
REVIEWS

Economic Policy Challenges

Michael Keating, Who Rules? How Government Retains Control of a Privatised Economy, The Federation Press, Sydney, 2004

Reviewed by John Freebairn

Michael Keating brings a rigorous economic analysis and his experience as a senior Commonwealth public servant ‘to critically examine the contention that marketisation of government necessarily leads to a loss of state power and policy discretion’. In fact, he draws the opposite conclusion. He argues that microeconomic reform of the past 30 years has not changed government objectives and accountability to its citizens, but that it has enabled governments to more efficiently and transparently meet growing societal demands on governments, and that further reforms to improve Australia’s supply capacity are required to enable governments to respond to a more challenging future. Arguably, a more aggressive reform agenda than that presented by Keating should be on the discussion table. This book provides an excellent complement to related studies on Australian economic policy, including Productivity Commission (2004), Dawkins and Steketee (2004) and Gans and King (2004).

Governments at Commonwealth, State and Local levels play a key role, and historically a growing relative role, in the Australian economy. Total government outlays and receipts represent over 30 per cent of GDP, at any one time over a third of Australian households depend principally on pensions and benefits for most of their income, and most Australians enjoy some government provided goods and services either free or at prices below cost of production, and government rules and regulations impinge on most business and many household decisions. From an economic perspective, the underlying reasons for government intervention in the economy are to provide a legal framework and a stable macroeconomic environment in which the private sector can operate, to correct for market failures associated with monopoly power, public goods, externalities and information asymmetries, and to meet society’s equalitarian goals of equality of opportunity and some redistribution of national income. Keating describes many of the microeconomic reforms of the last 30 years in terms of governments shifting their policy strategy towards greater use of managed markets to better meet enduring society goals of economic growth and equity in a world of changing technology and community aspirations.

Chapters 2, 3 and 4 trace out the major policy changes, economic and social outcomes, and future government policy challenges for, respectively, macroeconomic management, input and output markets as they affect the provision of primarily private good property goods and services, and human services such as education, health and aged care. In terms of an answer to the question *Who Rules?*, Keating is at pains to argue that in the absence of a growing economy it is extremely difficult for governments to gain access to resources for their many programs, and that economic growth provides a key ingredient for gaining community trust and support, both of which are necessary for effective government.

Keating draws a favourable picture of macroeconomic policy changes over recent decades. Important changes include independence of the Reserve Bank with a clearer and more credible set of policy objectives and strategy, the medium term focus of fiscal policy, and considerable taxation reform. He points to improvements in the outcomes achieved by, and the perceived credibility of, fiscal and monetary policy to support economic growth and to achieve low and predictable inflation. The low workforce participation rates, as much as high unemployment outcomes, are, however, of concern and a

future challenge. He argues that neither globalisation, nor the loss of direct controls over the nominal (as opposed to real) wages and exchange rates, has reduced the capacity for Australian authorities to pursue independent macroeconomic policies. The greater effectiveness of market forces in both the private sector and much of the formerly government business enterprise sector is argued to have complemented and strengthened the conventional macroeconomic policy instruments by adding to competition in the product and factor markets and by increasing flexibility of the economy to adjust to external and internal shocks.

Microeconomic reform and greater reliance on market forces to deliver productivity improvements over the last 30 years were particularly directed at increasing international and domestic competition in the product, capital and labour markets. Keating provides an excellent discussion of the reasons for and the processes of unwinding the 'Australian settlement' policy strategy of tariffs, centrally regulated finance and labour markets, and extensive direct monopoly government ownership and operation of key infrastructure industries. Nowadays, industry policy is focussed primarily on correcting market failures, and this involves more in the way of re-regulation rather than deregulation. However, he points out that even now there is not a coherent and transparent industry policy strategy, and that government grants and tax expenditures by the States as well as the Commonwealth offer selective industry assistance, a lack of transparency, with possible opportunities for crony capitalism. While considerable improvements in industrial relations and performance of the labour market have been achieved, Keating is critical of the weight many still attach to use of the labour market, including minimum wages, as a redistributive instrument. He shows that many on low incomes gain little, if anything, from higher minimum wages (because they are unemployed or have part-time hours, because some lose employment and the opportunity to acquire on-the-job skills and higher future wages, and because of high effective marginal tax rates) and about a half of those on minimum wages live in middle and high income families. Instead, he proposes use of the tax and social security systems to more directly target assistance to meet equity goals and for changes in the education and training systems to improve skills and labour productivity. The chapter concludes with a plea to continue microeconomic reform with the objective of raising productivity and living standards.

Human services, including education, health, employment services and housing, represent a growing share of the economy, most but not all funds are government provided, and governments are held responsible by a more discerning and critical public for better and better outcomes. Keating discusses policy changes towards marketisation in the provision of human services as involving the separation of policy development and monitoring outcomes from the delivery of the service, devolution from centralised bureaucracies and hierarchal rules towards local suppliers and communities, contracting of service supply to introduce competition, and in some cases a greater use of user-pays charging. With the notable exception of employment services, the use of competition and contracting-out of supply has been slow to develop. Even with the limited changes, Keating argues that there have been significant improvements in productivity and in better targeting assistance over recent decades. Clearly, human services are appearing as the important future areas for improved resource allocation and productivity. From my perspective, Keating's discussion on reform options ought to be extended to include resolving the conflict between free or below-cost pricing and the inevitable excess demand that follows, the present clumsy and costly interface between the Commonwealth and the States in the supply chain, and the fragmentation of policy and supply of different complementary and substitute forms of health, education and other human services. More radical reform options for consideration include reducing the extent of middle class welfare and the extent of government involvement in intra-family redistribution over one's lifetime for what are largely private good property services. Provided that governments effectively monitor and preside over market outcomes, whilst using competition and other measures to achieve efficiency gains and improvements in the mix of products sought by different individuals, Keating argues that government control is enhanced rather than diminished.

Chapter 5 considers changes over recent decades in measures of income inequality, quality of life issues such as the environment, and community relations. Where changes have been observed, Keating considers the relative contribution of greater marketisation *versus* other causes such as technology, greater individualism and higher incomes. While the distribution of private earnings has become more unequal, redistribution through changes in the tax and social security systems has resulted in a similar distribution of effective disposable incomes. Again, the distribution of wage rates per hour has been extremely constant over time, with most of the change in the distribution of private earnings arising because of changes in the mix of jobs, which, in turn, Keating attributes primarily to technological change and not to marketisation policy. Except for air pollution in cities, many of the ABS measures of environmental outcomes have declined over the last 30 years. The use of market-like instruments, including taxes and tradeable permits, rather than command and control regulations, are advanced as more effective ways to remedy these environmental externalities. Keating questions many of the conclusions drawn by sociologists that the self-assessed satisfaction of Australians with their lives and community has fallen over recent decades. Further, he contends that any changes are the result of a number of social and political evolutions and not just economic changes.

The penultimate chapter considers the future demands on governments and their capacity to deliver. It is argued that demands for expenditures on health, education, infrastructure, the environment and national security could increase the required government share of GDP by another 10 percentage points, and that it will be increasingly difficult for governments to reach consensus positions with a more diverse and articulate electorate. Against these challenges, and without proposing major changes to the operation of the Australian political and public service systems, I was left wondering whether Keating errs on the side of over-optimism in his assessment that Australia's current institutions, perhaps with further pragmatic evolution, will suffice.

Overall, Michael Keating has written an informative and thought-provoking assessment of the recent roles and future challenges for economic policy and its institutions in Australia.

References

Dawkins, P. and M. Steketee (2004), *Reforming Australia: New Policies for a New Generation*, Melbourne University Press, Melbourne.

Gans, J. and S. King (2004), *Finishing the Job: Real-world Policy Solutions in Health, Housing, Education and Transport*, Melbourne University Press, Melbourne.

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