Who’s that tugging at our skirts?

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Ian McAuley, University of Canberra and Centre for Policy Development

IN LUIS BUNUEL’S farcical film *Le Fantôme de la Liberté*, a little girl becomes separated from her parents. Her frantic parents are in the police station where a search is being arranged. Everyone is so preoccupied that they don’t see that the missing girl has wandered into the police station. She finds her mother talking to a police officer, and tugs her skirt to gain attention, but her mother’s response is to tell her she’s too busy to be interrupted.

So it is for the elusive role of government. Search parties are out scouring the landscape. *The Economist*, in an editorial in January this year, said ‘a great battle about the state is brewing’. The Global Financial Crisis has reminded us of the destructive instability of lightly regulated capitalism; many say we therefore need far more interventionist governments while others say that big government is prolonging the crisis because it is too permissive with stimulus spending. To add to the din, last November we celebrated the anniversary of the fall of the Berlin Wall—a reminder of the failure of central planning. If even the Germans couldn’t make Big Government work, how could anyone? Locally, we find Tony Abbott is advocating a carbon abatement policy that can be done without a ‘big new tax’, but with the imposition of regulations. It’s a confusion that transcends traditional ‘left/right’ alignments.

There is, however, a clear statement of the role of government, and it’s been tugging at our skirts since 1854, when Abraham Lincoln said:

> *The legitimate object of government is to do for a community of people whatever they need to have done, but cannot do at all, or cannot do so well for themselves, in their separate and individual capacities.*

We could go back further, to Adam Smith, who, in the more flowery language of the eighteenth century, articulated a theory of public goods—goods which governments should provide because of market failures. Just as those who proclaim themselves to be left’ rarely delve deeply into Marx’s writings, the advocates of gung-ho capitalism never really read *The Wealth of Nations*. They are content with the part about the `invisible hand’, which can be found in a few seconds with a Google search. They invoke Smith in the same way as dogmatic preachers choose a single phrase from the Koran or the Old Testament to match their prejudices.

The cynics’ view

Lincoln’s statement has one overriding sentiment—that the government’s role is to serve the community; it is beholden to the people. Hard-headed cynics, observing governments dispensing corporate largesse, would consider such a statement to be naive, but as an ideal or a normative standard about what government should be, few would disagree.

The cynics' view is supported by surveys of trust in government: in most democracies citizens' trust in government has been in decline for the last fifty years. In 1965 when Ronald Reagan was campaigning to become Governor of California, in an uncharacteristically lucid moment he captured the emerging view of government saying 'Government is like a baby. An alimentary canal with a big appetite at one end and no responsibility at the other'. (Over the 111 years since Lincoln's statement the Republican Party has changed somewhat.)

This dismal view was given a cloak of academic respectability with the misleading name 'public choice theory'. This body of theory, developed over the last 60 years, models 'government' as an economic actor motivated by venal self-interest rather than by any consideration of the public purpose. Its interests are to survive and preferably to grow, and in democracies this appetite is kept in check only by the ballot box, when a party on the 'right' mounts a campaign centred on the virtue of `small government'. Like so many economic models, public choice theory rests on an untested set of assumptions about the motivating power of 'rational' self-interest.

Well-respected academics have exposed the barrenness of public choice theory. Here in Australia in the early nineties Peter Self of the ANU showed its political shortcomings in his work *Government by the Market? The politics of public choice*. That was followed by the work of Hugh Stretton of the University of Adelaide and Lionel Orchard of Flinders University in their book *Public goods, public enterprise, public choice: Theoretical foundations of the contemporary attack on government*, where they analysed public choice from an economic perspective. From both political and economic perspectives it doesn't stand up. Public choice theory has survived in our universities, however, possibly for the most banal of reasons. First, it is fashionable, and second, it is easier to teach than the mathematically heavier theories of traditional public economics.

The public choice view of government finds a wide range of support across the political spectrum. For politicians it means they are unencumbered by any annoying checks such as the public interest. It gives legitimacy to the view that 'small government' is a desirable end in its own right and that taxes are an unmitigated evil. It unites corporate tax evaders and social security cheats in the comforting rationalisation that to steal from the government is to take back what has already been stolen. It supports teams of lobbyists in Canberra competing to get what they can out of government, each year's tournaments culminating on the Grand Final Budget Night when the spoils are revealed. It means there is no contradiction or shame when the champions of free enterprise go cap in hand (or, as the automobile tycoons did, travel in executive jets) to seek a government bail-out. If they hadn't got to the till first, some no more deserving interest group would have got there.

The shifting relationship—from economics to finance, from responsibility to accountability

Practically, this vision of government as an elected kleptocracy has led to a fundamental change in government accounting. Government accounting has morphed into a detailed set of fiscal statements about the government's own finances. Over the years, starting in the mid 1980s, the Commonwealth's budget statements, its main consolidated accounts, have grown in financial detail and complexity, while revealing less and less about what the government actually does. Their emphasis has shifted from economic accountability to financial accountability; that is from what government does to how government handles its finances. It's the sort of accountability a shareholder may reasonably expect from a public company, for the shareholder is comparatively indifferent to the company's activities; her interest is to ensure that the company attends to her financial interests.

This point was brought home by a visiting delegation of Norwegian public servants and academics who came to a seminar at our university. We had gathered together some academics and public servants to exchange ideas about government accounting 'reforms'. The Australian Treasury officials went first, outlining all the changes such as accrual accounting, portfolio allocation and budgetary reviews.

Then it was the Norwegians' turn. Their spokesperson's opening statement went something like this:

> *'I have heard a lot about `accountability'. My English isn't very good, but I don't think we have a similar word in Norwegian. We refer to 'responsibility' when we talk about the relationship between our government and the citizens.'*

In fact his English was excellent. He saw 'accountability' as something forced on an agency to keep it honest. It's about compliance, often sullen compliance, and the agency will do all it can to show itself in its best light, with no concern for any wider responsibility. It implies a distant and conflicted relationship between citizens and their governments.

Shaping the political agenda—the fiscal obsession

This narrow concern with fiscal accountability can be illustrated with reference to two policies, health care funding and Abbott's regulatory approach to carbon abatement, avoiding a 'big new tax'.

We may believe it is a reasonable policy objective to achieve quality health care at the lowest possible cost. Such a policy objective is consistent with the principles of cost-benefit analysis and cost-effectiveness analysis.

That is not how it works, however. Within a set of other constraints (such as appeasing petulant provider lobbies), the aim of government is to achieve the lowest possible *budgetary* cost of delivering health care. That's why this and the previous government support private health insurance, even though private health insurance is a much more expensive way to share health care costs than sharing through public insurance. That's why when private insurers say we cannot afford taxes to pay for Medicare but we can afford even higher outlays to pay for private insurance, their illogical claims are unchallenged. That's why the Commonwealth allows pharmacists to charge consumers more for pharmaceuticals sold without a Pharmaceutical Scheme benefit than those same drugs it covers under concessional benefits. The Commonwealth's concern is only with its own costs, even at the expense of imposing greater costs on the community.

We see this lack of concern with the community's costs in the Commonwealth's *Intergenerational Report*. *The Charter of Budget Honesty Act* requires that the Treasurer release a report every five years, assessing the long-term sustainability of government policies over the following 40 years. That report provides detailed projections of government spending on health programs, but it is silent on the community's cost of health care. What matters is what the government spends, regardless of the community's costs.

The same *Charter of Budget Honesty* provides for the Finance and Treasury Departments to produce a *Costing of Election Commitments* document during the 'caretaker' pre-election period. It provides costings of the pre-election promises of the government and opposition. The costings are only partial, however, for, like the *Intergenerational Report*, they are confined to budgetary costs. The guidelines, developed by the Howard Government in 1998, state that they will 'only provide financial costings, and not provide policy advice or assessments of the economic impact of policies'. It couldn't be clearer: it's a fiscal costing, not an economic costing. The public are therefore drawn to consider only fiscal aspects of competing policies, rather than to compare the economic outcomes of those policies—a convenient framework for a government which allows impression management to take over from economic management.

That's why, come election time, Abbott's regulations on carbon abatement will look attractive in comparison with more economically responsible measures, such as carbon taxes or emission trading operating through market mechanisms. Regulations, if tough enough, would have the same impact on prices as a carbon tax or a permit scheme. Prices of fuels and downstream products would rise, but not because of a 'big new tax'. Reliance on regulatory mechanisms rather than market mechanisms, in fact, imposes extra costs: regulators don't come cheaply. Furthermore, compared with market mechanisms, regulations tend to stifle innovation.

It's ironic to see a conservative opposition party proposing a 'command and control' policy while a nominally 'left' government is trying to implement a market mechanism, but that's where this narrow fiscal notion of accountability has left us. Rather than blaming Abbott for an economically dumb policy (after all, he's simply developing policies within the Government's fiscal framework), we should blame the present government for not repealing or amending poor legislation it inherited from the previous government. Why do we not have a Charter of *Economic* Honesty?

Devaluing the common wealth

More generally, we see this narrow fiscal obsession in our political debates. The dominant economic issue has become the size of the government deficit, and the related question of whether economic activity should be regulated through fiscal or monetary policy. We take a negative view of government debt, but we never look at the other side of the balance sheet to look at government assets, because, by assumption, nothing the government owns could be considered to be of value. To the extent that we ever think of those assets we consider them to be the 'government's' property, not as our shared property. The dropping of the inclusive term 'Commonwealth Government' and its replacement with the term 'Australian Government' was no mere editorial matter: it reflects a separation between citizen and government. Notice too the shift in language, from 'our government' to 'the government'. As Orwell pointed out, the powerful manipulate language for their own ends.

Similarly the political debate about the size of the stimulus package is confined to fiscal issues. Was it too much, too little, too early, too late? There is far less debate about its composition. Should it have included cash handouts? Should those handouts have been more targeted? Should school buildings have received priority over other possible projects, such as public transport? The thinking (if we can call it that) is that there is no point in arguing about its composition. All government expenditure is wasteful, therefore the less the better but sometimes, as when spending needs a boost, it becomes a necessary evil.

Of course this notion that nothing the government does is of any value is absurd. We do value our roads, our ABC, our parks, our schools and even our daggy public transport systems, but we are discouraged from thinking that way. As Robert Reich, former Harvard Professor and Secretary of Labor in the Clinton Administration points out, public ideas matter. The idea that government does nothing of value, and the related idea that all taxes are a deadweight loss, serves many interests. Government handouts don't have to pass any public interest test. The laborious tasks of benefit-cost analysis can be dispensed with. (Cabinet submissions require only short-term fiscal evaluation; there is no requirement for economic evaluation.) Interest groups can dip their snouts into the public trough with impunity. Government enterprises can be sold at fire sale prices, so that their new private owners can make a stag profit. Parties can campaign lazily on a platform of bringing 'small government' because shrinking government is much easier than reforming government. Shrinking simply requires a budgetary directive to reduce 'discretionary' expenditure, regardless of any economic considerations.

Reforming government is harder: whole programs may need to be scrapped and new ones established; incompetent managers appointed for political loyalty rather than competence need to be fired and replacements recruited; and some interest groups need to be shut out.

Those who benefit from the prevailing public choice model of -government, have every incentive to argue that the idea is uncontestable; whatever more noble, romantic notion of government we may naively entertain, we should be realistic and accept the model.

Re-claiming public ideas—a theory of public goods

But this public idea, like so many others, such as the superiority of the Aryan race or the invincibility of the British Empire, is a contrived one—contrived to serve vested interests. Noam Chomsky, still fighting hypocrisy and humbug, recently said on the *ABC's Background Briefing:*

> *Since the Second World War there has been a massive propaganda campaign, a huge propaganda campaign, run by the business world to try to make people hate government.*

There are other models, and there is ample evidence that people are not satisfied with the public choice model. To argue that because people do not trust or like government they do not want government is like saying that because people do not like or trust banks they do not want banking, or that those trapped in a bad marriage don't like marriage. Opinion polling consistently indicates that people are willing to pay more in taxes, provided those taxes can be spent on worthwhile public goods, particularly education, health care and environmental protection.

There is an established theory of public goods, and Lincoln articulated it clearly in the two parts of his statement. He refers to what we need to have done, *but cannot do at all*, *or cannot do so well for ourselves*.

The first part defines a minimalist role for government. There is a set of functions which even the most conservative of governments must grudgingly provide or at least fund, for there is no way the private sector will provide them. These include some of the strongest areas of market failure. Among such services are national defence, a trusted and stable currency, a network of roads, and basic public health, as well as many other minor services such as weather forecasting.

Also, in order to avoid social unrest or the indecorous sight of people starving in public, even the toughest governments feel compelled to provide a basic welfare system. When a government cannot provide these basic public goods, we generally consider it to be a failed state.

The second part of Lincoln's statement, his reference to what we cannot do so well for ourselves is more contentious. The private sector may be able to provide, but at higher cost or with lower quality. Most of the difference in public services between, say, Sweden and the USA, would fall into this category, and it is in this area where our governments, state and federal, have been so active in privatisation.

A minimalist view—the Yellow Pages

At one ideological extreme is the notion that there is nothing which government does that the private sector could not do better. The Howard Government, for example, adopted a 'Yellow Pages' test for the public-private division: if an activity appeared in the Yellow Pages directory then it should be privatised. There was no questioning the notion that it may be better carried out in the public sector. Advocates of private health insurance won't even look at evidence showing that a single insurer can do a better job at lower cost.

To confirm this prejudice right-wing governments have done everything possible to ensure that governments perform poorly, so that privatisation appears attractive. They hobble public sector organisations with onerous reporting requirements. They divert services to political pet projects. They constrain agencies' capital budgets, so that in time those operations are under-capitalised and over-staffed. They appoint managers for political loyalty rather than ability.

Such governments have not bothered to try to reform public services. (What's the point in trying if government is intrinsically inefficient?) Rather, they have used privatisation as a lazy substitute for reform.

Some believe that even if a public service starts off being well-run, in time it will become captive to interest groups—suppliers, unions, contractors. When we look at the history of some public utilities, such as our railroads and electricity suppliers, there is some supporting evidence, but the questions remain why governments have been so soft, and whether, over time, private suppliers behave in the same way, particularly in situations of natural monopoly.

At the ideological extreme there are those who accept that there are certain costs in having an activity performed in the private sector, but this is a price worth paying, for there is something intrinsically virtuous in private sector activity—a mirror image of the old Soviet unquestioned preference for activity to be in the public sector. John Halligan of the University of Canberra calls this dogma 'private sector primacy'.

A pragmatic view — the best private and public fit

In response to the notion that the public sector is intrinsically inefficient, Stretton and Orchard point out:

> *Public enterprises can be kept honest and accountable and encouraged to be efficient by ...appropriate corporate design, audit and reporting requirements, press and academic scrutiny, occasional parliamentary or congressional investigation, and more positively by good directors and managers of whom the world has plenty if the government will look for them. In democratic societies with reasonable culture and conventions of business and government behaviour there is no longer any need or excuse for tolerating scandalous or seriously inefficient public enterprise. (But there would be daily scandals in a 'public choice' society whose business and government were motivated by nothing but individual acquisitiveness.)*

The optimal division between the public and private sectors will always be difficult to define, but we know when there are glaring imbalances. In 1954 John Kenneth Galbraith, in his *Affluent Society*, pointed out the contrast between private affluence and public squalor—a useful reminder that those who argue for lower taxes are arguing that they want to deprive us of our public goods, because, paternalistically, they believe public goods are bad for us.

hi the same year that Galbraith wrote *The Affluent Society* Paul Samuelson (yes, the same one who wrote the textbook) wrote a seminal essay 'The pure theory of public expenditure', in which he said that the optimal mix of public and private goods is impossible to determine. There is, however, a well-established body of knowledge of market failure. In some cases we accept a small amount of market failure because government interventions have their costs too. The established policy tools of market analysis and cost-benefit analysis, rather than simplistic dogma, provide a good guide as to what should be in and out of the public sector.

Over time conditions change. In the 1940s and 1950s a government-owned and operated airline made good sense, particularly at Australia's stage of development, but the aviation market has changed and our transport infrastructure has matured. On the other hand, in 1950 only a science-fiction writer could have foreseen the need for a publicly-owned national broadband network.

Methods of correcting for market failure can change. Governments may find that in some cases they can do just as well through purchasing services rather than providing themselves, but that does not hold in all cases. There are different forms of public ownership, ranging from tight bureaucratic control through to arms' length corporatised arrangements.

Also, there will be mistakes to correct. Some of the privatisations of recent times have been unwise, to put it mildly. Many states have privatised water supply, without regard to the inherent contradictions between commercial and conservation objectives. Privatisation of public transport has come at the cost of fragmentation, as the potential gains from whole of network management are lost. Privately-owned toll roads have been disastrous; it makes no sense to have a paid road within an otherwise ‘free’ network—but comprehensive road user charging may make good sense once the technology is developed.

Some may say that an economic role for government based on correcting market failure is a call for ‘big government’, but that is a deceitful representation of economic orthodoxy. In fact, a well-articulated theory of public goods can constrain the government from those interventions that cannot be justified on grounds of market failure. Governments around Australia have been squandering money on sporting stadiums and public events which pass none of the tests of market failure. State governments fall over one another with subsidies to attract industries in a costly zero-sum game. In the backblocks of every marginal electorate are to be found one or more superbly built ‘Roads to Recovery’, while our national highways remain uncompleted.

Also, a criterion of market failure keeps the heat on both government and private enterprises. In their pragmatic approach to the division between the public and private sectors Stretton and Orchard say:

> *Socialists concentrate on nationalizing, liberals on privatizing, each accepting the characteristics of public and private enterprise as given and unimprovable. In real life both modes vary from excellent to terrible, and theories about their distinct potentialities can be useful if they focus on ways and means of improving each, and on questions about the best role for each in mixed economies in particular circumstances and with particular social purposes.*

These voices, in defence of well-established economic principles, may be voices from the past, but age does not negate their wisdom. There is a legitimate economic role of government, and even though we have been distracted by events such as the fall of central planning and the global financial crisis, it has been tugging at our skirts all along.