

States of Reform

*Mike Nahan, Myth and Reality in the Economic Reform Debate,
Institute of Public Affairs, Melbourne, 1994*

Reviewed by Ross Jones

The pace of economic reform in Australia has slowed in recent years. Some commentators have accused the States and Territories of failing to match the reformist zeal of the Commonwealth. The belief that the States and Territories are not serious about reform was reinforced by the almost universally negative press they received after the August 1994 meeting of the Council of Australian Governments to discuss the implementation of the Hilmer Report's recommendations on competition policy. The States and Territories were widely condemned for seeking financial compensation in return for agreeing to facilitate microeconomic reform and to stop protecting anti-competitive behaviour within their jurisdictions.

Mike Nahan challenges this view. In this publication of the IPA's Federalism Project, he tests recent economic reform against the checklist drawn up by the Business Council of Australia (BCA) in its 1993 publication *Australia 2010: Creating the Future Australia*. The key elements of the BCA's reform agenda comprise macroeconomic stability, limited government, taxation, savings, the labour market, microeconomic reform, depreciation, education, training, research, infrastructure and external policies. Nahan considers the first six elements of this agenda.

In the area of macroeconomic stability, Nahan argues that the Commonwealth learned little in the 1980s and is likely to repeat its mistakes. Since monetary policy was not reformed by changing the objectives and strengthening the independence of the Reserve Bank, the Commonwealth's commitment to low inflation appears weak. Similarly, the Commonwealth has been laggard in its commitment to reform of wages policy. The limited decentralisation has left most of the responsibility for wage moderation with the union movement and strengthened the power of the ACTU in more general economic management. Nahan is particularly critical of the performance of the Commonwealth in fiscal policy. The Commonwealth deficit reached 4.6 per cent of GDP in the recession year 1992/93, with much of the fiscal expansion caused by government decisions to increase spending and cut taxes. Failure to reform the indirect tax base further constrained the Commonwealth's ability to rein in the deficit so that it was still planning for a modest deficit as late as 1996/97.

In contrast, the States have made major progress towards fiscal responsibility over the past few years. Although the deficit of the State and local government sectors increased from 0.5 per cent to 1.5 per cent of GDP between 1988/89 and 1991/92, by 1993/4 it had fallen to 0.3 per cent. The States have cut back their workforces, increased taxes and reduced subsidies to government business enterprises (GBEs).

As for the size of government, in the 1980s the States earned a reputation for expanding government, probably because of the excesses of Victoria rather than the States collectively. But in the past few years most State governments have become

committed to vigorously reducing the scope of government. The States' own-purpose outlays have been falling while those of the Commonwealth have been rising. State governments also appear to be strongly committed to the sale of assets no longer considered to be part of the 'core' government activities. Public commitments by the States to asset sales over the next few years are substantially greater than those of the Commonwealth. Subsidies to State GBEs have fallen in recent years (although they remain large) while the Commonwealth, with fewer heavily subsidised GBEs, has not been under the same pressures to reform its GBEs. Further, the Commonwealth's handling of the reform of Australian National Line casts doubt on its commitment to imposing market disciplines on its own GBEs.

Nahan acknowledges that the Commonwealth instituted significant taxation reform in the 1980s. However, he argues that its failure to reform the processes by which States' grants are allocated has impaired the States' tax systems. He places much of the blame for the State's failure in tax reform on the Commonwealth. Inefficient State taxes such as stamp duties and payroll tax are blamed on the refusal by the Commonwealth to allow the States access to broadly based taxes.

Nahan identifies the major microeconomic reforms undertaken by the Commonwealth under the Hawke Government. Financial deregulation, agricultural reform, waterfront reform, floating the dollar, and massive tariff reform occurred in a short space in time, exposing much of Australian industry to competition for the first time. State reforms during this period were limited and it is mainly in the past three years that the States have undertaken significant reform. Nahan concludes that the States currently outpace the Commonwealth in microeconomic reform, largely on the grounds that at the Commonwealth has lost the will to pursue further reform.

This conclusion seems to be at odds with the Commonwealth's continuing push for reform of competition policy along the lines of the Hilmer Report. However, Nahan argues that the Hilmer reforms increase the powers of the Commonwealth at the expense of the States. The Commonwealth will receive considerable financial benefit while the States will lose the ability to earn monopoly profits from their trading enterprises. According to Nahan, the States' demand for financial compensation in return for utility reforms (which they have since apparently withdrawn) is entirely appropriate.

Finally, Nahan argues that the States must accept some of the responsibility for the failure to engage in any significant reform of the labour market. But he reserves his major criticism for the Commonwealth, arguing that the Commonwealth promoted the expansion of an inefficient centralised wage system and actively resisted any countervailing action by the States to introduce a more flexible system.

Myth and Reality in the Economic Reform Debate is a useful and informative account of the extent to which the Commonwealth and the States have embraced the reform process. It shows that the States lead the Commonwealth in a number of important areas of reform. Though at times dismissive of reforms instituted by the Commonwealth, it provides a welcome balance to the popular misconception that the States have been slow to embrace economic reform.

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