

Privatisation and Deregulation: Myths and Practicalities

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In 1949, as a Minister of the newly elected Menzies Liberal Government, R.G. (later Lord) Casey praised the role of public enterprises as “overcoming national impediments, providing essential infrastructure services, and so *creating a climate in which private enterprise could flourish*”². A few years later, in his maiden Parliamentary speech, Malcolm Fraser said that “Public bodies have an important part to play in our national development because many things are too big in scope or too important for private people or even groups of people to undertake alone”.³⁹

If Casey or Fraser were members of the Parliamentary Liberal Party today they would be dismissed as “wet”. The contemporary conservative catchcry of privatisation forms part of a broader philosophy bent upon reducing the size and scope of the public sector. The virtues of the marketplace are being reasserted as the appropriate means of allocating the community’s resources.

The economic and social role of government as we know it is under challenge. It is said by some that government has outgrown its proper role, that it has become too large and pervasive, that many of its social programs are ineffective as well as inefficient, and that it is stifling both individual initiative and economic growth.

This critique goes to the heart of Labor Party philosophy. Our party platform articulates the objective of the “democratic socialisation” of industry “to the extent necessary” to eliminate the anti-social aspects of market forces. It advocates a role for public enterprise while simultaneously the importance of a competitive and socially responsible private sector. The Hawke Government has pursued this vision, by seeking more than any other Commonwealth Government to improve the efficiency and accountability of the public sector, to eliminate unjustified and unnecessary restraints on private enterprise, and to defend the weak and the needy from the consequences of market failure.

Let me make my own position clear at the outset. I believe we must ensure that both the public *and* private sectors are efficient. If that means relinquishing or reorganising unnecessary, unjustified or unproductive government functions, or freeing business from equally fruitless government restrictions, then I am wholeheartedly in favour of it.

Equally, if efficiency suggests that we initiate new government programs or intervene in the private sector — and if it can be demonstrated that increased efficiency will be the outcome — then I am also disposed to that.

Privatisation and deregulation, like social ownership and intervention, are only tools for the pursuit of other goals. They have no intrinsic merits. Used uncritically they can be unproductive and even dangerous.

It is my purpose in this paper to highlight some of the limitations of privatisation as an automatic means of improving public sector efficiency. I think its more thoughtful proponents are gradually coming around to the view that

privatisation may not be the cure-all that they first thought, that the goal of efficiency is not necessarily synonymous with the technique of privatisation.

I should also make clear at the outset that I do not regard technical efficiency as the only goal of government — nor of private enterprise, if corporate citizenship means anything. Equally important are such goals as equity and social justice. These do not always coincide with doing things in the most economically efficient way. Compromising efficiency for the sake of fairness should nonetheless result in a net gain for the community. That, in my view, is a more efficient outcome in the broader, long-run sense of that term. It is why the Labor Party has a qualified belief in the merits of untrammelled market forces

1. THE EXISTING EXTENT OF PRIVATISATION

The basic thrust of the smaller government argument is hard to sustain in the Australian context. For instance, our public sector is small by international standards — in terms of public expenditure as a proportion of GDP we rank 18th among 24 OECD countries. Moreover, the weight of international evidence and of independent opinion shows no connection between economic performance and the size or growth of the public sector.²

Nonetheless, there is a widespread view that government must be reined in. Although loathe to tolerate any curtailment of government services, the community would certainly, as always, welcome tax reductions. This Government has already committed itself to the trilogy of fiscal objectives, as a proper tactic in the strategy of economic recovery.

But our political opponents would institutionalise public sector reduction for ideological reasons. They believe that rather than simply compensate for market failure, government actually retards the performance of the private sector. As well as reducing government programs, they advocate what they call privatisation.

I agree that for certain purposes it is hard to better the genuine free play of the marketplace as a device for promoting the so-called efficient use of resources. The profit motive and the price mechanism, however, have their limitations. They are such things as market failure, externalities, and monopoly power. As we all know, the most efficient distribution of resources is not necessarily the most equitable.

The privatisation lobby takes its lead from the experience of the Thatcher government. A large number of British government enterprises has been sold, ostensibly on the grounds that such functions could be better performed by the private sector. The public sector is nearly always in a no-win situation in regard to state enterprises because “some are pronounced undesirable because, as monopolies, they must be inefficient; others are undesirable because, as they are not

monopolies, they should not be in public ownership".²³

The extent of nationalised industry in Britain, eg steel, motor vehicles, coal, oil far exceeds that of Australia. Most of the individual State enterprises privatised by Mrs Thatcher are already wholly privately owned in Australia. It does not follow that the imported fad of privatisation — "a bad case of Anglophilia" as Ross Gittins called it — is equally relevant here. Although public business enterprises have contributed enormously to the development of Australia, government has tended to step in mainly where the private sector has been found wanting. In some instances, such as the soldier-settlement scheme, state intervention has been designed to promote private enterprise.

On the other hand, our first colonial railways were taken over by the government after they went bankrupt under private sponsorship. Public enterprise proved essential for the nation's development. The Snowy Mountains Authority was established because the challenge was beyond the resources of private enterprise. Malcolm Fraser said of the Snowy Mountains and associated Murray and Murrumbidgee River schemes:

This is one of the best examples of government action because it is providing new spheres of enterprise and activity for private people. The power from the projects will be used by private people in their homes or by companies to produce goods which we in Australia need for ourselves or for export. The water that will come down the two irrigation systems will be used again by individual farmers and add to the national wealth. That work shows partnership between the Australian Government and the people. Both play their part.³³

All non-Labor governments pursued similar policies, the oft-cited cases of AWA and Commonwealth Oil Refineries (privatised in the first years of the Menzies era) being the exception rather than the rule. Many European industries were first nationalized by right-wing governments. In Australia it was the Playford government, for instance, that nationalised private power companies in South Australia. Our primary industry Statutory Marketing Authorities were sponsored by a Liberal-National Country Party government, at the behest of private farmers.

Now John Howard says that "the *first goal* of privatisation is to achieve a more efficient balance between public and private use of our resources by (i) progressively allowing the private sector to do and own those things which the private sector does better and more naturally owns, and (ii) restricting the public sector to those functions which appropriately belong to it".³ By international standards, however, Australia is already one of the half dozen most privatised economies in the western world. We rank twelfth among the 18 industrialised countries in terms of public ownership of key industries such as communications, energy, transport and heavy manufacturing.⁴

It is true that Australia's electricity industry is nationalised, like that of Canada and the large majority of other countries; its telecommunications like that of Japan and most other countries; and its postal system like that of the US and all other western industrialised nations. On the other hand, consider the following examples.

Three-quarters of Canada's airline industry and all of Germany's and Italy's are state-owned, but overall only 25 per cent of Australia's;

a quarter of Britain's and Germany's oil production is state owned, but none of Australia's;

half of France's and Holland's motor vehicle industry and all of Austria's is state owned, but none of Australia's;

at least half of Belgium's. Britain's, France's and Italy's steel industry is state owned, but none of Australia's;

Britain's, France's and Austria's coal industries are entirely state owned, but none of Australia's.

As several of these examples imply, it is the character and extent of government regulation, not the form of ownership, that is the important consideration.

A further aspect of British privatisation policies is that the provision of certain government goods and services should be contracted out to the private sector, rather than be produced by government employees. In fact this is already the norm in Australia. Most government offices and buildings are constructed by or leased from (and indeed cleaned by) the private sector. In the last decade the Department of Housing and Construction's wages workforce has been almost halved to 3600, largely as a consequence of using private contractors. Similarly, two-thirds of Telecom's capital works program is sourced to the private sector, 90 per cent of it provided by Australian companies. Much of our defence equipment is manufactured by the private sector. Our publicly funded system of legal aid and basic health care is largely supplied by private professionals.

Much of Australian government is already "privatised" in other ways as well. The boards of most government trading enterprises, for instance, consist overwhelmingly of private businessmen. Our primary industry statutory marketing authorities are run largely by farmers. The State subsidises private education and Medicare finances mainly private medical practice. And, unlike Britain, we've traditionally allowed public housing tenants to purchase their (privately-built) homes.

2. THE MERITS OF PRIVATISATION

The fact that Australia has a small public sector and is already highly privatised by international standards, has not impaired the enthusiasm of the privatisation lobby. It is therefore appropriate to examine the merits of the privateers' case. The essence of their arguments is that the public sector is less efficient than the private sector and that therefore there should be economic advantages in (further) privatisation of government functions.

(a) Efficiency of the Public Sector

In reality, however, the case is not as clear-cut as this makes it seem. In the first place, many government enterprises, such as the Commonwealth Bank, Medibank Private, and government insurance offices, already compete in the private sector. They are subject to daily market pressures to be innovative, to maximise efficiency to minimise prices, and to be responsive to consumer preferences.

Like all public enterprises, however, they are not subject to the additional market stimulus of threatened takeover, but neither are non-listed private companies. (On the other hand,

for their political directors the ballot box might be seen as a sort of surrogate annual general meeting of shareholders.) Interestingly, BHP does not seem to consider Robert Holmes a Court's current attentions to be a particularly productive managerial stimulus, nor did Henry Bolte's Liberal Government see the economic merits of TNT's overtures to Ansett in the 1970s.

That aside, the privateers argue that, because the government stands behind them, public enterprises are not subject to the ultimate marketplace sanction of possible insolvency and liquidation. This does not mean, however, that governments are by any means indifferent to the financial performance and budgetary implications of their commercial subsidiaries, as evidenced by the conditions attached to the recent rescue of the Australian Opera and by the stringent efforts of both Commonwealth and State governments in recent years to improve the efficiency of their railways. Taxpayers can be more demanding than shareholders in such situations, particularly as they are often better informed (courtesy of the media, *inter alia*) about such matters.

Moreover, it is just silly to assume that any government would or could allow an "essential" privatised enterprise to go to the wall. If it was politically incumbent on a British government to rescue Rolls Royce — just as the Australian Government moved to ensure the future viability of our steel industry — so a privatised telephone or power company would be even more certain of government backing should it be threatened by commercial demise. In the case of essential industries privatisation does not remove the government safety net that, rightly or wrongly, the privateers regard as inimical to efficient performance. Indeed, in the case of privatised British Telecom the UK Government even remains guarantor for a proportion of its debt.

The mere fact of public ownership is not a determinant of efficiency. One has to look only at the varying levels of performance between public enterprises to realise that this is the case. Or, to take an international example, labour productivity in the US postal service has been found to be more than double that in the UK.⁵ Telecom's initiative in developing a new national optical fibre trunk network illustrates that existence of a protected public monopoly is still consistent with technological innovation.

Indeed, if improved efficiency were genuinely the basis of the privateers' case, one would expect them to focus on privatising the loss-making enterprises. Curiously, they tend to ignore this area.

Sometimes attempts are made to measure the efficiency or otherwise of public enterprises by reference to the comparative level of their profits. Most of the major Commonwealth enterprises are profit-making, several of them at record levels at present. But profit comparisons are a hazardous exercise, for various reasons. In the private sector profit figures are sometimes manipulated for tax purposes. In the public sector the enterprise may be subject to price controls which automatically limit its profitability. At the opposite extreme, profits say nothing about the internal efficiency of monopolies, public or private, or of firms operating in an oligopolistic or protected market. Furthermore, literal comparison of rates of return can be misleading in the case of public enterprises because it overlooks their community service obligations and because they tend to be highly geared and have high interest payments, partly because they have tended to be undercapitalised and partly because of their government backing.

Nonetheless, the bulk of evidence and analysis to date has failed to reveal a consistent or persuasive case against the relative efficiency of public enterprise.⁶ For example, a well-known study of the comparative costs of TAA and Ansett Airlines in the 1970s suggested that the private carrier was more cost effective⁷ but a similar study of the comparative productivity of the government-owned Canadian National and the (then) private Canadian Pacific Railways found no such difference.⁸ In citing such evidence by no means am I saying that our public enterprises have reached their optimal level of efficiency.

Because of their special obligations it would be surprising if public enterprises were revealed to be more efficient than private enterprises. In some cases, such as railways, the industry is almost inherently loss-making, whether publicly or privately owned. More importantly, whereas a private company exists to maximise its shareholders' returns, a public enterprise is also an expression of the government's social and economic policies. Technical efficiency is too narrow a concept by which to measure a public enterprise performance. At the very least account has to be taken of their non-economic obligations.

They frequently have equity objectives and community service obligations, such as providing universal services at affordable prices, especially to disadvantaged groups or people living in remote areas. Their borrowing capacity may be constrained by government economic policy. Expected to be model employers, personnel and industrial relations policies unique to the public sector may affect their costs and flexibility. In the conduct of commercial intercourse public enterprises are expected to be like Caesar's wife. The services they can offer are usually prescribed, sometimes in order to *prevent* their competing with private enterprise. They can be subject to political direction, often arising from interest group pressure. Such pressures can also influence private companies. The rigorous financial accountability requirements of the public sector may restrict their autonomy. In short, in the case of public enterprises the concept of efficiency has a public policy as well as a managerial dimension.

It is factors such as these — often dismissed as mere "red tape" — that are cited in support of privatisation. Aside from the fact that there are other ways of ameliorating these problems, it simply does not follow that privatisation will remove such constraints. The ethical constraints are just as relevant to the private sector. Where the government retains a financial or legal interest, as in the case of nearly all privatised British enterprises, many public sector constraints continue to apply and even new ones are applied. Even where the financial and legal bonds are totally severed, political responsibility and accountability remain. Equity considerations and community service expectations do not disappear. In the past it has been just such factors that have compelled governments of all persuasions to nationalise or otherwise control elements of private commerce. The currently noteworthy takeover target, Australian Gas Light Ltd, is an unusual and interesting example insofar as it is a 130-year-old statutorily-based, privately-owned, state-regulated utility monopoly.

(b) Efficiency of the private sector

The debate on the performance of public enterprises tends to take for granted the efficiency of the private sector. This assumption should not go unchallenged. There is a large body of evidence that the private sector is no model of hard-edged

efficiency, as its history of boom and bust readily implies. The disciplines of the marketplace have not prevented considerable disparities and fluctuations in the efficiency and performance of private companies. The mess that our privately-owned steel and motor vehicle industries got themselves into, with the aid of short-sighted government policies, is an obvious example. The traditional theory of the perfect market quickly wilted in the face of empirical study, the evidence of predatory behaviour, the fact of industry protection, the development of monopolies and cartels, and the reality of externalities.

The self-correcting devices of shareholder accountability and threatened takeover also have an unconvincing history. As Bob Ansett recently complained, the current rash of takeover raids has concentrated managements' attention on profit maximisation at the expense of a more productive expansion of market share. The extensive use of overseas borrowing by corporate raiders has increased our foreign debt. At the same time revenues may be diminished at least in the short term because it is expected that the interest paid on these borrowed funds will be offset against existing profits, including those of the raiders' subsidiaries and affiliates.

Large parts of our independently-minded private sector also conduct their business under the public umbrella of tariff and quota protection, with the support of R&D and export grants, bounties, and various tax concessions, including until recently the subsidised lunch.

More significant is the fact that a competitive market simply doesn't exist for many commodities. If a public monopoly is privatised but market dominance persists, then as the OECD observed the new company "could turn out to be worse or no better than the public sector monopoly it replaces".⁹ As P P McGuinness, one of the principal Australian proponents of privatisation, has warned:

There is mounting evidence that (privatisation) is not in itself a very useful way of correcting the deficiencies of bureaucratic corporations. . . The difficult problem of providing the right kind of incentive structure for public sector managements and effective competitive restraints on the abuse of market positions of a natural monopoly by management and unions, have little obviously to do with ownership. . . The central issue is to get the government-owned authorities working effectively and responsively. Who owns them, whether a public service bureaucracy or a private sector bureaucracy, is not really important.¹⁰

In short, the form of ownership, whether private or public, is *neither* a sufficient nor a necessary condition for improved performance. The actual determinants of productivity and efficiency are factors like managerial capacity, organisation, technology, capitalization, labour force morale and flexibility, market environment, regulatory structure and degree of competitions, none of which is naturally or exclusively associated with a particular form of ownership.

(c) Budgetary arguments

While the principal ostensible rationale for privatisation is that of increasing economic efficiency, interest in the idea was first triggered by the desire to reduce fiscal deficits and taxation generally. Such benefits are effectively obtainable, however, mainly where public enterprises receive budget subsidies. This has not been the case with many Commonwealth

enterprises which in fact have usually contributed to government revenues.

In the case of Britain, on the other hand, there is increasing consensus that the stated efficiency objective has given way to maximising cash sales as a means of balancing the Exchequer. This is reflected in the fact that today the most ardent Whitehall champion of privatisation is the Treasury. Nonetheless privatisation has still failed as a means of reducing the public sector which in Britain, during the first four years of the Thatcher government, increased from 40.5 to 43.5 per cent in terms of public expenditure as a proportion of GDP. In Australia by comparison, in the absence of privatisation, the Commonwealth share fell from 30.3 to 29.8 per cent during the first three years of Labor government.

This comparison suggests there is some foundation in the view that privatisation is no alternative to honest, straight-forward reduction in expenditure. Indeed, it may distract attention from that goal, as seems to be happening with the Opposition. Whilst temporarily reducing the public sector borrowing requirement (*infra*), privatisation at best delays the day when genuine expenditure restraint has to be applied. As the *Australian Financial Review* cautioned, "The Liberal Party should discard the illusion that privatisation is in any way a substitute for hard decisions on central government spending".¹¹

(d) Consumer sovereignty

Although the imagined budget benefits of privatisation are at least misleading, the privateers argue that there would also be net gains in terms of consumer sovereignty. They aver that the disciplines of the marketplace ensure that consumer preference prevails in terms of the range, price, quality and quantity of goods or services provided. At most this is an argument for competition, not privatisation, as the Commonwealth Bank and Qantas, for instance, are already exposed to the competitive forces of demand and supply.

The privateers' argument also makes all the customary free market assumptions about perfect knowledge, frictionless adjustment, foresight, and the like. The emergence of the consumer movement and related legislation is dramatic testimony to the fallacies of such classical market theory. The individual is just as powerless in the face of a private monopoly as a public monopoly.

Moreover, certain merit goods, such as basic education, health care, unemployment insurance and old age pensions, are compulsorily paid for by the taxpayer and supplied by the state because, left to the disposition of the market, they would be selectively and inequitably distributed.

In addition, the quality of public sector goods can be superior to those of the private sector. For example, if a homeless person were given a voucher or cash equivalent instead of public housing, the tenure of their privately rented accommodation would be limited to the duration of the lease (instead of being secure). Government suppliers also often set standards of quality which their private competitors are constrained to follow if they are to stay in business. It might also be recalled that the Fraser government restricted Australia Post's courier service because of its competitive pressure on private services. Government enterprises like Qantas, the Commonwealth Bank and Medibank Private would not survive unless they provided services at least comparable to those of their private competitors.

(e) Wider ownership

The final argument in favour of privatisation relates to the benefits of creating a large shareholding class and curbing or at least redirecting trade union power. It is said that public sector trade unions, particularly in Britain, have exploited their power to frustrate management and to win superior terms and conditions of employment at the expense of the public which has had to foot the bill. It is further argued that ownership of shares will not only increase staff involvement in enterprise management, it will also improve productivity through greater workforce motivation and job satisfaction.

These latter arguments are also those used in relation to industrial democracy which is generally considered the better tool for such purposes. Worker co-operatives, for instance, have tended to be more successful in small rather than large firms where identification with company interests is inevitably more attenuated. It is interesting to note, by the way, that the Opposition Parties have perceived employee shareholders as one of the benefits of privatisation. The prospect of staff controlled superannuation funds owning shares in the employing company has, by contrast, filled the Opposition and much of business with horror. Worker ownership is acceptable providing, it seems, that the workers are neither organised nor in a majority.

John Howard has advanced the worker-shareholder argument in favour of privatisation, claiming that in the UK "over 90 per cent of employees took up their preferential share entitlement".³ He has foreshadowed use of the Thatcherist technique of enticing staff to "invest at a discount". This is a strange technique indeed for any Party that simultaneously advocates privatisation on the grounds of stopping workers "ripping-off" public enterprises. In Britain, however, there is increasing suspicion that the staff-ownership strategem has disguised the actual transfer of ownership to the large institutional investors and foreign interests that now own most of the former public monopolies.

The initial staff discounts and general underpricing of shares encouraged preferential small subscribers to re-sell at a profit, resulting in an eventual concentration of ownership. The number of shareholders in British Aerospace for instance, fell from 158,000 to 27,000 within a year. The 2.1 million initial shareholders in British Telecom fell to 1.7m within 10 days, the staff now own only five per cent of its shares, and a mere 3,600 shareholders (mainly large companies and institutions) now own 87 per cent of the stock. The OECD neatly summarized this aspect of the British privatisation experience:

The typical pattern has been a fairly large number of small shareholders at the outset which has then dwindled as the initial shareholders have taken their profits as the share prices have risen in the early months after flotation. . . Although there has been considerable interest from employees in owning shares in their company, such holdings have been extremely small.⁹

Despite privatisation the proportion of the British population owning shares is still only seven per cent, which compares with Australian estimates (there is no hard date) of three-six per cent.

This is not the only flaw in the privateers' argument. Union featherbedding has been possible in the UK — and in certain non-competitive Commonwealth enterprises — through a combination of strong unions, weak management, and the ability of monopoly enterprises to pass on the extra costs to

customers. It has nothing necessarily to do with the mere fact of public ownership, as actually demonstrated by the fact that the best known (and recently eradicated) example of featherbedding in Australia Post was peculiarly a feature of its NSW and particularly Sydney operation. More to the point, the featherbedding phenomenon is also apparent in private monopolies, as well as in sensitive industries, eg, oil refineries, and, ironically, even in highly competitive industries, such as in Britain's privately owned Fleet Street newspapers, where market pressures have induced management to opt for quick-fix solutions to union claims. It happened in Australia during the Menzies-McEwen era when local companies relied on increased tariff protection to allow them to concede generous wage deals and pass on the costs to domestic consumers. Mere privatisation will not avoid these sorts of problems.

Indeed the problem could become worse under a deregulated system of enterprise-based wage-bargaining whereby employer and employee, operating in a monopoly or restricted market, could effectively conspire to exploit their powerful position. This is even more likely given that the rate of unionisation is much higher among public enterprises (73 per cent) than among existing private companies (39 per cent), and that only the more profitable enterprises lend themselves to privatisation.

Surveys of the effect of privatisation on British unions have tended to disprove the theory that privatisation weakens union power. Nearly all unions deny that their new bosses exhibit a tougher attitude towards wage claims or that worker shareholders have had an influence on industrial relations.¹³ The latter phenomenon is not really surprising given that the degree of individual employee-shareholder identification with company interests tends to be inverse to the size of the company.

There are numerous other doubts surrounding the concept of staff-ownership as proposed through privatisation. There is the risk of increasing and institutionalising the pressure for trade protection, particularly given that worker-shareholders would attract more public sympathy than ordinary shareholders. Discounted, preferential shares for employees would be at the expense of other sectors of the population, such as the unemployed and the retired. From the staff's own viewpoint, there is the increased risk — like that of small business-people — of having both their capital and their livelihood dependent on a single enterprise.

Finally, there are not insignificant risks attendant upon dispersed company ownership. Widespread community shareholding is meant to increase the accountability of public enterprises. It can be argued to the contrary, however, that the political leash of Ministerial responsibility makes Telecom more accountable to the Australian community than is BHP to its 186,000 shareholders or its diffused customers. Dispersed ownership can actually increase the power of management in the case of large corporations. In the case of a monopoly or dominant enterprise widening the ownership also confers an interest in abuse of the market position. Last, as BHP again demonstrates, dispersed ownership also makes the enterprise vulnerable to destabilising sharemarket raids, a not unimportant consideration in the case of essential industries like telecommunications.

This concludes the case for privatisation. The basic premise that public sector enterprises are inefficient by definition and that private enterprise is inevitably more efficient is wanting on both theoretical and empirical grounds. The putative budgetary advantages are illusory to the point of deception. The assumption of consumer sovereignty is both suspect and

unrelated to the form of enterprise ownership. And both the prospect and the alleged advantages of widespread ownership, including worker-shareholders, are highly unlikely.

3. THE TECHNIQUES OF PRIVATISATION

Privatisation is popularly perceived in terms of selling the assets, or, some or all, of the shares in a public enterprise. Its less naive proponents also advocate familiar measures such as market liberalisation (either removing monopoly status or fostering competition), contracting-out selected services, and breaking-up the enterprise through partial sale.

Tampering with established government services almost invariably offends some interest group, whether it be employees or clients. A high degree of "pragmatism" is necessary, as confessed by Dr Madsen Pirie, President of London's Adam Smith Institute:

To privatise successfully, you must identify all of the interest groups and buy them off. The civil servants support the public sector, so we would make them the managers of highly profitable private companies. The work force like the cushy jobs and the comfortable work, so we would need to make them rich; we'd give them shares. The beneficiaries we'd buy out and give them something more important: we'd guarantee their benefit for the rest of their lives and then we'd make sure no-one else ever got it.¹⁵

The cynical irresponsibility of this prescription is breathtaking. Public servants, condemned as unimaginative time-servers, would be put in charge of the privatised enterprises (and, if British experience is any guide, they would immediately increase their own salaries). The bulk of the employees, hitherto maligned as malingering industrial extortionists, would be given a gift at the taxpayers' expense. Worst of all, the current beneficiaries of government housing, health, education and welfare programs would get a lifetime guarantee, but nobody else would ever again get any such assistance.

(a) Sale of Enterprises

The most common privatisation technique, assuming the agency is a profitable one, is to sell the enterprise to a private buyer, eg Mugga Quarry and Hotmix Plant, or to sell shares to the public and staff. In the case of public housing, for instance, the Thatcher government has sold the dwellings to the tenants on vendor finance terms at price discounts of up to 50 per cent — a practice that enriched existing tenants at the expense of the needy still awaiting council houses and a practice that was advocated by the Liberal Opposition in the recent South Australian election. In other cases, such as the cross-Channel Hovercraft Service, the government just gave the business to the employees.

In most cases, however, the British government has sold only a minority shareholding in the enterprise or used some other method, eg the "golden share", to retain a controlling interest. These "hybrid" or mixed enterprises represent an attempt to gain most of the punitive advantages of privatisation, eg removal of some "red tape" and involvement of private capital, whilst still retaining political control and therefore responsibility.

To the extent that this is considered an acceptable reconciliation of economic and social interests, it is curious that the reverse process has not been suggested by the privateers. For example, since the free enterprise Thatcher government has retained majority ownership of British Steel, would it not be consistent for an Australian government to acquire a significant shareholding in BHP and other economically important national industries? The government has other budgetary priorities, of course.

Finally one of the other many implications of public enterprise share issues is the effect on existing private companies operating in the same market area. For example, floating the Commonwealth Bank could easily depress the share price for Westpac.

(b) Market liberalisation

The second privatisation technique is to open up the market to competition, a process with profound financial implications (*infra*). Ironically, this often requires new government regulation, in order to control exploitative or predatory behaviour by the previously dominant public enterprise. Thus when the Thatcher government sold half of British Telecom and also opened the monopoly to competitors, it deemed it necessary to establish an Office of Telecommunications (OfTel), a new regulatory authority, to oversee the public interest and to protect Mercury, the licensed private competitor.

This raises another curiosity of the privatisation debate. It is assumed that it is only public monopolies that need competition. In fact competition flows both ways, the ABC and government-owned banks and insurance offices, for instance, provide desirable competition to their private counterparts. Would it not be consistent with the objectives of privatisation, therefore, to establish new public enterprises to compete with private monopolies or dominant companies like BHP?

(c) Contracting-out

The third method of privatisation is to contract out certain government services, eg having garbage collection done by private contractors instead of staff labour. In effect this is privatising production without privatising the financing. The technique has limited relevance to the Commonwealth government, as even John Howard has conceded that "much of the scope for this type of privatisation rests with State rather than national governments".³ Many Commonwealth services are already contracted out, including building construction, basic health care, defence procurement, and manufacture of most Telecom equipment.

There are, however, limits and complications in contracting out. It can amount to handing out a monopoly rather than really opening the service to a free market, eg TV frequency licenses, once granted, are hard to rescind. More importantly, the advantages are easily over-estimated, since the government can lose the economic advantages of vertical integration and internal co-ordination. For example, the contracting-out of road construction in the UK appears to have increased rather than reduced costs.¹⁶ As with so much of privatisation, this demonstrates the hazards of confusing means and ends.

(d) Hiving-off

The fourth privatisation technique is to break-up public enterprises by hiving-off discrete services to private competition. Jim Carlton claims this is the preferable way of dealing with public monopolies¹⁷ and that in the case of Telecom, for instance, competition would be allowed on the supply and installation of subscriber equipment, and long-distance trunk routes would be opened to private micro-wave, satellite and optical fibre transmission.¹⁸ This was the sort of deregulatory policy applied in breaking up AT & T's Bell Telephone System in the US in 1983, the immediate result of which was described by Mr Carlton's colleague, Senator Alan Missen, as "chaos"¹⁹ and by *Fortune* magazine in these terms:

Unfortunately, no one company is now responsible for things that go wrong. The result is increasing pain and suffering for customers — businesses in particular — who can't get the service they need when they want it.²⁰

Aside from the organisational mayhem of breaking-up integrated enterprises, the other major problem is financial. Selling or franchising only the profitable parts — it is hard to imagine anyone wanting the uneconomic elements — has implications for the remaining principal business. For example, if high-revenue peak-hour public bus services were sold-off or exposed to specialised competition, the public bus company could only sustain unprofitable off-peak services with the aid of substantial price increases or additional budget subsidies. This is the classic conservative technique of privatising profits and socialising losses. The profitable private company and its unprofitable state competitor are then compared as artificial "proof" of public sector "inefficiency". As the OECD cautioned:

If the inefficiencies which characterise many public services are due to the inherent nature of the service itself, rather than the fact that it is provided publicly, then the gains from privatisation may be small or non-existent.²¹

(e) Privatising welfare

This is an important point because it raises the final and perhaps most alarming of all privatisation techniques — the privatisation of *welfare* services. In this case the Opposition sometimes uses the less provocative euphemism "marketisation".

The privateers' targets are not confined just to getting the government out of business. In fact they want to privatise most public sector activity, including welfare services in particular. In the latest issue of the *Institute of Public Affairs Review*, Dr Madsen Pirie writes that first come the state enterprises; second the public utilities; third the health, education, pensions [*sic*] and welfare services; and finally [interestingly] the regulatory functions of government.¹⁵

This same agenda has been embraced by the Opposition. John Howard has said that:

Continued government assistance to private schools in Australia is part of the process of privatisation³

and that:

The reintroduction of private health insurance for basic medical cover by a future Liberal government will be privatisation.²¹

The same ideas have been propounded by Opposition front-bench spokesman Peter Shack who has said that education, health and welfare services would be invested with a privatisation element.²²

4. IMPLEMENTATION ISSUES

While the rationale and methodology of privatisation are fraught with problems and impracticalities, these are straightforward matters as compared to the difficulties of actual implementation. Jim Carlton was quite right when he told the WA Division of the Liberal Party that "We will succeed in selling the privatisation policy only if we move beyond the statement of general principles to explain the bread and butter realities of privatisation."¹⁸

(a) Monopolies and regulated enterprises

The most obvious problem in implementing privatisation is how to deal with monopolies. The public monopoly concerned may be a natural one, reflecting the contemporary state of technology and the nature of the domestic market, or it may be a legislated one, reflecting desirable economies of scale or other social concerns. Where the industry is a key one, politically or economically, it has been common for the state to run the monopoly. In some countries at some times it has been assumed that public ownership of any monopoly is essential in order to protect the community from exploitation and to pool any monopoly rents for the common interest.

It is true that a legislated or natural monopoly is subject to none of the normal competitive pressures of the marketplace. But this is also true of a privately owned natural or franchised monopoly and, to a lesser extent, of any enterprise, public or private, that operates in a regulated, protected or otherwise restricted environment. A monopoly can remain inefficient and indifferent to consumer preferences regardless of its form of ownership, eg the restaurant concession at an airport of shopping complex.

But some of the most zealous privateers still reject the very principle of public ownership of monopolies, on the grounds that private ownership is inherently more efficient — because of what they see as the effective diffusion of ownership and absence of interested shareholders implicit in the nature of government enterprises. Diffused private ownership, however, can be as "bad" (*supra*). In the longer term, moreover, mere privatisation may simply lead back to nationalisation. As one privateer observed:

There is the danger that in hiving-off large government-owned monopolies as large privately-owned monopolies, without any effective fragmentation or establishment of competitive checks on the exercise of power, the Thatcher government may also be sowing the seeds of yet another swing towards State intervention.¹⁴

To privatise a natural or necessary monopoly without imposing any regulatory constraints means that public accountability is lost without any observable gain. The enterprise is regulated neither by the market nor the

government. Indeed this enticing prospect is the reason that the managers of most British state monopolies have been enthusiastic about privatisation.

Most privatised monopolies have to be subjected to regulation by some government agency. Such agencies are notoriously prone to regulatory capture, whereby eventually the interests of the regulated enterprise and of the regulators converge, with the result that the regulatory authority functions in the interests of the industry rather than the community.

Even in the absence of this phenomenon, inefficiency has been shown to persist, in spite of attempted government regulation of private monopoly pricing. Cost-plus forms of price regulation are notoriously vulnerable to cost-padding, the price regulating agents being unable to penetrate the managerial thicket. Simple allowance of a "fair" return provides no incentive for innovation or even cost control. Attempts to regulate monopoly prices by tying them to inflation indices (the technique used by the Thatcher Government) tend to be countered by threatened closure or curtailment of services, often the sensitive cross-subsidised services. In the ultimate, attempts to curtail monopoly rents merely cause them to be taken in kind, through such devices as bigger salaries, more staff, more perks, an easier life, or (as the NSW Government found with AGL) higher capital reserves.

The other big problem with privatising monopolies — at least the legislated ones — is how and when to expose them to competition. If you de-monopolise them prior to privatisation, you limit their market appeal and their sale proceeds. If instead you privatise them first, you capitalise the monopoly into the share price and entrench the status quo, because then the share-holders as well as the staff and management have a vested interest in resisting exposure to competition.

This dilemma applies as much to privatising a duopoly competitor like TAA as it does to monopolists like Telecom. It also applies to privatising any public enterprise that has been required to provide unprofitable services. As one investment analyst said in relation to privatising TAA:

Any buyer of TAA would be certifiable if he did not first seek from the government answers to the following questions: (a) Will the two-airline policy be maintained and, if so, for how long? (b) To what extent could be buyer shed uneconomic routes; alternatively, to what extent would he be required to continue cross-subsidising routes?¹²

(b) Consumers and cross-subsidies

Even if the privateers can find a satisfactory way of privatising monopolies, they are still left with the dilemmas of cross subsidisation. This is where the potential effect of consumers becomes direct. It is the point where the argument ceases being simply economic, where it inevitably and properly becomes a political issue concerning the fair distribution of resources and services within the community.

As a matter of government policy many public enterprises provide services to certain members of the community at sub-economic prices. Under the tradition of uniform services at uniform prices it costs the taxpayer no more to send a standard letter 3000 kilometres than to send it three kilometres. Domestic telephone subscribers pay no more per call (and less in rental) than high volume business users. Pensioners are granted discounts. Each subscriber in Ian Sinclair's rural

electorate is subsidised to the extent of \$408 pa. Public telephones are maintained in spite of the losses they incur. The price of flying TAA to certain isolated destinations is less than the actual cost.

Australia Post, Telecom and TAA finance such uneconomic services, these so-called community services obligations, out of the revenues earned from more lucrative services. Those profits cross-subsidise the unprofitable services. As the current deputy Liberal leader, Neil Brown, said in respect of Telecom when he was Minister for Communications:

It is essential that a national common carrier, particularly in a country as large as Australia, should be able to draw on its profitable services to subsidise other services that are costly to provide as a result of great distance involved.³⁷

The problem the privateers face is how to prevent privatisation resulting in a collapse of this system, how to pursue their notion of economic efficiency without sacrificing social equity. Why would a private company feel compelled to use profits from lucrative services to finance other services? Why not discontinue those services or at least increase their price to an economic level?

If privatisation and de-monopolisation increase competition for lucrative services, as intended, the monopoly profits that previously subsidised uneconomic services will no longer be available. In addition, new technology, in the area of telecommunications for instance, is breaking-down traditional natural monopolies and increasing the possibility of competition in high volume, high profit areas. In any case, part of the aim of privatisation is to eliminate cross-subsidies and introduce market prices that reflect actual costs.

The prospect of privatisation has the potential to benefit a minority of consumers but at considerable expense to the rest of the community. The size and distribution of the Australian population are starkly different to the UK or USA and this is why cross-subsidised services have been so necessary. As the Australian manager of AT & T said:

I've always encouraged privatisation, but with Australia's small population and large, remote areas, it wouldn't work. Companies like mine would want only the profitable routes — Perth, Adelaide, Melbourne, Canberra and Sydney — because that's where the money is. Rural people would be left high and dry.²⁴

The Opposition has yet to offer a satisfactory answer as to how it will implement privatisation without penalising those Australians who depend on cross-subsidisation. Most recently John Howard has said that "you could licence people on the basis that they provide services in certain areas in a certain manner. Of course this would involve the loss of some of the potential efficiency gains".²⁵ Aside from its utter vagueness, this suggestion simply implies that an efficient public enterprise would be replaced by a regulated private company. It implicitly repudiates the very market forces in which the policy of privatisation rests — the belief that the profit motive will produce a lower-cost, more efficient service.

The same contradiction is inherent in the Opposition's alternative suggestion that explicit budget subsidies "might" be used in lieu of cross-subsidies.³

Calculating such budget subsidies, particularly if paid to private suppliers, would be as problem-prone (and susceptible to "extortion") as estimating price ceilings for monopolies

(*supra*). The Opposition claims that these subsidies could, theoretically, be financed out of the taxes raised from the privatised enterprises and their new competitors. The economics of this proposal are suspect to the point of being fanciful. Even John Howard has conceded that such tax revenues would make only "a significant contribution"²³ towards defraying the budget cost of an explicit subsidy. His colleague, Alan Missen, has been more frank:

We are left to wonder whether such enthusiasm for privatisation is warranted when one considers the large subsidies that would have to be paid to successors of Telecom or TAA in paying for the provision of necessary services to outback Australia.¹⁹

By contrast, enthusiastic privateer and Shadow Treasurer Jim Carlton is happy to gloss over the arithmetic:

If remote rural subscribers need a subsidy to maintain reasonable charges, then that can be afforded many time over from the taxation of the profitable private businesses spawned by privatisation.¹⁸

Coming to grips with such vague statements is like wrestling with a snake under water. But one example is sufficient to debunk this nonsense. Telecom cross-subsidies currently amount to \$500m pa. To fund this sum from tax on Mr Carlton's new enterprises would require an *eight* per cent increase in existing company tax receipts.

Does Mr Carlton, the Shadow Treasurer, expect anyone to believe that privatising Telecom will yield such increased receipts, let alone many time over? Will they also be sufficient to replace the Commonwealth's current \$600m in interest revenue from Telecom, ie the equivalent of a further *nine* per cent increase in company tax receipts.

The most likely prospects are that, by eliminating cross subsidisation, privatisation will, as a matter of simple arithmetic, result in either:

(a) increased charges and perhaps reduced services for significant sections of the community, including some of the most needy sections;

and/or

(b) some form of increased taxation for everyone in order to finance the necessary budget subsidies and to replenish revenue foregone.

At the same time private companies will reap the benefits of servicing profitable areas of the market and select groups, such as high-volume business users of Telecom, are likely to receive the benefit of reduced or discounted tariffs. Certain of these profitable, privatised companies will also receive budget subsidies to maintain uneconomic services, while simultaneously retaining the income which their public enterprise predecessors previously paid to Consolidated Revenue in the form of interest and dividends.

The issue of cross-subsidies is one of the most complex to be resolved in any Australian program of privatisation. It raises fundamental questions of equity. Even without privatisation there is a need, in economic terms, to identify the value of cross-subsidies and to expose them to public scrutiny. It may well be more appropriate to subsidise uneconomic services through explicit taxes of some kind, although in some cases direct cross-subsidies can be the simplest and most efficient form of financing those services.

(c) Sale pricing

The third implementation question to be addressed is that of how to price the sale of public enterprises. As already pointed out, the price put on the share will depend on whether the previous monopoly is to be preserved and on whether regulations are to be imposed in order to ensure continued observance of community service obligations, eg, the provision of services to disadvantaged or isolated groups at sub-economic rates. The greater this type of regulation, the lower the market price.

The Thatcher government has gone a step further. In most cases where a British public corporation has been privatised, the shares have been deliberately under-priced, partly in order to ensure the "success" of the float and also in order to encourage dispersed ownership, including that of employees. John Howard has similarly spoken of giving employees "the opportunity of buying shares at a preferential price".³

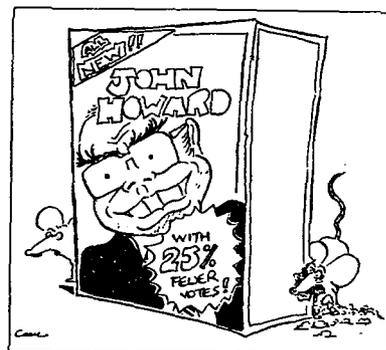
This technique effectively amounts to robbing the Exchequer and giving away millions of pounds worth of public assets.²⁶ After the initial float the shares quickly rise to their real market value, prompting small subscribers and employees to divest and realise their capital gain. The big money is made by the stockbrokers and underwriters. This was the experience with British Telecom where the value of the shares jumped by 90 per cent after the float and where, as the *Australian Financial Review* concluded, "the main beneficiaries of that exercise were the City of London rather than the consumer".²⁷

(d) Effects on financial markets

Assuming the problems relating to monopolies, cross-subsidies and share-pricing are resolved, there is still the vexing issue of the effect of privatisation on the federal budget, the financial system and the economy generally.

The first illusion that needs to be dispelled is that privatisation can have a significant impact on Commonwealth expenditure and taxation. John Valder correctly described it as "fiddling at the edges". Because the sale proceeds are non-recurring even John Howard conceded that it would be a "fiscal fool's paradise"³ to use the revenue to finance current consumption.

The initial point to note is that most of our public enterprises, including Telecom, Qantas, the Commonwealth Bank and Australia Post, do *not* cost the taxpayers money. Not only do they cover their running costs out of charges — and finance a large proportion of their capital replacement and expansion from retained earnings — they also yield revenue to the Treasury in the form of taxes, interest and dividends.



The most appropriate use of the sales revenue from privatisation is to reduce the government debt, perhaps through a *temporary* reduction in the public sector borrowing requirement (PSBR). Otherwise, for example, selling just 50 per cent of Telecom would, in terms of its impact on financial markets and interest rates, be equivalent to doubling the federal deficit. Using the proceeds to reduce the PSBR generates a continuing reduction in interest rates and repayments. But this is neither a net, nor a guaranteed, gain.

First, privatisation also means a continuing loss of the interest and dividend revenue previously generated by the privatised enterprises, eg, \$600m pa in the case of Telecom. It is argued that this revenue would be replaced by the tax receipts from the privatised enterprises and their new competitors. Not only is this implausible (*supra*) but it ignores the facts that many public enterprises already pay tax, eg, Qantas, Commonwealth Bank, and that the taxable profits from government monopolies are likely to fall once the market is open to competition.

Finally, because the market value of a public enterprise is a function of its guaranteed market share, the removal of monopoly status is likely to reduce its sale proceeds and thereby the possible reduction in the PSBR. It has been estimated, for instance, that TAA's market value would be cut by 40 per cent if the two-airline agreement were scrapped.¹² In this sense the greater the revenue-raising motive of privatisation, the less the incentive to expose the enterprise to competition — and this the less the putative gains in efficiency, consumer sovereignty and continuing tax revenue.

Not only are the budgetary benefits of privatisation misleading, the policy also has some negative implications for the economy generally. The technique is really one of transferring part of the PSBR from the public to the private sector, the effect on interest rates and inflation being identical. The so-called crowding-out effect is at least the same because the government is still competing for funds with private companies and consumers. In fact the interest rate effect could be worse than that of conventional government borrowing. Instead of drawing on certain traditional lending sources who invest in Treasury bonds, the government would be relying entirely on share market investors, perhaps also depressing general share prices in the process. Interest rates could be increased also because the new borrowings would be made without the usual government backing. If the public enterprise shares are underpriced and promise a capital gain, prospective investors may be enticed to borrow more than they otherwise would, thereby putting upward pressure on interest rates.

Privatisation can have other unusual effects on the financial market. Privatised enterprises would be freed from the macroeconomic borrowing limitations previously applied to them by government. Combined with removal of government backing as well, this can also exert upward pressure on interest rates. In response to such problems the British government has resorted to External Financial Limits (EFLs) to circumscribe the fund-raising activities of privatised enterprises, a practice which has limited some of the intended free enterprise benefits of privatisation.

A further problem is the way that privatisation distorts normal investment patterns. For instance, savings previously channelled to consumer credit or the housing market, through finance companies, credit unions, savings banks and building societies for example, are redirected to finance the purchase of shares in privatised enterprises. Some critics also argue that the capital attracted by privatisation would be better

channelled to other purposes, such as modernising the manufacturing sector, developing high technology enterprises, or simply substituting for the rapidly growing foreign borrowings that increasingly finance our share-market raiders.

Finally, there is the effect in terms of increased foreign ownership and foreign debt. Local professional opinion is that any individual share flotation in excess of \$500m (roughly equivalent to selling five per cent of Telecom, for example) would require resort of offshore capital markets³⁶ although, just to compound the problem, foreign interest would be inhibited by the nature and extent of any continuing government control or regulation of the enterprise. John Howard has acknowledged that "if you don't allow any foreign capital in (to facilitate privatisation), you'd push interest rates through the roof".²⁸ He has also said that he is not averse to foreign ownership of our public enterprises, including even majority overseas ownership of the Commonwealth Bank in due course.²⁸

Given that the largest and fastest growing component of our foreign debt is due to private borrowing, not government loan-raising,²⁹ using privatisation to transfer the PSBR from the public to the private sector is likely to increase Australia's foreign debt. There is the further prospect of foreign ownership of the privatised enterprises, including those that are sensitive for reasons of defence or internal security. British Telecom, for example, is now 13 per cent foreign owned. The Japanese government has responded to this prospect by insisting that only Japanese nationals will be able to purchase shares in Nippon Telegraph and Telephone.

(e) Other problems

There are, finally, a range of other implementation problems that the proponents of privatisation must address. A whole complex of transitional arrangements need to be sorted out, particularly to increase the attractiveness of the enterprises. To improve the marketability of certain enterprises the Thatcher government has indulged in such "softening-up" processes as writing-off debts owed to Treasury or converting them to equity.

As a number of government enterprises do not pay tax, the availability of past losses against future tax liabilities would be an important condition of sale. They could not remain tax exempt without creating a potential loophole for tax evasion.

The problem of staff superannuation liabilities would also have to be addressed. Apparently in anticipation of this industrial minefield, John Howard has spoken of "special treatment" and "a special deal" in terms of discounted shares.²⁵ This suggestion is reminiscent of Madsen Pirie's prescription that "the workforce like the cushy jobs and the comfortable work, so we would need to make them rich".¹⁵

The more closely one looks at the witches' brew of uncritical privatisation the more apparent it becomes that as a policy it is both ill-considered and ill-intentioned. Its premises are unsubstantiated and illogical, its techniques are fraught with contradictions, and the problems attendant upon its implementation are either insoluble or frightening or both.

It is all the more alarming therefore to contemplate the implications of one business commentator's observation that "privatisation is almost the only coherent economic policy

being offered by the Federal Opposition”³⁰ Subsequent public examination has exposed the flaws and illogicalities in the policy, throwing its Australian proponents into a tangle of qualifications and contradictions. More recently the *Sydney Morning Herald* has described the privatisation policy as “a fiasco”, concluding that “if it was ever dry, privatisation is now dripping wet and a dangerous gimmick”³¹ Just last week Steele Hall, likening privatisation to an irreparably injured race horse, lamented that “it is a sad business and there seems no alternative but to put it down”³⁵

5. DEREGULATION

Allied to the issue of privatisation is that of deregulation. If government enterprises are bad enough in the eyes of the privateers, attempted government regulation of private enterprise is even more distasteful. It is quite possible, however, to be opposed to wholesale privatisation of public enterprises whilst still being in favour of removing unnecessary public regulation of private enterprises.

This government, unlike *any* of its predecessors, has embarked on a deliberate program of reviewing the broad field of business regulation, with the object of rescinding those requirements that have outlived their usefulness, that do not serve legitimate purposes, that fail to meet their objectives, or whose costs exceed their benefits.

This process began in October 1984 when the Prime Minister invited industry, union and state government interests to identify regulations that impose unnecessary and substantial costs on business. In May 1985 the government announced details of its review of business regulation, including:

- the requirement for a regulation impact statement for any new regulatory proposals, and
- the establishment of the Business Regulation Review Unit (BRRU) to assist Cabinet’s Industry Committee in scrutinising existing as well as new regulations.

The creation of the BRRU guarantees a continuing attack on unnecessary regulations. The Unit screens all new Commonwealth regulations to ensure they are efficient, cost effective, likely to achieve their desired objectives, avoid duplication, and are not excessively rigid.

(a) Objective of Regulation

Broadly defined, business regulation constitutes government intervention in the marketplace such as to influence the ways in which business pursues its commercial interests. The state uses its power either to override the market mechanism or to tax and disburse revenues in such a way as to induce buyers and sellers to modify their behaviour.

Regulation or intervention proceeds from the premise that a free market can produce inequitable or economically wasteful results inconsistent with the public interest. Adam Smith’s invisible hand does not always work to the common good, particularly given the state of technology and economic organisation in the late twentieth century.

We now understand how the process of individuals’ maximising their own benefits can be at the expense of community interests. Indeed even in eighteenth century Britain, when Smith was writing, the courts and the common

law had already recognised the need for regulating private commercial behaviour *pro bono publico*. The technological and economic world of the late twentieth century is a lot more complex and integrated than that of Smith, with the result that individual commercial behaviour has much greater ramifications, whether it be a failure in a nuclear power plant or the failure of a finance company. Nor are we today as inured and indifferent to inequality and injustice as was the world of the eighteenth century.

Nowadays there are two basic sorts of interests that lie behind government regulation of commerce. First, there are *social objectives* relating to issues such as consumer protection, employees’ and employers’ rights, product safety, the environment, and the legitimate interests of certain groups, eg, children, women, Aborigines, migrants, the handicapped. Some of these socially inspired measures, including industrial democracy, affirmative action, and occupational health and safety, have the effect of increasing *efficiency* as well as equality, by making better use of our human resources and reducing social costs.

Thoughtless or uncritical application of such requirements can, of course, have unintended side-effects, can unduly increase costs, and can stifle productive activity.

Business regulation also has *economic objectives*. There are, for instance, prudential requirements to ensure the stable operation of stockmarkets and the banking industry. Trade practices legislation aims to control monopolies and *promote* competition.

In other cases competition may have to be restrained in order to promote economies of scale, to prevent wasteful rivalry (such as in the overseas marketing of Australian mineral or rural products) or to ration scarce resources such as radio frequencies or water. Regulation of designs and patents act to protect domestic producers from unfair foreign competition. Indeed, without laws and regulations to protect intellectual property, for instance, there would be no commercial incentive or reward for people like Ralph Sarich. Productive inventions could well be withheld from the market concerned, as for example is currently happening in the absence of law governing plant breeders’ rights.

This variety of regulatory activity tends to dispel any naive belief that government intervention in business is automatically and always bad. It might be noted, however, that the proponents of deregulation tend to focus their attack on the social rather than some of these *economic forms* of regulation.

(b) Types of Regulation

Not all types of regulation are imposed by government. For example, professional and trade associations, such as doctors, lawyers, accountants and motor vehicle traders, often seek to regulate or even limit their own members — in order to safeguard the integrity, reputation and supply of their trade, and thereby their income. This type of self-imposed regulation, by the way, rarely incurs the hostility of the free marketers, despite its impact on costs and prices.

Where self-regulation works effectively and to the common good there should be no need for public regulation. But in some cases these self-regulatory groups effectively amount to professional cartels. Just the other week, for instance, the Association of Surgeons recommended a nine-fold increase in

fees charged by their members. This included the same surgeons who a year ago were involved in a contentious dispute in which they alleged Medicare was a threat to private enterprise. In the light of hindsight one has more cause than ever to query the motives of their objection to public regulation.

Where government regulation proves necessary, it tends to take either of two forms.

First, there are measures designed to influence the cost at which goods and services may be sold. The state may provide the service itself, in order to realise economies of scale, such as provision of essentials like electricity and water. Alternatively, the government may regulate private suppliers. The scheduled fees for doctors, for instance, are intended to promote wide access to essential services.

Price control devices of either kind, however, may encourage over-consumption and under-investment, where they are set too low, or overproduction and inefficiency where they are set too high or where new competition is restrained. The EEC's Common Agricultural Policy is a case in point.

The second form of government regulation, instead of influencing prices, may require that certain costs and benefits be internalised by the producer, who is then left free to establish the resultant price. This is the method usually adopted in relation to health, environmental and safety objectives. Superannuation is another topical example.

Because industry is naturally inclined to minimise its costs, in order to remain price competitive, the relevant prudential and other standards must often be set by government rather than the company itself.

Whichever of the two regulatory methods is chosen, any costs are ultimately borne by the public, in terms of higher prices or taxes. The community, including business, also receives the corresponding social or economic benefits, a fundamental point usually ignored or disputed by free market critics of regulation.

(c) The costs of regulation

The deregulation debate tends at present to focus on the cost of regulation, both to government and to business. This is understandable in a climate of opinion where the efficiency and effectiveness of the public sector are under scrutiny, where the theoretical virtues of the free market are being asserted, and where there is a clamour for smaller government and lower taxes. As Minister for Trade, of course, I have a vested interest in minimising the cost structure and maximising the international competitiveness of the business sector.

It is undoubtedly true that certain forms of government regulation have failed in their aim to increase equity or redress market failure. Direct control of rents is an example of a measure that is usually counter-productive.

Recently, however, the government's Business Regulation Review Unit (BRRU) has attempted some very qualified upper estimates of the costs of business regulation.³² It calculated that there are up to 16,400 Commonwealth employees involved in regulatory activity, at a total cost (including overheads) of some \$700m pa to the government. This represents one per cent of total Commonwealth expenditure,

by the way. It is a disquieting measure of the shallowness of public understanding of deregulation that these cost estimates were the only aspects of the BRRU report to attract media attention or elicit business reaction.

A number of features of the estimate are quite thought-provoking in terms of popular assumptions about government regulation. For instance, the estimate included not only regulations that require certain provisions to be met but also incentives to encourage certain activities, eg, the staff involved in administering export development grants and industrial R&D grants were included.

The largest single regulatory department (accounting for more than 20 per cent of the regulators) was Primary Industry. We all know which free enterprise political party was largely responsible for the current regulated state of our rural sector. The NFF is a constant critic of government taxes and imposts, but I wonder how many of its members would remain enthusiastic deregulators if it meant abolishing the animal health, quality control and so-called orderly marketing arrangements that underpin our farm sector?

The second largest component (almost 20 per cent) of the \$700m estimate related to the Department of Industry, Technology and Commerce:

- I wonder how many business critics of government regulation would remain fervent deregulators once they realised it would entail abolition of the Customs Service which administers tariffs and import quotas?
- Some of them, no doubt, would rejoice at the prospect of abolishing the Industries Assistance Commission, an agency that has played an invaluable role, on behalf of both consumers and business, in helping distinguish between genuine and less plausible claims for protection.
- And how many consumers — or small businesspersons — would welcome the abolition of the Trade Practices Commission which regulates industry in order to *promote* fair competition?

The TPC, the IAC and the Customs Service are all part of the regulatory machinery of government, all part of the 16,400 regulatory staff identified by the BRRU. As the report observed, a lot of regulatory activity can in fact be:

characterised as greasing the wheels of commerce and little more than administering common law. . . In these as in many cases, the activities doubtlessly confer benefits, which in many, perhaps most cases will outweigh the costs.³²

Other examples include the Departments of Aviation, Health, and Employment and Industrial Relations which between them employ more than a quarter (26.7 per cent) of the 16,400 regulators, attending to such matters as the safety of aircraft and factories. The five largest departments I have mentioned account for more than two-thirds of Canberra's regulatory staff. The remaining 5,000 work in such unlikely departments as Aboriginal Affairs and Prime Minister and Cabinet, a quarter of each of whose staff, at least according to the BRRU, are involved in regulatory activity.

Of course the cost to the Commonwealth is not the totality of the economic cost of business regulation. Our federal constitution inevitably generates a range of kindred or distinct activities in the states, many of which have been as irksome to

Canberra as they are to Collins Street, eg, state purchasing preferences.

There is also the cost of regulation to business itself, perhaps as much or more than that to government. The paperwork of importing goods through customs is no doubt tedious — and probably capable of improvements — but neither the BCA nor the CAI advocates general abolition of import controls. It is undoubtedly costly to companies to provide information to the IAC, or the Australian Bureau of Statistics (ABS), but the successful applicants and end-users are well aware of the benefits. It was an ABS survey, ironically, which suggested that government paperwork costs the average small business a thousand dollars pa, but interestingly most of those costs relate to Commonwealth taxation provisions.

The CAI has estimated the cost of business regulation as 4.6 per cent of GDP. This, of course, is a gross estimate which takes no account of the offsetting benefits, economic or social, including GDP benefits, that flow from public regulation. How do you measure, for instance, the value of lives saved and reduced health care costs resulting from compulsory car seat belts or anti-pollution devices? How do you calculate the amount of GDP growth arising from the *Trade Practices Act* or from less industrial accidents? To take another example, the requirements of the Tax Office may be burdensome — and they should not be unnecessarily so — but without the tax revenues resulting from compliance, business would be without the public infrastructure on which it depends.

(d) Deregulation to date

The creation of the Business Regulation Review Unit has been the most significant organisational step in implementing the Government's policy of freeing business from unnecessary public regulation. In October 1985 the Prime Minister announced further developments, including the application of sunset provisions to new regulations and the identification of eleven priority areas for review of existing regulations. These include foreign investment, export controls on minerals, customs administration, collection of business statistics, building regulations and the like.

Some of this deregulation machinery has already produced results, including for example:

- deregulation of the banking sector
- liberalisation of foreign investment policy
- simplified and streamlined Customs clearance procedures.

In my own portfolio I have released for industry consideration a paper proposing substantial changes to controls on the export of bauxite and alumina. This industry offers an illuminating example of the pros and cons of regulation, because its international vertical integration emphasises the national interest need to ensure arms' length negotiation of export prices.

At the moment I am also involved in consultations with industry and union representatives about traditional exports controls on coal. Given the importance of coal as an export commodity, and the unfortunate national consequences if Australian producers bid down one another's prices, we must proceed very carefully in deregulating such an area.

It is practicalities such as these and others I've mentioned that put the free market rhetoric of deregulation in a somewhat

more realistic light. Most government regulations serve — or should serve — a necessary and important community service. Many of them have been introduced either at the request of the regulated industry or because the free play of the market has proved to be unsatisfactory, either to the participants or to the community. Nonetheless, we have embarked on a continuing process of identifying unnecessary regulation of business.

(e) Labour Market Deregulation

One deregulatory route that we have not pursued is that of labour market deregulation. Although we certainly need to adopt more flexible work practices, anyone who has read the Hancock Report³³ would appreciate both the basic value of our current centralised wage-fixing system and the impracticality of the alternative. The awful, incoherent mess that the Opposition has got itself into over this issue is yet further evidence, if any were needed, that this type of deregulation is largely fanciful nonsense.

Under the alternative policy, Australia's tradition of centralised wage fixation — with its culture of comparative wage justice, its history of established relativities and its framework of craft-based unions and arbitral bodies — would be changed to include a system of at least industry-based and preferably enterprise-based wage bargaining.

Wages would be determined according to the profitability of the employer concerned. Workers doing the same jobs in different companies could be paid different wages. It is curious to observe that no other factor of production, such as money, land, factories or machinery, would have its price determined according to the profitability of the individual purchaser.

Whatever the economic merits of such a wages policy, its most glaring weakness is that it is unacceptable to the majority of both employers and employees, the principal interested parties.

The major employers, such as the multi-union companies grouped around the CAI and the BCA, fear that a deregulated labour market would leave them vulnerable to powerful, disciplined trade unions. The prospect of inflationary real wage increases, above and beyond the current cost of living adjustments, is a very real one.

Whilst partly attracted by such prospects, the trade unions as a group nonetheless worry that employer-based wage negotiation will disadvantage weak unions and more particularly non-unionised employees of small business. The latter is exactly the reason why small employer groups favour the proposal.

We should all be aware of the exploitative labour arrangements that characterise certain non-unionised and inadequately supervised areas of small business, such as the abuse of female migrant labour in certain sections of the garment industry. This is deregulation at work. It is believed, for example, that there are some 30,000 unregistered "outworkers" in our glamorous and highly protective clothing industry who receive one-quarter of the legal wage — and no sick leave, holiday pay or workers compensation — for producing garments that retail for 30-40 times their cost of manufacture.³⁴ Government inspectors and trade unions are unable to police this practice and the industry itself has no form of self-regulation or code of conduct. This exploitation is the product of uncontrolled market forces, albeit behind protective barriers, with ethical manufacturers being driven

out of business by extremely profitable illegal operators.

Under a system of decentralised, enterprise-based wage determination, such exploitation would be legalised and allowed to spread throughout the rest of the economy. For every Mudginberry there will be a dozen sweatshops. The victims will not be economists, forex dealers, doctors, lawyers or even ordinary skilled and unionised workers. Rather they will be the lower end of the labour market — youth, women, migrants, the unskilled, the non-organised. In other words, the poor and the powerless.

Decentralised, enterprise-based wage fixation can really function only if the trade unions are broken. The Opposition makes little secret of this. It is the ideological motive underlying their preference for so-called wage flexibility. As their statements and particularly those of their less circumspect supporters clearly indicate, the only wage flexibility they anticipate and desire is downward flexibility.

As in the area of privatisation, the real motives of the free marketeers are related more to the advancement of sectional and class interests than to economic efficiency or some alleged community benefit. It is no coincidence the the most vociferous industry advocates of labour market regulation also happen to be aspiring Liberal Party parliamentarians.

The Opposition finds itself caught between the two poles of employer opinion — the large employers who fear real wage increases and the small employers who imagine real wage reductions. Hence the two-bob-each-way compromise of a Clayton's two-tier wages policy — centralised control where there is the possibility of wage increases and decentralisation where there is a prospect of wage cuts. How you would separate and keep separate the two wage systems is yet to be explained.

The government for its part favours the existing centralised wage fixation system as the only means of sustaining an Accord-based, anti-inflationary incomes policy, particularly at a time of strong economic recovery when shortages are appearing in sections of the labour market. Wages have increased less than inflation, real unit labour costs have been dramatically reduced, and the wages share of GDP is at its lowest level in 15 years.

In the absence of the existing wage fixation arrangements economic recovery would have been aborted, as it has been in the past, by an inflationary wages explosion. It is only the good offices and sound economic sense of the much-maligned ACTU that has held these forces in check. The Opposition, however, is pledged to destroy the social and economic compact that underpins this system of restraint.

A system of industry — or company-based wage negotiations is no alternative. Given our history of industrial relations and our exceptionally high level of unionisation, American-style collective wage bargaining is neither desirable nor practical in Australia, least of all while the principle of comparative wage justice remains vigorous.

Such a system would unleash a debilitating industrial free-for-all in which the most disciplined, the best organised, the strongest will win. As the major employers apprehend, that is unlikely to be them.

We all saw what happened when the centralised system was abandoned in 1981/82. Without centralisation the Fraser government would never have been able to impose its wages "pause", nor would this government have been able to

negotiate across-the-board wage discounting to offset the inflationary potential of the dollar's depreciation. Such demonstrated macro-flexibility is possible only within a centralised system.

Labour market deregulation amounts to surrendering government influence over a crucial area of economic activity. The free marketeers may be misguided and short-sighted, but at least they are frank enough to proclaim that this is what they want.

6. THE LABOR APPROACH

The Labor Party differs fundamentally from the Liberal Party in its belief in the necessary and beneficial role of the public sector, as both an engine of economic prosperity and a vehicle of social justice.

This implies neither hostile distrust of the private sector nor blind faith in the public sector. Both are capable of efficiency and waste, of compassion and injustice, of freedom and oppression.

But we do not share our opponent's naive faith in the virtues of privatisation, not least because it is an incomplete prescription for the problem. No matter what the benefits or extent of privatisation, there will always be a public sector that deserves to be managed, that must be managed, efficiently and effectively. Privatisation offers no answers to this question. Furthermore, we do not believe that uncritical deregulation is a sufficient solution to the manifest problems of the private sector. On the other hand, ironically, privatisation is certain to increase the extent of government regulation, as public ownership is replaced by market controls.

We agree with our opponents that the present Australian boundary between the public and private sectors is neither natural, immutable nor in every aspect satisfactory. The current jagged border is a product of the accumulated imperatives of two hundred years. Much of the current pattern was in fact set during the Menzies era, building on the Curtin-Chifley foundation. It was extended by Whitlam and merely tinkered with by Fraser. We have set about rationalising it.

We are not wedded to the status quo, either in terms of the extent or the composition of the public sector. Whether a particular function should be controlled or deregulated, privatised or nationalised (in some sense or other) depends largely on social needs, economic circumstances, political priorities, and, not least, technological developments.

We may be — I hope we are — a practical government, but we are not mere pragmatists in our approach to these matters. We proceed from a philosophical position as spelled out by the Labor Party platform. The Party's Objectives state that "The ALP is a democratic socialist party and has the objective of the democratic socialisation of industry, production, distribution and exchange, *to the extent necessary* to eliminate exploitation and other anti-social feature in these fields".

The Platform further asserts that, in order to achieve "the political and social values of equality, democracy, liberty and social co-operation inherent in this objective", the Party stands for, among other things:

- (2) Establishment and development of *public enterprises* based on federal, state and other forms of social ownership, in appropriate sectors of the economy

and

(4) Maintenance of and support for a competitive non-monopolistic *private sector*, including small business and farming, controlled and owned by Australians, operating within clear social guidelines and objectives.

The Australian public sector is a crucial component of the national economy. It employs at least a quarter of the workforce and generates a similar proportion of GDP. While we reject the Opposition's simplistic privatisation policies, we do not assume that the government sector is incapable of improvement. Indeed, we have initiated a radical and pervasive program of public sector management reform such as Canberra has never seen.

We have also overhauled our ossified private sector in a manner our opponents barely dreamed of during the seven wasted years they were in government:

- We have embarked on the overdue and delicate process of restructuring the *inefficient* sectors of private enterprise, beginning with the motor vehicle and steel industries.
- Our opponents permitting, we will remove the constraints that have distorted our primary sector, including the sugar and dairy industries for example.
- We have deregulated where they have failed — witness the removal of foreign exchange controls, liberalisation of foreign investment guidelines, the admission of foreign banks and the floating of the currency.
- And we have established an ongoing process of business deregulation such as our opponents never even contemplated, let alone initiated.

Instead of merely privatising our great public enterprises, we are in the process of making them more efficient, after years of neglect. Already we have reorganised and re-established several of our public enterprises on a more conventional commercial footing. We will shortly be releasing a document containing a blueprint for the revitalisation of the entire public enterprise sector. Among those innovations will be requirements for corporate planning, public accountability, and specified rates of return, a type of surrogate market force.

We have resisted facile sloganeering and false panaceas like privatisation. We have instead pursued policies that will genuinely improve the efficiency and performance of both the private and public sectors of our economy. As Lord Casey said, our public enterprises create the climate in which private enterprises can flourish.

Notes

* Minister for Trade and Minister Assisting the Prime Minister for Youth Affairs. This is the text of a paper to which the Minister spoke at the RAIPA (ACT Division) 1986 Autumn Seminar on Privatisation and Deregulation, Canberra, 3 March 1986.

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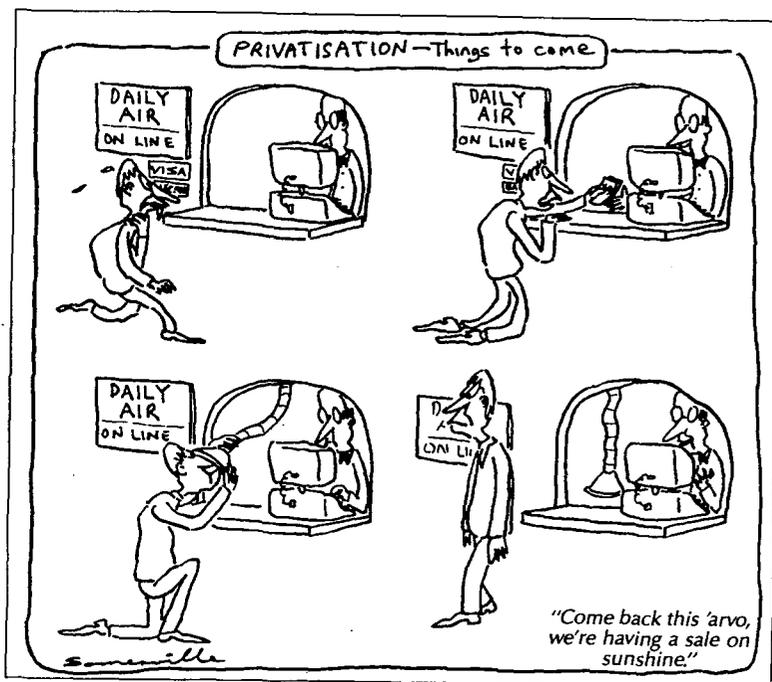
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