

Enterprise: Free, Dependent or Captor?

Warren P. Hogan

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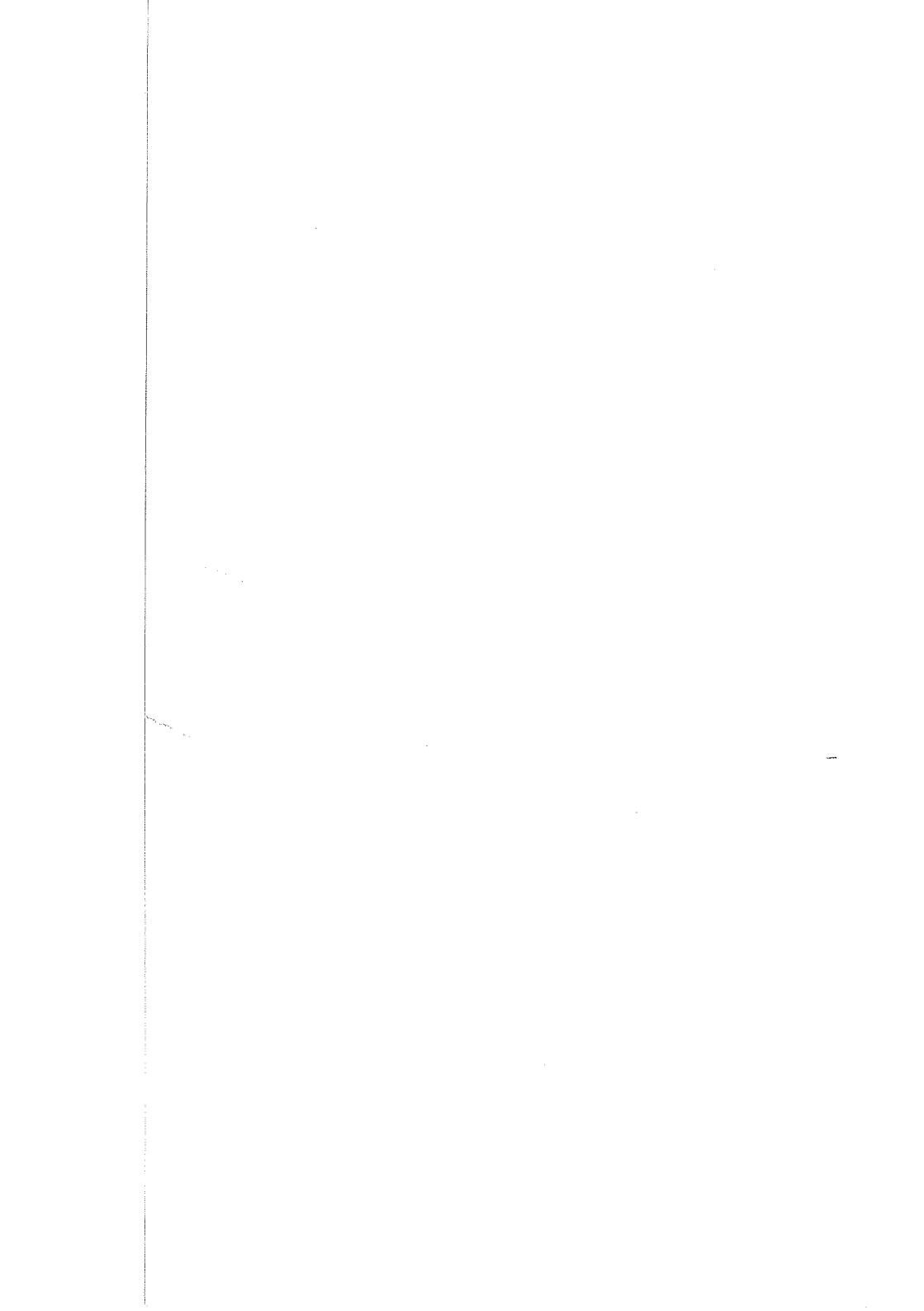
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Foreword

Professor Hogan's theme is the nature of the relationships, cooperative and conflicting, between government and business. His rich and condensed exposition contains numerous sub-themes. One is the contrast between reality and rhetoric about the roles of government and business. 'All too often', he writes, 'the underlying themes relevant to antagonisms and ties are lost from sight in the welter of superficial claims about public interest, private enterprise, and so forth'. He is out to debunk simplistic and ideological points of view. Indeed there is a thread of scepticism in his paper that goes beyond such easy exposés. For example, after drawing attention to the conventional distinction between general rules and procedures applying to all firms in the industry, and those that bear on some firms and not others, and giving some spectacular examples of the latter, Professor Hogan rather pulls the rug from under the reader by arguing that the distinction between general and discriminatory rules 'becomes more tenuous the more issues are explored'. Laws and regulations that appear to be non-discriminatory may nevertheless have a discriminatory economic impact.

Another sub-theme of the paper is the interconnectedness of the market economy, both spatially and temporally. 'The capital market is the core of the industrialised economy.' It links the future and the present; or, more prosaically, it enables future prospects to influence the present value of shares and hence the ability of firms to raise investment funds. Stress is placed on the complex ways in which the economy reacts to interventions, with the result that the outcome of policies is not necessarily what was intended. Furthermore, because 'personal links are lost in the intricacies of interdependence', individuals are often unaware of the adverse effects upon them of interventions, especially those affecting the corporate sector.

Professor Hogan's vision tends to the tragic rather than the hopeful. Firms seek favours from government, and government wants firms to be dependent upon it. This situation is hardly likely to change: 'the reason is that business collectively cannot agree not to appeal to government for individual favours. It always pays some business participant to seek favourable conditions. This in turn plays directly into the hands of politicians and officials anxious to enhance their own roles. Once some business or business group succeeds in its effort, others are inevitably formed to press their own causes. In short, business preferment can be secured by playing upon the distributional concerns of government'. However, on a more

optimistic note, Professor Hogan argues that the distributional claims upon government mean that it cannot ignore the importance of economic growth and productivity gains, and hence that fear of hindering growth acts as a restraint on government's willingness to accommodate the demands of business groups or to intervene generally.

Ross Parish

The Author

Warren Hogan has been a Professor of Economics in the University of Sydney since May, 1968. He has had a long-standing interest in the relationships between the government and the market sector of the Australian economy.

His initial views were conveyed in the 1977 Alfred Deakin Lecture, 'Command and Choice: Issues for Government Intervention'. More recent writings, including this Occasional Paper, reflect an analytical basis in games and bargaining theories, especially John Harsanyi's work. Implicit in these contributions is a rejection of Marxist interpretations of the role of the state in market economies, in particular the failure to discern the state as entrepreneur.

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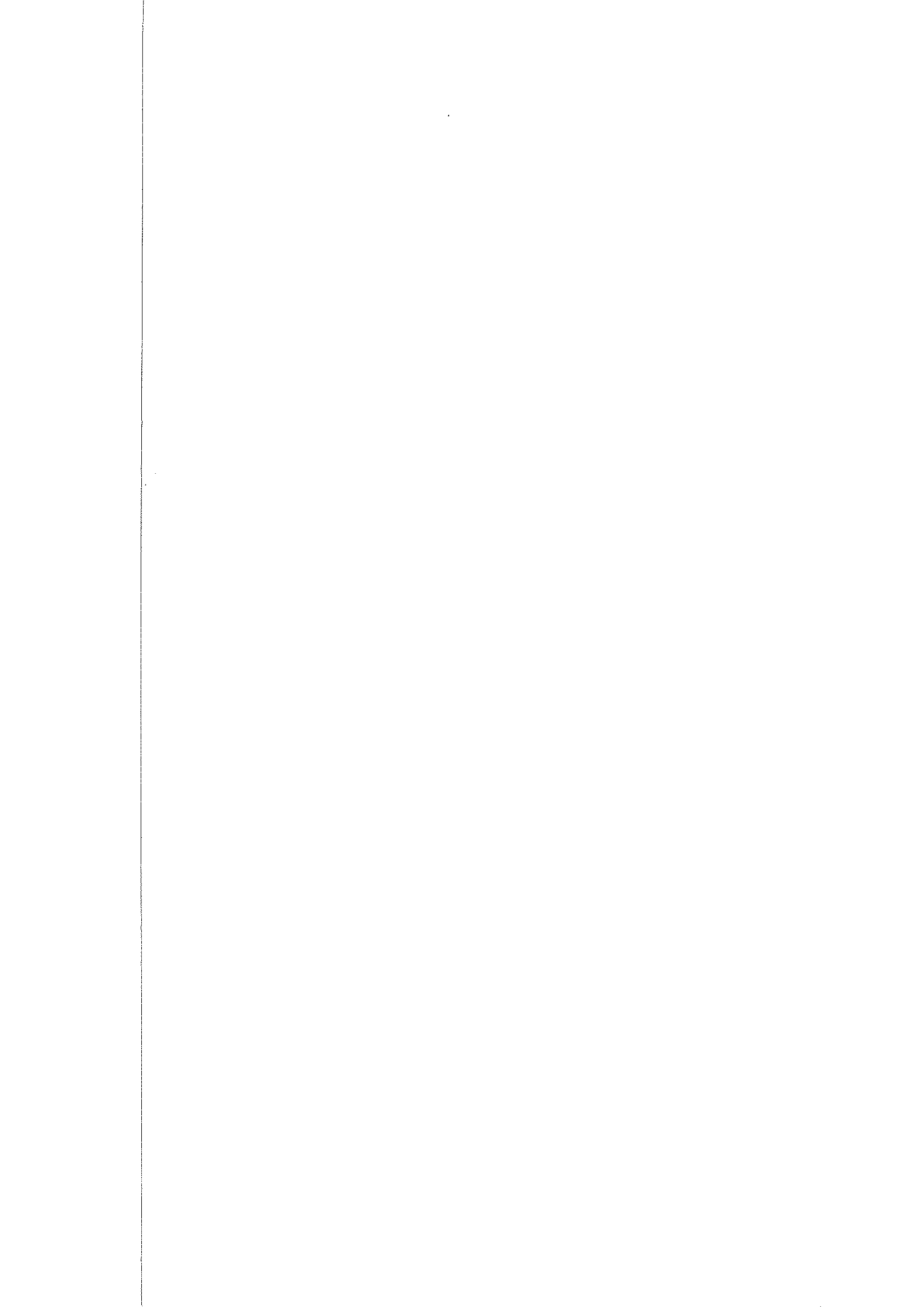
Richard Neville Spann

Professor of Government and
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in the

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1953 — 1981



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I. ISSUES

Conflict and cooperation form the see-saw of government and business relations. Here I will examine connections between business and government in Australia and try to explain the difference between rhetoric and reality in the roles of business and government over the past few decades. Although the setting is Australian, the issues apply to many societies (Winter, 1978).

Government pursues the public interest with little regard for the workings of markets and firms. Its benefits and costs cannot necessarily be judged in economic terms (Tullock, 1965). Often it seems dissatisfied with the way the market process distributes income and employment. Although government frequently responds to criticism of its involvement in economic affairs by trying to reduce 'big government', curtailing or abandoning some activities, yet its role grows more prominent in most economies, determining market behaviour as well as assigning incomes to various groups in the community.

'Private enterprise', on the other hand, rejects the notion that government should participate in the production and distribution of goods and services. Business extols the efficiency associated with individuals or corporations pursuing their own advantage independently of other participants in markets. This position

This paper is developed from 'Government and Business Links', Australian Journal of Public Administration 42(1, March 1983):53-72. Helpful comments have been offered by Associate Professor Miloslav Bernasek, Elizabeth Brownlee, Ross Curnow and Ernestine Gross.

implicitly assumes that, given the available productive capacity and technology for the economy, the market provides the optimal output of goods and services and the most efficient guide to new investment and the application of new technologies.

Nonetheless business continues to seek government help in many spheres: for example, providing public utilities needed for industrial expansion, providing financial support on preferred terms and assistance in export markets, and sustaining research and development programmes. Thus any simplification of the relationship between business and government is confounded by evidence of cooperation. The full potential for conflict between business and government is not realised, at most it is muted.

Definitions

The term 'government' in this paper means the political and administrative leadership in federal, state, and local spheres. 'Business' means the owners and managers of legal entities in Australia deriving income, not necessarily taxable income, from the purchase and sale of goods and services or the supervision of portfolios of assets and liabilities. Some government activities have a business character in that they are concerned with earning income in a market. Often these activities exhibit characteristics of oligopoly, as in shipping and air and sea transport, or of monopoly, as with Telecom and Australia Post. They call attention to the distinction between the actions of government through ministers and departments, and the separate roles of statutory authorities and other organisations often referred to as quasi-autonomous government organisations — 'quagos' — and quasi-autonomous nongovernmental organisations — 'quangos'. This confusing nomenclature (Wettenhall, 1983) may have obscured the important role of the quango in understanding ties between business and government.

Despite concentration on business and government in this paper, the roles of other groups in the community, such as trade unions and professional groups, cannot be ignored. Their presence helps to explain the relative strength and permanence of the connections between government and business. Such an interpretation is supported, for example, by the mutual arrangements negotiated at the National Economic Summit in May, 1983.

This analysis of the relationships between business and government proceeds as follows. Section II reviews the setting, concentrating mainly on government performance and activity. Section III summarises the conventional interpretation of the government-business relationship. The fourth section turns to some

examples of overlap between business and government activities. Section V examines the significance of rights for interpreting these relationships, with themes and illustrations drawn mainly from Australian sources. This aspect is further developed in Section VI, which queries the purpose of rights so as to interpret the concerns of government with distributional outcomes. That analysis leads directly into later sections, which treat the connections of business and government in a variety of contexts. The closing sections attempt to place the task of government in the perspective of the supplier of regulatory services, for which business is a client.

II. THE SETTING

Connections between government and business are embedded in Australia's social and economic origins. Australia was founded on government initiative, a familiar circumstance in the colonial 18th and 19th centuries. Government in Australia has consistently been a development agency, whether it was granting land rights to settlers, allocating the convict or indentured labour force to public works and private activities, or enticing business to establish plant in some location or another. Interdependency has been present from the beginning.

Ministerial Responsibility

Some characteristics of government were clearly inherited. There is the miasma of British administrative conventions: obsessive concern with procedures, emphasis on centralisation, fascination with secrecy, and most importantly, gross absence of personal accountability. Anonymity of the senior administrative echelons may have been all right when government was small and ministerial responsibility was an honoured convention of parliamentary behaviour. But when government has comprehensive economic and social roles, ministers can no longer supervise the extent of these involvements. It is even difficult for parliament to supervise executive performance, notwithstanding recent spurts of activity by Senate and House committees at both the federal and state levels.

Perhaps too much is made of ministerial responsibility in conventional interpretations. Certainly the strength claimed for the discipline of ministerial responsibility may be exaggerated and even in the British House of Commons the convention may never have enjoyed the standing often claimed for it (Economist, 1984; Finer, 1956). At any rate, the practice of ministerial responsibility has been much different from the importance given it in the theory of parliamentary government (Reid, 1982). The explanation of that

discrepancy may lie partly with problems of reconciling cabinet and ministerial responsibilities in a parliamentary setting.

When administrative anonymity is combined with the cloak of ministerial responsibility the scope for analysing the public performance of government is restricted. This could cause cleavage between the political and administrative branches of government, with ministers unable to command the activities pursued by the government sector. The situation is complicated by numerous statutory bodies, some of which are major business undertakings with limited requirements for public accountability. Delays in reporting also cause problems.

What Does Accountability Mean?

The fact that cleavage does not often occur may reflect the waning strength of ministerial responsibility (Butler, 1973). A more likely explanation is that the political and administrative sectors of the executive have a common interest in exercising the powers of government. It is reasonable to ask what results do matter when there is a diffusion of accountability and responsibility.

Further complexity stems from cooperative legislative provisions between federal and state governments whereby majority agreement among relevant ministers requires the legislation to be passed in each parliament. Examples of such provisions are found in the agriculture and companies supervision spheres. The notion of ministerial responsibility is then diffused in joint ministerial councils.

The very concept of accountability is deceptive in its apparent simplicity. In an open democratic society the principal thrust of accountability should be access to information about the conduct of government and its agencies and the accountability of the political leadership and senior administrative officers executing policies. Other aspects of accountability, such as the maintenance of professional standards, are subservient to this requirement.

This approach is complicated because the ordinary person may not be able to judge the adequacy of reported conduct. Professional peer groups may be able to advise government on legislative provisions and administrative rules against which to judge performance, but they may not understand why their advice is not always followed. For example, suggestions on needs for medical and health services may be frustrated by revenue constraints on political leadership, however much that leadership may support the provision of those professional services.

III. THE BASIS OF THE RELATIONSHIP

The importance of institutions and legislative arrangements for the conduct of business is often lost in discussions about the workings of markets. Even the most determined claims for the pursuit of 'laissez-faire', with government leaving business alone to pursue its activities, imply an environment with a common set of rules. It is well to recall that the origins of laissez-faire lay in the escape from discriminatory administrative fiat of the state reflecting a lingering inheritance from feudal autocracy.

Rules of the Game

What most advocates of laissez-faire appear to want is a consistent set of rules not subject to rapid and uncertain adaptation. In some societies, especially the United States, that set of rules reflects some notion of a competitive ideal, though changing ideas about how to achieve it bring amendments to those rules.¹ Precedent may be viewed as the legal and administrative instrument for maintaining consistency in the application of rules.

Given a consistent set of rules each business pursues its activities subject to its assessments of the commercial risks entailed. The allocation of capital among commercial and industrial firms reflects the valuations placed upon each of them by transactions on stock exchanges. Those valuations are a more efficient guide for the direction of capital flows if the market is not subject to sharp changes in policy arrangements, whether specific to industries and markets or bearing upon the level of activity in the economy. This is most important to long-term projects that take time to come into commercial production.

Nowhere has the impact of instability in policy arrangements on industries been more evident than in the case of tariffs and similar protective measures during recent years. Longer-term programmes for some activities, such as automobile production, have no sooner been agreed to than further changes have been suggested. Other

1. In other societies the competitive ideal may be limited by demands for the equal treatment of all members of the community. However, making those demands effective is no less difficult than the competitive ideal. Whether these arrangements are fully compatible with the workings of an open democratic society is debatable. That an economically competitive society offers these possibilities is not the subject of this analysis. What may be in dispute is the scope for other approaches to economic organisation to retain an open democratic society. But these themes are well beyond the purposes of this paper.

examples are shifts in 'Buy Australian' preferences by the Federal Government and frequent changes in the attitude toward longer-term protection for Australian industry. In the latter case changes were all too apparent between 1979 and 1981.

Thus government designs the 'rules of the game', in the sense of being the custodian of the legal and administrative framework in which rights to trade are determined. In the Australian context the federal and state governments exercise this role, with some tendency to centralise the functions as states legislate complementary provisions. However, administrative interpretation of statutory arrangements brings local as well as state government into direct relationship with business. Private enterprise must work to these rules. Competitive advantage of one business over another is achieved by a more efficient use of the rights provided in the established legal and administrative arrangements.

Government as Entrepreneur

Yet, one business may seek advantage over another by a quite separate device: by negotiating adjustments of the existing structure of rights through political and administrative processes. Such adjustments may serve many purposes. Legislation on trade practices is often directed to preserving competition by restricting mergers and takeovers and maintaining access to markets for new firms — despite the difficulties in distinguishing mergers that would restrain competition from those where economies of scale in production and distribution would bring greater efficiency with fewer companies. Equally, government intervention may be designed to restrain the effects of competition by regulating the number of participants to limit instability in an industry or market arising, say, from excess capacity. Examples are found in primary production with sole selling agents, such as in the wheat industry, or controls on areas sown, as with sugar (Sieper, 1982). Indeed, intervention may be sought for some potential rather than realised disturbance, such as risks of crop failure. In some ways business may be said to demand regulation as a means of reducing uncertainty.

However, this interpretation is still far from reality. Business entities compete within a malleable framework of rights, with government providing the forum in which those rights are established and developed. But this still ignores the entrepreneurial flair of government. That flair is revealed in two ways: the political arm can initiate measures to maintain or increase its support; and the administrative arm is concerned to protect its negotiating position on the availability of and access to rights sought by business. Both arms of government may be said to be in the business of creating new

rights and abridging existing ones, to suit themselves as well as business.

The effects of such actions are straightforward. The economic effects are changes in the relative command of individuals, households and firms over the use of resources. Government assigns income in ways not determined by markets. This means that the present value of future income earnings and the expenditure flowing from those earnings will have changed. The effects are political when different supporters are accommodated and opponents thwarted.

Different Interests

So far so good. Business and government are treated as having separate constituencies of interest. The economic concerns of business are markets and the individuals participating in them. Government, at least in its political sector, is directed to maintaining and expanding its range of general support while undermining the activities of its opposition. Certainly the two spheres interact but they are qualitatively different. When economic or business activities are brought into the realm of government, the political response is to judge the value of economic actions in terms of political imperatives. Nowhere is this more clearly seen than in the housing sphere, where successive governments have devised measures to aid home-owners, especially first home-owners, regardless of other claims on the productive capacity of the building and construction industries and the manufacturers supplying them. Another example is placating petrol station owners by curtailing takeovers of existing outlets or prohibiting the establishment of new ones by major oil companies.

The desire to sustain political support may encourage government to draw economic activities to its ambit. This would appear to be the interpretation of recent studies showing how governments adapt programmes to the timing of elections (Frey, 1979). These studies confirm the significance of politico-economic cycles. Measures with potential popular appeal are more likely to be inaugurated near elections than at other times. But such studies are directed to the broad policy environment. They do not dwell upon the interaction of government and firms aimed at the gaining of advantage in a specific market. This interaction must be studied in light of the structure and workings of each industry and market.

Contemporary markets for many goods, whether raw materials or finished products, are characterised by the existence of relatively few producers or sellers. Similar patterns are evident in distribution and some services such as banking. The atomistic market, with many buyers and sellers, is not so common. The accepted explanation for

the phenomenon of oligopoly — few producers as sellers in a market — is the existence of both economies of scale and economies of scope in production and distribution. Economies of scale imply a lower unit cost of production as the volume of output increases. Economies of scope arise when each of a variety of products incorporates one or more components characterised by economies of scale in their individual production. For example, household durable goods such as refrigerators, air-conditioners and cleaners may have some components in common, such as electric motors. Different models and makes of automobiles often use similar electrical equipment, suspensions and engine components.

Oligopoly means that rival firms are aware of their interdependencies with respect to investment, output and price, particularly in extractive industries and the processing associated with them. Much the same is true for many branches of manufacturing. With few participants it is relatively easy for government to mitigate instabilities encountered by individual firms through restrictions on entry or regulating the conduct of industry. Regulations may confer advantages on firms meeting specified requirements: for example, local content rules bearing upon automobile manufacturing in Australia, preserving shares of the domestic market for local producers as in steel, and discriminatory taxes in Japan placing imported cigarettes at a considerable disadvantage in that country's domestic market.

Mutual Dependence

In other instances governments foster the development of industry by granting favourable arrangements for access to utilities, providing factories under special financial arrangement, and granting tax concessions. Competition between states to attract new industrial companies is familiar in the United States and Australia. One effect in Australia has been to encourage a proliferation of plants, often of less than minimum efficient size, thus reducing the relative competitiveness of Australian production against foreign suppliers. State inducements may work against gains in efficiency arising from economies of scale and scope. A familiar Australian example has been manufacturing plant for making electricity generation and transmission equipment located in most states. This process generates a mutual dependence of business and government at a state level, which may be in opposition to the national perspective in Canberra.

The same thing happens in the international arena. National governments offer inducements for the establishment of new activities within their borders. The aim is to reduce direct costs of

operating plants to the firms concerned so that their products will compete on world markets or replace existing imports. The result is a burgeoning of policy devices to promote investment, exports and employment, often without much thought for the effects on government revenues or the impact on the structure as well as the amount of government spending.

There is potential for mutual relationships between business and government. In their separate spheres there is room for new approaches to gaining or preserving advantages over rivals. These advantages can be reinforced by the mutual actions of government and particular sectors of business. Just as business tries to differentiate products in markets so as to secure competitive advantage, so politicians try to introduce measures that will fit the disparate interests of many groups in the community. Business and political groups even use the same survey techniques to establish interests and preferences in the community in their search for potential advantages in their respective markets. This search for difference helps stimulate the promotion of separate interests so the process may be seen to feed upon itself. In short, differentiation of rights is the likely outcome of the political process and the administrative leadership adds to this by its command over many routes of access to such rights.

IV. AN OVERLAPPING RELATIONSHIP?

Conventional interpretations of government intervention in markets have distinguished between general rules and procedures applicable to all companies pursuing an activity, and those rules that bear upon some companies and not others. Companies seeking preferment through government are trying to gain discriminatory advantages in existing or potential markets. This interpretation of the interaction between government and business calls into question just what is meant by the autonomy of business.

The difference between the roles of business and government in the economy is familiar in rhetoric at least as much as in experience. But the overlapping of business and government activities deserves a much closer scrutiny than it has received. The connections are found not only in the adaptation of institutional and legal arrangements to changing circumstances arising from market structures and technological developments. Interaction is also possible in the actual conduct of business affairs. Our thinking should be revised, for example, about those hybrid organisations referred to earlier as 'quagos' and 'quangos'. They are not merely governmental organisations; they also play nongovernmental roles (Wettenhall, 1983). Examples within the Australian setting may help illustrate some aspects of this interaction.

A 'Special' Public Company

The first example is The Australian Gas Light Company (AGL). This is a public company listed on stock exchanges, but it does not work within the general companies legislation enacted by federal and state governments. It has been subject to its own Acts brought down by the Parliament of New South Wales ever since its founding in 1837. The company's financial affairs are scrutinised by the New South Wales Government, which controls pricing policy and the dividends paid to shareholders. That dividend rate is now directly linked to the long-term government bond rate: it may exceed the bond rate by no more than two per cent. These provisions affect AGL's capacity to finance new investments as well as compete against other suppliers of energy, especially to commercial users. The Australian stockmarket values AGL shares as if they were fixed interest securities, so that risk associated with them is minimal. That is hardly surprising given the extent of government supervision of its activities. Moreover, its special legislative position removes much of AGL's activity from detailed public scrutiny. For example, the accounts of the parent company and its subsidiaries are not consolidated; the stock exchanges have exempted AGL from this requirement for listed companies.

Dividend limitations are not unique to AGL. Similar impositions have arisen when state governments have supported companies in their financing needs during expansion of productive facilities. The usual instrument is a loan guarantee. This policy was pursued in South Australia during the industrialisation programme fostered by the Playford Government in the 1950s. The reason for restraining dividends is to help ensure the financial liquidity of the borrowing company during expansion. Retaining rather than distributing earnings means there is no need for the company to go to the capital market for funding additional to the guaranteed loans and debentures. Restraint also ensures repayments of the guaranteed funding.

An example of the South Australian approach was the financing of Adelaide Cement's reconstruction and expansion in the early 1950s. The South Australian Government guaranteed the loan from the State Bank. Dividends were restricted throughout the decade as retained earnings were accumulated in debenture redemption and general reserves. Between 1950 and 1959 the ratio of dividend payments to net profits declined from 95.83 per cent in 1949-50 to 71.34 per cent in 1952-53, 26.38 per cent in 1955-56 and 18.65 per cent in 1958-59. When the guaranteed debenture was redeemed in 1959-60 the capital structure of the cement company was reorganised. The effect was to treble the dividend to ordinary

shareholders. The debenture guarantee also provided for the South Australian Treasurer to appoint two directors.

Ownership Restrictions

Legislative and administrative intervention has not been confined to pricing and dividend policies of public companies. Ownership has also been determined. A spectacular example occurred in May 1979 when the South Australian Government legislated to restrict ownership by individuals or groups in Santos Limited to 15 per cent. The purpose was to thwart any takeover of the company and retain it as a South Australian legal entity. This type of legislation restrains the workings of the Australian stock market by restricting the choices of individuals or companies about shares they may wish to hold in their portfolios. Once government intervention is initiated the shares take on new characteristics for portfolio management. Such restraint impedes market efficiency.

Administrative determinations may bear directly upon production and investment decisions. Nowhere is this better illustrated than in the workings of the New South Wales bread industry. Working conditions bearing upon times for starting and completing bread-making, beginning deliveries to retail outlets and pricing arrangements are laid down by that state's Industrial and Prices Commissions. Many of those determinations are a reflection of provisions in the New South Wales Bread Act, 1969, and related legislation. The effects have been to curtail bread-making by the major manufacturers to about 26 hours per week, stimulate the installation of capital-intensive equipment for maximum speed of production, and proliferate productive capacity. If the same production hours were observed in New South Wales as in Victoria, installed capacity would exceed the size of the market by three or four times. Consumers have been restricted in their choices by prohibitions on discounting so that competitive pricing is eliminated. In practice the legislative and administrative provisions apply only to the major producers while the smaller ones are not effectively supervised. Thus discriminatory features as well may be observed in the administration of the industry.

General Rules Become Discriminatory

These four instances illustrate how the autonomy of business is limited in the conduct of pricing, production and investment decisions as well as the determination of ownership. They are not trivial examples; rather, they point to an overlapping of business and government that is quite significant in its impact. When legislation is

discriminatory in the sense that it applies only to specific companies, in an important sense these companies and ones similarly placed might best be treated as quasi-autonomous entities, or 'quangos'.

Contrast between general and discriminatory rules, whether or not the latter stem from legislative provisions or executive determinations, becomes more tenuous the more issues are explored. General rules applicable to one type of activity may nonetheless bring relative gains over participants in activities that are close substitutes. For example, deposits with trading banks, building societies, finance companies, and cash management trusts are similar for the great bulk of users. Yet distinctions are drawn in the nature of shareholdings between trading banks and the others. Further, the granting of banking licences to new banks means that the provisions of bank shareholding legislation will be discriminatory between local shareholders, especially those in 'old' banks, and overseas principals.

V. RIGHTS

In this paper rights refer to property, broadly conceived, and contracts. Some of these rights need not be explicitly stated. Rights are reflected not simply by physical transactions in markets, but also by the objects on which such transactions are based: the right to take physical control of such objects, to re-sell, to consume, to transform their physical nature and to transport. The terms and conditions on which the work force is employed also reflect rights. Some aspects of rights may be a reflection of long-standing conventions and practices recognised in common law.

This conception of rights is important to an understanding of relationships between business and government. All too often the underlying themes relevant to antagonisms and ties are lost from sight in the welter of superficial claims about public interest, private enterprise and so forth. The modern industrialised community with its specialised activities, ephemeral as some may be, obscures the immediacy of connections between real performance and its rewards as well as the real use of goods and services that flow from productivity. Rather one finds these connections and compromises between the holders of rights expressed in complicated ways so that the rights, and the command over the real resources they supposedly imply, are poles apart. Nowhere is this more apparent than in the workings of financial markets, where claims on future resources are embodied in insurance and pension funds which in turn have portfolios of assets being claims upon governments, companies and individuals. The divorce between ultimate owners and managers of enterprises is complete in the array of financial intermediaries.

Stability in the System

The concern with rights has particular importance for financial instruments — shares, bonds, debentures, notes and money. Financial instruments are essentially contractual obligations. Their value depends on the rights they confer on their owners. Shares give the owner a residual claim on the company: a claim on what remains after all others are paid out. Holders of bonds, debentures and notes have claims on the assets of a company that are usually fixed in dollar amounts. One of the reasons why companies are particularly vulnerable to changes in the legal framework is that their very existence depends on the viability of a stable system of financial claims and commitments. Furthermore a stable financial framework permits the variety of transactions between market participants that distinguishes the modern economy from a primitive barter economy or from one that relies upon completion of contracts in notes or coin rather than the exchange of monetary claims and liabilities.

A stable environment in which rights can be exercised is particularly important to the workings of capital markets. The curtailing or abrogating of rights will lead to a decline in the value of claims on companies, which has implications for the capacity of companies to raise additional capital through equity issues or the offering of debentures, notes and similar instruments. This relationship in the capital market is central for an understanding of the significance of rights. Such rights, whether contractual or property, provide the basis on which future implications of present acts are valued. This is not a statement about the predictability of future events; rather it is a valuation reflecting judgments in light of the available information on future possibilities.

A market valuation denotes the present price of these future actions and consequences, as foreseen with due allowance for risk and uncertainty. These valuations denote for all participants in the community, not just the owners of claims, what the consequences are for the use of a particular resource or resources. In this way the future is linked to the present. However remote the individual may be from the holders of financial claims and liabilities, that isolation does not remove her or him from the effects of changes in the basis of upholding those claims. Employment prospects and real living standards are involved in such changes.

The Future and the Present

The capital market is the core of the industrialised economy. Within the capital market, the stock exchange, as the forum for the exchange of legally recognised financial claims and obligations,

provides the basis for valuing the comparative worth of major companies. That valuing of the equity or share capital provides an assessment of present circumstances and future prospects. The workings of the modern industrial economy depend upon this pricing and valuation in a decentralised market with many participating agents, because equity capital is the basis for generating additional funds by borrowings in one form or another. The absence or weakness of such a forum impairs the effective allocation of resources both now and in the future. The purpose of government involvement in capital markets — to sustain the efficiency of the stock market — reflects this concern for an effective link between the future and the present.

Intervention that changes the basis on which rights over resources are determined — for example the abrogation of mining leases without compensation — increases the uncertainty that particular future events will take place. Such prospects or projects will be less fully capitalised as they become more uncertain and will be treated as less significant to present activities. Rights that are perceived as tenuous rather than permanent will have little value to their holders and to those from whom the holders may wish to borrow. In effect, a higher premium should be paid to compensate the holders of financial claims for the higher risks associated with economic activity in such an environment. Longer-term projects, which are important in determining future real incomes and employment, could be jeopardised. A whittling away of the stability of rights favours the present against the future and this is represented in higher interest rates in financial markets.

If rights are provided in ways that favour some participants and damage other roughly comparable ones, then the stability of those rights will be suspect. For example, the allocation of leases for exploration and development of coal mining confers major prospective gains on the recipients. If the allocation procedures are questionable then those denied access might seek to overturn them by political means. In circumstances where those allocations bring together political and business interests, the stability of arrangements is easily embroiled in the seeking of advantages. This is all the more serious when rights to exhaustible resources imply that further prospects of access by others to similar leases are doubtful.

Unexpected Results

There are many other ways in which interference with existing rights, or the failure to adapt the existing arrangements, may influence the provision and use of goods and services. Regulations

aimed at protecting some types of activity may simply lead to the development of other ways of doing things. Thus the gains expected from the provision of 'improved' rights for some participants may not accrue. The outcome of intervention is not necessarily what was intended because other ways of providing goods and services may be devised, even if at higher real costs than applied prior to intervention. Moreover, where intervention leads to increased prices for the goods or services provided, the users may dispose of their incomes in other ways, changing the structure of household expenditure in the economy. Accordingly, shifts in relative prices for goods and services may frustrate the purpose of intervention. On the other hand, patent legislation providing for quasi-monopoly rights over a specified period may stimulate new approaches. Regulations may well be the mother of innovation in organisational arrangements as with technological change, though the evidence on these matters is inconclusive.

A now familiar issue in this field of rights, though perhaps not obvious initially, is the stability of the national currency. Failure to 'protect the value of the monetary unit' is reflected in inflation. This abrogation of monetary responsibility bears heavily upon the workings of national financial arrangements. Inflation undermines the basis for exchanging financial claims and commitments. It bears upon current production as firms may be handicapped in their capacity to maintain output owing to risks of running down the real value of capital employed. With historical values eroded by inflation any firm is confused by the problems of estimating the present value of its buildings, plant, equipment and working stocks of material. Similarly any household seeking to provide for future commitments, such as retirement or risk of loss of earning power, is thwarted by the loss in real value of financial claims accumulated over time. In this respect inflation may be perceived as a retrospective tax on past incomes, especially those portions set aside for acquiring financial assets.

Accelerating Inflation

Let there be no doubt about the pace of inflation. In Figure 1 (see p.32) the rate of growth of consumer prices between 1952 and 1982 is shown on a logarithmic scale. The base year 1952 was chosen to eliminate the impacts of economic reconstruction after World War II and the Korean War commodity boom of 1950-51. The data from official series published by the International Monetary Fund are for five countries — United States, United Kingdom, Japan, Federal Republic of Germany and Australia — and an estimate of world prices. The six indices of consumer prices are shown on logarithmic

scale to bring out the acceleration in the rate of price rises during the past decade. Using this scale a constant slope means a stable rate of increase in prices.

With the exception of Japan, the series shows a modest acceleration in the rate of price increase in the 1960s compared with the 1950s, followed by a sharp acceleration in price levels from the early 1970s. Nevertheless the disparity in the rate of growth of prices is marked. In Germany consumer prices increased by only about 159 per cent between 1952 and 1982. For the United Kingdom prices rose nearly 700 per cent. This graph provides conclusive evidence of the erosion in value of national monetary units over three decades.

Households have been the sources of funding to governments and companies during the past three decades through life insurance, superannuation and similar funds, and other financial intermediaries. Yet the real value of those sums has been eroded by inflation. In 1969-70 household savings amounted to A\$1,824 million. By 1981-82, with the inflation over 12 years, the real value of those savings was down to A\$595 million. This is a gross simplification as this calculation does not account for interest earned or bonus allocations in the case of life insurance. Nonetheless the basis of the analysis holds true. Inflation has severely penalised lenders. The integrity of the national monetary unit has been impaired with all its implications for 'taxing' one element in past incomes.

VI. QUERIES ABOUT RIGHTS

Distinctions are often made among 'human' rights and 'property' and 'contractual' rights, with the implication that the first is 'good' and the others are 'bad'. Yet this common distinction is a remarkable fallacy. All rights are human rights.

Those who distinguish between human and other rights see business, especially the larger company, as the symbol of property and wealth on which impositions can be made in order to transfer resources from one group to another for what are most often claimed to be socially responsible goals. But in what sense are these impositions different from altering human rights? Since the company or partnership itself is not human, to speak of imposing costs upon it or providing benefits for it is just as sensible as speaking about imposing costs on or providing benefits to a building, a machine or a truck. Costs and benefits accrue to those people working with the machine, truck or building in some way or another. A company is only a legal and organisational construct, a nexus for complex sets of contracts between individuals. These individuals are the company shareholders and debenture holders, its work force, its suppliers and its consumers.

Undoubtedly there is a recognition problem as relatively few people can trace the complicated relationships of a modern economic and legal system. Personal links are lost in the intricacies of interdependence, but they exist as fully as any other kind of human right. When there are impositions on companies and other forms of business organisation in the name of human rights, as with equal opportunity legislation or comparative wage justice in the name of equality of treatment, then the repercussions are felt by all of the participants in the workings of companies. Additional capital equipment and new productive processes may reduce the size or change the structure of the workforce employed. Further investment may be deterred with implications for 'loss' of potential gains in efficiency and productivity.

Increasing Complexity

Those complicated ties are nowhere more easily illustrated than in the workings of the capital market, on which so much depends for the future well-being of the economy. In Table 1 a comparison is made of ways households, companies, life insurance and pension funds, and other financial groups have acquired financial assets and incurred financial liabilities during the past quarter century. Information contained in the table is derived from estimates of financial flows provided by the Reserve Bank of Australia. The vivid contrast between the value of financial assets acquired and liabilities incurred in 1954-55 and 1981-82 is a sharp reminder of a sustained inflationary experience regardless of the significant real growth recorded in the period. Despite shortcomings with the data owing to errors and omissions, this selected set of estimates shows the complexity of the financial connections in the modern economy. Moreover, a cursory examination of the changes during this 25 years reveals just how much more complicated those connections have become.

The data are a salutary reminder of the complex relationships between households, companies and the range of financial intermediaries. When the performances in 1954-55 and 1981-82 are compared it is striking to note the relative growth of other financial intermediaries, shown in the totals for columns 3 and 4, to that of life insurance and pension funds shown in the totals for columns 1 and 2, being the traditional repositories of households' savings. This can be seen when comparing the entries of 1954-55 and 1981-82 in row 1 (j) for households. Between those two benchmark years contributions to life insurance and pension funds rose seven-fold from \$103 millions to \$791 millions, while assets acquired by households rose

Table 1: Financial Flows in Some Sectors of the Economy
1954-55 and 1981-82

	Life Offices Pension Funds		Other Financial Groups		Corporate Trade Enterprises		Households	
	1954-55	1981-82	1954-55	1981-82	1954-55	1981-82	1954-55	1981-82
1. Financial Assets Acquired								
a. Bank Deposits	3	108	-8	627	158	1369	-74	2557
b. Savings Bank Deposits	-	-	-	-	-	-	127	1830
c. Advances on Trading Banks	58	614	133	6735	-	-	-	-
d. Other Advances	72	1395	6	225	-6	68	46	527
e. Govt. Securities	-	-	-	-	-	-	14	3321
f. Shares, deposits in Co-operatives	8	681	20	553	-	-	154	-563
g. Shares	23	674	1	2300	6	157	29	957
h. Debentures, etc.	-	-	-	-	-	-	103	791
i. Contributions to Life Insurance	5	-	-	-	-	-	67	2951
j. Interest on Pension and Life Funds	-	280	5	1915	12	811	14	-255
Total	169	3752	157	11905	170	2405	480	12116
2. Financial Liabilities Incurred								
a. Advances of Trading Bank	2	288	11	442	124	632	145	1745
b. Other Advances	-	-	25	2933	62	7200	257	3822
c. Shares, deposits in Co-operatives	-	-	14	3321	-	-	-	-
d. Shares	-	-	45	792	208	1163	-	-
e. Debentures, etc.	2	81	32	4640	25	494	-	-
f. Contributions to Life Insurance	103	788	-	20	-	-	-	-
g. Interest on Pension and Life Funds	70	2951	2	-	-	-	-	-
h. Other	2	56	25	374	90	2391	52	-
Total	179	4164	154	12522	509	11880	454	5567

Source: *Financial Flows Bulletin Supplement*, Reserve Bank of Australia, various issues.

25 times. Householders have found other outlets for savings in building societies, credit unions, finance companies and other financial intermediaries. It is important to realise the role of households in providing those savings by which activities of the corporate sector and governments are financed, however indirectly, through financial intermediaries.

Allocating the Gains

Confusion about rights is reflected in arguments about distribution. Individuals and groups can improve their material well-being by producing goods and services sought by others and by implementing technological and organisational changes that permit higher production from the same input of resources or improved products not previously available to users. One way or another, the producers of goods and services and the users of them are made better off.

Another approach is to secure changes in legislative or administrative arrangements, so altering access to rights with the purpose of reallocating income and wealth among participants. With rule-changing, when some are better off than before, others are worse placed. Indirect effects may arise from the heightened uncertainty about future behaviour bearing upon investment decisions and the future growth of productive capacity.

Governments cannot ignore the importance of expanded production and gains in productivity. Population growth alone ensures some concern, if only to maintain existing levels of real income per head of population. Growth of real output commensurate with population growth maintains real incomes of individuals and households. Greater complications arise when a changing age structure shifts the balance in the population between active participants in the work force and dependents, whether they be the young or retired members of the community. A rising ratio of dependents calls for increased real output per member of the work force — the common notion of productivity gain — to maintain the existing real income per head across the whole population. Yet this point barely touches upon the issues of how gains in real output should be divided for spending. With a rising proportion of retired people in the population and public health costs rising faster than other prices, the proportion of increased real incomes to be swept up in public revenues must rise as the population ages. Gains in real output and income cannot be divorced from these distributional features.

Distributional concerns dominate the picture. They reflect the political entrepreneurship associated with courting supporters. The proliferation of rights that discriminate between groups within the

political market is essential to this process. Specifying rights reflects attempts to identify the apparent needs of separate groups within the community, and the attempt to identify such specific needs is often taken by the groups concerned as an expression of the good intentions of government. The rights most easily whittled away are those that are least easily related to identifiable claims linked directly to significant political groups.

Undoubtedly the distributional claims upon government help explain the interest in expanding real output. Only with gains in the output of goods and services is it possible for the government to pursue the needs of different groups without the risk of disenchanting others. Nowhere is this more obvious than in contemporary disputes on the amount and proportion of government spending going to social welfare and related activities.

VII. THE CLASH OF BUSINESS AND GOVERNMENT

The connections between business and government reflect this dual role of government as rule maker and entrepreneur. It is true that business is only one element in the constituency of government. Other groups also claim attention and some of these have links with business. For example, trade unions and business may join when investment and employment are challenged, as has been the case on such matters as timber-felling and the longer-term structure of the automobile industry. However, compared with the links between government and business, these are, in most instances, indirect and tenuous relationships.

Business vitally depends upon the rulemakers of government for the framework of rights within which it operates. This is evident in the complex legislative and administrative arrangements for the conduct and regulation of business, which permeate its whole fabric whether it be in financial, manufacturing or mining activities.

Government Creates Dependence

While it would be stretching the point too far to claim that in Australia and elsewhere the business of business is government, there can be no denying the preferment sought by firms and others to sustain their business positions. In part this reflects the entrepreneurial skill of government in creating dependence of business on the services offered by government, often reinforced by control as the sole supplier provided by legislation. Can this position be reversed? This is hardly likely.

The reason is that business collectively cannot agree not to appeal

to government for individual favours. It always pays some business participant to seek favourable conditions. This in turn plays directly into the hands of politicians and officials anxious to enhance their own roles. Once some business or business group succeeds in its efforts, others are inevitably formed to press their own causes. In short, business preferment can be secured by playing upon the distributional concerns of government.

This circumstance is illustrated by government supervision of access to natural resources. As ownership of minerals is vested in government, access to explore, develop and commercially produce depends upon political sanction. The methods adopted for the granting of leases or rights at any stage influence the relative advantages enjoyed by the preferred companies. For example, exploration leases conferring exclusive rights over wide areas reduce the available supply of potential leasing land to competing firms. Similar problems of access have arisen with the granting of licences for radio and television transmission. In this case the question of what access and how much may also be determined by the authority's control over the speed of technological applications; for example, the implementation of very high frequency (VHF) and ultra high frequency (UHF) transmissions as well as alternative approaches to the supply of television programmes.

In short, participants in the government sector, the politicians and the administrative leadership, are no different from others in the community in preferring more rights to fewer. Their constituency for influence and preferment is enlarged by their capacity to alter, curtail, create and abrogate rights. This entrepreneurial flair is directed to creating new approaches to rights.

Exchange of Benefits

Transactions in rights are central to the politico-administrative process. The more readily governments control access to and use of assets, the greater the opportunity to ensure their gaining of some benefits — benefits that need not accrue directly. Political leadership uses its position to bestow benefits on others in exchange for votes, campaign funds, favours and jobs, all of which yield their own benefits in one way or another. The proliferation of post offices during the 1950s and 1960s was matched with health and day care centres by the mid-seventies. Local airports have offered the same opportunities for aggrandisement. The administrative hierarchy exercises its discretion within the broad policy commitments of the political leadership, but has its own interests in enlarging its power to adapt, deprive and bestow.

Where business and government interests become one in the

persons of the political leadership, then the abrogation of rights for other participants in the market place is a real possibility. Familiar in Australian historical experience is the dominance of the New South Wales Corps in the early days of settlement. In the United States, Lyndon Johnson exercised his immense senatorial influence on regulating agencies and others to expand his business interests by frustrating or eliminating potential or actual competitors (Caro, 1982:xxii-xxiii).

The main restraint on the potential impositions of government towards business lies in its consequences for the stability of the electorate. Policy measures, often reflecting concerns with equity and fairness, have redistributive effects on the balance between wages and salaries, and gross profits. This in turn may weaken the expectations of future profitability of possible investment projects because the experience of intervention will increase the probability of future interventions being pursued. Heightened uncertainty, arising from the frequent adaptation of policies to meet pressures upon government, may further impair investment as well as current decisions about production. In all circumstances there will be a risk of hindering growth of real income and employment. These possibilities act as some restraint on the willingness of government to accommodate the demands of companies or industry groups or to initiate changes in existing policies for one purpose or another.

Evidence from the early 1970s onwards points to a very belated recognition by government of the instabilities generated by shifts in policies. Nowhere has this been more evident than in policy arrangements bearing upon Australian manufacturing activity. Instability inherent in some aspects of the market sector may be exaggerated rather than countered by government intervention. In short, efforts to 'fine tune' the economy may hinder rather than help economic performance. However, too much can be made of this shift in views. Government interest lies in seeking to match the wants of various groups in its constituency by changes in existing arrangements, legal and administrative.

VIII. REGULATION

The most obvious ties between government and business are in regulation of market activities. While much regulatory effort bears upon rights and right abridgement, other government activities that establish the structure of rights through statute may reflect more fundamental adjustments.

Intervention in the 'Public Interest'

There are two contrasting theories of regulation. The first is the 'public interest' theory, which claims that markets fail to achieve efficient outcomes so that intervention is called for. The two main sources of market failure are the existence of 'externalities', meaning costs and benefits not recognised fully in market determinations, and the exercise of market power in ways that could harm other market participants. A familiar example of externalities is safety provisions on motor vehicles. Failure to provide safety measures may impose costs on other road users and hospitals. Pollution issues arise in much the same manner.

This public interest theory of regulation is held to explain many established forms of intervention. Trade practices legislation was designed to thwart collusive practices, the exercise of market power and monopolisation of markets. In other instances the 'public interest' criterion has been advanced to justify the establishment of government monopolies such as communications and public utilities, or government participation in shipping and domestic air transport around Australia.

What this approach has failed to achieve is public accountability of the government agencies and statutory authorities involved. In both the federal and state jurisdictions in Australia, public access to information about conduct of these bodies is very restricted. Where annual reports are provided they are often late and extremely sketchy in the information provided. Electricity generation and distribution and water supplies and transport are examples. The mechanisms for protecting the 'public interest' have failed to answer the old question: Who guards the guardians of the public interest? In these circumstances the efficiency of government intervention is hard to assess. The question of whether that intervention can be justified, in the sense of moderating the claimed market failure, is hard to answer.

Contestability

Recent developments in the analysis of the nature and structure of markets suggest that the claims for market failure owing to the presence of market power, arising from economies of scale or oligopoly, are exaggerated. These challenges to established interpretations of market structure and conduct are embodied in the concepts of contestable markets (Baumol, Panzar and Willig, 1982). Much of what is advanced in this new approach is not startling. But the coherence of this contestable markets theme seriously questions the extent to which apparent market imperfections can deflect a

competitively efficient market allocation of resources. The reason for this strong claim is straightforward: the contestable markets theory emphasises cost-minimising structures and their efficiency in face of economies of scale and multi-product firms, common features of oligopoly. Important as these possibilities are, they take on an even stronger tone when combined with other well-known features about actual and potential entry deterring firms' abilities to set their own prices rather than take market prices as given. What it all means is that the 'public interest' justification for government intervention seems less secure than ever.

What is at issue is how intervention has influenced specific markets. It is not a question of how general economic policies guide the economy as a whole. However, where such intervention requires government spending it is only stating the obvious to point to the possibilities of budgeting constraints affecting the extent of intervention.

Economic Advantage

The second theory of regulation is 'economic', in the sense that economic argument can explain the reason for seeking the application of regulations. This approach developed from experiences of regulation based allegedly upon the public interest. Those experiences in the United States were most revealing. For example, in industries where there was monopolisation, or at least market dominance by one participant, regulation had little or no impact on profitability. But in industries that would have been competitive but for the imposition of government regulations, the effect was to increase profitability. Justification for government intervention, namely to increase efficiency by thwarting the exercise of market power, was not upheld.

Thus the economic interpretation of regulation was derived from empirical appraisals. Emphasis shifted away from the gains of efficiency associated with intervention in the public interest to the analysis of the results of regulation for the participants. There is a subtle move underlying this revision. Public interest notions rest upon the intention of government intervention in relation to market performance. But the economic interpretation concentrates more on the distribution of the value added in production among the work force, consumers, management and suppliers of capital including shareholders. It does not reject the possibilities of gains in efficiency from regulation but it questions their significance when compared with distributive aspects.

How does this 'economic' theory of regulation interpret the results of government intervention? First, intervention is unlikely to work

when regulated firms can deceive regulators by making their costs appear greater than they actually are, so justifying price increases that could not be upheld if true costs were known. Second, when public authorities concentrate on price and restriction of entry, firms will maintain profits by reducing the range and quality of the goods or services offered and therefore costs of providing them. Third, the regulations are frequently stated in ways that help firms circumvent their aims. For example, authorities tend to determine prices on the basis of a 'fair rate of return of profitability' on investment. This gives an incentive to substitute capital assets, plant and equipment, for other inputs, such as labour, in order to maintain or raise profits while complying with government requirements. Working capital may be inflated.

Business Captures Regulators

These three aspects reflect upon the techniques of intervention. But there are more insidious features. Whatever the good intentions with which intervention is initiated, the authorities sooner or later are captured by the regulated firms. According to this argument, government departments and statutory authorities become filled with people whose careers are bound to the industries they seek to regulate. Hence the regulatory staff have a strong interest in maintaining the existing structure and conduct of the supervised industry. This 'theory of capture' is often viewed as separate from the analysis of effects treated in the previous paragraph.

Finally, some mention must be made of longer-term effects. The structure of regulatory arrangements is impervious to potential market changes arising from technological developments and rising real incomes. Rigidity is a reflection of imposed business 'rules'. Lack of flexibility may thwart adapting to changing circumstances. These prospects are all the more confusing when intervention is often seen as having the object of simulating a competitive outcome to create market efficiency by other than market devices.

The thrust of this 'economic' theory is that regulation is seen not as something imposed on industry, commerce and the professions, but as actively sought by market participants for the relative advantages it confers. Government is the supplier of regulatory services. These services include price fixing, restriction on entry, subsidies, suppression of substitute goods, and promotion of complementary goods including the provision of utilities. Moreover, firms need not act alone when seeking preferment. They may combine with the management of trade unions, for example, in order to restrict foreign entry to markets and preserve employment and union membership while sustaining existing business earnings. Rigidity is the handmaiden of restraint.

Examples

Recent experiences in Australia provide clear empirical support for these interpretations. Industry protection issues are closely tied to regional political considerations in Tasmania and South Australia. Fuel price subsidies aim at support in country electorates despite the obvious conflict with a national pricing policy relating domestic prices to the import parity price. Entry restrictions protect the position of petrol retailers against the oil companies that supply them. Insofar as that same legislation prohibits the oil companies from entering into retail selling directly, the effect is to forestall entry and structural change. Further provisions are then called for to supervise the number and location of retail petrol outlets.

The domestic airlines policy in Australia further illustrates the effects of regulation. The Domestic Air Fares Inquiry some four years ago drew attention to questions about the pricing and costing of air travel within Australia (Domestic Air Fares, 1981). The lack of specific objectives for air transport regulation was a striking feature of official submissions. That the Inquiry was brought to an abrupt end well before it could complete public hearings and examine relevant information may be material to the 'theory of capture'. A national network remains a challenge to the supervisory authorities.

Risk and uncertainty may also explain the quest for public intervention. Many stabilisation programmes for primary industry and tax provisions for averaging farm income across fiscal years transfer some aspects of risk to the public purse or the consumer or both without apparent justification. Marketing Boards are the devices for this purpose. However, spreading risk and minimising uncertainty are only two of their tasks. They also reflect the claims of producers on the political leadership to provide services to curtail the influence of merchants, especially stock and station agents, and other buyers of farm output over the earnings of farmers. Often these boards have powers over entry as with the registration of egg producers.

Creating Favourable Conditions

Many factors affect the demand for regulation. For example, if firms within an industry decide to form a workable cartel, monopoly profits can be achieved. However, if a cartel is formed in a market, it may not survive for two important economic reasons regardless of the legal issues involved. First, there is the ever-present threat of new firms or imports entering the market and forcing prices back to competitive levels. Second, there is the possibility of a firm or firms welshing on any agreement. The costs of reaching a collusive

agreement and ensuring adherence to its provisions may thus be high. Government regulation can be a less costly means for firms to gain effective control over a market. Consequently, such situations generate a demand for regulation. Moreover, legal aspects of collusive arrangements are taken out of the trade practices jurisdiction, in Australia at least, when specific legislation governs conduct in an industry or the federal government invokes provisions to give directions in the public interest on trade practices matters.

The ramifications of government intervention are also important. The effect of securing regulatory sanction of a collusive arrangement is to transfer private costs to the public sector; the administrative costs of supervising market behaviour are borne by the government department or board. Other devices, such as import quotas, mean not only that government bears the costs of market-sharing agreements, but also that rights are created in the form of restricted access to foreign supplies. Where those rights are transferable, as in the case of a proportion of import quotas, a valuable asset is created by government benefitting the initial holders regardless of transactions in the goods to which the licences apply.

IX. CHOICES IN PUBLIC POLICY

Ties between business and government are complex. Interests of both groups are intimately linked, often in irreversible ways. While both sides justify their actions differently, association of the two creates institutional frameworks that add rigidity to the economy. Political rather than market changes are then required to restore flexibility in economic activity. But all too frequently expectations of economic possibilities are seen, or thought, to rest upon government influences. And for good reason because further political action is necessary to relieve the strains.

Yet the links between government and business are flawed. New processes emerge, often reflecting technological change within or outside the country. These processes bring new constituencies for the political and administrative leaderships, thus shifting the uneasy balance among established contenders for preferment. New opportunities strain established connections, weakening capacity to sustain existing practices. For example, major technological changes now challenge long-established monopolies in postal services and telecommunications. Those same technological changes have altered irrevocably the ways of conducting business, especially in financial markets, thus permitting a greater integration of activities within national markets as well as between them.

Coordination Problems

Strains do not emanate solely from the effects of innovation in the market sector of the economy. The proliferation of government intervention and regulation tests the capacity of political and administrative leadership to coordinate measures. This predicament is a reflection of how apparent solutions to public policy issues turn into problems in their own right, for example in the health sphere in Australia and elsewhere. So has been adumbrated the Law of Large Solutions to Policy Problems (Wildavsky, 1979). What this amounts to is a generalisation from policy experience: namely, that the larger and more comprehensive a problem is in its ramifications for society, the less can be done about it.

The implications are straightforward. It is best to minimise the scale of problems by taking elements separately and not searching for connections. Then policy measures have a reasonable prospect of sustained success not requiring further attention. This would seem to justify the differentiation of issues for policy determination referred to in Section III. Is this more than saying something about nipping matters in the bud? It would seem so as the analysis is not about the ramifications of an overall policy strategy but rather the way markets work.

Certainly weaving an intricate web of intervention to placate supporters in the political arena demands more and more attention from policy makers to ensure consistency and avoid outright contradiction. Providing fair and equal outcomes is the aim of many measures directed at economic and social issues. Complicated policy tasks demand sustained analysis and the 'space' in the attention of policy makers and advisers fills rapidly. It is harder to devote sufficient time to devising effective means of handling problems — witness the problems of implementing an assets test on pensions for the elderly. Resort to public inquiries and commissions is one result of this strain, conceding a public recognition of policy tasks while gaining time for determining policy approaches to the issues treated.

Are Any Problems Small?

Furthermore, contemporary economic circumstances limit policy makers. Budget constraints, concerns about inflation and limited prospects for sustained real growth provide little scope for enhancing the economic position of some without imposts on the real standard of living of others. Since the mid-seventies governments have faced economic conditions markedly different from the fifties and sixties, two decades of relatively stable economic growth, and rates historically high by all past experiences. Worse still, the expectations

for continued real gains linger on in the demands on government and the generation of public wants.

In fact the Law of Large Solutions is not convincing. What indeed are small problems? They may only appear to be small because their links with other features of the economic and social fabric are not recognised or are ignored. Failure to appreciate interdependence weakens policy measures as much as the apparent size of the problem. Complexity rather than scale may be the better explanation for policy failures and shortcomings. Furthermore, an effective measure of what is meant by size in this context is hard to conceive let alone establish.

X. MARKETS AND GOVERNMENT

Mutual advantage may go some way to explaining the ties between business and government. There are obvious examples where rules protect the efficiency of markets. For example, regulations on 'insider trading' are intended to ensure a widely informed stockmarket, though how successful those efforts have been remains uncertain (Jaffe, 1974). But mutual advantage is by no means the full explanation. Some participants from one or another group may welcome links because of the specific advantages they bring, often at the expense of others. Various participants see the possibilities of gain in their economic or political standing by devising new approaches. All too frequently they ignore the general implications of their actions.

Appeals to government on behalf of one or more firms have a self-destructive quality. When pursued with sufficient frequency, they undermine consistency and so engender uncertainty in the stability of the institutional framework of rights. The familiar uncertainties of market prospects and technological change are magnified greatly by the instability of legislative and administrative provisions. Focus shifts to the present and the near future when assessing potential rewards from new adventures.

In all this the role of the market is abridged as the arbiter of resource allocation and company performance. How can a pricing system continue to work efficiently when its influence is eroded by a sustained inflation quite high by historical standards, and when it is by-passed all too often as prices are no longer taken as given? Only if prices are taken as given by market participants is there an effective allocation of goods and services not circumscribed by the impact of market power, perhaps having its origin in political and administrative preferment. The unwillingness of business and others to accept prices as determined by markets destroys the effective functioning of those markets.

These interpretations of government intervention in markets do not rest upon claims of 'market failure', by which is meant the inability of markets to provide efficient outcomes. Quite the contrary, they imply the imposing of market failure to the advantage of some or all producers of goods or services in a particular market.

XI. WHITHER INTERVENTION?

Where does this leave government intervention? By analogy one might compare 'market failure' with 'government failure' from intervention (Buchanan, 1983:15). But the analogy, however superficially attractive, cannot be sustained. The reason is simple. The basis for judging market failure is not that for examining government intervention. For example, there are no measures of externalities for government activities while the government determines the rules through which market power is exercised.

Nevertheless the possibility of some government intervention improving efficiency cannot be denied.² This may be tested by analysing the impact on productivity, employment, costs, and changes in relative prices following that intervention. However, that does not help with the distributive concerns embodied in concepts of fairness and equal treatment and rarely spelt out clearly in objectives capable of precise assessment. The effects of measures implemented under this guise are hard to test, for what is treated is the assigning of present and future incomes by government, as the supplier of regulatory services, rather than through market processes.

The Voters

The effectiveness of government assignments of income cannot be tested by economic measurement. Acceptance is a matter for the political processes. The economic effects may be measured, but that is another issue. Nor is this distinction between acceptance and effects blurred by the repercussions of those economic effects on political will. That acceptance, in a democratic society, is reflected in voting behaviour.

But voting behaviour is a fickle instrument for judging acceptance

2. It should again be noted that these comments on government policy refer to intervention in, and regulation of, market activities. They do not bear upon the effectiveness with which government influences the overall level of activity in the economy. Concerns on that effectiveness brought rejection of the scope for 'fine-tuning' the economy because the benefits of such efforts could be exaggerated. There are real possibilities for those efforts to accentuate rather than diminish fluctuations in activity.

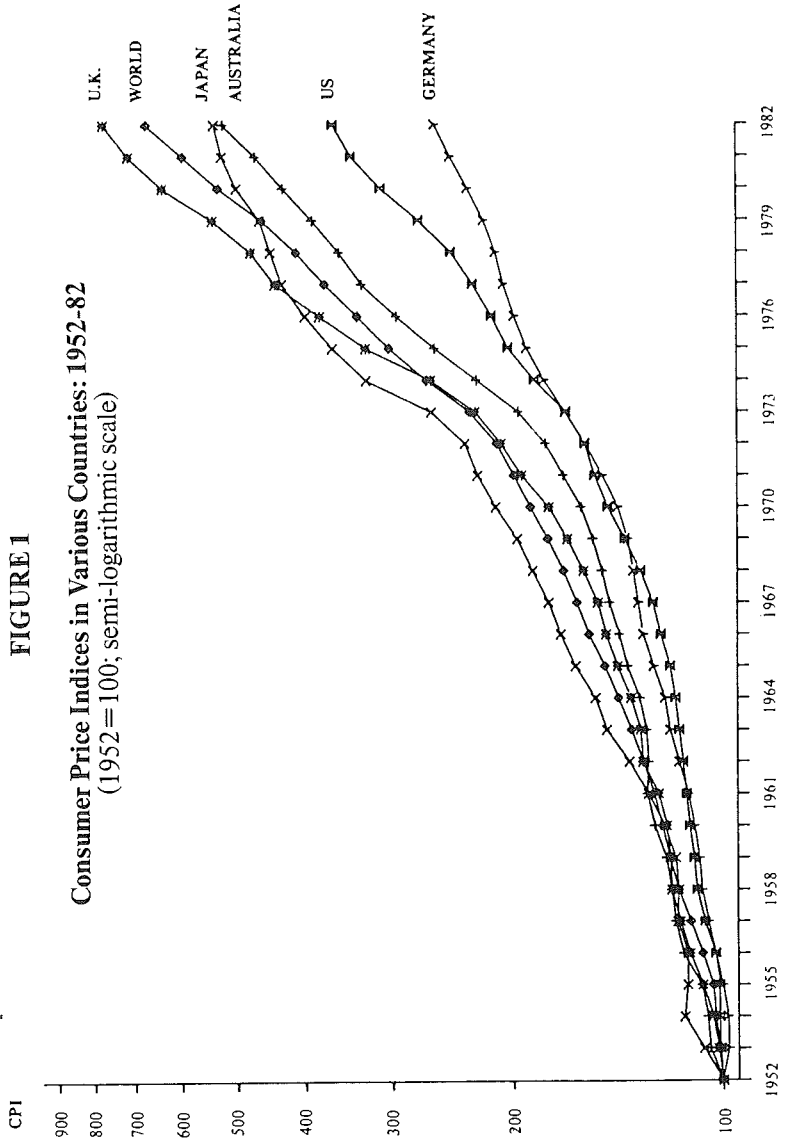
(Tullock, 1959). Without traversing the extensive literature on the problems of majority votes in relation to acceptance, suffice it to point to the instability of voting on issues where there is a wide range of conflicting views on what constitutes appropriate policy (Arrow, 1951; Brams, 1975; Dahl, 1956). As the analysis developed through preceding sections shows, the distributive impacts of government intervention are more likely to be the very ones that appeal to separate groups in an economy, this being the essence of the differentiation of rights to accommodate the wants of various groups. Each provision is a matter for the interested group, but the proliferation of provisions, stemming from the pursuing of support from many groups, risks the diffusion of focus as one group's interests conflict with those of others. Coalitions of interests may bring only temporary respite from factionalism, to be disturbed by further proliferation or adaptation of rights. Accepting the results of government intervention becomes a movable feast.

XII. CONCLUDING COMMENT

The interests of business and government cannot be separated, however much the rhetoric of their antagonisms claims the opposite. Government interventions in markets are as attractive to some firms or business groups as they are to government as the suppliers of regulatory services.

Arguments supporting government intervention in markets because of imperfections that do not permit efficient allocation of resources are less impressive than ever owing to recent contributions to the analyses of market structures and firms' performance. This is not to say that prices reflect all the information needed to make thoroughly efficient allocations of resources or, putting it another way, that the markets in which prices are formed are completely efficient and fully reflect relevant information. What is true, however, is that markets and the prices reflected in them are a lot more efficient than much discussion of market failure would suggest. In failing to accept those prices business is searching for market advantage by means of government intervention — a political assignment of income-earning opportunities rather than redress of market imperfections.

In these circumstances whether or not government has the ability to make more consistently informed decisions than markets is not a major issue, let alone the sole one. What is central is the separability of business and government roles which, on the face of it, is incapable of realisation.



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**Ray Ball
and
John Bowers**

The Resource Rent Tax proposal has raised tremendous concern in the resources industries in recent months. Although the subject is fairly complex, this paper presents the major features of the proposed tax in clear, understandable language. It also traces the effects of the tax through a resources project from start to finish, exposing hidden distortions in resource allocation the tax will cause.

Proponents of the RRT have tried to show that it will be a fair tax by calculating its effect on existing, proven resources projects. But this analysis ignores the huge element of uncertainty that colours every investment decision. No one ever knows for sure how an investment will come out. If a tax will reduce any profits from an investment, then obviously the tax must figure in the decision of whether or not to invest in the first place.

Perhaps the most pernicious feature of the proposed RRT is that it does not allow the investor any relief if the project is unsuccessful. The investor must bear all the risk; the government steps in to collect its revenue only if the project is a winner.

Ray Ball and John Bowers use techniques from the investment analysis field to demonstrate that the RRT will not only inhibit new exploration for resources, but will also impede innovation in development and production techniques, thereby weakening Australia's position in the international raw materials markets.

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The only hope for reform is to abolish the Commission altogether.

P.P. McGuinness is Editor-in-Chief of the *Australian Financial Review* and a frequent commentator on industrial relations.

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Enterprise: Free, Dependent or Captor?

Warren P. Hogan

The relationship between government and business is the theme of this essay. Each depends on the other, and each uses the other for its own purposes. Business seeks favours from government in the form of protective legislation and other interventions. Government caters to business because its power is increased.

The only hopeful note is that government cannot afford to ignore the importance of economic growth and productivity. This serves to restrain government's willingness to accommodate the demands of business groups or to intervene in the market more generally.

Warren Hogan is Professor of Economics in the University of Sydney. He has had a long-standing interest in the relationships between the government and the market sector of the Australian economy.

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