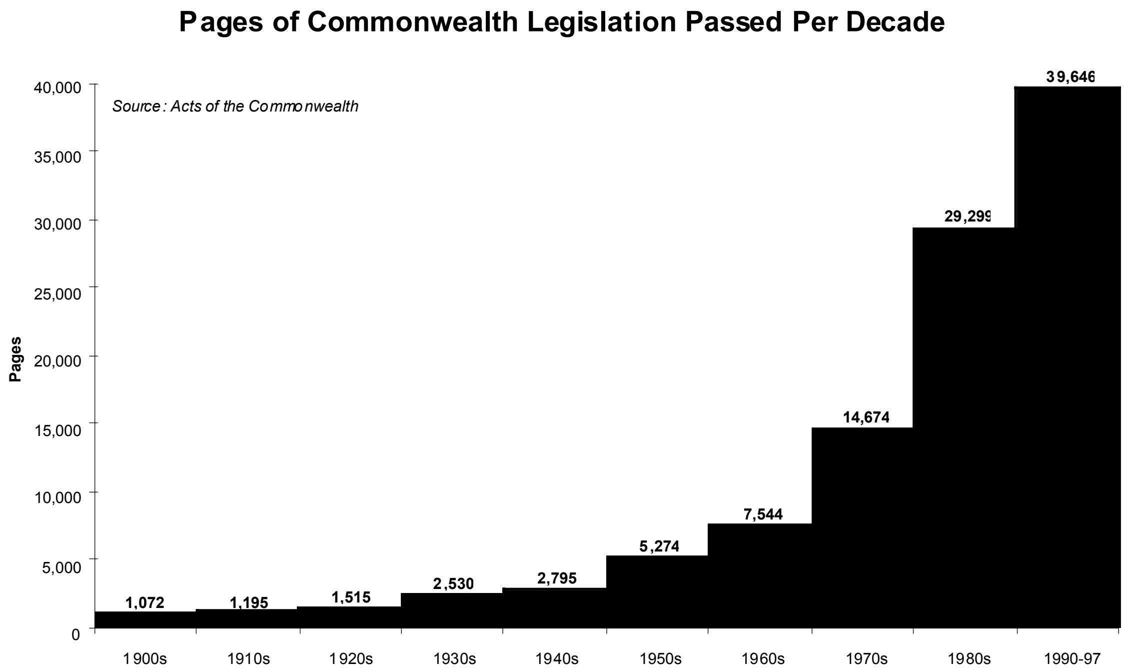
The consequence has been continuing foreign debt and growing foreign ownership, as capital is imported to cover investment and other capital demands.

Graph 19



Government continues to be increasingly intrusive. It took the Commonwealth Parliament 84 years to pass its first 50,000 pages of legislation, and a mere 12 to pass its next 50,000 pages. In the eight years 1990 to 1997, the Commonwealth Parliament passed more pages of legislation than it did from 1901 to 1980.

Graph 20



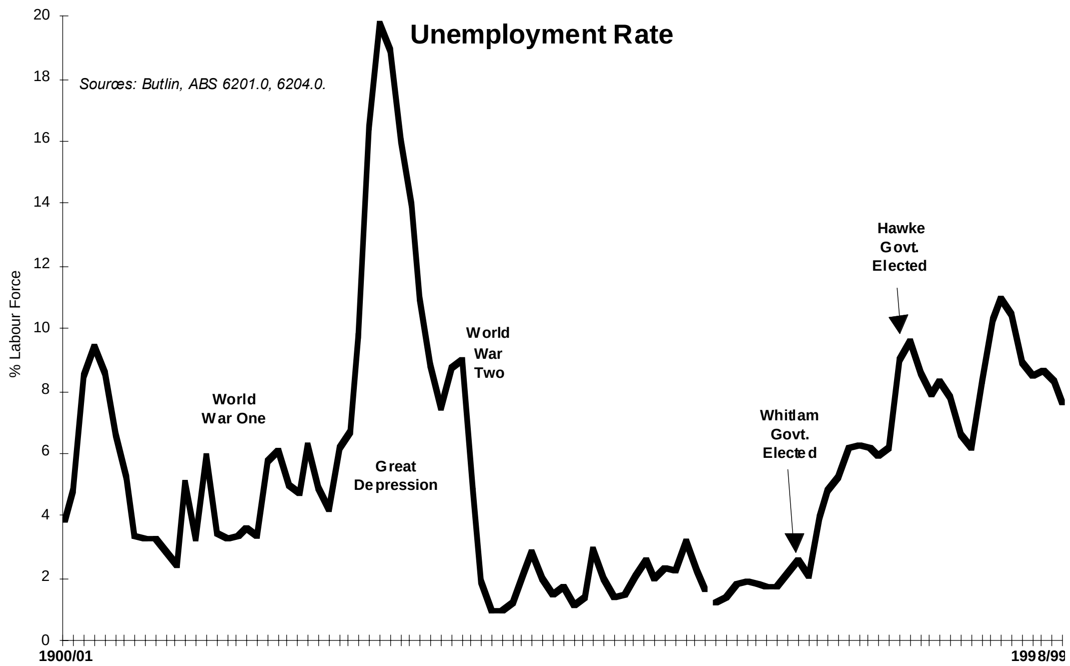
To put it another way, eight years marked by no great national emergency apparently required more legislation than the establishment of the Commonwealth jurisdiction, two World Wars, the Depression, postwar prosperity and the Whitlam reforms *combined*.

This is a legislative engine gone mad. Even given much of this has been operating instructions for the burgeoning welfare state or rewriting of previous law, the coherence of Commonwealth law is steadily being lost. Nor is this production of law subject to anything even vaguely resembling careful cost-benefit analysis. It is precisely the type of wasteful, process-oriented, quality-control-deficient output public sectors have become notorious for.

The Labour Market

The area of most striking failure has been the labour market. The almost 30 years from the end of the Second World War to the 1973 Oil Shock was the only period this century when Australia has enjoyed full employment.

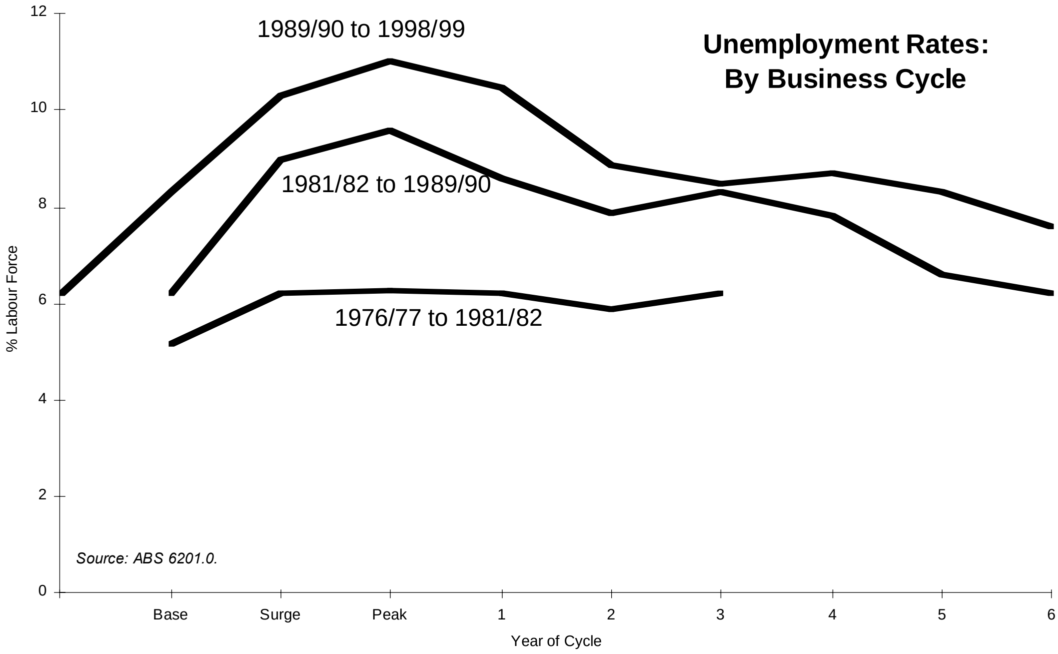
Graph 21



Since the 1970s, Australia has been moving further and further away from full employment. The period since the Whitlam Government has seen Australia's worst sustained period of unemployment this century—22 years during which annual average unemployment rate has not fallen below 6 per cent.

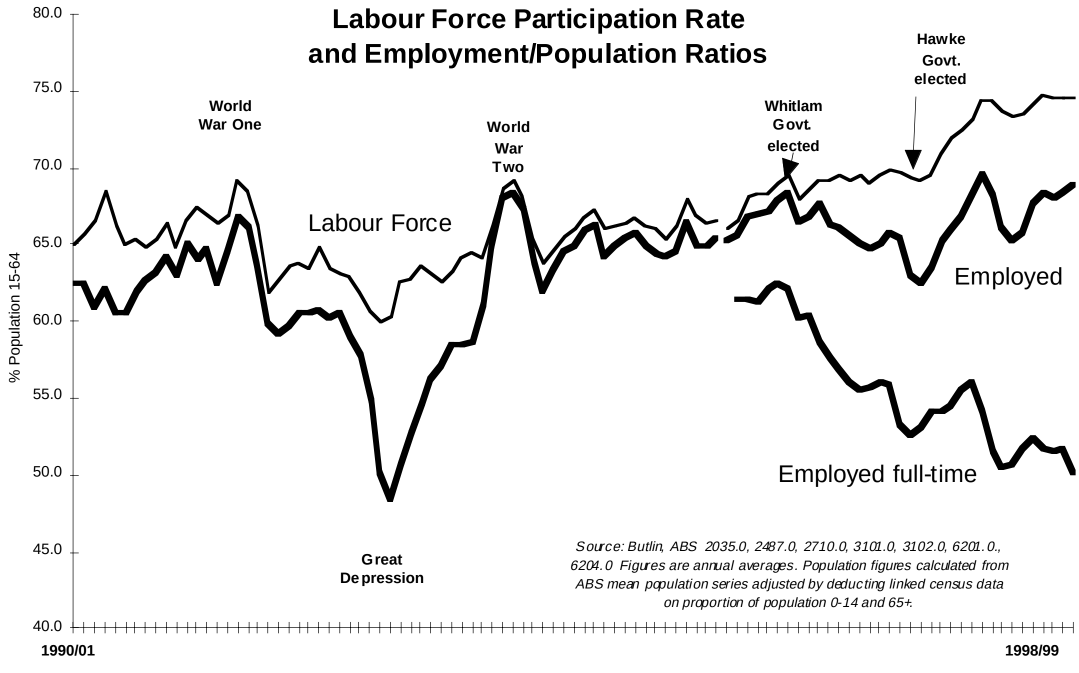
Australia has been experiencing what might be described as the 'rising mountain' pattern of unemployment, where the peak of unemployment in each recession is higher than in the previous recession, and unemployment generally does not quite recover to its low at the peak of the previous economic boom.

Graph 22



Part of this increase in unemployment has been attributed to the increase in the labour force to a historically high proportion of the population, largely due to the entry of women into the workforce.

Graph 23



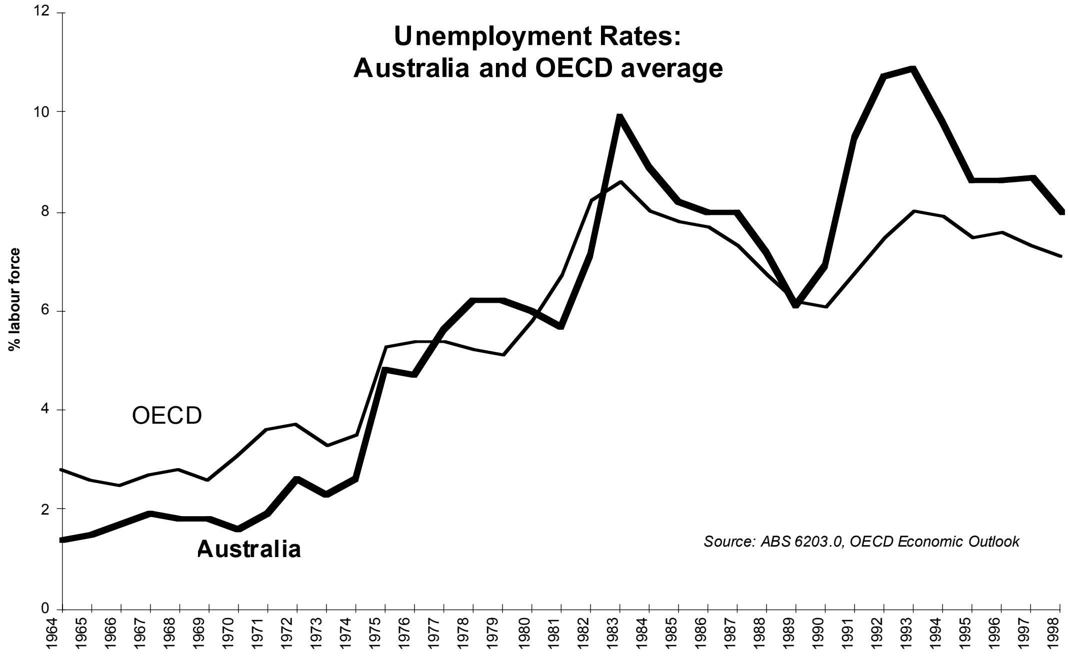
The declining proportion of the working-age population in full-time employment and the fall in the proportion of the working-age population in employment during the later 1970s and early

1980s tends to undermine any such argument. More fundamentally, it is reasonable to expect economic institutions to be able to adapt to reflect changing preferences. There is no known limit to the useful goods and services that might be produced if people are permitted to produce them at prices that people are prepared to pay. The more that is produced, the greater the resources of the community as a whole.

International comparisons weaken even further the argument that unemployment is caused by the increased supply of labour, and provide more evidence of the deterioration in Australia's overall labour market performance.

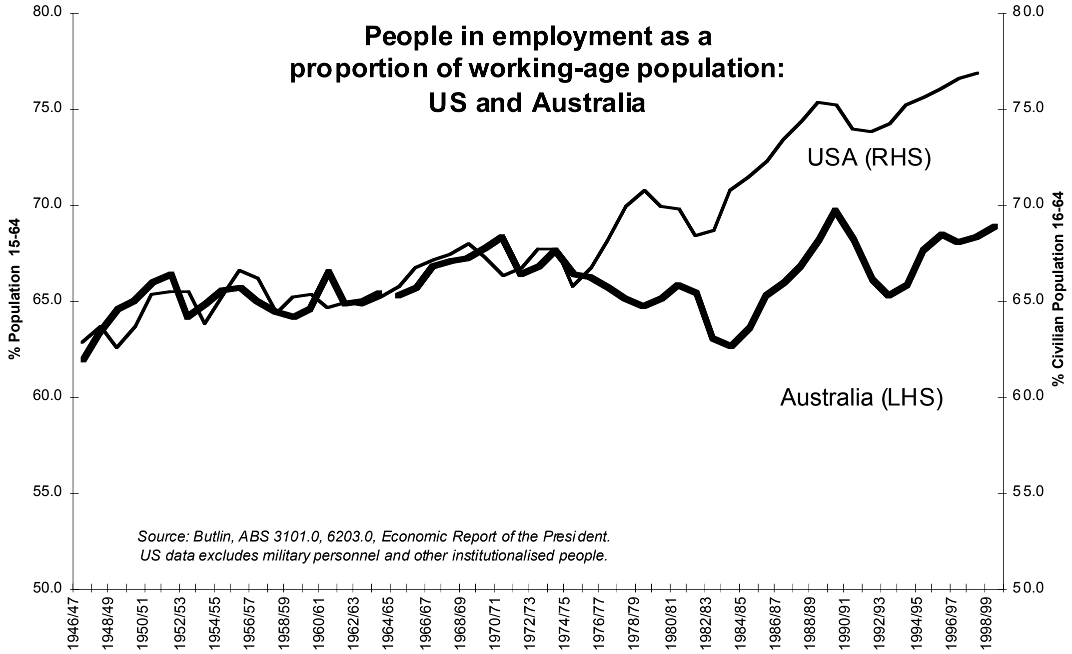
Throughout the OECD nations, an increased proportion of women have entered the paid workforce yet, prior to 1975, Australia's rate of unemployment was consistently below the OECD average. From 1975 to 1988 it moved up to around the OECD average. Since 1988 it has been above the OECD average.

Graph 24



Yet another stark indicator of Australia's deteriorating labour market performance is shown by comparison with the United States. Prior to 1974, Australia and the US had very similar proportions of their working-age population in employment. Since 1974, the US has employed a higher proportion of its working-age population than Australia, a gap that has tended to increase over time.

Graph 25



In the United States, where women have entered the workforce in great numbers, a greater proportion of the population is working age is in the labour market than in Australia, yet unemployment is lower there than in Australia.

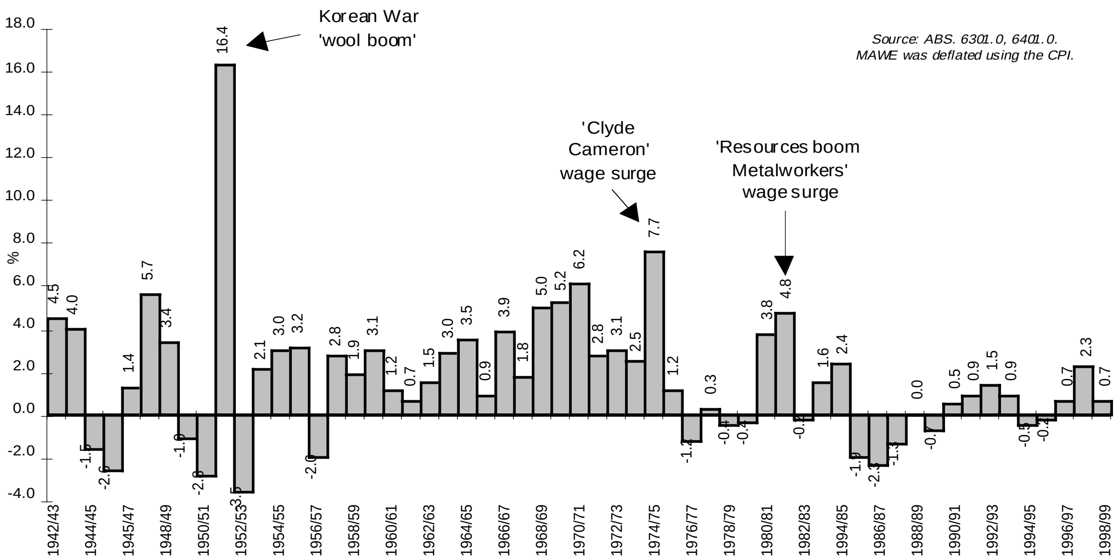
A final piece of telling evidence that labour markets can cope with people who want to work is the manner in which Australia itself absorbed the return of the troops, and then high levels of post-war immigration, without suffering unemployment.

Economic adjustment are not necessarily immediate. A sudden increase in the supply of labour can cause temporary unemployment, but that is not what Australia is facing. What is more, the experience of Hong Kong was that, when refugees caused a sudden and unexpected increase in the number of people seeking work, these were absorbed very quickly by the colony's relatively unfettered labour markets.

If unemployment is not cause by the increased supply of labour, then another cause of Australia moving up to the OECD average rate of unemployment, and the diverging Australian and US employment/population ratio, must be found. These tendencies began with the wage surge of the Whitlam years. The Australian labour market was not able to recover full employment afterwards—in contrast to the greater wage surge in the Korean War 'wool boom'. In the wool boom case, however, the wage surge had been a result of a genuine upward shift in national income from a dramatic increase in exports. Employees were sharing the increase in national wealth. The Whitlam-period wage surge was a result of political deals at a time when Australia was actually under significant negative economic stresses. While the lower earnings growth of the later 1980s was associated with higher employment growth, the Australian labour market has not yet regained full employment, nor does it seem likely to. A highly-regulated system generating wage-surges not based on genuinely improved economic conditions, preventing their reversal and imposing additional costs upon employment. (The last would, if wages were totally responsive to supply and demand, not cause unemployment but lower wages instead. Wages are, however, not totally responsive.)

Graph 26[18]

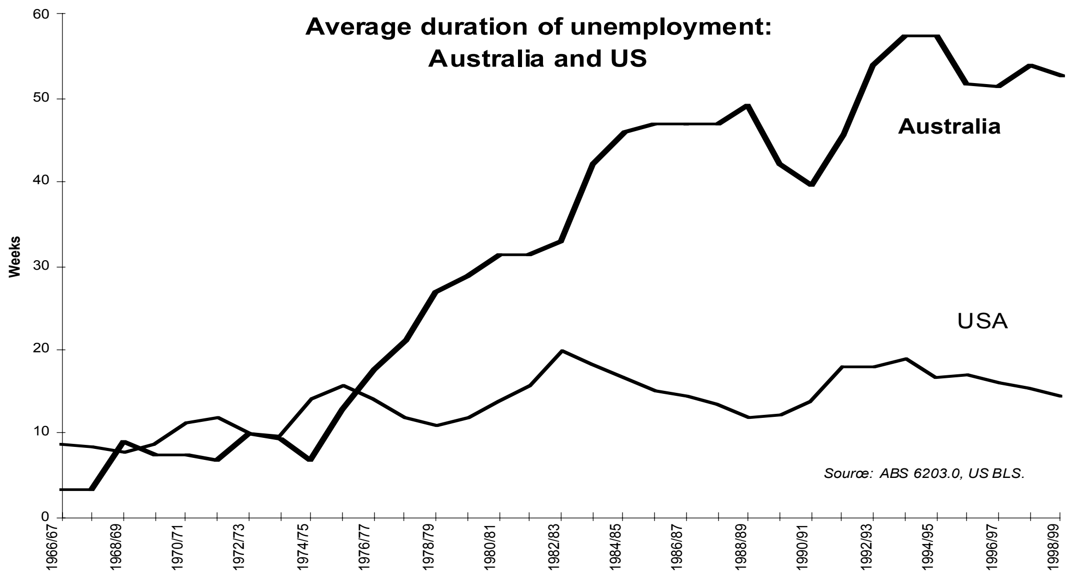
Real change in annual average male average weekly earnings



An even more stark indicator of Australia's declining labour market performance has been the increase in the average duration of unemployed, from about 13 weeks in 1975 to about a year now. This is a record which contrasts markedly with the USA's generally steady average duration of unemployment.

Graph 27

[18] Information on female average earnings is not available prior to September quarter 1981.

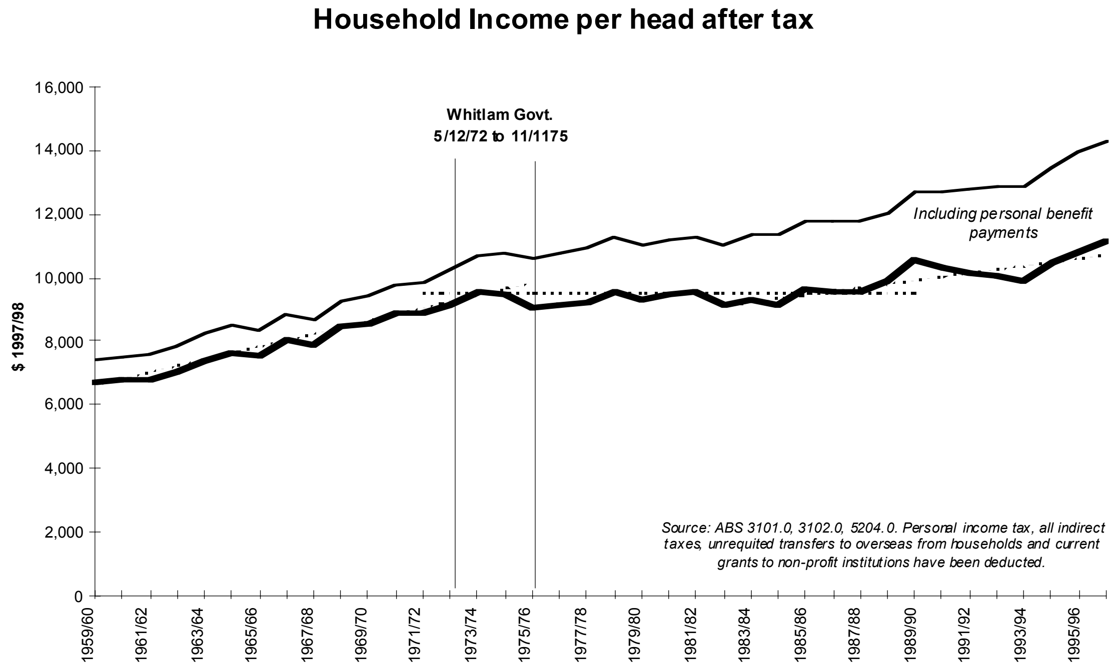


The failure to substantially improve the deteriorating performance of the Australian labour market is the most powerful evidence that the Australian political system, in practice, rates more highly goals other than restoring full employment—such as not antagonising the advantaged labour market 'insiders'. Indeed, so far from being, in practice, seriously interested in reducing unemployment, the political process has regularly produced outcomes whose most likely effect would be to make unemployment higher than it would otherwise have been—such as unfair dismissals legislation, legally-imposed wage minimums unconnected with productivity, legally enforcing benefits to employees, increased employer liability for employee actions and increased legal obligations consequent on employment.

Wage Arbitration remains the last great survival of the Deakinite Settlement. Indeed, with the exception of some very partial freeing up under the Howard Government, the labour market has been a conspicuous holdout from the process of de-regulation in factor and product markets, becoming steadily more regulated during the reform period whether through unfair dismissal laws and affirmative action and equal opportunity legislation, or indirectly, through health and safety regulations, welfare changes and so forth. The perverse interaction of the first two sets of laws—where unfair dismissal laws raise the *general* risks of employing someone new, since it is harder and more costly to get rid of dud employees, while equal opportunity legislation has increased employer liability for aberrant behaviour by employees—exemplifies the problems generated by the explosion of statute law.

The massive expansion in the Australian welfare state since Whitlam Government has not been good for earned incomes, as is demonstrated by household income data.

Graph 28



Wage Arbitration exemplifies the inflexibilities and risk transfers mentioned earlier. For example, the increased security of those in jobs which unfair dismissal laws provide, results in lower chances of employment for those not in jobs. The complex job demarcations in awards which provide useful weaponry for union organisers reduce the efficiency of, and ultimately the returns to, labour. And so forth.

As is typical of political action, debate tends to concentrate on the *intention* of regulation rather than their actual costs and effects. Indeed, to raise concerns about the same is often taken to indicate a wicked hostility to the good intentions. Needless to say, this is not an intelligent way to conduct public policy. Many people, however, become quite angry at any suggestion that others might be bearing unreasonable costs for their warm inner glows.[19] That many of these costs are things which don't happen—such as all the extra staff people don't take on, or take on as casual rather than permanent employees—makes it even harder to assess net benefit.

Even here, however, there are clear signs that Deakin's legacy is fading away. Increasing use of part-time, casual[20] and contract labour all represent attempts to evade the imposed rigidities of the system. The relentless pressure of international competition forces even the most myopic, quiet-life, 'IR-club' company management eventually to face the need for change. Just as the expenditure demands of the welfare state drive policy-makers to eliminate inefficient government provision of services and to phase out the resource mal-allocations of protectionism, so the revenue costs of unemployment are (slowly) driving policy-makers to confront the last great mal-

[19] Indeed, making such matters open to genuine debate undermines their 'moral assets'. If, for example, the value of arbitration and labour market regulation is genuinely debatable, one cannot establish one is a 'good person' merely by supporting arbitration and extensive regulation.

[20] The proportion of employees working as casuals rose from 17 per cent in 1986 to 27 per cent in 1998 (ABS Cat No. 6325.0).

functioning factor market—the labour market. The ‘Kernot-Reith’ *Workplace Relations Act* does allow significant award simplification, though the comparative advantage which larger companies enjoy in complex arrangements that disroportionately penalise smaller competitors and new entrants (unless they avoid the award system altogether) means such opportunities are still being resisted.

Trade Protection and Wage Arbitration are, indeed, intimately connected. The costs of the welfare state have driven Australia to eliminate Trade Protection. The pressures of free trade and the costs of the welfare state will, sooner or later, drive Australia to abolish Wage Arbitration. George Reid, first Commonwealth Leader of the Opposition and the great advocate of Free Trade, will have the last laugh on Deakin’s pretensions. The framework of the Deakinite Settlement has been shattered and it is not possible to put Humpty-Dumpty back together again. And it was Gough Whitlam’s expansion of the welfare state which was the prime cause of that shattering.

Bankruptcy of the Critics of Reform

Little or no sense of any of this can be gained from perusal of the outpourings of most of the critics of ‘economic rationalism’. These critics typically ascribe the reforms to the abstract delusions of pro-market economists, not as responses to pressing and urgent budgetary problems. Since they will not acknowledge the existence of those very real problems, they have nothing useful to say in response to them. (Of course, it could be that their lack of answers is what drives their refusal to acknowledge the problems.) They are locked into the *good person = advocate of more government / bad person = someone who sees problems with this* simplicities within contemporary moral vanity.

In particular, the perennial demand to increase spending—with an implicit or explicit agenda of tax increases to go with it—flatly refuses to grapple with the experience of all OECD countries that there is *no* level of taxation which is somehow magically ‘enough’. If it is believed that the role of government is to do good, and there is no accepted limit to the ‘good’ it can do, there is no limit to the growth of government, since there is always more ‘good’ to be done. If governments can always increase taxes to cover budget problems, then there is no reason to accept any set budget constraint. It is only by serious acceptance of the limits of government competence, acceptance which is then built into institutional structures, that the growth of government can be halted.

Government is not omni-competent: it is not always, or even usually, the best social mechanism to do anything which the broadsheet scribblers might think it should do. The typical problem of the critics of economic reform is that they are committed to the idea that government *is* omni-competent, so have nothing useful to say as policy-makers grapple with the limits to government.

Economic reform will continue, precisely because the critics have nothing useful to offer as an alternative response to the relentless fiscal pressure. The critics’ fulminations in Op.Ed. pages on the airwaves will certainly make reform slower and more difficult, by contributing to a hostile climate of opinion, but their own policy vacuousness will ensure that that is their only effect.

Note: This paper in was developed from an IPA Backgrounder by Michael Warby and Mike Nahan, *From Workfare State to Welfare State: Where We Were and Why We’ve Changed*, August 1998.

Acknowledgments: I would like to thank Dr Robert Albon, Ray Evans, John Hyde, Stephen Joske, Steven Kates, Des Moore and John Stone for their helpful comments.