HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON FINANCIAL INSTITUTIONS AND PUBLIC ADMINISTRATION

Reference: Aspects of the national competition policy reform package

CANBERRA

Thursday, 6 February 1997

OFFICIAL HANSARD REPORT

CANBERRA

HOUSE OF REPRESENTATIVES
STANDING COMMITTEE ON FINANCIAL INSTITUTIONS AND PUBLIC ADMINISTRATION

Members:

Mr Hawker (Chair)

Mr Albanese	Mr McMullan
Mr Anthony	Mr Mutch
Mrs Bailey	Dr Nelson
Mr Causley	Mr Pyne
Mrs Gallus	Mr Willis
Mr Hockey	Mr Wilton
Mr Latham	

Matter referred to the Committee:

The aspects of the national competition policy reform package. The major issues the Committee has been requested to inquire into are:

(1) the appropriate means, including review processes, for applying the ‘public interest’ tests included in the Competition Principles Agreement:

These tests are a critical feature of this Agreement. They are described in Principle 1(3), which provides that:

without limiting the matters that may be taken into account, where this Agreement calls:

(a) for the benefits of a particular policy or course of action to be balanced against the costs of the policy or course of action; or

(b) for the merits or appropriateness of a particular policy or course of action to be determined; or

(c) for an assessment of the most effective means of achieving a policy objective;

the following matters shall, where relevant, be taken into account:

(d) government legislation and policies relating to ecologically sustainable development;

(e) social welfare and equity considerations, including community service obligations;

(f) government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;

(g) economic and regional development, including employment and investment growth;

(h) the interests of consumers generally or of a class of consumers;

(i) the competitiveness of Australian businesses; and

(j) the efficient allocation of resources.

(2) the impact of competition policy reform on the efficient delivery of community service obligations including an assessment of:

(a) existing government policies relating to community service obligations and

(b) options for the delivery and funding of these services;

(3) the implications of competition policy reform for the efficient delivery of services by local government, including arrangements that have been developed between State Governments and local government authorities for the implementation of the Competition Principles Agreement.

WITNESSES

HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON FINANCIAL INSTITUTIONS AND PUBLIC ADMINISTRATION

Aspects of the national competition policy reform package

CANBERRA

Thursday, 6 February 1997

Present

Mr Hawker (Chair)

Mr Albanese	Dr Nelson
Mr Anthony	Mr Pyne
Mr Causley	Dr Southcott
Mr Latham	Mr Wilton
Mr McMullan	

The committee met at 10.19 a.m.

Mr Hawker took the chair.

QUIGGIN, Professor John Charles, Department of Economics, James Cook University, Townsville, Queensland 4811

CHAIR—I declare open the House of Representatives Standing Committee on Financial Institutions and Public Administration inquiry into aspects of the national competition policy reform package. This is the fifth hearing of the committee since the inquiry began late in 1996.

I would like to welcome Professor Quiggin to today's public hearing. I remind you that the evidence you give at the public hearing today is considered to be part of the proceedings of parliament. Accordingly, I advise you that any attempt to mislead the committee is a very serious matter and could amount to a contempt of the parliament. Do you want to make a brief opening statement before we ask some questions?

Prof. Quiggin—I could give a presentation, and I am quite happy to go straight to questions—whichever the committee thinks better.

CHAIR—We might move straight to questions.

Prof. Quiggin—I have done a good deal of work on the micro-economic reform process in general. Broadly speaking, I have been critical of particular aspects of micro-economic reform which I regard as having harmed economic welfare, particularly in the areas of telecommunications policy and financial deregulation.

Overall, I have also disputed the general estimates of the aggregate benefits of the micro-economic reform process. The Industry Commission, for example, had estimated gains of six per cent of GDP back in 1989-90 for the part of the micro-economic reform program that was in operation then and, more recently and relevantly, in 1995 for the Hilmer and associated reforms package. I have criticised both the way in which those estimates were constructed and the detailed estimates in particular areas. I have argued that in general the benefits of reform are likely to be quite a bit smaller than have been claimed and that particular areas of reform policy have been misconceived and have reduced welfare.

I have been concerned to argue the quantitative side of the debate because I perceive that a significant element—particularly in the way in which, for example, national competition policy has been pushed through—has been an assumption that this process has such massive benefits that essentially it is best to push it through without time for questioning and without time for debate. Also, any opposition to any part of the process is seen as in some sense opposing a process which is so vital to our national interest that we should really not question the merits of any individual piece of the process for fear of harming the whole.

I have argued that we need to take a much more case by case approach to policy. There are certainly a lot of elements of micro reform which I think have been beneficial. But, as I have said, particularly in the areas of telecommunications policy and in important aspects of financial deregulation, I would argue that the way in which policy was introduced reduced welfare.

CHAIR—Thank you. I think it will create a lot of interest from the committee to hear a contrary view on some of these things. First of all, you have suggested that the benefits of micro-economic reform have been systematically overstated; would you like to expand a bit on that?

Prof. Quiggin—There are a number of reasons. The first is a technical reason. The Industry Commission has always reported gains in estimated GDP coming out of their Orani model. The way they estimate that tends to project big increases in total capital stock, so we have a lot more physical investment, and that contributes to about half the increase in GDP.

In the model, that does not have to be paid for, but in reality we would have to either reduce consumption and save to acquire that capital or more probably divert capital from other areas or import it. If we borrow the capital from overseas, we would have to make payments. So, typically, out of the models you can look at variables like estimated gains in consumption, and they are a lot smaller than the estimated gain in GDP. That is a technical point.

Secondly, in my view they frequently confuse transfers within the community with aggregate gains. This is particularly relevant in the estimate of competitive tendering and contracting. It is clear that, if people are in a secure job and those jobs are put up to competitive tendering, they are likely to be willing to work harder for the same money, which will lead to a reduction in cost to whoever is paying them. But that reduction in cost is simply a transfer—the person is now putting in more work for the same money. If they had wanted, they could have taken a second job, or previously could have got overtime.

So that gain is not a net benefit to the Australian community; it is simply a transfer from one group in the community to another. I think in its most recent draft report on competitive tendering the Productivity Commission has given a bit of ground on that point compared with what was suggested in the study of Hilmer and associated reforms.

Also, there is a failure to take appropriate account of economies of scale. I think that is particularly important in telecommunications policy. It also was an important fact in the first stage of financial deregulation. Competition works best when we have a lot of firms. But there are a lot of industries in which the Australian market—indeed, frequently any market—is too small to support a large number of firms.

There has been a tendency for wishful thinking in this respect, which claims that technology means that this kind of problem has gone away. That is simply untrue. I think we are seeing the consequence of that—for example, in duplication of telecommunications infrastructure. That is totally unnecessary. In fact, it is resulting in a technically worse service than had we saved the second network altogether and simply built one network. That is an example where policy has been constructed with a disregard for economies of scale, and I think that is reflected also in the kinds of estimates that are being made.

Finally, I think there is a misunderstanding of what the role of competition in the economy is. Competition drives prices down to the market clearing level so that, whereas a monopolist can charge essentially whatever the market will bear, a competitive firm has to charge the price that their competitors will make. That eliminates monopoly rents in the economy and it also means that we get a better allocation of resources.

But there is nothing in economic theory that suggests that a monopolistic firm in general will be technically less efficient than a competitive firm. There is nothing in standard economic theory which suggests that by introducing competition firms will become more efficient, that we will get any of the things that are frequently referred to in public debate as dynamic gains or X efficiency—as sometimes used in the economic literature. All of these claims have no basis in sound economic theory and in my view are not supported by the evidence.

This sort of claim though is frequently used in the Industry Commission's work and, although it cannot formally be fitted into their model because the only model they use is a standard economics model and does not contain those sorts of factors, they tend to use that to justify erring on the optimistic side whenever they make estimates of, for example, the kind of world best practice we could achieve. I have disputed at length in detail the specific world best practice estimates that they have made in a number of areas. That is available, and I can supply it to the committee.

CHAIR—Can I go back to your first point about your criticism of the model that is being used. You are saying it does not take into account the cost of capital and that type of thing: why would the model not be altered to include that?

Prof. Quiggin—I should clarify that I am not criticising the model but the way in which the Industry Commission chooses to report its results. On that first point, the relevant model results should be variables like consumption, which they do sometimes report, but typically their headline report is the GDP number. The way in which they close the model means, in my view, that in fact they can give an overestimate of what the GDP growth would in fact be.

But the important point is that GDP growth achieved by importing capital is not a welfare improvement in the way that GDP growth achieved by raising the domestic productivity of labour is. So the model does produce the results that we would be interested in—subject to the other criticisms I have made,—but the Industry Commission systematically chooses to report GDP as the main figure of interest rather than a more relevant variable like national income or consumption.

CHAIR—You were talking about competition leading to people working harder or, say, more efficiently: does that not also allow some fall in price and therefore the resources that would have gone in to that particular product will now be extended into something else?

Prof. Quiggin—The critical difference is the difference between working harder and working more efficiently. Obviously, if any of us choose to work harder in whatever business we are engaged in, we can supply the product we make at lower cost—just as we can if we choose to work the same hours and take a lower wage for ourselves. But there is no net gain to the community. All that is happening is that the consumer is benefiting and the producer is losing. If you spread that across the entire economy, since we are all both producers and consumers, that nets out.

The issue of dispute is whether, by putting pressure on people, you will lead them to find ways of working more efficiently that produce a gain to everybody. This cold winds of competition sort of claim is never made in a way that makes it very easy to analyse in detail, but in my view it is a mistaken view.

The basic assumption of economics is that ordinary profit motive will drive people to seek gains and efficiency that they do not need to be forced by government action to seek more efficient ways of doing things. And if this view which is underlying a lot of the claims about micro-economic reform were taken seriously it would in fact justify very extensive programs of government intervention aimed at forcing people to become more efficient and so, far from supporting a free market, it would actually do the opposite.

CHAIR—Yes, but we are not in the position of trying to coerce people.

Prof. Quiggin—But the claim is frequently made nonetheless—not the standard economics claim, for example, that by having free trade we will improve the allocation of resources within the economy—that by removing tariff barriers we will indeed force people to be more efficient. That phrase is used quite frequently in the literature, and I make the point that if that is true and we can as a community gain by making people's external environment more hostile, that would in general justify, for example, going beyond free trade and for example subsidising imports, thereby making the internal environment even more hostile and thereby forcing people to become yet more efficient. I do not believe that that is correct. I am merely pointing out that is a concept that is—

CHAIR—Where do you get the balance? You could go back the other way which we have in the past where you have actually increased protection increased protection and increased protection and we have not gained.

Prof. Quiggin—I think it is fair to say that certain sorts of protection policies create incentive problems above and beyond the resource mis-allocation effects normally considered. If you have a standing policy that whatever the cost difference between your industry and the competitors you will cover it—the so-called scientific tariff that was around back in the early 1960s—then obviously there is an incentive for people within the organisation to pad their costs, to make misleadingly high statements of the costs while taking off larger and larger rents for themselves. It is certainly true that that kind of effect can be present, but I think in general the standard analysis which economists would use gets the measures pretty right, and that analysis does not include any sort of notion of forcing people to work harder or smarter. It assumes that most of the time people are acting in a more or less sensible way.

CHAIR—Does someone else want to follow those points?

Mr WILTON—Yes. In your *Australian Financial Review* article in September you estimated that the gains from the Hilmer reforms were something like one per cent of GDP. Do you have any empirical evidence to substantiate that claim?

Prof. Quiggin—I have a detailed paper which I would be happy to supply to the committee. The Industry Commission, as it then was, produced a report examining about 11 different areas of the economy and then fed those into the Orani model, as I mentioned earlier. So what I have done in this paper is both construct a detailed critique of their analyses of each of the 11 sectors and then make the point, as I explained earlier, about the way in which the use of GDP as the reporting measure and the use of that particular closure assumption have tended to inflate the benefits.

One of the major sources I have already mentioned is contracting out, where I have argued that a lot of what the Industry Commission has measured as a productivity gain is, in fact, a transfer within the community because, basically, the gains are coming from either lower wages or harder work.

I have also criticised some of the world best practice estimates because I think they do not compare like with like. For example, in the electricity sector we have got a coal based industry but the world best practice estimates take leading firms which either have a very big component of hydro or nuclear or else are generating firms with very limited distribution. Of course, with those kinds of set-ups you get massively better labour productivity than in coal based electricity generation.

CHAIR—Just on that point: if you take Victoria, the previous government actually started down the track of bringing in outside ownership and the efficiency of performance of the power stations—forget about the other points—actually jumped quite significantly and has now gone from about 70 per cent nudging up towards 90 per cent in the generation—just the existing plants, not a change of methods of anything—by bringing in this competitive element. Is that not an advantage?

Prof. Quiggin—There certainly are advantages to be gained, but the way in which the pool system is operating—although I have not examined the Victorian industry in detail—the way in which pool pricing systems operate, I suspect, tends to encourage overuse of capacity rather than the socially optimal use.

CHAIR—I was just talking about the actual efficiency of generation.

Prof. Quiggin—I am not quite sure what figure you are referring to. I was assuming that means a proportion of capacity in use at—

CHAIR—No, the efficiency of the generator itself.

Prof. Quiggin—I doubt that the technical efficiency of a generator can be changed in that sort of way.

CHAIR—Yes, it can because you have got your down time.

Prof. Quiggin—Yes.

CHAIR—Because the thing is actually operating 90 per cent of the time instead of around 70 per cent.

Prof. Quiggin—That is what I was referring to, and I think it is fair to say that the system they have introduced certainly encourages minimal down time because it is bidding in at marginal cost. But I think it is possible to have too little down time as well as too much. With a centralised planning system you have an order of merit calling the stations into operation as you need them. With a pool system you tend to encourage all the power stations to have an incentive to be operating at all times. I think we need to see the pool system in operation for some time before we—

CHAIR—I will separate a simple element, if you like, and that is the generation itself. A US firm came in and took 50 per cent—I think it was called Mission Energy—and the efficiency of that power plant that they got involved in went up quite dramatically towards the sorts of efficiencies that are assumed in some of the overseas operations, which had not been the case in Victoria up until then.

Prof. Quiggin—I would certainly say there is room for efficiency improvements but, without having looked at the details of it, I think that part of the problem is that partial measures of any kind can be misleading. Labour productivity, in particular, is a misleading measure in the electricity generation industry because it is such a small portion of costs.

With capital stock, the question of the technically optimal proportion of down time, I think, is a complicated one. I agree that some of that improvement is almost certainly an efficiency improvement; part of it though may be an incentive to keep plants operating more of the time than they in fact optimally should be in terms of the optimal system.

CHAIR—The net result has been power stations generating cheaper electricity.

Prof. Quiggin—Certainly, there have been some cost savings and I do estimate positive cost savings, but I nonetheless doubt that a coal fired power station is ever going to achieve, for example, the labour productivity of a nuclear hydro-station, no matter how efficiently it is run.

I do not deny that there certainly can be efficiency improvements and that the process of micro-reform has led to efficiency improvements; simply that they are unlikely to be to the extent claimed by the Industry Commission and therefore those things do not justify rushing ahead in other areas and making clear mistakes in terms of capital allocation, like the duplication of cable TV, where we have got a system working by definition at 50 per cent capacity, if that.

Mr ALBANESE—Professor Quiggin, part of the ongoing themes from people that we have had before this committee and indeed in our own discussions is the difference between the theory and the practice in terms of measuring the results of micro-economic reform. I personally have been a bit disappointed by some of the people we have had before the committee who say that the outcome does not seem to matter as long as you put the theory in place. Can you point the committee towards, I guess, models or empirical evidence regarding the outcomes of micro-reform. It seems to me that your book *Great Expectations: Microeconomic Reform in Australia* represents an attempt to have a critique, but it is also, I guess, on the theoretical level, largely.

Prof. Quiggin—There are two ways of looking at the empirical evidence. One is at the aggregate evidence—and I think there is fairly general agreement of people who have studied the aggregate performance of economies, OECD economies that have undertaken radical micro-economic reform, that the benefits are significantly smaller than have been claimed in the more optimistic assessments. That is looking at the performance of Australia, New Zealand and the United Kingdom, in particular—all countries where, to one degree or another, micro-economic reform has been undertaken. All these countries, of course, were motivated in part by relatively poor performance—or perceived relatively poor performance in the post-war period. On the whole, there has not been the kind of improvement in performance at the aggregate level that was certainly hoped for.

Looking at the Australian case, we went to micro-reform because it was seen as a way of getting around some of the macro-economic restraints—in particular the difficulty of maintaining a growth rate of more than about four per cent without running into balance of payments problems. There does not seem to have been any upward revision in people's estimates of the sustainable rate of growth of the economy.

So if we go back 10 years to when the term was first introduced there was a conscious distinction between micro- reform and the old style macro policy, which had worked very well in the post-war period but not since the early 1970s. The hope was that with micro-reform we would be able to sustainably run higher rates of growth by at least, say, half of one percent per year, and that does not seem to have happened so far.

Similarly, the same appears to be true of New Zealand which has undertaken much more radical reform but their sustainable growth rate does not appear to be any faster now than either Australia's or their growth rate in the period post-war, despite the fact that their reform involved a much longer period of dislocation and a much bigger once-off drop in GDP than Australia. So during the reform period in the late 1980s New Zealand GDP fell by 10 to 15 per cent relative to Australia and very little of that has been caught up in the recent expansion in both countries.

I think it is fair to say that at the macro level the more optimistic claims of gains of the order of one per cent a year can be shown not to be true, unless we assume that without the reform we would have deteriorated relative to our fairly poor performance of the mid-1970s and early 1980s. Then you can look at the individual sector studies, and there are quite a few. The problem is that in each case there are a lot of traps and it is particularly necessary to look out for things like income transfers.

The area is pretty contentious. What you find is one set of studies minimising the transfers and claiming large gains and another set of studies suggesting that most of what has happened has been an income transfer and there is very little net gain. In areas like contracting out, I could produce a pile of studies on both sides and not contribute to that literature; but, in those specific cases, it is very difficult to find areas where there is a really settled agreement as to the outcomes.

CHAIR—On this New Zealand business, surely New Zealand were facing a situation where the IMF were breathing down their neck? They had to do something.

Prof. Quiggin—They certainly had to undertake macro adjustment. Other countries have been in the position of having to undertake macro adjustment. I think the badness of their situation in the early 1980s has been exaggerated in retrospect. If we go back and look at Australia in the same period, I can remember books like *Australia, the worst is yet to come* and *Australia and Argentina: on parallel paths*. Had we undertaken radical reform, had the same drop in GDP that New Zealand had as a result and had the same experience, it would be easy now to say that back in 1984 we were in a really parlous situation. We had plenty of big problems, too.

I am not asserting that the reform caused the drop; I am merely saying that they had a very traumatic reform which one would expect to create some capacity for bouncing back in very rapid growth. In fact, over this expansionary phase from 1991 they have grown more or less in parallel with Australia; they have not caught up to anything like the extent one would expect. Even without the micro reform, if you have the IMF breathing down your neck and you have that sort of structural macro package, you expect a macro bounce back in the economy as you finish the adjustment phase and come into expansion.

Although I do not think you can claim that New Zealand proves that you should not have micro-reform, it certainly is not a case where there are demonstrable benefits. The best that can be said is that, taking account of all the difficulties they faced, they might perhaps have done even worse without the micro aspects of the reforms. Certainly they had to do something on the macro front in terms of their budget balance and so forth. But, in the past, a lot of countries have done that without undertaking micro type structural reforms.

Mr CAUSLEY—Professor, I note that you say that you are not opposed to micro-economic reform, and I suppose I am trying to come to terms with just where you do sit. But I would believe that in the past there are examples of government monopolies that were terribly inefficient and the consumers were paying dearly for it. On the other hand, I suppose that with the reforms we have had it would be fair to say that in some instances it is hard to identify where the benefits have been, particularly the prices to consumers.

I take it then that you are saying that there should be an assessment and we should probably follow very closely where the money is going, who is gaining from the benefits and how far you should go—whether in fact you can do the practical side of it and some of this high theory that talks about transferring electricity from one end of the east coast to the other; that you look very closely at the benefits of that?

Prof. Quiggin—If I can come back to government monopolies: we have certainly seen beneficial aspects of reform and things that tell us some things about theoretical claims. I date in some ways micro reform right back to the early 1970s. We had the post office run on the lines of a government department. In that sphere, the most effective single micro reform was the creation of Australia Post as a statutory authority—that is not the corporatisation but simply the transfer from a government department with the procedures of a government department to a statutory authority. That produced very substantial gains in efficiency.

We have also seen further gains in efficiency arising in the process of corporatisation, although those gains are not as great and are not as unmixed, I think, as the benefits that we got from going to the statutory corporation model. So I think we can learn two things from that. The first is that the range of ways of delivering those services is much wider than we might have thought 20 or 30 years ago. The second is that we have had experience of a big range of public and private sector mixes and we can see that general claims about the properties of public sector and private sector operation are rarely true. The public sector enterprises can operate like government departments, or they can operate almost exactly like private businesses or they can operate somewhere in between. Typically, if we have significant social concerns, as in the case of Australia Post, for example, I would suggest that the optimal point is somewhere in between rather than at one extreme or the other.

Dr SOUTHCOTT—I take your point about splitting up the PMG and so on, but I read an article which said that the improvements with corporatisation with Australia Post, in terms of total factor productivity, in terms of labour productivity, were significantly higher than what the private sector experienced between about 1979 and the mid-1990s, and that was attributed mainly to the process of corporatisation. This is with both Telecom and Australia Post.

Prof. Quiggin—I will try get back to those figures. My reading of the data is that the big gains were in fact achieved in the statutory corporation phase which was from, I guess, 1975 to the late 1980s. The rate of progress in TFP growth has been above the private sector, reflecting of course that a government department is generally not a good way of providing business services of any kind. But those gains were large relative to those of the corporatisation phase. Although ‘corporatisation’ is a somewhat imprecise term, I guess I would date from the late 1980s to the present that the gains on the whole have in fact somewhat slowed down since corporatisation—reflecting in large measure the fact that the easy gains were being made as we got away from the kinds of procedures that a government department has to have with public money but which are not very useful in terms of running a business selling goods and services.

Dr SOUTHCOTT—We are talking about the same period. I use ‘corporatisation’ to describe that period as well from about 1979 or late 1970s onwards in Telecom and Australia Post, and I think the improvements were something like four per cent or something.

Prof. Quiggin—Yes; there certainly have been very substantial improvements. In the case of Telstra, they are largely just the continuing technological trend exogenous to Australia that all telecommunication services, no matter how provided, have shown productivity growth rates of about four or five per cent for a great many years. In the case of Australia Post, I think you can see a significant benefit from that restructuring. I merely observed that the biggest single benefit was the move from the government department former organisation to the statutory corporation model, and that the difference between a statutory corporation and a corporatised enterprise is much smaller than the difference between either of those and a government department.

Dr SOUTHCOTT—Do you include the introduced limited competition to Australia Post as well through this assessment?

Prof. Quiggin—It certainly affects the figures in various ways. In part, of course, it makes them more difficult to read, especially when you use measures like labour productivity. You have to take account of the fact that contractors are not included in labour input; they are included in others, and that makes those assessments more difficult. But there certainly are areas of the services previously provided by Australia Post which are clearly naturally competitive and which do not have a close overlap with the basic letter carrying service. When we come to the introduction of competition in letter carrying, we raise a bunch of issues because we are really addressing both the issue of the network and the existing cross-subsidy and how we propose to sustain that. I have done quite a bit of work on that topic.

Mr McMULLAN—What you were talking about I think certainly reflects all our experience, in relation to the competing piles of arguments on either side of the case concerning the relative gains from contracting out, to take that as the example you used. Do you think the uncertainty about outcome is a product of a lack of time for implementation of these changes on a grand scale, it has been happening a little bit forever, this is in terms of its contemporary implementation and measurement for the empirical weight to overrun one or other theoretical argument, or is it simply the complexity of the matters being measured and therefore the capacity of it forever to outweigh any attempt to get an objective assessment?

Prof. Quiggin—I think there is a bit of both. I would certainly say that the Industry Commission in its final report on competitive tendering and contracting takes significant account of the kinds of criticisms that I and others have made. Certainly the claim about increased work intensity is a matter of experience. It is now unquestionable that full-time workers are working significantly harder than they had worked before.

That question was an open one even two or three years ago when we were talking about this. The data seemed to show, and anecdotal evidence seemed to support, that people were working harder but there was not a general consensus that there was a real phenomenon there. I think that fact is now generally accepted. Therefore, the fact that many more workers are subject to competition through things like outsourcing is widely accepted, although that would still be a point for debate. Over time we are coming to terms with things. I have raised a point about one form of transfer, which is that in many cases of contracting out the new employers have much greater opportunities for tax evasion than their predecessors had.

CHAIR—Can you qualify that?

Prof. Quiggin—For example, there is garbage collection by wage employees. Cleaning services are a major area of contracting out, and where they are provided by individual contractors they are also a very major area of tax evasion. I am not casting aspersions on the character of the people employed. If you have a system of wage employment, you get the money and the PAYE tax is taken out. If you are employing people at odd hours and with individual contract arrangements, the opportunities are much greater—and where there are opportunities they will tend to be taken.

As to aggregate figures, we may be seeing some of those difficulties in aggregate revenue as we as an economy move towards increased replacement of wage employees by contracting. I think we are seeing some erosion of income tax payers at the aggregate level.

CHAIR—It is a very important point; would you like to take a stab at a figure?

Prof. Quiggin—I have no idea what the numbers are, and it varies a lot from sector to sector. For example, information technology is another area of contracting out, where I imagine this problem is much less significant. If we look at the figure of 20 per cent savings—which is frequently quoted; the average person pays around 20 per cent of their income as an average rate of tax—certainly one way of saving 20 per cent is simply to employ somebody who does not want their activities to be known by taxation authorities.

CHAIR—You are opening up a new front. We might not pursue it too much.

Mr McMULLAN—That last point that Professor Quiggin made, other than an attempt to quantify it, was not controversial. One of the reasons that people are attracted to contract employment, and one of the reasons that changing from salary to contract employment is often sold to people, is that they will be able to change their tax arrangements. In the building industry that is common talk. It is not a controversial remark.

It is quite straightforward. There is nothing unusual about that. That is what happens. People can change the way in which they pay tax and the things they can claim. It is fairly obvious.

I was interested in a whole lot of issues. Most of them are written by you and others, and I would just be duplicating them if I asked you questions on them here. You made a passing reference to consumer-producer transfers. That seems to me to be an interesting part of a discussion that has not had much emphasis. I think it ended heavy protection, not just tariff protection but protection in the broader sense model. We were an economy obsessed with the interest of producers and as consumers we paid a price.

I think some evidence is emerging that the pendulum has swung back too far the other way and we are now looking at ourselves solely as a society of consumers and ignoring the interests of some of the producers, whether they are primary producers, or producers as employees, et cetera. Do you have a view on that, and is there any research or material on that which can take that argument any further? It is a very hard judgment to make at this early stage.

Prof. Quiggin—It is, but I certainly think in terms of working hours in particular and the way in which they are being divided among the community and divided over people's life cycle we are getting an arrangement which is not the socially optimal one. It has been justified by the fact that all this will certainly benefit consumers—justified by the fact that it will be more efficient in terms of delivering services and lower costs and that will benefit consumers. So we are getting to a point where a smaller proportion of the work force has secure full-time jobs and those jobs are increasingly long hours.

According to Professor Gregory at ANU, all of the growth in full time employment over the past 10 years has been in jobs working more than 50 hours a week. There has been no net growth in employment in ordinary full-time jobs. All of the growth has been, in net terms, in jobs of more than 50 hours a week.

Mr McMULLAN—That is all of us, is it not?

Prof. Quiggin—Certainly, I am putting in my 50! That cannot be sustained by individuals; it is not going to be sustained over the entire life span. It means that when somebody is, say, 55, their capacity to put in effectively those 50 hour weeks is another factor in people being marginalised from the work force much earlier—so you are getting to a narrower and narrower core work force concentrated typically in the years when people are raising children.

I think the point you make is right: in the past we thought of ourselves as producers and made life cosy for ourselves as producers, and if as consumers we could not shop on Sunday and we had to pay a bit for things well that was too bad. I think we are not paying attention to those sorts of issues. Where the debate has been raised there has been a very strong tendency from the advocates of reforms to say, 'Look, we should not really worry too much about these working hour issues because it would detract from efficiency.' They see themselves very much as advocates of consumers against producers even though of course we are all both.

Mr CAUSLEY—Has the basis of the theory not always been that if there are more efficiencies in the economy therefore the consumables are cheaper, therefore the wage earner or the person has more money available either to save or to spend and also the inputs are cheaper so therefore we are more competitive on the world market? It that not the basis of the theory.

Prof. Quiggin—That certainly is the basis of it. I am not denying the validity of it; I am merely pointing out that it is easy to have hidden costs on both sides of the equation. One hidden cost is—

Mr CAUSLEY—So is the theory working? Are we getting more money in the hands of the consumers, and are we more efficient on the world market?

Prof. Quiggin—The world market part of the story in a sense is somewhat misleading, partly because our export industries have always been highly efficient, our primary export industries have always been highly efficient and still are. In the areas in which we are growing, there is more relevance in areas like tourism and, for that matter, education where we are growing exports and we are doing a somewhat better job than we did in the past, I think.

Mr CAUSLEY—Only because we sell below the cost of production.

Prof. Quiggin—Certainly, there is an element of that in education and also often enough in rural production of course. I think we are seeing significant benefits, but it is important to at all times take a total view of these things. It was a criticism of protection that we looked at the interests of one sector and did not look at the costs of other. Again, if they are achieved by pushing people in the short run to simply work harder it will not be sustainable in the long term. We are seeing a significant element of that and as a society we need to deal with it.

Dr NELSON—In your September 17 *AFR* article, you said:

Equally significantly, the focus on microeconomic reform has led us to divert resources away from those areas of the economy where success over the past two decades has been greatest and where the prospects of future benefits are most promising.

. . . .

Two of the most prominent examples are health and education. Since 1970, life expectancy in Australia has risen from 72 to 77 years. Because of the nature of aging such a gain implies a major reduction in death rates, and a substantial improvement in the performance of the health sector.

If that is the case, why is it that the Australian Institute of Health and Welfare tells us that from years 1984-85 through to 1992-93 the increase in government expenditure on community and public health has been 9.2 percent in real terms, whereas general health expenditure in the public sector increased by four percent? It also says that in 1984-85 we spent five per cent of total public spending on community and public health, whereas in 1992-93 it had increased to seven per cent. And if you also look at the private sector, I would suggest to you that if the people running private health insurance companies, for example, were unshackled from their social responsibilities they would be increasingly moving into reducing their liability for health claims. And in recent years we have seen private health providers increasingly moving into health management, keeping people well, promoting products which give incentives for no smoking, keeping fit and all that sort of stuff. So I take you up on your research on that.

Prof. Quiggin—Sure. I think there are a number of points. There is, in my view, a natural growth in those areas. In the case of education, in my view that has been stopped altogether by policy, so that we are not spending any more as a proportion of GDP on education than we were around about 1970 even though in terms of the needs of the economy we should be spending a lot more.

In the case of health, it has been a standing objective of government policy to hold both total expenditure and public expenditure on health down as much as possible and there has been a view that, for example, the smaller the increase in the share of GDP going to health, the better. I guess I am reacting, in large measure, against that claim, which is frequently coming from the same sources who were advocating micro-economic reform. I think there are a lot of issues of detail on the appropriate balance between, for example, preventive and community types of medicine—front end treatment and that kind of thing.

In fact, one of the major contributors to that decline in death rate has been our successful road safety campaigns, for example, but of course that is another area which has been very short of funds and which I think would be an easy target for some of the kinds of pressures we see in terms of micro-economic reform.

Dr NELSON—But what you are suggesting is that, particularly with government policy where micro-economic reform principles and policies are pursued and enthusiastically, these are the first areas to go. In fact, I would suggest to you that the evidence is to the contrary and that, even under this government which would probably be described as more enthusiastically committed to micro-economic reform perhaps than the previous one—some of my colleagues might disagree with that—we have seen increases in expenditure on medical research, on immunisation, on suicide prevention, on collaborative research programs, for example in diabetes, and so what I am suggesting to you is that what you have said is not borne out by the evidence. I do not see that it is a sustainable argument.

Prof. Quiggin—Although I do not have the figures on GDP to hand, there was a big rise in the health share of GDP from about 1970 to the early 1980s and it has certainly been an objective of government policy to hold it constant since that time—and the increase, if there has been an increase in total, has been small.

It is certainly true that there has been re-allocation of resources, and most of the ones you mention I have certainly welcomed but it is typically true that gains in one area within an increasingly inadequate - relative to our needs - total budget are achieved at the expense of others. I think, for example, that the kinds of problems that emerge in the mental health area in the late 1980s can be traced directly to that process—that the pressure to hold down health expenditure led to cuts in the areas that were least likely to cause complaints in the short term. And given that those cuts are ultimately driven by cuts in transfers from the federal government to the states, I thought it was in fact somewhat unreasonable that the federal government then posed as the defender of the mentally ill against the dreadful state governments when the process had really been set in motion by those cuts.

The basic fact is that the demand for health care of all kinds is naturally growing and that pressure is coming up against a set of government policy directives—not only general stringency but a widespread view that sectors like health and education are a burden on the real economy in some sense. I am concerned to challenge that view. I think it has been more influential in some ways in education in recent years than it has been in health because it turns out to be very difficult to cut health. But we are spending as a country too little of our resources in both those sectors and we will benefit from spending more. The question of how we manage the financing of it is—

Dr NELSON—I still think your assertion is unsustainable and, even in last year's budget, this government which did reduce expenditure in treatment in terms of Commonwealth outlays actually increased expenditures in public and community health and those things which do contribute to longer life expectancy.

Prof. Quiggin—I do not want to run down public and community health. I think the allocation has been beneficial—

Dr NELSON—I know you are not.

Prof. Quiggin—I think that, in general, while you can do better on a limited budget, the basic fact is that we are cutting the aggregate, and if our total demands as a community could be expressed, I think—and this is reflected in things like news polls and things like that—the concerns of people as to what we do not have or enough quality of are things like health and education, but policy has been directed to contracting those sectors in order that we can have more marketed goods and services. And that, in broad terms, is what I am seeking to criticise. If I had 1,000 words to write instead of a paragraph I would certainly have expressed myself more precisely on those points than I was able to.

Mr CAUSLEY—How far would you go because, when I was in the cabinet in New South Wales, the budget for health and education was around $9 billion? And might I say that the health went from $4.2 billion to $5.6 billion, so that is a fair increase. But the total budget was $22 billion. Now you have got $9 billion out of $22 billion being expended on health and education: how far do you go if you want to spend more?

Prof. Quiggin—This is the finance problem. We have to get more private expenditure in those areas—which was done in higher education, to some extent, with HECS, for example—or we need to, as a community, bite the bullet and pay more taxes. And if we want to expand our consumption of services and the funding at least passes through government those are really the only two options we have.

I agree that there is certainly a great difficulty in that when you look at the remaining areas of the budget most of them are tied up in various ways. So I think, as a community what we get is what we pay for in that context.

CHAIR—I did not want to get too much into policy.

Mr ANTHONY—As you may, or may not, be aware, we have had a number of people, of course, before us on national competition policy, and I must admit that, the more I hear it, the more I am becoming probably less convinced of either argument. But the need may be on a case by case basis, looking at micro-economic reform. In your paper in the *Financial Review* on 17 September telecommunications is an area where you have got numerous carriers rolling out cable. I remember reading an article not so long ago which said that it is a bit like Britain in the turn of the last century when they put the channel system in: that was meant to be the saviour and, of course, it was redundant soon after. So what about other areas like airlines, for instance? When Compass was around, there were lower prices.

In financial deregulation, certainly in many areas, there has been a substantial shift. There have been some downfalls as well, but is it as clear, as you point out, that there are really two options? Secondly, I note also from that article that, with unemployment levels right through the 1980s, you estimate that micro-economic reform has cost between $40 billion and $80 billion a year. So if you had been a policy maker back in the 1980s, what would you have done, and how would you have tackled that problem?

Prof. Quiggin—I think the first thing is that there are frequently many options and a feeling that some are more pure than others has been a major problem. For example, in telecommunications we have got one model of competition in analog mobile phones, which is a single physical network shared by the two carriers; in digital, we have three separate networks. Now, I do not think the average consumer has seen any difference at all in the way in which the competing carriers treat them, the prices and so forth. Yet the first one is massively more technically efficient, and that model was scrapped because it was not seen as sufficiently pure; it was not seen as sufficiently competitive, and we have seen the same physical duplication model go ahead with cable. And that was totally unnecessary.

We could have got just as much competition, we could have got more competition, in fact, because in order to make digital work we have had to force out analog by legislation. It must be the very antithesis of competition to actually ban the technology because it will stop us from having enough competition in another technology. This was all done because one model was seen as more pure than another. That is the general point: if we try to adopt a more sceptical approach, maybe we will step back a bit from rushing into mistakes of that kind—remembering that mistakes can always be made, of course.

I have argued—and the point that was just made is a reference to it—that the natural growth areas of employment and demand in the economy are in the skilled, labour intensive services—things like health, education and tourism and so forth—and that we should be expanding those areas more rapidly than we have been. As I have said, that would be both making a more creative use of private sector contributions and increasing our total contribution in taxes. I have argued that with John Langmore. So that is the broad direction of policy which I would see us taking.

I am concerned that the pursuit of relatively modest gains in micro reform has taken our eyes off even debating those issues. Those proposals have been around for a while and have not really been discussed. People are much more interested in hearing what I have got to say about micro reform because that is where the debate is at. In my view, whether or not those proposals I put forward are the right ones, we would be much better off debating those issues and debating what we can really do, in less than the mythical medium or long term, about unemployment than focusing the amount of attention we have been on competition policy.

CHAIR—Professor, you mentioned Telstra and the competition there. With the introduction of a competitor using the one network, we have actually seen for the first time in living memory a drop in the charge for local calls—a natural drop.

Prof. Quiggin—I suppose I have seen on TV Optus saying that if you live in 20 houses in Melbourne you can get local calls for 20c. Certainly, as a resident of Townsville, I have not seen—

Mr CAUSLEY—That is not true; Optus and Telstra have been advertising weekend rates—

Prof. Quiggin—That is for long distance.

CHAIR—Both, yes.

Prof. Quiggin—The price of long distance calls under the Telstra monopoly was falling about five per cent a year from as far back as I can trace the records. When the duopoly was introduced, one condition was that Telstra have a price cap on its average bundle of services, that it should continue to fall no slower than that five per cent a year in real terms—and it has exactly met that price cap. Of course, there has been a reduction in prices but there was a reduction in prices every year before that. The difference is that in the past it was an across-the-board reduction in the standard of rates.

Since the duopoly, it has been targeted at those customers most likely to switch to Optus. So people initially in the areas not served by Optus, and more generally those customers not seen as attractive, have missed out. They have missed out on the price declines they could have expected under the old system. Those customers who were ready and willing to switch have in general been targeted and have done very well.

We have not seen that. We have seen efficiency gains, but they have been dissipated in waste or duplication in areas like digital mobile telephony and cable TV. As to those services with a duopoly arrangement, we can see cross-subsidy from standard telephone services towards these kinds of strategic investments on which both carriers appear to be losing money hand over fist.

Mr LATHAM—Professor Quiggin, your critique of the Orani model and the Productivity Commission’s use of it is a substantial piece of work. Have you had an opportunity to respond to the Productivity Commission’s—

Prof. Quiggin—Response to me?

Mr LATHAM—Response to you?

Prof. Quiggin—Yes, I have had discussions also with Professor Dixon, who is the creator of the Orani model. I think my focus now is pretty much exclusively on the Industry Commission’s choice of closure assumptions and things. Although I have some concerns about the model—no model is perfect—I would say that my concern lies almost exclusively with two things. One is the way in which the Industry Commission chooses to close the model so that, in order to get a solution, you have to make particular assumptions, which are always somewhat unrealistic. The second is the way it chooses to report them—the use of GDP. As far as I am aware, their only defence of the use of GDP is, ‘It is what we were told to report.’ I do not know where the blame lies but—

Mr LATHAM—I do not have it with me, but I think the material they sent me had six or seven items where they wanted to bounce back at your criticisms. Have you had a chance to obtain them?

Prof. Quiggin—Unfortunately, I received the paper by Dr Philippa Dee by accident only a few weeks ago. She was under the impression that I had already received it. So I have gone through that. Particularly, the efficiency or working smarter arguments have been the main areas where I have placed emphasis. Because those are not formally put forward in most Industry Commission's work, that is the most substantial area where I have sought to develop a response. I presented a paper at the agricultural and resource economics conference, held on the Gold Coast a week or so ago, in which I set out at length my views on that question of the supposed efficiency or working smarter gains from reform.

On the GDP point, the only criticism was that they were told to report, and they did. I think it is generally agreed by everybody I am aware of that it is inappropriate and that the net gains—you can look at Professor Forsyth's book on micro reform back in 1992 and see that this is not an original point of mine—should be netted out. The result is to significantly reduce the estimates of the Industry Commission.

On the closure point, having discussed it with Professor Dixon, I have come to the conclusion that my previous analysis was not entirely correct, although the conclusion was valid. The basic problem is that, in the case of the Hilmer studies, those projected big increases in the net profitability of government enterprises, because of the way in which the model is closed, are not passed back to the community in terms of increased government spending or reduced taxation. Then, because the model has a twin deficits property, it leads to an expansion in the mineral sector, which is forced in there to make the model close. I guess I would still be of the view that the likely expansion in mining output associated with Hilmer reforms is much smaller than the Industry Commission projects because of that choice of closure assumption.

Mr LATHAM—My second question relates to some of the points you made earlier on. If not competition, then what? If it is not competition that drives down monopoly rents, if it is not competition that produces economic efficiency, what is it?

Prof. Quiggin—We first need to recognise there is no perfect answer. What we have seen is a complete loss of belief that regulation can do anything, when the evidence is that, although regulation is by no means a perfect instrument, it is in fact a useful one and one that we should not abandon. The telecommunications case illustrates that. If we had not had that price cap, I think we would have seen very significant increases in telecommunications charges in some areas because, although competition has been effective in some areas, it creates incentives to cross-subsidise that competition from other areas.

The other point is that there has been a belief that we have to have external regulation—there is no possibility of having the kind of statutory corporation model where the management is supposed to pursue the public interest. So the behaviour of Telstra—as directed—as a company seeking to maximise its own profits subject only to community service obligations has been, in many respects, damaging to public welfare, relative to what we could have achieved under a less precise but more flexible model of a corporation with the general objective of promoting telecommunications services to the country rather than simply protecting the interests of its shareholders. We could use a mixture of all of those models.

Undoubtedly, in many cases in the past there was over reliance on the model of government monopoly and a naive belief that simply telling somebody to go out and maximise the public welfare meant they would do that. But we have abandoned that and believe that only competition will achieve things. I think we see costs of that in terms of telecommunications policy particularly—if the only way of achieving a decent outcome is to duplicate national monopoly services, then we are going to be in very bad shape as an economy. There are lots of those sorts of services all over the place, and one could argue that we should really have duplicate road networks—one on top of the other—in order that we could have competition between them.

Clearly we have to accept that, in an industry where we cannot have the nice case that economists like of thousands of small firms all competing for the consumer's business, we will never get the perfect outcome. We have to try a mixture of different approaches.

Mr LATHAM—So you are arguing a better balance of market competition, external regulation and internal altruism?

Prof. Quiggin—Yes. Certainly the positive aspects of the statutory corporation model in particular have been dismissed much too rapidly, in favour of the naive belief either that competition will achieve the outcome or that the external, as you would, adversary regulatory model will work well. I think the British experience, where they have gone down that track, has come to the point where the external regulators' regulations are becoming more and more detailed and they are becoming more and more like a second management. There are problems with that sort of model of setting one group of people up to maximise their profits and another group outside to regulate that model. While it has its benefits in certain areas, it is by no means a panacea; yet it is being treated as if it were a panacea.

Mr LATHAM—Is there a fourth way? I am interested in some of the literature about the value of cooperation, mutual trust, cultural aspects that lower transaction costs and lower checking costs, and higher productivity. There seems to be a correlation between higher productivity economies and higher trust societies—the Putnam and Fukayama type stuff. Is that something you are interested in?

Prof. Quiggin—I am very interested in it.

Mr LATHAM—It is this idea that cooperation might be the answer for more efficient production and competition the answer for more efficient points of exchange and transaction.

Prof. Quiggin—I am certainly interested in that point. I think there are lots of areas, and the university sector is one. You cannot simply apply a model designed to handle once-off anonymous transactions to the kinds of relationships that exist in, for example, a university. But those are also significant aspects of a lot of the kinds of public services we are talking about.

So, at the same time, you cannot assume that cooperation is going to emerge or that cooperation among one group is not going to lead to cooperating against the rest of the communities. It is a delicate balance. I am certainly not saying, 'I have the answers; listen to me,' I am largely saying that a naive belief that we have the answers, which has pervaded so much of policy in the last 10 years, is going to lead us into making disastrous mistakes and already has done so.

Mr ANTHONY—In your book *Great Expectations: Microeconomic Reform in Australia* you talk about waterfront reform and you question the economic benefit that would be derived from it; yet when you look at any other country where there has been microeconomic reform—and we go back to the New Zealand example—you see that there has been a significant reduction in turnaround time and a significant increase in cargo. Maybe there is not enough mutual trust between the waterfront workers' union and the stevedoring companies. Some areas of your critique are very provocative and valid, like the discussion on telecommunications, but in other areas it does not seem to gel with the potential gains that have happened in most ports around the world.

Prof. Quiggin—What I deny is the claims about the size. I do not deny that—

Mr ANTHONY—Do you think 15 million is a bit low?

Prof. Quiggin—I am confident it is closer to the mark than the kinds of figures that are being quoted. I saw in the *Financial Review* the other day a figure about the crane rates. If we are allocating resources correctly, a crane on a waterfront is no more important than a crane on a building site. It is a crane. It is great news that that crane is working better. If a headline in the *Financial Review* said, 'A major road project is being completed ahead of schedule and under cost,' that would be good news for the economy and would save us a lot. But part of the problem has been a focus on what are really second order issues.

The waterfront employed about 4,000 or 5,000 employees before reform. They were being paid a lot of money and a large element of the reform was to say, 'That deal we cut back in the 1960s that said you could keep these jobs for life because of the hard times you experienced in the depression, we cannot really afford that deal anymore. You are going to have to take a lump sum and retire.' That is a significant saving. But those 5,000 employees are not more important than the 5,000 employees in a major university. If they are more important, that is saying that in some sense there is a case for a strategic intervention policy in which we would actually subsidise the waterfront. So we can make savings in those areas, but the savings we make in the case of the waterfront employees are the additional output we could get by deploying those waterfront workers elsewhere in the economy. I estimate that that is quite small.

CHAIR—I want to move back to another area you have been keen to look at, and that is financial deregulation. You suggested that all the increased resources have not really led to more availability of capital. Do you want to expand on that?

Prof. Quiggin—When we introduced financial deregulation—it is an example partly of wishful thinking in terms of scale economies—there was a widespread belief that we would see more competition at the retail level. That has proved to be certainly false in the medium term and I would say remains false. There are fewer enterprises and the number of full service retail banking enterprises is likely to decline over time rather than increase.

We certainly saw a big expansion in the early period after deregulation of resources going into the financial services sector. That was not reflected, except in a few specialised areas like superannuation advice, in more services being seen by households as final product. So the justification—and it was advanced quite openly before the stock market crash—was that the entrepreneurial activities that were going on were leading to a better allocation of capital, that companies like BHP, by being subject to takeover threats and so on, were being forced to lift their game and improve their performance. That is not borne out in the aggregate data and, looking at yesterday's newspaper, for example, the notion that the kinds of resources that flowed to people like Alan Bond represent an improvement in the community's welfare I do not think is sustainable.

Mr ANTHONY—I do not think anyone would disagree with that.

Prof. Quiggin—But that point was seriously made by advocates of financial deregulation right through the 1980s—that the resources we were paying those people were beneficial. I am concerned that what we have seen since then is that there is the current generation of people with their hands on the levers and many of them got badly burnt back then and are more cautious, but we have not made any structural changes that will prevent those kinds of problems re-emerging.

The fundamental structural problem is the fact that we have deregulated the activities of the banking sector but we have not removed the government guarantee. I think that is certainly an issue. I know it has been raised in the context of the Wallis inquiry. It is certainly something that we need to focus on. It is my view that we need to tell institutions to go one way or the other: either back to a narrow banking model with tight regulation or into a genuinely free market where there is a clear government commitment not to intervene, not to rescue them if they get into trouble and not to rescue anybody who loses money as a result of their default.

Mr ANTHONY—Like S&L in the United States.

Prof. Quiggin—Yes, S&L deregulation was precisely like that. They deregulated, but they retained the guarantee and of course you got people taking the one-way bets that that created. Despite the crash, even the people who directed the institutions that failed most spectacularly benefited and the depositors with those institutions benefited because they were all rescued by the government. So in the end the taxpayers were the only losers.

CHAIR—I still see a bit of interest around here, and I have another meeting at 11.30. So I will hand over to the Deputy Chairman, Mr Wilton, to continue because it looks like you are generating a lot of interest and I think some members of the committee still have some questions.

Dr SOUTHCOTT—You mentioned the fact that the speed limits to Australia's economy growth rates have not really changed as being the main evidence that we have not seen the benefits of micro-economic reform. New Zealand, which you said grew at about the same rate as us after their recession, actually experienced a drop in unemployment rates of something like twice what we experienced.

If you look at the United States, you see that there is now a school of thought that believes that the natural rate of unemployment has actually decreased for the first time in the United States and they may be able to go below what the natural rate of unemployment was previously without setting off an inflationary spiral. Is it possible that micro-economic reform has not gone far enough. The current account blow-out two years ago has been the only evidence we have had so far that our speed limits have not changed?

Prof. Quiggin—I will come back to the unemployment rate. I observe that New Zealand, in terms of the current account version of the speed limit, is still facing that. At about the same time we did, they ran into current account problems and slowed down their growth rate. I think it was even more relative to us. Last year it was about one per cent, whereas we have maintained three per cent.

Looking at unemployment, I observe that the US has no permanent unemployment benefit. They have unemployment insurance. But for a single man with no job and no history that puts him in unemployment insurance, basically the only alternative is crime. So I would say you certainly ought to add in the one per cent or more of the US male population who are currently in prison to that 5½ per cent to get their unemployment rate.

New Zealand, when it introduced labour market reform, also cut the unemployment benefit absolutely and relative to other benefits such as the invalid pension. Although they have had good employment growth and have done reasonably well in that respect, you need to take into account the move from unemployment to the invalid pensions and you also need to look at the existence of Australia. If you added in all the New Zealand citizens drawing unemployment benefits in Australia into the unemployment rate in New Zealand—which in certain respects is reasonable because there is a steady flow back and forth in response to economic conditions—New Zealand's picture would not look nearly as good.

So, obviously, simply making being unemployed less attractive is a very effective way of reducing unemployment. Although unemployment is a great problem, I would rather have five people unemployed than one person turn into an armed robber, which is essentially the American trade-off in my view.

Dr SOUTHCOTT—Is the hard evidence that the speed limits have not changed that current account blow-out of two years ago?

Prof. Quiggin—I do not know. I am not saying there is hard evidence. I am saying Treasury on the one hand will say, 'Quiggin doesn't know what he is talking about in terms of micro reform.' Their actions in terms of macro policy certainly indicate that they believe the speed limit is still at about 3½ per cent.

Being temperamentally optimistic, I think we probably could push a little bit further. As to policy changes, for example, my preferred policy mix involves a change in the expenditure, a mix such that we would spend less on importables and more on domestically produced goods and services. So I would say with that we could raise our speed limit. But there certainly does not seem to be any general consensus that the speed limit has grown.

Looking at the US experience, I think the Americans do not pay much attention to the economy at most times, and I think their belief is that this expansion is different from all previous expansions. It is a long expansion. We have had long expansions before. The business cycle is not very predictable. Nothing is more certain, though, than that one day in the not too distant future there is going to be another recession there and another recession in Australia.

Dr SOUTHCOTT—They are entering an unknown period, but I read somewhere that they attributed that drop in the natural rate of unemployment to the reforms that it had undergone in the 1980s.

Prof. Quiggin—There have not been significant reforms in the United States. There has been no real change in policy there. I think it is fair to say that their minimum wage fell very substantially in real terms. Again, you can get some employment growth out of that. It is also true that all low income wages fall, which has supply as well as demand effects.

Going right back to the mid-eighties, the Congressional Budget Office produced the 'Families on a treadmill' report, which suggested that the huge expansion in full-time work by women can be explained in large measure by the desire to maintain real incomes. Of course, if you have a strong supply side, and you have a very low minimum wage—only $US4.00 an hour—that certainly would reduce our unemployment somewhat. More importantly, of course, the absence of any unemployment benefit certainly will reduce unemployment. We could make that choice if we wanted to. It is largely independent of the kind of micro-reform we have been talking about today.

Mr CAUSLEY—Professor, would it not be true to say that, whether we like it or not, we are being dragged along in this process to a certain extent because we now belong to a world economy and we cannot live in isolation? The fact is that, if we are not competitive in the world market place, then we are going to be forced into some of these reforms anyway, are we not?

Prof. Quiggin—There is truth in that, although I think it is frequently overstated. There is no sense in which an economy can go bankrupt from non-competitiveness in the way that a firm can. If we are less productive, we will have lower incomes.

Mr CAUSLEY—A lower standard of living.

Prof. Quiggin—Yes. In the case of the agriculture sector, for example, which is my background, if our farmers are less productive, farm incomes will be lower; but Australia will not go out of business as a producer of agricultural commodities.

Mr CAUSLEY—We might question that, but anyway.

Prof. Quiggin—Having worked in agricultural economics for 25 years I have been hearing that this is going to happen for a long time.

Mr CAUSLEY—The banks are patient, but I do not know how patient.

Prof. Quiggin—It is certainly true that many individual farmers have gone out of business and that living standards in many cases are not as high as we would like, but that is the way of thinking about the costs. To suggest that in some sense the international economy can come in and shut us down, which is conveyed by a lot of the rhetoric about competitiveness, is a mistaken way of viewing the questions. But, at the same time, it is certainly true that we have entered into treaty obligations—

Mr CAUSLEY—GATT, in particular.

Prof. Quiggin—And in the current environment there is no real alternative to doing that. We cannot say, ‘We’re going to stand outside that process.’ That gives us certain legal obligations to undertake certain sorts of reforms. It is certainly true that the maintenance of the old style of manufacturing protection was not really a sustainable option in view of the kinds of changes in the economy that we saw. So we have to take into account that the world economy and the pressures in general are in the direction of undertaking micro-reform types of initiatives.

But I think it is important to conceive of this as a way of maximising our own national interest, given a world environment, rather than saying, ‘The world is going this way, therefore we have to go this way.’ For example, when I have debated privatisation, I frequently find that people are unwilling to argue the merits. They simply say, ‘Everybody is doing this, therefore we must, too.’ My response is, ‘Twenty years ago everybody was nationalising.’ We have not got substantially cleverer in the last 20 years. If the argument is simply, ‘Everybody is doing it,’ everybody is just as likely to be wrong now as they were 20 years ago. So I think we need to distinguish between those things which are necessary adaptations to the world economy and those things which are seen as basically going with the international fashion.

Also we need to reflect that these processes have both benefits and costs. The kind of rhetoric of globalisation we heard under the last government was harmful in that respect. The claim was made that this must be a beneficial process and anybody who feels they are not benefiting from it doesn’t know what they are talking about, when obviously lots of people were suffering adverse consequences, even as we had also beneficial consequences.

Mr CAUSLEY—This is one of my hobby horses, I suppose, but I think I have evidence to back it up: in this whole deregulation process I see the big players manipulating it, particularly the middle people, I suppose, who are often multinationals. It seems to me that the theory falls down because in fact what we are saying is that, if we are more efficient, then all the consumers in the country get a better deal; but in fact in many cases it is not passed on to the consumer.

Prof. Quiggin—I think the most obvious examples of this are the deal driven private infrastructure projects we have seen. We have now got an industry of people going around promoting these sorts of deals because they will be able to put together financial packages and take commissions on those packages. In general, the work of the New South Wales Auditor-General on private roads, for example, demonstrates that those things have been far less efficient than if we had put the project out to competitive tender with a requirement that it be maintained for a certain number of years, made a lump sum payment on completion with progress payments for satisfactory work and then left the financing side of the equation entirely to government, to normal processes. They should put tolls where they are needed in the system to manage traffic flow, not in line with particular packages constructed by these financial groups that are currently promoting deals of this kind. Certainly in that sort of area we have not seen benefits because we are seeing public policy being the subject of moneymaking promotions, and we certainly have had a big loss of welfare in that area.

Mr CAUSLEY—In some instances so-called competition is really an effort by one or two groups to drive every other competitor out of the marketplace.

Prof. Quiggin—Obviously, for example, in its way, the judgment on Super League reflected that. The issue is that in the long run we are going to see only one and the notion that competitiveness in some way enters into what the best outcome is reflects a misunderstanding by the relevant court of what is really happening and what competition is about.

ACTING CHAIR—Thank you, Professor Quiggin. This has been certainly one of the best attended and no doubt the longest running session we have had in the public hearings conducted to date. It is indicative of the level of interest that you generate. Thank you for such a comprehensive and incisive presentation.

Resolved (on motion by Mr Albanese)

That this committee authorises publication, including publication on the parliamentary database, of the proof transcript of the evidence given before it at public hearing this day.

Committee adjourned at 11.42 a.m.