

Insiders and outsiders

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You can fool too many people too much of the time.

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Australia in 2005 has a certain resemblance to Australia in the early seventies, when we came to realise that the easy prosperity of the postwar years was coming to an end.

Those years were a period of unbridled economic growth. Migrants from war-torn Europe flocked to our shores. Agricultural and mineral booms boosted our coffers of foreign exchange. Tariff protection, government patronage and restrictive trade practices gave high returns to both labour and capital. Much of our prosperity was built on consumption of capital – particularly soils and easily-won minerals.

For governments, economic management was easy – tariff revenues, high employment and a young population do wonders for a country's public finances.

In 1964 Donald Horne wrote *The Lucky Country*¹, a warning that these good times could not last, but we were all enjoying ourselves so much that we did no more than to glance at the title and assume it to be another paean of self-congratulation.

By early 1972, when I came to Canberra to work in the Commonwealth public service, the fragility of what Charles Kindleberger came to call “the long boom”², was evident to all. Or nearly all, for the Prime Minister of the time, Billy McMahon, kept repeating: “the economy is basically sound”.

On arriving in Canberra and seeing the public service from the inside, I came to realise that McMahon's delusion was not entirely of his own making. One of the main tasks of the public service was, and still is, the courtly function of providing a buffer of support and comfort to Executive Government – to protect ministers from discomforting news, to provide *ex post* justifications for government incompetence, and to help politicians sell their message to the public. (Coming from the culture of plain, direct communication in a manufacturing firm, I found this culture weird to say the least.)

McMahon lost office; the public servants kept their jobs. Three years later, as the economy went into a bout of stagflation, the same public servants were still protecting Treasurer Jim Cairns from the horrible news from the economic battlefield.

In 2005 we are at the tail end of a similar, if shorter boom, and our Prime Minister is once again telling us about the soundness of the economy. This business cycle has had the longest positive phase we have ever known. We have weathered the Asian crisis of 1997 and the 2001 US slowdown. Our unemployment rate has halved since its peak in the early nineties, even while real wages have risen. Inflation is low. The stock exchange keeps breaking

records, boosted by high commodity prices, and our real estate boom has created many new millionaires. When only eight percent of Australians nominate the risk of economic reversal as their highest concern³, Prime Minister Howard can truly say Australians are feeling “relaxed and comfortable”.

As in the early seventies, however, there is a debate about the sustainability of Australia’s performance. Those who are associated with government tend to be more optimistic; those who are on the outside, as Donald Horne was in 1964, are sounding warnings.

Two recently published books illustrate this difference. Both are written by people of a liberal disposition – they could hardly be classified as “right wing” or apparatchiks of the Liberal Party. Both works are carefully researched and well-referenced. The greatest difference relates to the perspectives and backgrounds of their authors. One is from inside the Canberra bureaucracy, the other is from outside.

The view from the inside

Dr Michael Keating, now a Visiting Fellow at ANU, had a distinguished public service career under the Hawke, Keating and Howard Governments. Among his appointments he has been head of the Departments of Prime Minister and Cabinet, Employment & Industrial Relations and Finance.

His work *Who rules? How government retains control of a privatised economy*⁴ is a thorough and dispassionate account of government policy developments, mainly in the realm of economic policy, over the last thirty years. Those are the years in which the Australian economy went through a huge transformation following the end of the “long boom”. Tariffs were lowered, the exchange rate was floated, the financial sector was freed of many constraints, tough competition policy was introduced, government business enterprises such as Qantas, Telstra, the Commonwealth Bank and various state utilities were privatised or corporatised, and many previously free government services became subject to user charges.

Keating’s work is a rejoinder to those who complain that these developments represent a wholesale withdrawal of government from the economy. He points out, correctly, that ownership is not necessary for control, that user charges are not necessarily regressive, and that while many regulations have been relaxed, many more appropriate regulations have been put in their place. Some of the old regulations, such as interest rate cross-subsidies for home buyers, were ineffective or worse, had perverse unintended consequences. Conversely, a tougher set of competition laws has been necessary to ensure market liberalisation has brought its intended benefits to consumers. Similarly, while Hawke’s Accord was effective in its time, it would not have been an effective instrument as the economy modernised and as the workforce in self-employment and non-unionised industries grew.

Much of his work is devoted to refuting the view that Commonwealth Governments, particularly those of Paul Keating and John Howard, could be described as dogmatically neoliberal. While his case is convincing in itself, he has tended to avoid mentioning some examples which would strengthen his argument, such as the huge subsidies to private health insurance, the paternalistic protection of pharmacists, and the programs of grants to firms in sensitive rural electorates. These are not the policies of a government committed to

allocation through market forces. Possibly we are seeing something of Keating the public servant – avoiding territory which may embarrass the government.

Similarly he acknowledges the role Medicare has had in providing high quality and affordable health care, but he does not mention that since 1999 the Commonwealth has been on a determined campaign to destroy its two main features of universality and cost control.

It's not as if Keating is an apologist for the Howard Government, or, indeed, for the previous Labor Government. He criticises the populist assumption that Australia needs lower taxes; in fact he makes a strong and well-reasoned case for raising taxes to cope with the growing demands people will put on governments. He makes a strong case for more funding for education and training, acknowledging that economic growth will be constrained unless we address skill shortages. While Labor is taking the easy populist option of calling for tax cuts, Keating is putting economic responsibility above popularity.

In any serious work of this nature it is inevitable that technical errors will occur. It would be nitpicking and distracting for a reviewer to devote much attention to them. But there is one major plank of Keating's thesis that requires further consideration.

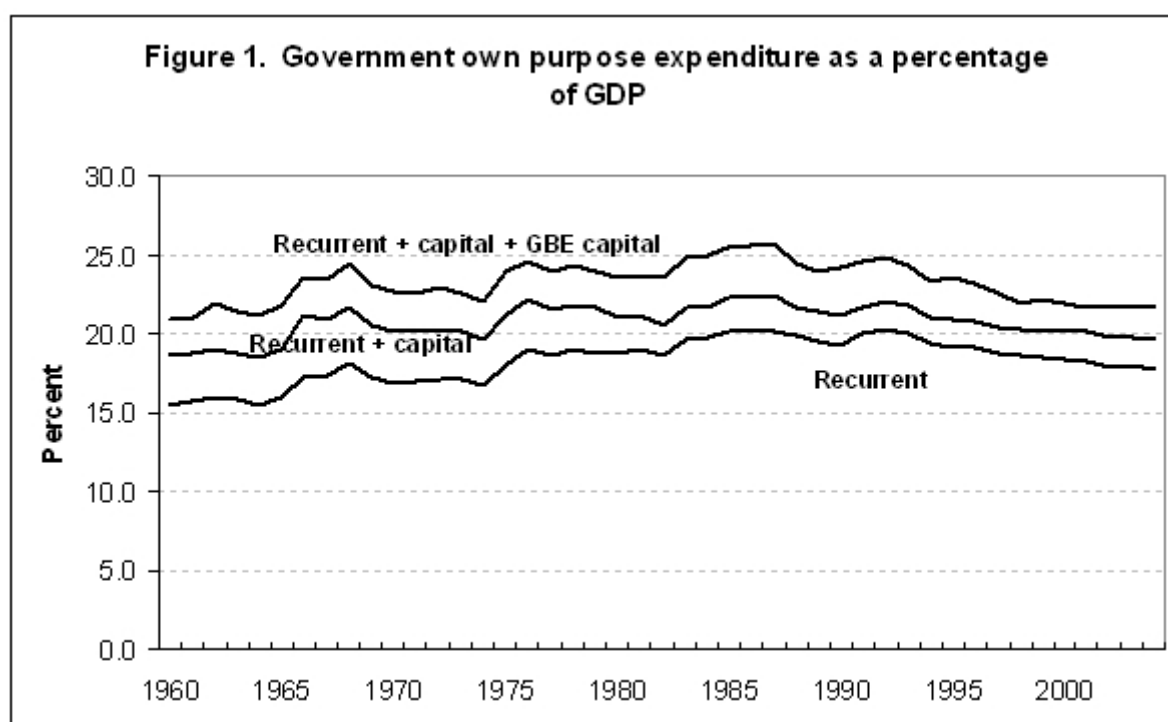
As Keating points out, both the "left" and "right" have their ideological reasons for overstating the extent of the fall in government expenditure. The "left" wants to show what damage has been done to public services, while the "right" wants to show its toughness in tackling government expenditure. Keating devotes quite an amount of argument to pointing out that the claims are overstated. Contrary to this rhetoric, government expenditure, as a percentage of GDP, after accounting for business cycle effects, has not fallen significantly. He points out government expenditure rose strongly to 1986, and has not fallen significantly since – at 33 percent of GDP it is still at around the level it had been when Whitlam was in office.

That is so, but if one is to consider the government's role in the economy, it is perhaps more instructive to examine the government's own-purpose expenditure. That is, expenditure excluding transfers such as pensions, family support payments etc. Governments have control over their own-purpose expenditure on health care, roads, defence etc., but once a transfer payment is made control passes to the individual. The allocative effect of transfers is generally weak.

Figure 1 shows recurrent and capital expenditure of all levels of Australian governments. The top line includes government business enterprises, and its decline can be explained, in part, by privatisation, which do not necessarily involve any real change in resource allocation. (If Great Southern Energy builds a powerline the real resource effect is no different from that which would result if the State Electricity Commission built it.) But even excluding this effect, it can be seen that the outlays of general government, capital and recurrent, have been falling since the mid 1980s. There has been a retreat of government.

The difference between the stability revealed in Keating's aggregate figures and the decline revealed in these figures is explained by the growth in transfers. As transfers have risen, general government outlays have fallen. That's why we are paying the same taxes, but getting less in return in terms of public goods and services.

Keating does acknowledge the rise in transfers, but in another context. In discussing inequality he criticises those who focus only on private incomes as indicators of rising inequality. Private incomes have indeed widened; he points out that in 1975 the ratio of the highest decile male earnings to the lowest decile was 1.86:1, and by 2000 it had risen to 2.51:1. (There has been a similar widening of female earnings.) But these inequalities are compensated for by a substantial rise in transfer payments; Keating points out that government transfers now account for almost half of the disposable income of a low income family, while in 1983 they accounted for only four percent of such a family's income.



While he presents this information in a clear and straightforward way, he does not go on to state the strong inference one can draw from this data – that we are using transfer payments to compensate for fundamental structural weaknesses in our economy. That is, our economy cannot generate enough well-paid jobs to sustain the living standards we have come to expect. It is extraordinary that in a country of 20 million people there are 6.5 million people receiving some form of Centrelink benefit⁵, and that there are 46,000 people in Centrelink and the Tax Office churning precious public money in an effort to defer the day of reckoning, when we will have to start living within our means, or expanding our means.

Indeed, there is a degree of complacency about Keating's work. While we may not be living in the very best of all possible worlds, in his view it wouldn't take a great deal to fix it – a small rise in taxes, more expenditure on education, and a few other reforms, and all will be well.

As in the early seventies, however, a run of impressive economic performance can hide serious structural problems. Even at a time when resource prices are high, we are running a record deficit on current account. Our exports of competitive high technology manufactures

and services have grown, but our performance is still way behind that of other developed countries. Many Australians are financing their spending from debt, and from the fictitious gains in household balance sheets – gains which have resulted from a policy-induced inflation in housing assets. Our income tax system, modified by the 1999 Ralph “reforms”, rewards short term speculation and penalises long term patient investment – as is evident in present constraints in private infrastructure. Our environmental resources are becoming seriously depleted and degraded. And our physical public infrastructure, particularly our surface transport infrastructure, is crumbling, victim to the simplistic policy obsession that debt is bad.

For political reasons the Government has not wanted to bring structural issues to our attention, and for an inexplicable reason Labor has deliberately run dead on economic policy.⁶ Our inattention to structural issues goes beyond mere political manipulation, however; it seems to be embedded in Canberra’s public service culture. Perhaps the public service has been so conditioned to telling governments how successful they are that they believe their own comforting stories. Keating, inadvertently perhaps, gives us some insight to how this culture has developed.

In a statement out of keeping with the general sober analysis of the rest of this work, Keating defends the politicisation of the public service – the emphasis on “responsiveness” as is embodied in the new Public Service Act. He states:

[A]lthough PM&C is the most politically-attuned department in the bureaucracy, political government has been concerned that an independent bureaucracy based on merit selection will inevitably not be sensitive to the government’s political needs. ... [P]robably the most important change over the last 30 years has been the growth in Ministerial private offices, both in numbers of staff and in influence. The Prime Minister’s office (PMO) staff now act as his alter ego and have greatly expanded his reach in coordinating the government’s political activity. When the PMO and PM&C are working well together – and they mostly do – then they basically complement each other and together they provide a powerful coordinating mechanism. (P 171)

Five hundred years ago Machiavelli warned about the dangers facing rulers who surrounded themselves with like-minded myrmidons while shutting out the voices of reasonable criticism. Recent experiences, most notably the “weapons of mass destruction” myth, reveal the dangers of political groupthink.

What Keating has done is to explain, very clearly, how Canberra works. In spite of being the employer of choice for Australia’s brightest graduates – including people of Keating’s calibre – the public service seems to suffer a deficit of critical capacity and imagination. The notion that the Prime Minister needs a political “alter ego” shows, perhaps how much we have come to accept Howard’s presidential style of government. Of course a prime minister has a right to be political – that’s his or her job. But if he or she wants political advice, there is a cabinet, a ministry, a party room, a parliament. After all, even Howard was elected by only 40,000 out of 12 million voting Australians.

Perhaps if we had a strong opposition we would not so readily accept Howard’s concentration of political power and his lack of leadership in the way he avoids hard issues (such as

structural weaknesses). Perhaps if Parliamentary debates raised these hard issues Canberra's public servants would be less inclined to accept the apparent inevitability of political trends. In fact, Keating draws on the minor policy differences between Labor and the Coalition as evidence that there aren't too many pressing problems or realistic policy alternatives.

To his credit, in a section "Augmenting political capacity", Keating does outline several different policy development processes involving Australia's citizens. If his ideas were implemented he, and others in public life, may be surprised to find what a source of creative energy there is among thoughtful Australians – as exemplified by the other recent publication.

The view from the outside

MacGregor Duncan, Andrew Leigh, David Madden and Peter Tynan are four Australians who have at least two characteristics in common. All have postgraduate qualifications from Harvard, and none of them have worked in the Commonwealth public service. But all have been involved, in Australia and overseas, in politics and public policy. At least one is a member of the Labor Party and one is a member of the Liberal Party.

Their work *Imagining Australia: Ideas for our future*⁷ lives up to its name; they exhibit a generous measure of imagination. No options, including constitutional change, are ruled out. If Keating's work can be described as dispassionate and cautious, the work of these writers shows passion on every page.

Although their work is more visionary than analytical, they root their work in traditional Australian values of egalitarianism, mateship and the "fair go". While public policy initiatives of the last thirty years have been about taking down the pillars of the "Australian Settlement" (imperial benevolence, White Australia, the tariff, state paternalism and centralised wage control) Duncan et al have asked themselves what the Australian Settlement may look like if formulated today in an energetic, cosmopolitan society:

Refashioning Australian identity – in a way that appeals to all Australians – will require new storymakers who can weave together the legends of our national past and make us feel like we are all part of a great Australian story; a story that includes the young and old, the urban and the rural, the native born and the migrant, the established and the struggling, men and women, white and black. It will require Australia to rework and update its old values and traditions into something new and coherent, capable of speaking to all of us about what it means to be Australian. This is the challenge for all Australians: can we fashion a new national story that lifts us up and inspires our people? (P 12)

These writers reclaim the word "inspiration". It isn't about coveting a Toyota Land Cruiser, top cover private health insurance or a negatively geared investment property. And they reject the complacency and acceptance of mediocrity that characterise Howard's vision. They are anything but "relaxed and comfortable".

Their starting point isn't to suggest all is ruin, although they do point out some facts that our politicians would prefer us not to dwell upon. Such as our slipping standard of living

compared with other countries, our depletion of scarce environmental resources, and our lagging efforts in education and research. But their six chapters (covering national identity, the democratic system, nation-building, growth, social policy and global citizenship) all include carefully argued and well-referenced ideas for practical change. Some of these ideas are about capturing values in symbols, such as their idea for a new flag. Some involve significant constitutional change, such as increasing the power of Parliament, particularly the Senate, to balance the power of Executive Government. Some are detailed, such as their suggestion that all university courses commence with a year of liberal arts studies.

Reflecting, perhaps, the philosophy of Harvard's Kennedy School of Government, they bracket their work by reference to Isaiah Berlin's essay "The Hedgehog and the Fox".⁸ The hedgehog is a grand visionary, knowing one big thing; the fox knows many things, and can see their interrelatedness. The policy advisor has to be both, but, the Canberra bureaucracy nurtures neither hedgehogs nor foxes. Senior managers are focussed on three minor things: keeping their ministers out of trouble, writing glowing speeches, press releases and correspondence for ministers, and managing their portfolios within budgetary constraints.

Duncan et al make some suggestions which our present politicians are more comfortable avoiding, such as the re-introduction of inheritance taxes. Perhaps their most contentious idea of all is that immigration be increased to aim for a target population of 40 million by 2050. (They have practical ideas on how to solve the accompanying problem of water supplies.)

Recalling Australia's earlier role in global citizenship, when Evatt and others took a lead in formulating the UN charter, they suggest Australia can once again take its place on the world stage:

Power is about much more than military might; power also lies in the strength and attractiveness of values and ideas. That is why democratic states – including small democracies such as Australia – have an unprecedented opportunity to help address the world's challenges and manage the processes of globalisation. (P 227)

and:

We believe that in our generation the great states will be those who help to ensure that this century is not like the last. These states will recognise our common humanity, take a broad view of their national interests and use their ideas, values and resources to shape a better world. (P 228)

Their view is liberal, economically and socially. (Within that liberal view they have some realistic and hard-nosed ideas on combatting terrorism.) It's visionary but not utopian. In comparison with Keating's work it reflects the same underlying values – an acceptance that the original construction of the Australian Settlement is no longer relevant, and a commitment to liberal values. The main practical difference, perhaps, is Duncan et al do not accept the notion that globalisation means low-paid jobs have to be supplemented with welfare payments. Rather, our investment in human and social capital should ensure that once again we can ensure that all jobs are good jobs capable of providing a decent living standard.

Their liberalism extends to an assertion of the values of trade multilateralism. It's a welcome reminder of our historical strong support of GATT and the WTO, a history which the Howard Government tried to obliterate when it suggested that our choices lay between the US Trade Agreement and protectionism.

Readers will find much to disagree with in this work, but that's part of its value. It is designed to stimulate ideas, to show that Australia can be something more than timid colony, a quarry for the more advanced nations, attached symbolically to a distant European monarch and economically to a declining superpower.

While they show all their proposals to be affordable, they admit that they do not address the questions of implementation – how to make those difficult transitions in a country which has lost its self-confidence and zeal for reform. That is a task for others – those who know how Canberra works but who are open to the prospect of fundamental, rather than incremental, change.

Both these works have their place in the realm of public ideas. They cover much of the same ground, but from different perspectives. It is notable that neither proposes simple solutions; even Keating's comparatively cautious approach involves the hard reality of increased taxes. Although both are written by people of economically liberal dispositions, neither work suggests that our future productivity lies in labour market deregulation. Rather, they recognise that our challenge is to ensure our workforce is employed productively.⁹ In raising hard issues, and in exposing the way governments distract us from attention to these hard issues, they expose the lack of leadership on both sides of Parliament.¹⁰

Those who believe that works such as these are merely academic entertainments would do well to recall the previous boom of the fifties and sixties when, as now, we were living off capital. Business as usual was not a wise option then and it is not a wise option now. We could, of course, continue to take the expedient, populist path, avoiding difficult issues, pretending that we can consume more than we earn, and sustaining a level of anxiety about change. That has been the politically successful strategy of the Howard Government for at least the last two terms in office.

Fault does not reside only with the Coalition Government – over most of the last nine years Labor has refrained from any fundamental criticism of government policy and from articulation of a different vision. In this regard the present period is unlike the early seventies, which was a period of vigorous political debate. In this political vacuum the task of re-igniting debate about public ideas has been assumed by public intellectuals like Keating, Duncan, Leigh, Madden and Tynan.

Notes

1. Horne, Donald. *The Lucky Country: Australia in the Sixties* (Penguin Books Vic 1964).
2. Kindleberger, Charles *Manias, panics and crashes: A history of financial crises* (MacMillan London UK 1978)

3. <http://www.roymorgan.com/news/polls/2005/3827/> (Accessed 7 Feb 2005).
4. Keating, Michael *Who rules? How government retains control of a privatised economy* (Federation Press Sydney 2004)
5. “Customers” is the name Centrelink assigns to those who use its services. The word “citizen” has fallen from use.
6. Williams, Pamela “Labor’s loner: how Labor lost the plot” *Australian Financial Review* 8 February 2005.
7. MacGregor, Duncan; Leigh, Andrew; Madden, David; Tynan, Peter *Imaging Australia: Ideas for our future* (Allen & Unwin NSW 2004)
8. Berlin, Isaiah *Tolstoy and History* (Weidenfeld & Nicholson, London UK 1953).
9. Subsequent to publication of these works the OECD has warned that in terms of productivity per hour worked, we are now at 15th place. Our “productivity” boom is a result of working harder, not smarter, and further labour market deregulation isn’t going to help employers see employees as valuable assets to be employed productively
10. The work of Duncan et al reflects the ideas on political leadership developed by Ron Heifetz, Professor of Leadership at the Kennedy School of Government, to whose ideas these authors would have been exposed, directly or indirectly. For a review of his work, see *Dissent* # 9 Spring 2002 “Leading Questions”.