CONFERENCE PROCEEDINGS

ECONOMICS '92

A NATIONAL ECONOMICS TEACHERS CONFERENCE

MACRO AND MICRO POLICY IN THE '90's

Macroeconomic Management • Monetary Policy
Fiscal Policy • Wages Policy • Industry Policy
International Trade • Comparative Economic Systems
Income & Wealth Distribution • Environmental Economics
Evolution of Economic Ideas • Teaching Strategies

EERC

Edited by Tim Riley

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EERC The Economics Education Resource Centre

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EDITORIAL NOTE

This is the second book in a series which records the proceedings of a National Economics Teachers' Conference conducted by the Economics Education Resource Centre. **Economics '92** was held at the University of New South Wales in Sydney over July 13th to July 14th 1992.

Fourteen papers were presented to the conference by economists and educators under the theme of **Macro and Micro Policy in the '90's.** The programme covered a wide range of topics relevant to secondary economics teaching and highlighted many of the issues in the current debate over the formulation of economic policy in Australia, and in the states that now comprise the Commonwealth of Independent States.

I am indebted to all of the speakers who gave permission for their papers to be published and for their co-operation in matters of consistency in style and presentation. The quality of the content and analysis is indeed a reflection of the authors' attention to detail and their expertise in the topic areas treated. ***Economics '92 Conference Proceedings*** is thus a valuable collection of readings for secondary economics teachers, students and librarians.

I wish to thank Andrew Davies for his creative and technical expertise in preparing the manuscript so quickly and accurately for publication. My thanks must also go to the 100 or so teachers from all over Australia who attended the conference, and the resource exhibitors who gave their support to the conference exhibition. Finally, I would like to acknowledge the considerable financial support of Coca-Cola Amatil Limited and the Australian Bankers' Association in sponsoring **Economics '92**.

Tim Riley

C O N T

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INTRODUCTION

TIM RILEY

The Economics '92 Conference made a valuable contribution to the professional development of Australian economics teachers by bringing together a group of expert economists and educators who presented papers on a range of relevant topics and so assisting teachers to update their knowledge and skills in the subject matter of economics.

Teaching economics requires a commitment on the part of educators to being familiar with and having an understanding of the issues canvassed in the current debate on economic policy. The conference theme of **Macro and Micro Policy in the '90's** was addressed by all presenters who endeavoured to outline, explain and illustrate the major issues of current relevance in their respective topic areas. Some of the strategies and resources used in the teaching of economics were also canvassed as a means of giving alternative, innovative and interesting ways of presenting content material to students in the classroom. The **Conference Resource Exhibition** featured displays by twenty publishers and resource suppliers who gave teachers the opportunity to observe and discuss the range of support material available in the teaching of economics.

Economics '92 Conference Proceedings addresses many of the topic areas taught currently in Australian secondary economics courses. Dr Ken Boston opened the conference by discussing the move towards a national curriculum and the recognition of key competency areas as well as the importance of economics education and work related skills. Colin Dunn develops many of these ideas in his discussion of changes to the national association, Business Educators Australasia Inc, and the implications of the Finn Report, the recommendations of the Mayer Committee and the implications of the Carmichael Report's findings on education and training. Ken Baker gives a brief yet clear idea of the approach to the teaching of economics and school–industry links in New Zealand.

Significant developments have taken place in the Australian economy's performance in the 1980s and 1990s. Primarily, the asset boom and price inflation of the late 1980s have given way to a severe 'policy induced recession' and the emergence of historically low levels of inflation coupled with unacceptable levels of unemployment, and the subsummation of the current account deficit and foreign debt problems as the prime focus of the formulation of macroeconomic policy. Price stability and full employment are back on the agenda as the primary objectives of macroeconomic policy. Furthermore, industry policy and microeconomic reform are seen as crucial elements in fostering long term structural change, particularly in dismantling protection, making public enterprises more efficient, increasing the flexibility of the labour market and overhauling the rigidities in Australia's infrastructure base. There is also much debate in Australia about the effects of the recession and structural change on the distribution of income and the environment.

It is against this background that Chris Caton outlines the key indicators of our recent economic performance and the problems being experienced in fostering a modest economic recovery. Stephen Grenville provides an excellent insight into the operation of monetary policy in a deregulated financial system and the difficulties faced by the monetary authorities in finding a stable intermediate target in conducting monetary policy as the 'swing arm' of macroeconomic policy. Don Stammer highlights the often ignored functions of the federal budget in affecting resource allocation, income distribution, the provision of incentives to save and invest and the promotion of price stability and structural change. He argues the case strongly for not using fiscal policy to 'fine tune' the economy, but rather as a means of achieving alternative goals. John Burgess provides a thorough report card on the Accord, its achievements and its failures. The Opposition's labour market reform proposals are outlined and an analysis of the current unemployment problem undertaken. Recent developments in industry and competition policy are discussed by Ross Jones, who uses numerous case studies to illustrate the application of new developments in microeconomic theory to the design of microeconomic policies. The external sector's role in contributing to economic recovery is explained by Janet Torney. Recent calls for Australia to increase its trade with Asia are examined in the context of increasing global restrictions to free trade and the formation of trade blocs in Europe, North America and Asia.

John Paine, who has visited the former USSR on many occasions, uses this experience, together with his wide reading, to summarise the failure of the Gorbachev reforms implemented under the banner of *Perestroika*. The Yeltsin reform package is detailed along with its prospects for success in achieving a smooth transition to a market economy and improved economic performance in Russia and the CIS. The failure of command planning to preserve environmental resources is a theme taken up by Jeff Bennett as he discusses the shortcomings of command and control type solutions to environmental problems. A reconciliation of market forces and environmental goals is suggested as a means of achieving more optimal solutions to environmental problems.

The economics of distribution, which involves an analysis of income and wealth statistics is presented by John Mangan in a carefully structured paper. The most recent ABS statistics and calculations of Gini co-efficients are interpreted and some projections made about future trends in the distribution of income and wealth in Australia. Devotees of the history of economic thought will be impressed with Peter Kriesler's account of the major developments in economic theory since Keynes. The basic tenets of neoclassicism and Keynes' critique are explained before recent developments are discussed in some detail.

Of crucial interest to teachers are the ways in which much of the content of economics courses can be applied in the classroom. Anita Forsyth does an admirable job in this regard. Her ideas on teaching strategies and resources are innovative and will help teachers to remain enthusiastic about attempting new strategies to make economics interesting and relevant to students.

Economics '92 Conference Proceedings is an exciting collection of readings in Australian secondary economics. It is a valuable resource for teachers, students and librarians and exemplifies a conference initiative organised by the **Economics Education Resource Centre** which helps to strengthen the interface between schools, industry and government. Economic literacy is now an essential element in shaping citizenship and let us hope that conferences such as **Economics '92** will be a regular feature of the professional development of Australian secondary economics teachers.

1

THE IMPORTANCE OF ECONOMICS EDUCATION

DR KEN BOSTON

NSW DIRECTOR-GENERAL OF EDUCATION

Dr Ken Boston is Director-General of School Education, New South Wales. Prior to this appointment, Dr Boston was Director-General of Education in South Australia and had held a number of senior positions in the Victorian Ministry of Education. He is a past chairman of the Australian Education Council Standing Committee on Schools (1991) and the Australian Education Council Committee on National Goals for Schooling (1988, 1989). Dr Boston is a fellow of the Royal Geographical Society, London, and a member of the Australian College of Education.

THE IMPORTANCE OF ECONOMICS EDUCATION

DR KEN BOSTON

I wish to thank the Economics Education Resource Centre for inviting me to open this 1992 National Conference of Economic Teachers. I extend a special welcome to teachers from interstate.

Teachers need, and want, to be abreast of the latest developments and debates in their discipline. From the conference agenda it is clear that these two days will engage you in discussion about some of the most pressing macro and micro policy issues facing, not just the discipline of economics, but the nation. I have agreed to speak on 'The Importance of Economics Education'. In reflecting upon this theme I found myself inevitably reaching into other related areas of current thinking and debate. My opening remarks today will therefore go a little wider than the agreed topic. I will comment on the role and importance of economics education in the school sector. I also want to make some observations about prevailing views and debates about the economics of education.

The Economic *Moment*

It is difficult to enter into discussion about the state of economics education, or debates about the economics of education, without acknowledging our broad economic and historical context. This context serves to sharpen the relevance of any discussion about the discipline of economics. In one obvious sense, the value of the discipline lies in its capacity to help us meet current economic and social challenges. On the world scene we are several years into the most extraordinary and turbulent of eras:

- the collapse of communism;
- the break up of Eastern Europe;
- the emergence of hyper nationalism;
- the turbulence in the Middle East;
- depression and uncertainty in the United States.

(On this front one can only speculate about the political consequences for the current President. Under normal circumstances falling per capita income guarantees a president a lost election).

Closer to home, the surge in unemployment announced last week and the stubborn persistence of recession across Australia, pose huge challenges for us as educators. At its simplest, but most critical level, we are teaching young people, whose hope and optimism about the future are seriously threatened. As an OECD report recently put it:

> 'The problem is a shock to the past expectations that a person's opportunities were limited only by one's competence, ambitions and willingness to work.'

At another level, we are being forced to think more directly about the role of education in underpinning national recovery and well being. Part of this involves a deeper and more pervasive recognition that Australia is irretrievably in an international context and must compete and survive in that context. The political and economic problems requiring solution are clear enough. The ways forward are not so clear. At this macro level it is hard to think of a time when the discipline of economics has been under greater pressure to come up with some coherent analyses and some answers. And this, at a time when the broad ideological certainties driving major economic approaches have been dismantled. It is also hard to think of a time when educators have been under greater challenge to think through and be clear about their role and the role of education in the nation's response to these challenges.

This brings me to the substance of my opening comments this morning.

The Importance of Economics Education

I will confine my comments to schooling though there are obvious flow-ons to the higher education arena. There are to my mind two dimensions to this issue:

1. What, if any, are the elements of an economics education that should be gained by all young people during their schooling?;
2. The nature and place of specialised elective study in the economics area in the school years.

The first of these involves a discussion about the core curriculum and essential learning, skills and understandings that should be the outcomes of schooling. This is no new topic for educators or for the broader community. It is however back on the agenda in a very focused way for debate across Australia and internationally. In Australia we are exploring this issue at State and national levels. The articulation, in January 1989, of a set of national agreed goals for Australian schools can be seen as a first go at a broad delineation of what students should learn at school. Most States have reviewed their curriculum requirements and provisions in recent years in the light of that statement. Right now, at the direction of the Ministers for Education (Australian Education Council), we are involved in an historic national project to map the school curriculum across Australia, to develop profiles in each of the eight learning areas we have defined, thereby establishing the framework for a common curriculum and common standards across the nation. This collaborative process, which is on line and on target will be finished by June next year.

There are also pertinent debates at a national level emerging from the proposals being argued by an interconnected series of reviews and reports:

- The Finn Report;
- The Mayer Committee due to report to Ministers in September;
- The Report of the Employment and Skills Formation Council (the Carmichael Report).

One way or another, all these enterprises are grappling with the fundamental issue of what young people will need to know and be able to do and be able to understand in the world of the 1990s. Let me put my in-principle position simply. I am of the view that a basic economic literacy is one of the essentials which all young people must acquire from their schooling. There are a number of reasons for arguing this. Possibly the strongest is that it is hard to think of any significant social or political issue which does not have an underpinning or constraining economic dimension these days. It is not possible to think about solutions to such issues, or even to understand them adequately, without a grasp of the interrelated economic dimension. David Mahoney recently argued:

> 'The point should be made that political literacy and economic literacy are now almost perfectly synonymous and personal dignity and economic self-dependence are usually closely related.'

Or to come at the proposition from another perspective — There is in NSW at the moment an energetic campaign for a more coherent approach in our curriculum to the general area of civics ie the coverage of institutions, processes and pressures that underpin our democratic society. If the broad objective of such curriculum is to enable a young person to function effectively as an informed citizen, it is clear that such a coherent approach would have to incorporate basic economic concepts and understandings. While no-one is arguing that all students, in either the junior or senior secondary years, should be required to do a full blown course in economics, there are some interesting, more general propositions under exploration.

The debate about essential **key areas of competence** initiated by the **Finn Report** into Post Compulsory Education, and currently being further developed by the Mayer Committee, puts the issue on the agenda. One of the key areas of competence identified by Finn was the somewhat inscrutably named **'Cultural Understanding'**. Finn was explicit that this was an area of competence with a strong knowledge/understanding base. The Report did not define the area in any detail but put forward a broad outline:

- understanding and knowledge of Australia's historical, geographical and political context;
- understanding of major global issues — eg competing environmental, technological and social priorities;
- understanding of the world of work, its importance and requirements.

This outline does not make any explicit reference to economic literacy. Economic literacy is however an underpinning element in each of them.

The **Mayer Committee** has explored the issue further and in its current discussion paper is arguing that **cultural understanding**, while not a competence as such, constitutes a bundle of knowledge and understandings which are without doubt essential for all young people. Mayer does not at this stage expand upon the broad content outlined by Finn, nor is Mayer at all explicit as to where or how young people will acquire this essential knowledge and understandings in their school or training courses. Notwithstanding this, the reaction of the education and wider community to the issues raised in this section of Mayer will be extremely interesting but critical.

It is also worth noting that there are other voices raising similar or related arguments. The National Industry Education Forum (NIEF) has proposed that the senior curriculum should ensure that all young people gain an understanding of broad economic and business issues. Educators, in a number of forums, including the national profiles exercise, are also debating what is important content within the learning areas and the overall curriculum. I would guess many of you are involved in that process.

If there is national agreement that a basic level of economic literacy is essential for all young people as they leave school, the hard work of defining what such literacy would actually entail would need to be done and it needs to be done by you. I expect that teachers of economics will be expressing their views on this in the various forums for responding to Mayer's current proposals.

I want to make a few observations about the place and importance of economics education as currently pursued by many students through specific elective courses in the secondary school. The discipline of economics has long held an unchallenged position in the secondary and higher education curriculum. That continues to be the case. However economics courses are now complemented by a range of related but more specific, and in some cases more explicitly vocational, courses. In NSW we maintain an economics course in Years 11–12. It is one of the most popular of the elective courses we offer. The course has as its rationale:

> 'the need for students to understand the significance of economic events as well as the implications of individual, corporate and government economic decision making. In emphasising the application of economic tools and concepts to the problems and issues confronting Australian society, it seeks to help senior students gain the skills and competence required to participate in, and contribute to, that society in an effective way.'

It builds upon (although not as a prerequisite) a junior secondary course in commerce which has also maintained strong participation.

In NSW the participation in this course will be affected by the introduction of mandatory one year courses in history and geography from 1992. In Years 11–12 we now have a two and three unit **business studies** course. While business studies is not a narrow skills course, its focus is more directly vocational than the general economics course. The broad aim is to give students a better understanding of business and management in the Australian and international context. The course is described as providing students with an opportunity to bridge the gap between school and work and to develop a range of business related skills. The NSW Board of Studies is in the process of developing a suite of industry studies within a common course framework. These courses are intended to incorporate significant workplace experience and workplace based learning. The intention of those courses is that they will be jointly accredited by the school and the training sectors. This initiative is intended to be one of the more significant responses of the school sector in NSW to the challenge of better integrating general and vocational education and training. It is therefore of immense importance to us that we get the most effective and useful model in place.

I make reference to these specific NSW developments in your broad field to emphasise a trend of which I am sure you are all aware: the increased willingness of teachers and curriculum designers to relate general schooling to the realities of the world of work. If one takes a broad perspective on economics education, what we are attempting to put in place is a variety of ways to access economic knowledge, understanding and competencies. To use the language of the **Carmichael Report** we are creating more opportunities for **contextually based learning**. This is but one manifestation of the broader convergence of general and vocational education in this country. There is currently much discussion about this trend and quite a deal of debate about its implications.

I want to say a few words about it in the context of the economics of education.

The Economics of Education

The macroeconomic and political issues of the times are not surprisingly having a direct impact on the way in which education is viewed. In particular, the accepted approaches to the economics of education are changing. The old 'human capital' theory of the economics of education has been challenged and all but replaced in current education policy thinking. The old view assumed an unproblematic progression from investment in the general education of the individual to the economic betterment of the individual, and that this somehow or other guaranteed increased national productivity. The theory came unstuck when the equation became improbable. Growing education budgets quite simply failed to deliver productivity increases. Richard Sweet has noted that:

> 'By the end of the 1970s, national policy-makers were beginning to question whether continued growth in educational expenditure was justified in economic terms, in the face of both a decline in productivity growth despite nearly twenty years of annual real growth in educational budgets in developed economies, and a stubborn failure of economic growth to respond rapidly enough to the large educational investments that had been a feature of aid programmes in much of the third world.'

In the Australian context, our declining economic status and competitiveness provoked some probing analyses of our industrial and economic future, and some equally probing comparisons of our approaches to education and training with that of some of our existing and emerging competitors. The outcome has been that we have an urgent commitment to microeconomic reform in this country and an emerging acceptance that a revitalised and refocused education and training system must support our national economic recovery.

The debate in this country is no longer over whether education should deliberately support our national productivity, but how this is best achieved. It is in this context that we should be assessing the proposals of the Finn/Mayer and Carmichael reports.

What I am putting forward then is essentially an instrumental view of education and training. It is no longer viable to argue for schooling to ignore the world of work or the broad skills, knowledge and understandings essential for effective participation in the workforce of the 1990s. The affirmation of this approach should not be construed as a rejection of the broader purposes of education which relate to the development of the individual as a citizen and social being. They are complementary, not competing, purposes of education. Our goal in schooling must be to make Australia a culturally rich and also an internationally competitive nation.

There are real debates to have and hard issues to address. Where possible, we should avoid unnecessary and misconstrued arguments. These debates and changes in education policy are moving quickly. It is important that educators engage in the debate and the resulting policy developments. As teachers of economics with a particular and expert interest in economic developments and solutions, as well as in education, you are well situated to and indeed must contribute to the debate. I wish you well in your deliberations over the next two days.

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2

MACROECONOMIC OUTLOOK AND POLICY UPDATE

DR CHRIS CATON

CHIEF ECONOMIST
BANKERS TRUST AUSTRALIA LIMITED

Dr Chris Caton is Chief Economist of Bankers Trust Australia. His major role is to provide advice on the implications for financial markets of economic developments, including major economic statistics and policy pronouncements, and major political developments.

He has worked as an econometrician with the former Bureau of Census and Statistics and in the forecasting section of the Treasury. From 1977 to 1990, Chris held various positions in the prestigious US economic consulting firm, DRI/McGraw-Hill, where most of his time was spent on modelling and forecasting the US economy. In 1990 he returned to Australia to head the Economic Division of the Department of the Prime Minister and Cabinet.

THE DOMESTIC ECONOMY

DR CHRIS CATON

The Australian economy began a recovery in production late in 1991. Since then, a modest upturn has been fuelled by consumption and housing activity, reflecting the substantial interest rate cuts since January 1990. However, business investment and employment growth continue to lag the upturn, and the unemployment rate is yet to reach its peak in this business cycle.

Partly reflecting the slow recovery, underlying inflation continues to decline and inflationary expectations are adjusting accordingly. Wage pressures remain weak. The current account deficit also remains subdued. All of the above provide scope for policy stimulus, even though economic recovery has already begun and previous policy easings have not yet had their full impact on activity.

Recent Evidence

The latest economic data continue to confirm that a weak recovery is underway. The weakness of this upturn is reflected in continued 'data schizophrenia' in recent partial indicators, and in the favourable outlook for wages and prices.

GDP (A)[1](see **Figure 1**) grew by 0.6% in the March quarter, following an upwardly revised 0.7% growth in the December quarter 1991. The March quarter national accounts were consistent with the slow recovery in activity, and show three consecutive quarterly rises in GDP. Over the year to the March quarter, GDP (A) rose 0.8%, but remains 0.7% below its March 1990 peak.

Private consumption rose by 0.8% in the March quarter, its fourth consecutive increase. It has grown by 2.9% in the past year. Spending on motor vehicles, household durables and other goods rose.

Capital expenditure on dwellings grew by 4.4%, its second consecutive increase, following falls in eight of the nine previous quarters.

Business fixed investment (see **Figure 2**) fell by 3.7% in the March quarter, its eleventh consecutive fall. It has dropped by 14.1% in the past year. **Non-dwelling construction** fell by 2.3%, while expenditure on **plant and equipment** was down by 4.3%.

Private non-farm stocks (see **Figure 3**) increased by $208m in the March quarter, following a $50m rise in the December quarter. This represented a

Figure 1: **Economic growth** (quarterly % change)

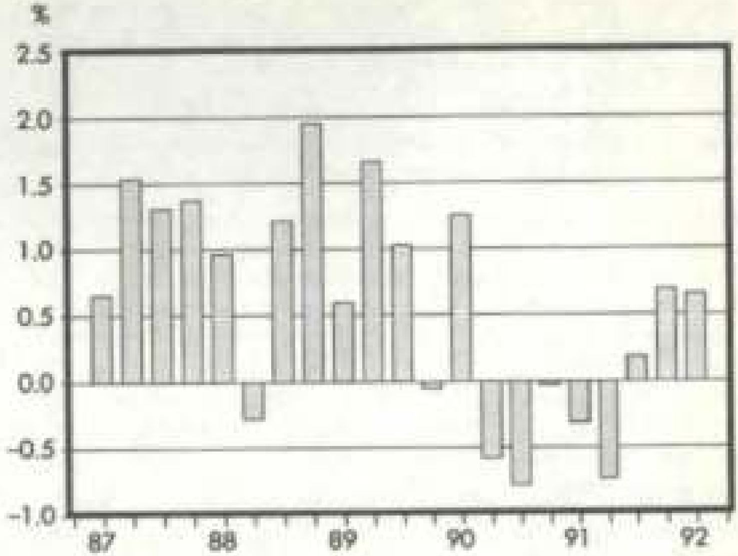
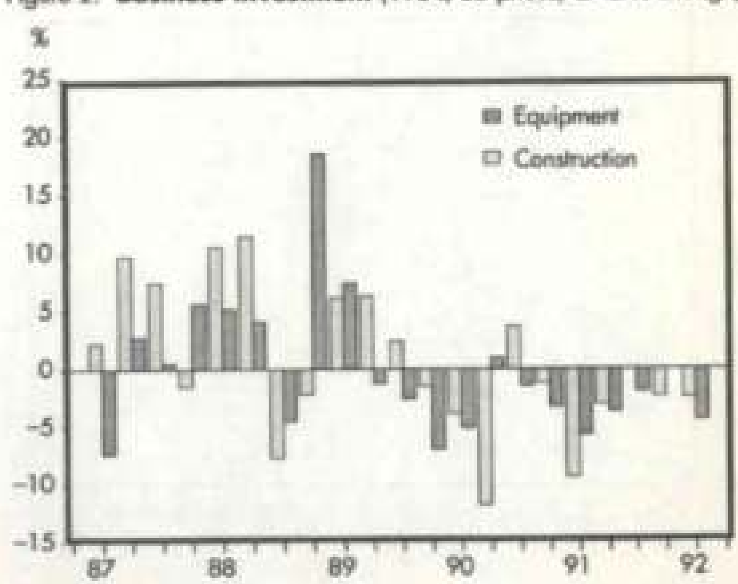


Figure 2: **Business investment** (1984/85 prices, Q–Q % change)



0.2 percentage point contribution to growth in GDP (E)[2] in the quarter. Farm and public authority stocks contributed 0.4 percentage point to this measure of growth. Despite the accumulation, the non-farm stocks to sales ratio continued to fall, and recorded another historic low.

Net exports (see Figure 4) reduced March quarter GDP (E) growth by 0.6 percentage point with imports growing 0.7% and exports falling 1.9%. In the past year, imports have grown by 8.1% with exports up 7.3%.

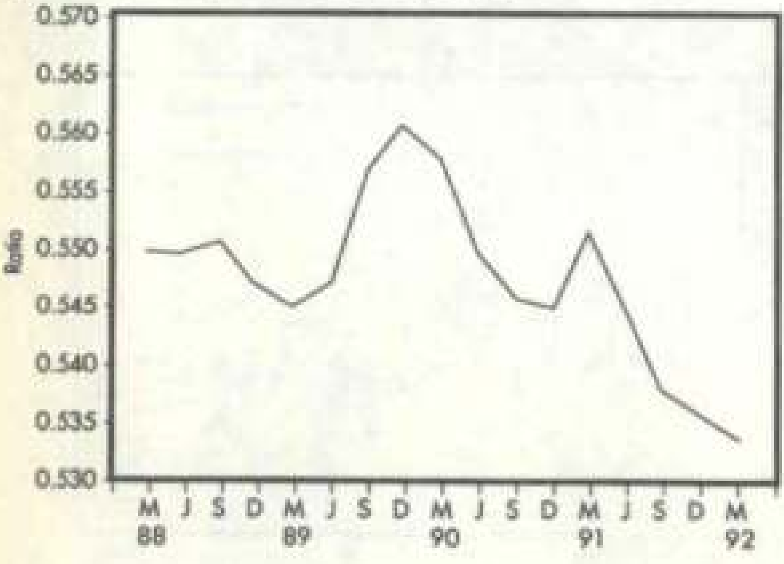
The trend estimates of **production** in the March quarter increased in ten industry groups and fell in the other three that constitute GDP (P)[3]. Nine of the ten have grown for at least the last two quarters. Manufacturing production rose by 1.4% in the quarter, mainly because of increased demand rather than stock accumulation. The increase in manufacturing output was widespread.

More recent partial economic indicators generally support the slow recovery hypothesis, although month-to-month fluctuations reflect the patchiness and limited momentum of the upturn:

Retail trade in April rose 2.9% (sa), lifting the provisional trend growth over the year to 5.8%. The latest data were boosted by the one-off family allowance payment in early April.

After a strong increase in March, to their highest level since October 1990,

Figure 3: **Private non-farm stocks to sales**



new motor vehicle registrations fell a substantial 12.6% in April, to be only 2.2% above the level of April 1991 (see **Figure 5**). The trend estimate for registrations is currently rising only slowly. A further fall in registrations in May is unlikely, but would be a clear sign of renewed weakness if it occurred.

Leading indicators for dwellings demand continue to trend upward, although excessive growth in the sector is not expected. **Building approvals** rose by 9.7% in April, the fourth increase in the last five months, to be 35.8% above their level of April 1991 (see **Figure 6**). The trend series for approvals has risen 25.3% in the last year, including an 18.6% increase in private sector approvals. The latest data predate the early May easing in monetary policy. Much of the recent growth in approvals has come from the public sector via the Commonwealth State Housing Agreement. Public housing employs fewer resources than private sector units, and occupies less land per unit. Public activity should decline in the second half of the year. Concerns about overheating of the sector should also be reduced by the latest cuts to the immigration programme for 1992–93.

Consistent with the modest recovery in activity, the lagging labour market remains subdued with the prospect of only slow improvement ahead.

Total employment in May fell 9,400 (sa), including a 22,100 decline in male full-time employment (see **Figure 7**). The trend in total employment remains flat.

Figure 4: **Export growth** (volumes of goods and services)

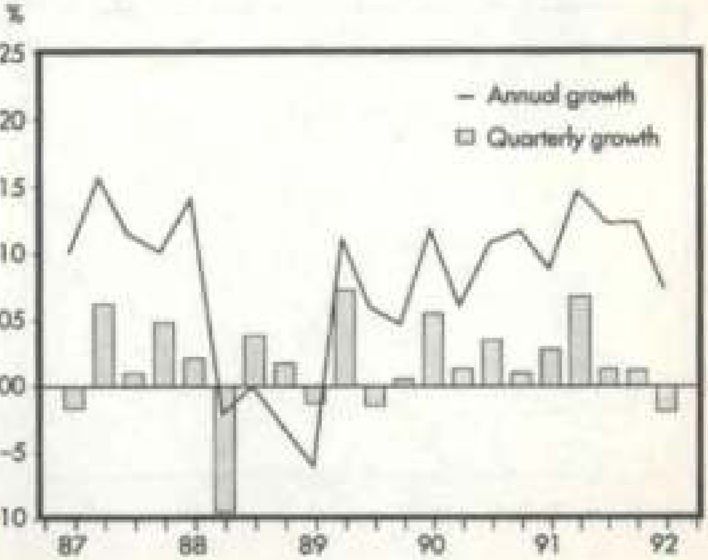


Figure 5: **Motor vehicle registrations** (trend estimates)

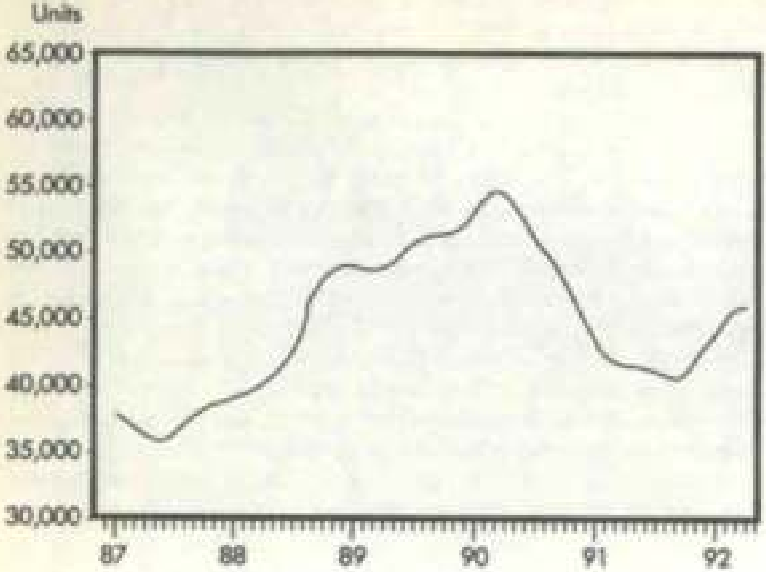
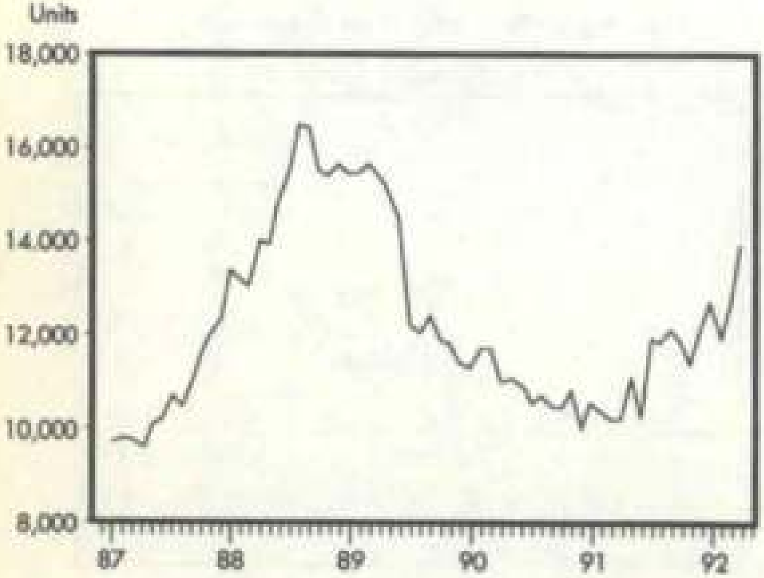


Figure 6: **Building approvals** (seasonally adjusted)



The **unemployment rate** in May rose to 10.6% (sa), continuing the relatively flat trend since early 1992, but with the prospect of a higher rate in coming months.

ANZ job vacancies rose 0.9% (sa) in May following a 1.4% rise in April, to give a 2.2% rise from May 1991. Although this series bottomed in early 1991, it has shown little subsequent growth and the number of vacancies remains close to an historically low level.

Partly reflecting the weak domestic recovery, the current account deficit remains subdued and in 1991–92 will total less than $12b, well below the government's budget-time forecast of $14b.

The **current account deficit** in April was $798m ($897m sa). Seasonally adjusted the deficit for the ten months to April totalled $9,382m (see **Figure 8**).

Export receipts have resumed their upward trend in recent months after a mild downturn in late 1991. In the first quarter of 1992 receipts were largely unchanged from the previous period. However, export volumes in the same period declined by almost 4%. In April receipts rose $66m (sa). These data reflect revisions that have followed the move to a more timely recording of export flows.

Spending on **imports** has trended slowly upwards in recent months. This embodies an apparent upward trend in seasonally adjusted daily endogenous imports, partly reflecting the recovery in domestic consumer demand. The strength of capital goods imports remains surprising given the continued poor performance of business investment.

The improvement in the current account is due to both a persistently positive trade balance and a reduced contribution from the **net income** deficit. In the ten months to April 1992 this deficit has totalled $13.2b compared with $15.0b for the same period in 1990–91. This force should continue to exist through 1992 as lower coupon payments on foreign liabilities reduce monthly debt servicing.

Wages and Inflation

One of the key differences between this cycle and previous cycles is that the recession was not preceded by a wages breakout. The implications of this have been profound. Wages growth has slowed to between 3 and 4% from 6 to 8% in the late 1980s, which has contributed to a significant fall in underlying inflation (see **Figure 9**).

Wages growth is expected to remain moderate. Enterprise agreements so far cover less than 2% of the workforce, reflecting the state of the labour

Figure 7: **Employment in previous and current cycle** (trend series)

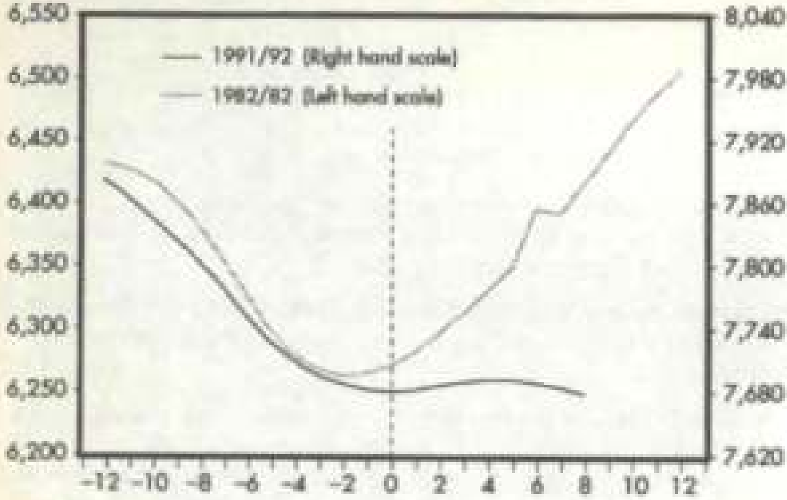
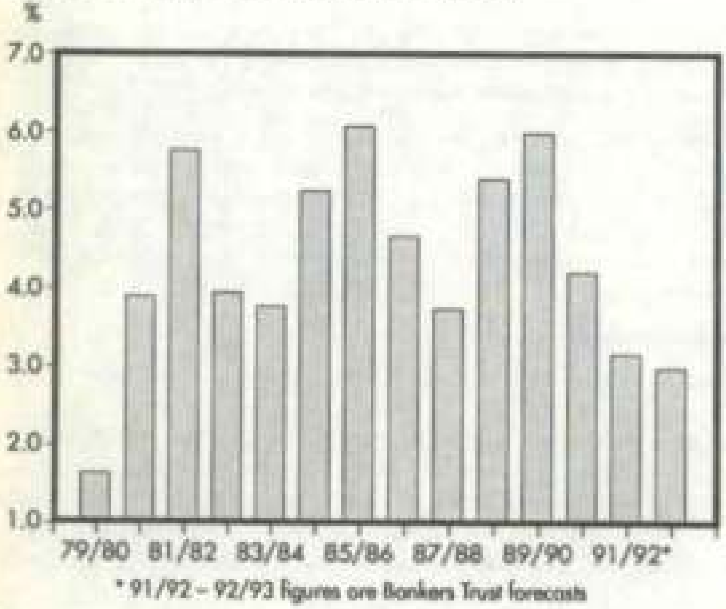
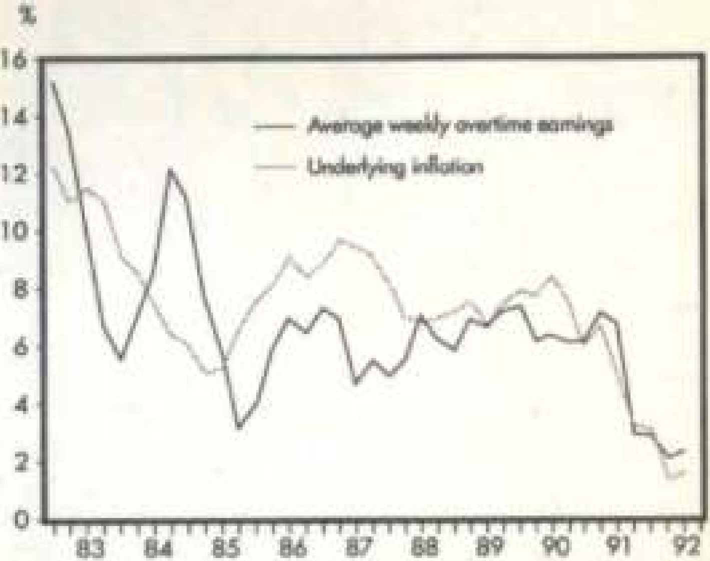


Figure 8: **Current account deficit** (% of GDP)



* 91/92 – 92/93 figures are Bankers Trust forecasts

Figure 9: **Wages and prices**
(Year-to % change)



market and the time taken to negotiate genuine productivity deals. The last national wage rise (of 2.5%) was in May last year and the next national wage claim has been deferred until later this year. We have assumed a claim of 1.5% (based on the CPI increase from the March quarter 1991 to the June quarter 1992) and that it would be available from January next year. Average earnings are forecast to rise by 3.5% in 1991–92 and by 3.7% in 1992–93 (see **Table 1**).

If the Superannuation Guarantee Levy is deferred for six months to 1 January 1993 — as seems increasingly likely — average earnings growth in 1992–93 would be just 3.1%.

The outlook for wages suggests very low inflation will be maintained in Australia in 1992–93. Moreover, there are three reasons to expect the continuation of low inflation into the mid-1990s:

- first, the commitment of the ACTU to low inflation as illustrated by the Secretary of ACTU, Bill Kelty in May this year:

  'The real issue as we see it, is we've got to be competitive against the rest of the world. We've got to ensure that our rates of inflation are not going to be above the rest of the world'.

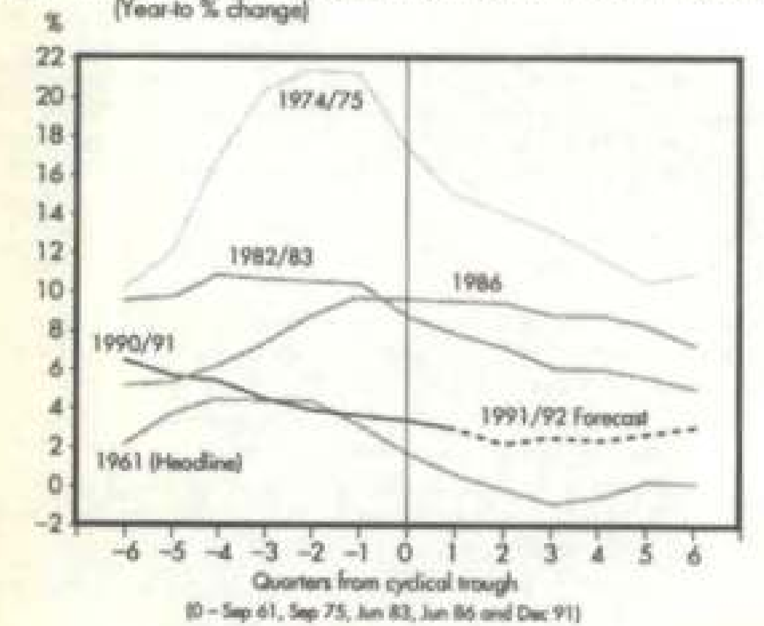
- second, underlying inflation does not rise in recoveries due to cyclical

Table 1: **Average earnings** (national accounts basis)

	1991–92				1992–93			
	Sep*	Dec*	Mar*	Jun	Sep	Dec	Mar	Jun
Award increases								
– May 1991 NWC	0.2	1.2	0.5	0.2				
– Jan 1993 NWC							0.2	0.5
enterprise bargaining					0.2	0.4	0.4	0.3
supplementary payments	0.1	0.1	0.1	0.1		0.1		
drift/balance item	1.9	0.1						0.2
superannuation					0.85		0.3	
Average earnings								
– quarterly	2.2	1.4	0.6	0.3	1.1	0.5	0.9	1.0
– annual	**3.0**	**3.5**	**3.0**	**4.6**	**3.5**	**2.5**	**2.8**	**3.5**

* Actual

Figure 10: **Underlying inflation in previous and current cycles**
(Year-to % change)



productivity gains which offset the tendency to expand margins (see **Figure 10**).

- third, the sharp fall in inflation expectations during the recession — largely because there was no wages breakout to boost inflation before the recession (**Figure 11**).

Annual headline inflation is expected to remain around 1-1.5 % for the rest of this calendar year. In the first half of 1993, headline inflation is expected to converge with the underlying rate at between 3 and 3.5% as the one-off influences of lower mortgage interest charges washes out of the annual calculation (see **Table 2**).

Fiscal Policy

The initial stimulus from the *One Nation* fiscal package came via the February cut in the sales tax on new cars plus the April one-off family allowance payment worth over $300m. The bulk of the stimulus is in 1992-93.

The May *Review* of the 1991-92 Budget estimates revealed a further significant deterioration in the Commonwealth's Budget position. The Budget deficit estimate for 1991-92 was revised up to $9.3b from $6.8b at the time of the *One Nation Statement*. The starting point deficit for 1992-93 was correspondingly increased to $10.5b from $8b.

The deterioration in the Budget reflects lower revenue collections as a

Table 2: **Inflation and earnings forecasts**

	1992			1993		
	Mar*	Jun	Sep	Dec	Mar	Jun
Average earnings (national accounts)						
• Quarterly	0.6	0.3	1.1	0.5	0.9	1.0
• Annual	3.0	4.6	3.5	2.5	2.8	3.5
Headline CPI						
• Quarterly	0.0	-0.1	0.6	0.7	0.8	0.9
• Annual	1.7	1.4	1.4	1.2	2.0	2.9
Underlying CPI						
• Quarterly	0.4	0.4	0.8	0.9	0.7	0.8
• Annual	3.0	2.4	2.7	2.6	2.8	3.2

* Actual figures.

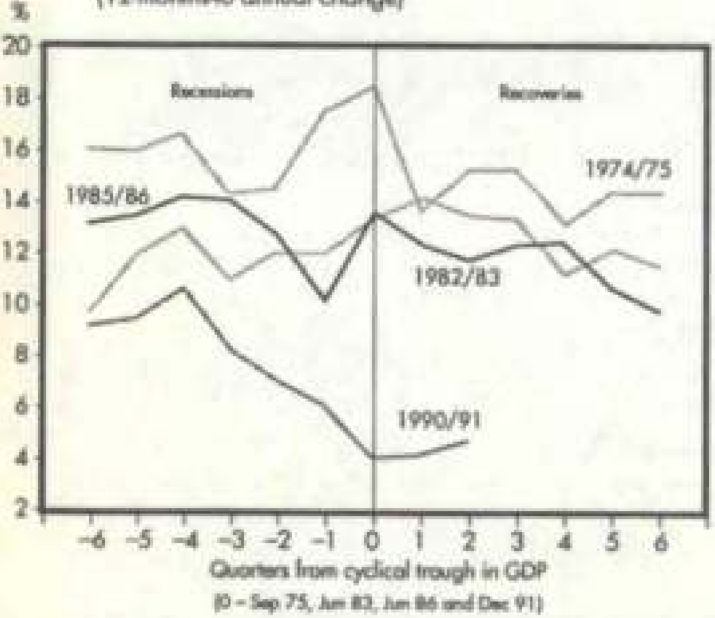
result of lower than expected income in 1990–91. The largest revision is to provisional tax collections which are estimated to be $1.55b lower in 1991–92 than at the time of *One Nation*, primarily due to an overestimation of revenue from the introduction of the tax file number ($0.7b), and downward revisions to income growth in 1990–91 in the December quarter national accounts ($0.55b). Other significant revisions reflect lower PAYE collections due to much slower wages growth ($0.36b) and lower company tax collections ($0.58b).

The Budget deficit is now estimated to be 2.4% of GDP in 1991–92 and 2.5% of GDP in 1992–93 (see **Figure 12**).

The government reiterated its commitment to a surplus in 1995–96. At the time of *One Nation*, the surplus in 1995–96 was estimated to be $2b. The May Review did not include revised forecasts for the out-years 1993–94 to 1995–96 but it is likely that the Budget is now forecast to be marginally in deficit in 1995–96.

This implies that the government has very limited flexibility in the 1992–93 Budget. The government must balance its political objectives with the discipline imposed by the financial markets. To meet the latter objective the government will need to minimise net new spending in 1992–93, bring the 1992–93 deficit down below $10b and present a credible

Figure 11: **Inflation expectations in previous and current cycles**
(12-months-to annual change)



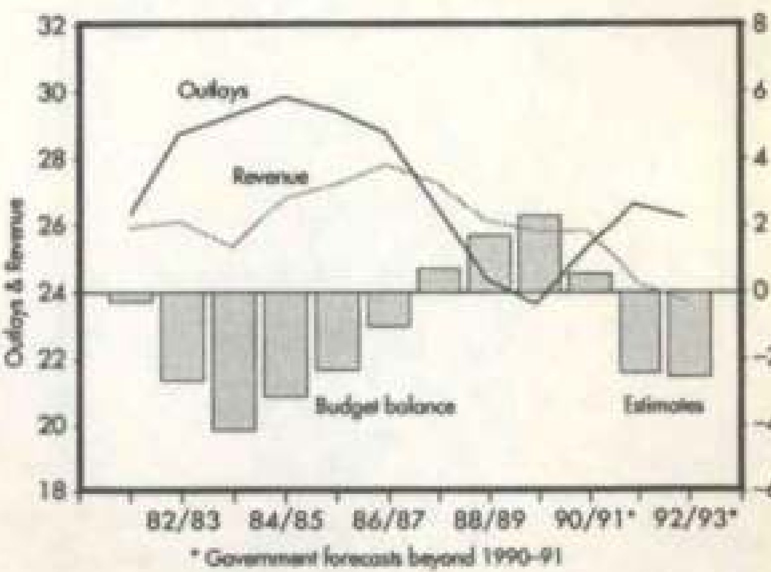
strategy for returning the Budget to surplus in 1995–96.

A deficit below $10b in 1992–93 is certainly achievable. Press reports indicate there is considerable fat in the starting point deficit. In addition, the privatisation of the merged Qantas–Australian will contribute about $1b to the 1992–93 Budget. The Prime Minister has indicated that this creates added flexibility for the 1992–93 Budget — the clear implication is that some of the proceeds from the privatisation will be spent. But it is likely that some of the new spending in the 1992–93 Budget will phase out by 1995–96. This would assist in bringing down an election Budget while still projecting a return to surplus by 1995–96.

The national wage claim, which is expected in August, will undoubtedly generate speculation of a wage/tax trade off. We consider this to be unlikely for three reasons:

- the cost to the Budget — particularly in 1995–96 would be considerable (perhaps around $2b).
- a trade-off does not make sense for a national wage rise which will not flow to much of the workforce who receive enterprise-based wage increases.
- a national wage rise is politically attractive (providing, of course, the IRC accedes to the claim) as the Coalition is proposing to abolish National Wage cases.

Figure 12: **Commonwealth budget aggregates** (% of GDP)



* Government forecasts beyond 1990–91

Nevertheless, a wage-tax trade-off cannot be ruled out — particularly if the June quarter CPI is better than expected, say –0.5%. This would imply a national wage claim of only 1%, which would be less costly for the Budget.

Access Economics expects the net PSBR to peak this year at 5.1% of GDP — well below the previous cyclical peak of 7% of GDP in 1983–84. Access expects the net PSBR (see **Figure 13**) to fall to 3.7% of GDP in 1992–93 reflecting:

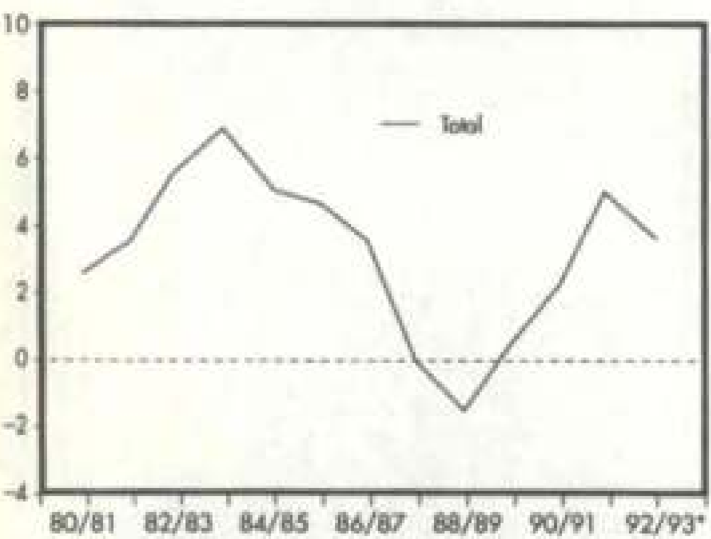
- some cyclical improvement in State Budgets;
- the proceeds of the GIO sale in NSW; and
- the distortion to the 1991–92 figure caused by the $1.7b SBSA bail-out.

At the time of the Budget, the government estimated both the total funding task and the gross bond issue programme to be $11b in 1991–92. With the deterioration in the Budget, the total funding task has increased to $15.5b and is expected to remain at around that level in 1992–93.

The **gross bond issue programme** has increased by less to just over $12b as some of the increased funding task has been met by a run-up in T-notes (see **Table 3**).

The increase in **net bond supply to the non-official sector** in 1991–92 is expected to be $4.3b. This figure would have been much higher in the

Figure 13: **Net public sector borrowing requirement**
(% GDP — negative denotes a surplus)



* Figures for 91/92 and 92/93 are 'Access Economics' forecasts

absence of the RBA's sterilisation of their foreign exchange intervention. In 1992-93, a larger budget deficit, and an assumption that foreign exchange intervention by the Reserve Bank will be much less, imply a much larger increase in net bond supply to the non-official sector of $9b.

Monetary Policy

Monetary policy was last eased on 6 May, with a cut in the official cash rate by 100 basis points to 6.5%. The easing followed the release of the

Table 3: **Bond selling task** ($b)

	1991-92	1992-93
Funds available		
Budget outcome	9.3	10.5
Less foreign currency deficit	-2.6	-2.8
Equals domestic budget outcome	6.7	7.7
Plus net RBA contribution		
– Profit	1.5	1.75
Interest on reserves	-0.4	-0.65
Equals domestic liquidity impact of budget	7.8	8.8
Plus RBA Forex Purchases		
{ – Fund forex deficit – Fund Commonwealth overseas loan repayments	2.9	2.9
– Forex intervention	-4.8	-1.0
Plus miscellaneous RBA transactions	0.3	0.3
Plus superannuation payments	1.0	1.0
Equals total funds available	7.2	12.0
Funds used		
(or changes in CGS on issue plus changes in notes and coin)		
Notes and coin	0.6	0.7
T-Notes	2.0	2.0
Net ASBs	0.2	0.2
Non-callable deposits	0.1	0.1
Net bonds	4.3	9.0
Equals total funds used	7.2	12.0
Net bonds	4.3	9.0
Plus maturities	4.6	2.9
Equals gross bonds to the non-official sector	8.9	11.9

lower-than-expected March quarter CPI on 29 April and a meeting of the Reserve Bank Board on 5 May. The decision also took into account the likelihood that the June quarter CPI will also be low.

A further easing in monetary policy in 1992 remains a strong possibility. Continued evidence of low inflationary pressures and falling inflationary expectations remain the major consideration for the central bank. The outlook for activity or the current account is not a constraint at this point. Although the housing sector is clearly recovering, it is a long way from overheating. Moreover, prospects for business confidence and investment remain, at best, subdued.

Declines in overseas interest rates would provide further scope for a Reserve Bank easing. The domestic bond market has become more accepting of the low inflation scenario and this has underpinned the recent stability of the Australian dollar. We look for a 100 basis point cut in the official cash rate in early August or September, but cannot rule out a smaller cut, or an earlier one.

Since 23 January 1990, overnight cash rates have been reduced on eleven occasions as illustrated in **Table 4**.

Table 5 illustrates Bankers Trust economic forecasts for 1991–92 and 1992–93.

Table 4: **Reductions in overnight cash rates** 1990-92

	Reduction (% points)
23 January 1990	1
15 February 1990	.5
4 April 1990	1.5
2 August 1990	1
15 October 1990	1
18 December 1990	1
4 April 1991	.5
16 May 1991	1
3 September 1991	1
6 November 1991	1
8 January 1992	1
6 May 1992	1
8 July	0.75

Table 5: **Economic forecasts** (% change unless stated)

	BANKERS TRUST	
	(1991–92)	(1992–93)
Real GDP (A) *	0.4	3.5
Private consumption	2.1	2.5
Private fixed investment	–9.5	7.0
GNE	–0.8	3.9
Net exports (contribution)	0.9	–0.4
CPI **	1.4	2.9
Average earnings *	3.5	3.1
Unemployment rate *	10.4	10.5
Employment *	–1.6	1.4
Current account deficit *	$11.5b (3.1% GDP)	$12.0b (3.0% GDP)
90 day bank bills ***	6.2	5.0-6.0
10 year bonds ***	8.8	8.25–9.25
TWI ***	55.2	55.0

* Period average
** Through the year
*** End period

Notes

1 GDP (A) is an average of income, expenditure and production methods of measuring GDP.

2 GDP (E) is an expenditure measure of GDP.

3 GDP (P) is production measure of GDP.

3

THE OPERATION OF MONETARY POLICY

DR STEPHEN GRENVILLE

RESERVE BANK OF AUSTRALIA

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THE OPERATION OF MONETARY POLICY

DR STEPHEN GRENVILLE

The Reserve Bank has a number of functions. It is banker to the government; it prints the currency; it has an important prudential role — assisting in the smooth functioning of the financial system by helping to ensure the integrity of banks and the avoidance of system-wide crises.

In today's session, I'll be talking about one aspect of the Bank's operations: the connections between the instruments of monetary policy and the objectives.

The Reserve Bank Act requires the Bank to 'contribute to the stability of the currency, the maintenance of full employment and the economic prosperity and welfare of the people of Australia'. Leaving aside the very general requirement to contribute to the welfare of the people of Australia, the other two objectives — price stability and full employment — are the broad general instructions given to many central banks. These joint objectives mean that price stability is a very important goal but in pursuing this, we must take into account the effects that our actions have on output and employment. In the longer term, however, these twin objectives are not necessarily contradictory since stable and low inflation boosts real economic activity in the longer term.

Transmission

In a simple economy with no external sector, the principal channel through which monetary policy influences the price level and activity is by affecting the financial flows between borrowers and lenders. Some people in the economy spend more than their income — they are net borrowers: others in the economy are net lenders. Monetary policy can influence the cost of borrowing (ie. the interest rate) or — in the old regulated financial system — it could directly restrict these flows, through credit ceilings on bank lending. If the price or quantity of financial flows alters, then people alter their behaviour. Investors may find that a project which was profitable at one rate of interest is no longer profitable at a higher rate of interest, and so they will not proceed with the investment.

As background to this, I should spell out how the Reserve Bank's actions affect the transmission channel. We can summarise this using two simple balance sheets — one for the central bank and one representing the commercial banks taken together (see Figure 1). The balance sheets are greatly simplified. In the central bank balance sheet, the only liabilities shown are currency (banknotes held by the public) and banks' reserves: together, these comprise base money (also known as reserve money or

Figure 1: **Financial balance sheets**

Reserve Bank		Commercial Banks	
Assets	Liabilities	Assets	Liabilities
• Foreign Exchange Reserves • Government Securities – Budget – OMO	• Base Money – Banks' Reserves – Currency	• Loans • Banks' Reserves	• Deposits

primary liquidity). On the asset side of the central bank balance sheet, we have the factors affecting base money. First, foreign exchange reserves. To the extent that the Reserve Bank has bought foreign currency in the foreign exchange market, it has paid for this foreign exchange by giving $A currency to the seller, thus creating base money. The central bank also has government securities (bonds or Treasury notes) as part of its asset portfolio: these were either obtained in the course of open market operations (OMO) or were a legacy of the time, before 1982, when the government was running budget deficits and was not funding the deficit by selling government securities to the public.

The simplified commercial bank balance sheet shown here has credit (ie. loans given by the banks) as the principal asset of the banks. They also hold reserves. Deposits are their sole liability.

The textbook model of money creation will be familiar to you. Open market operations (where the Reserve Bank, for example, sells bonds, thus reducing the volume of base money) remove base money from the system. This leaves the banks short of required reserves, so they are forced to contract their balance sheets. In this textbook credit multiplier process, the required reserves are the basic building block of the commercial banks' balance sheets, because the banks are required to hold a minimum ratio between reserves and deposits. With fewer reserves, this forces the commercial banks to contract the size of their balance sheets. In the process, interest rates are bid up and deposits (the major component of M3) contract. The sequence here is:

OMO —> Bank reserves —> Deposits (M3) —> Supply of Credit/Interest Rates

An alternative view, and one we tend to hold in the Reserve Bank, is that our open market operations influence the rates of interest directly. Our market operations affect the rate of interest at the very short end of the yield curve — the 'cash' rate. This, in turn, is the basic building block of the yield curve, so that when we influence cash rates, other rates at the short end of the yield curve are affected also. If our open market operations bid up interest rates, this makes it more expensive for people to borrow and so some expenditure is delayed or abandoned. This is reflected in the banks' balance sheets by a decline in the demand for bank credit. The banks then need fewer deposits to fund their lending and this is then reflected in deposits (ie. in the monetary aggregates). The sequence here is:

OMO —> Interest rates —> Demand for credit —> Deposits (M3)

I can't resolve this issue here. In our view of the process, you are not very concerned with money formation tables, reserve requirements or the credit multiplier process: you are more concerned with the interest-elasticity of the demand for credit, because that is the critical link between the RBA's actions and economic activity. We see ourselves as not controlling money supply directly, but rather setting a rate of interest and then supplying whatever base money the system demands at that level of interest rate and nominal income level. We see the monetary aggregates as being an endogenous outcome of the setting of policy and the state of the economy, so our influence is not direct, via base money, but indirect, via the influence of interest rates on output (and hence on the demand for money). But the important point, for the present discussion, is that in either case the authorities do have the ability to influence interest rates, the quantity of lending, and the various components of the financial system's balance sheet which go to make up the different monetary aggregates. Any differences of view here relate to how this influence operates and the sequence and exactness of the authorities' control.

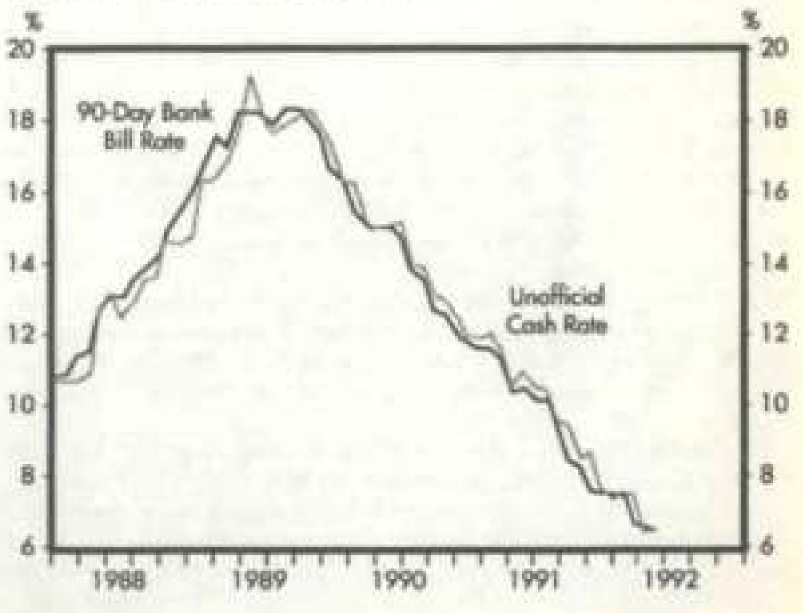
The Mechanics

To describe in detail how the Reserve Bank influences interest rates would be a lecture in itself. It's enough here to say that in the old days before deregulation, monetary policy operated largely through constraining the balance sheets of the banks, over which the Federal government has constitutional power, by direct controls. These controls, however, provided an incentive for the establishment of financial institutions which were outside the direct control of the Federal authorities, and for recourse by borrowers to non-intermediated funds. Over time, these forces were such that it was no longer enough for policy to constrain the balance sheets of the banks. It was also inequitable to constrain just one segment of the financial sector. The essence of the deregulated system was that, rather than constrain the growth of financial intermediation in one particular group of financial intermediaries (working from the supply side), financial intermediation would be influenced by altering the price at which borrowers and lenders would do business. This would clearly impinge not only on the transactions done by banks, but the transactions done by non-banks and even the price at which direct finance — where the borrower and lender meet directly — would be done.

To give a simple synopsis of this other lecture, let me just say that the Reserve Bank, through its open market operations, can influence the very short end of the yield curve — the so-called 'cash' rate — and that this cash rate is the building-block on which the short-term end of the yield curve is constructed. The Reserve Bank has the capability of setting this interest rate, within limits, more or less where it wants to (see **Figure 2**).

The critical question for policy is to know just where to set this operational objective of the short-term interest rate: how to judge whether the short-term interest rate is too high, too low, or just about right. It is this issue that we turn to now.

Figure 2: **Cash rate and bill rate**



Judging the Setting of Policy

It may be helpful to summarise the operation of policy in the conventional 'operating instrument — intermediate objective — final objective' framework. The Bank's ultimate policy objective is some level of nominal output or, more specifically, the level of prices and real activity. Information on inflation and activity, however is only available with a considerable lag. If monetary policy were based on what was actually occurring four months ago rather than at present, then policy may be counter-productive. Therefore, in setting the operating instrument of policy — cash rates — is there some intermediate target which basically proxies the ultimate target? For such an intermediate target to be of use, it must possess the following characteristics:

- that it be timely;
- that it be under the control of the authorities;
- that it be closely connected to the final objectives of policy.

This section might have the sub-heading 'The search for an intermediate target'. This problem of finding the appropriate intermediate target has plagued a number of central banks. While this may give the story away at the start, the search has not been successful and there has been a tendency to try to use the operating instrument to influence the final objective directly, but monitoring progress by continually checking various critical indicators of policy.

Short-term nominal interest rates are, as I have noted, closely influenced by the authorities. However, we know that we cannot judge, simply by looking at the nominal interest rate, whether monetary policy is too tight, too loose, or just about right. For one thing, the nominal interest rate would not give a firm anchor for prices. A high nominal interest rate might sound like tight policy, but if this were to be accompanied by a high rate of inflation, it would not constrain the economy very much at all. So we cannot use the level of the nominal interest rate to tell us whether monetary policy is in the right setting.

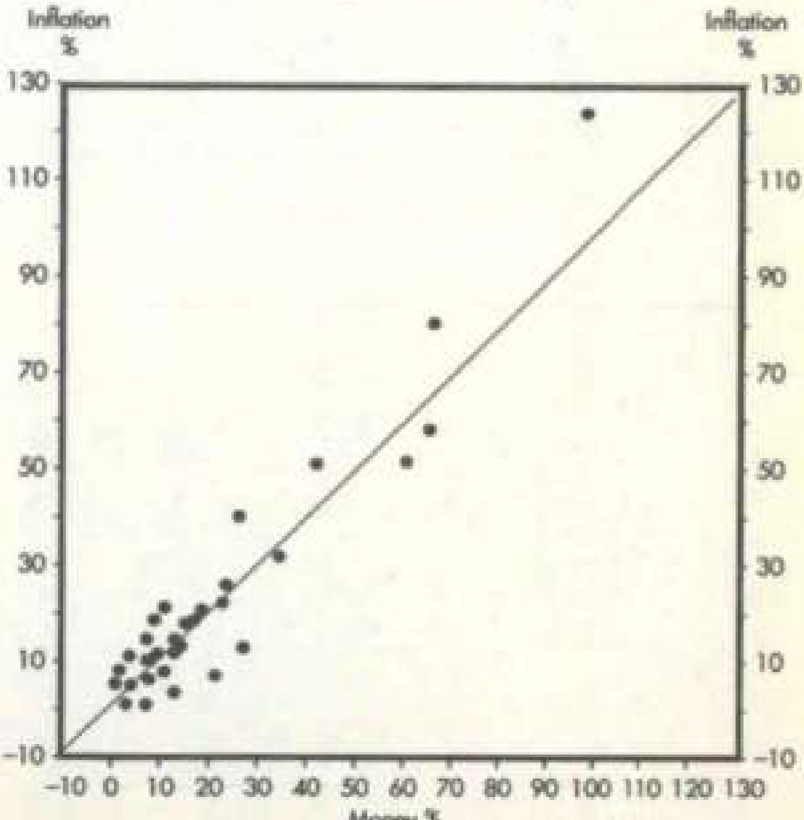
Historically, central banks have been attracted to the idea of using some form of monetary aggregate as the central measure of the stance of policy. This has a few obvious attractions. Firstly, the monetary aggregates are, at least to some degree, under the control of the monetary authorities.

But the much more compelling reason is in the long-term historical relationships between money, prices and real income.

Let's look, for a moment, at the relationship between these three variables which join together one thing (money) that central banks can have some influence over and the two things which they have some interest in influencing — prices and real income.

Before looking at Australia, we can draw some very general conclusions from overseas. Figure 3 shows, for 20 or 30 different countries, the relationship between increases in the money supply and increases in prices. It used to be said that inflation was 'too much money chasing too *few goods*': in other words, if the money supply increased, this would be reflected in price increases. Figure 3 would give some general support to this view. What seems clear is that when money supply increases substantially (say, by 100 per cent) then you will get a lot of inflation (close to 100 per cent). If this relationship was perfect, we would expect to see all the dots lying along a 45 degree line on this graph. More or less, they do.

Figure 3: **Inflation rate and growth in money**, 1979 to 1984

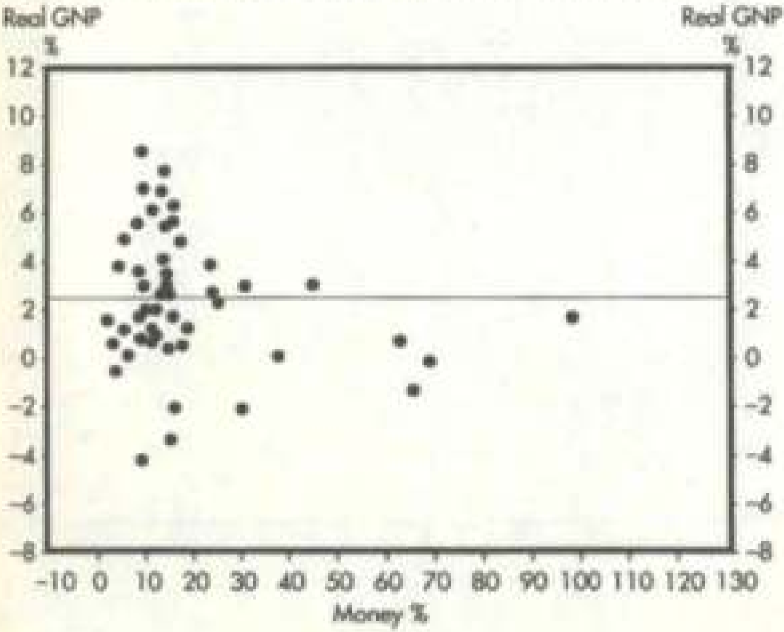


What effect do increases in money have on real income? **Figure 4** shows the relationship between increases in money supply and increases in real income for the same 20 or 30 countries. In the long run, increases in real income are determined by the real resource endowment of an economy and how well these resources are used. Increases in real income will come from such things as population increase, productivity increases or increases in the stock of capital. In this view, an increase in the money supply does not have any effect on the productive capacity of the economy, and so would not have any impact on real income. If this is so, we would expect to find the relationship between increases in money supply and increases in real income to be a horizontal straight line lying at about the level of the growth in capacity of the economy. When we look at **Figure 4**, that, too, is more or less true. What is very clear is that if there are large increases in money supply, it does not give you large increases in real income.

So where does that leave us? Large increases in money supply give rise to large increases in prices but do not give rise to large increases in real income.

If this relationship were precisely true (even for small changes in money supply), then the task of monetary policy would be relatively

Figure 4: **Growth in real GNP and growth in money**, 1979 to 1984



simple. We could adjust the money supply so as to achieve price stability, knowing that we would not have any effect on real income or output. In this view of the world (where money is 'neutral'), the monetary authorities could concentrate on the price stability objective and leave other instruments to achieve the income or unemployment objective. But it is clear that in practice the economy responds to a moderate change in the money supply through changes in *both* prices and output. How much of each occurs will depend on the exact circumstances of the time and how much spare capacity there is, and so on. Money is not neutral in the short term.

In practice, there is a fair amount of 'slippage' in the velocity of circulation. It may be true that large increases of money supply have most of their impact on prices, but the relationship for smaller changes in money supply in the short run is not so clear cut. An increase in money does not give rise to an exactly equal proportional increase in prices. The productive capacity of the economy may be the constraint on growth over the long term; but in the short term, the economy 'cycles' around this trend growth of productive capacity, sometimes being overheated and sometimes being in recession. So within the cycle, money may have some impact on the course of real income growth.

With inflation a common experience right round the world in the early 1970s, and this usually associated with rapid growth of money supply, it is not surprising that attention turned to the possibility of controlling prices through control of the money supply.

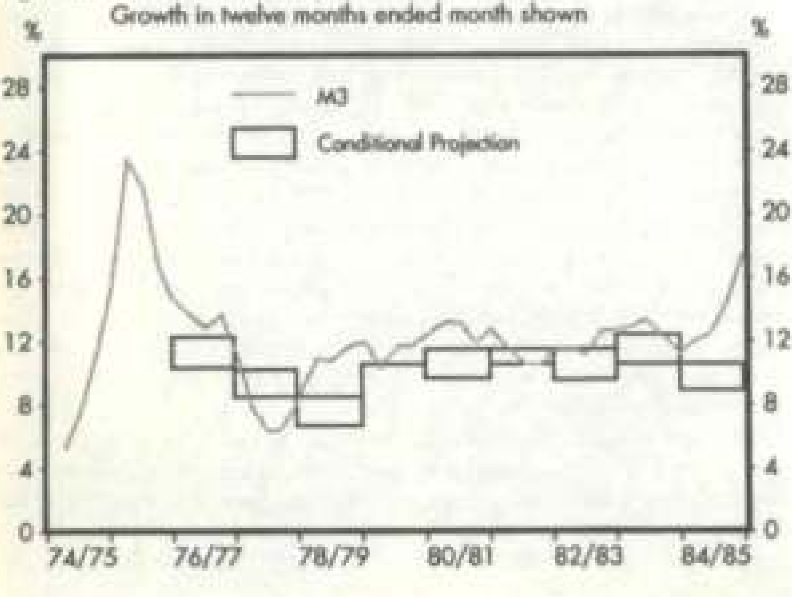
Like a number of countries, Australia adopted a form of **monetary targeting** in the mid 1970s and maintained this until the mid 1980s. It seems to me that we didn't have a very rigid view about this. (This was emphasised in the words chosen to describe it — it wasn't a 'target' — it was a 'conditional projection'.) We accepted that there may not have been a very precise short-term relationship between money and prices. We may have believed in the general notion that inflation was, in the longer term, a monetary phenomenon. More important, we believed that this kind of targeting could provide some discipline on a system which had shown itself to be inflation-prone. It could also provide a degree of accountability — a way of evaluating whether monetary policy had done its job. It was also very important in anchoring price expectations. By the 1970s, most people saw expectations as being a very important element in the inflationary process.

The operational question was to decide on the appropriate rate of growth for the chosen aggregate — M3. In the early years of targeting, the target was set so as to put some downward pressure on prices, but not so much as to imply an unacceptable level of unemployment. Deregulation complicated matters, with the entry of new banks significantly distorting the relationships between monetary aggregates, economic activity and prices. By early 1985 it was clear that the M3 aggregate was giving very misleading signals on the stance of monetary policy, and targeting was suspended (see Figure 5). Since then, we have seen no reason to resume it. Recent experience has continued to demonstrate the instability of M3 and other monetary aggregates, with the various aggregates often moving in quite different directions.

Let's look at this in more detail. Using monetary aggregates as intermediate targets presents problems both in the short and medium term:

- in the short run, the margin of error — or variability — in the money demand function is sufficiently large so as to prevent the authorities from knowing if they are 'off track' or not. For example, the Bank's most recent published estimate of the money demand function (Blundell-Wignall and Thorpe, 1987) has satisfactory statistical properties but a root mean square error of 1.4 per cent. This defines the margin for error around the quarterly growth rate of M3. If we were aiming for, say, 3 per cent growth in a quarter and observed actual growth of 5 per cent, we wouldn't know if this was just a normal variation or whether we were 'off track'. By the time enough evidence has accumulated to answer this question, getting back on track again would be a traumatic process;

Figure 5: **Volume of money**
Growth in twelve months ended month shown



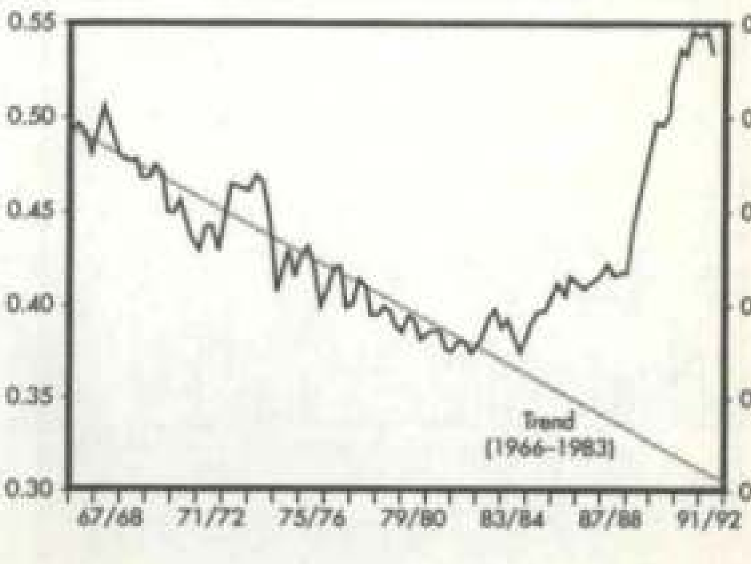
- suppose the authorities stuck to their target growth rates, never allowing any 'base drift' (i.e. the shortfall of one year's target has to be made up the following year). Will the money demand function, despite the short-term variance, provide a long-term anchor? **Figure 6** helps answer this. If the M3/GDP ratio had continued to fall in the 1980s as it did in the preceding two decades, it would have been 0.31 by March 1992. It was, in fact, 0.53, which is 70 per cent (or more than four standard deviations) away from its trend level. The problem is not in fine tuning, but in the anchor itself.

Why has it been so difficult to find stability in the aggregates over the past few years? The entry of new banks (many of them building societies who simply transferred their balance sheets *in toto* into the new bank, so that their deposits boosted M3) clearly pushed up M3 in 1985 (see **Figure 7**). Even earlier, deregulation had allowed banks to compete more vigorously, so that M3 had expanded quite quickly.

The M3 target was suspended in early 1985, because the authorities recognised that it was not a useful guide to the setting of policy. But let's follow the chronology of M3 a little further to see how it behaved in the post-target period.

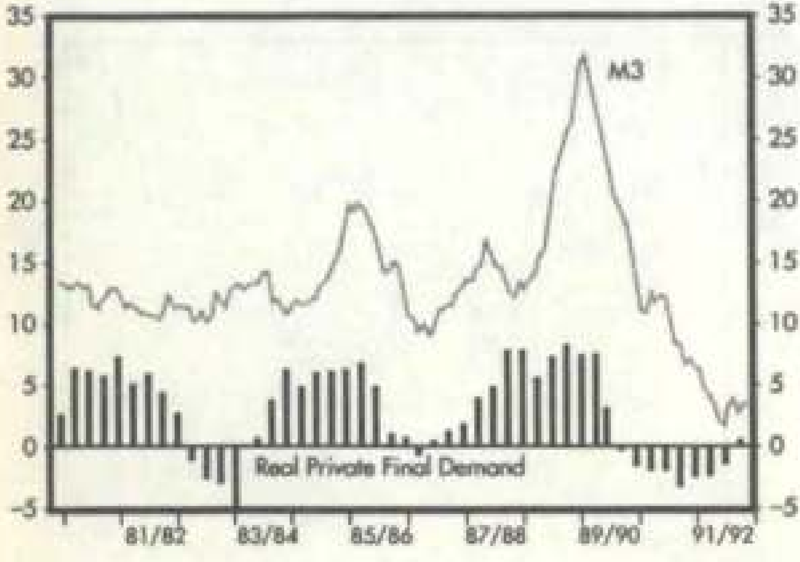
The banks' entry to the short-term money market in 1984 allowed them to compete for funding, thus boosting M3 (see Battellino and McMillan, 1989). The impact of deregulation on M3 was not always in the one

Figure 6: **Ratio of M3 to GDP**



direction — sometimes deregulation restrained monetary growth. By 1986, M3 growth slowed: it is clear in retrospect that during this period banks focused more clearly on the implicit tax of the SRDs (the banks received a less-than-market rate of interest on these deposits). In response to this (and perhaps because of other institutional changes) they turned to other forms of balance-sheet funding (overseas borrowings and increases in capital). More importantly, much of the focus of new intermediation shifted into the bank bill[1] market which grew very rapidly — to exceed $60 billion or the equivalent of nearly half of M3 at the time. So a big part of the action which had previously been on banks' balance sheets now went through the bank bill market. As a result, the growth of the M3 component of banks' balance sheets was slower than the total intermediation of the system. This is clearer with hindsight than it was at the time: since the SRD arrangements were changed in September 1988, there has been a substantial change in the banks' funding arrangements, which is perhaps the best measure of the earlier distortion. With the reduction in the implicit tax imposed by the SRD, banks have funded a much greater part of their lending by deposits, and as a result M3 grew very quickly indeed — by around 30 per cent in 1989 (See Figure 7) (See RBA *Bulletin*, November 1989). Since then, money growth has eased

Figure 7: **M3 & real private final demand**
12-month-ended percentage change



substantially, reflecting the reduced need to fund credit as the economy moved into recession.

The more effective monetary instruments which became available after 1983 seemed to promise the key to better and simpler monetary policy. It became possible, in concept at least, to control money supply. But the experience of the next couple of years showed that this was, in itself, not the answer to operating monetary policy. While M3 was, at least conceptually, under greater potential control by the authorities, the problem was that M3 did not seem to be closely related to the ultimate objectives, which one could see in terms of either a nominal income target or some combination of inflation and real output.

What other possible intermediate targets are there that have the dual characteristic of being reasonably under the control of the monetary authorities and having a simple, clear and well-defined relationship with the ultimate objectives?

An Alternative to M3 as Intermediate Target?

There clearly are other variables which give some clues as to the stance of monetary policy. But do they provide a realistic guide for policy?

Other financial aggregates. Could a different monetary aggregate, other than M3, serve as an intermediate target? One of the reasons for the instability of M3 was the shuffling-around of banks' balance sheets which occurred during the 1980s. This encouraged the Bank to look at wider and wider aggregates in the hope of netting out the effects of these inter-institutional changes. Hence the interest in **broad money** at the time when building societies were becoming banks (**Figure 8**). However, broad money does not include the bill market and so misses the important changes there. Hence, the attention given to **credit** (**Figure 9**) — the widest of aggregates, including the whole of the balance sheets of the formal financial sector. Even this widest of aggregates seems to have been substantially influenced by various institutional changes which were occurring during the 1980s — it grew by well over 20 per cent a year for more than five years, in a period when some progress was being made in reducing inflation and the nominal income aggregates were in fact growing less rapidly than in the previous five years (see **Figure 10**) (For more discussion, see MacFarlane, 1989).

Credit growth slowed quite markedly in 1989. At the time, the traditional monetary aggregates — M3 and broad money — were still growing at an accelerating and extraordinarily rapid pace, while both the narrow and wide aggregates (currency, M1 and credit) were decelerating, to grow at around the same pace as nominal income, or slower. In 1989, it

Figure 8: **M3 & broad money**
12-month-ended percentage change

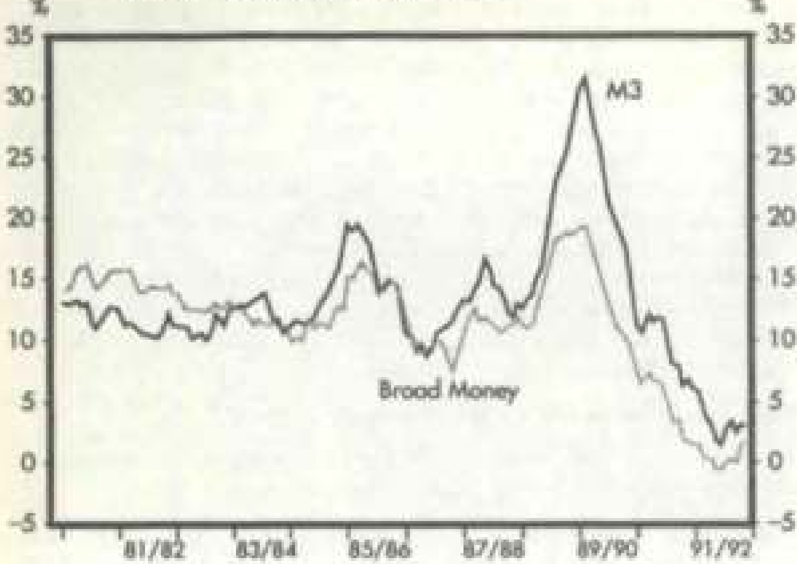


Figure 9: **M3, broad money & credit**
12-month-ended percentage change

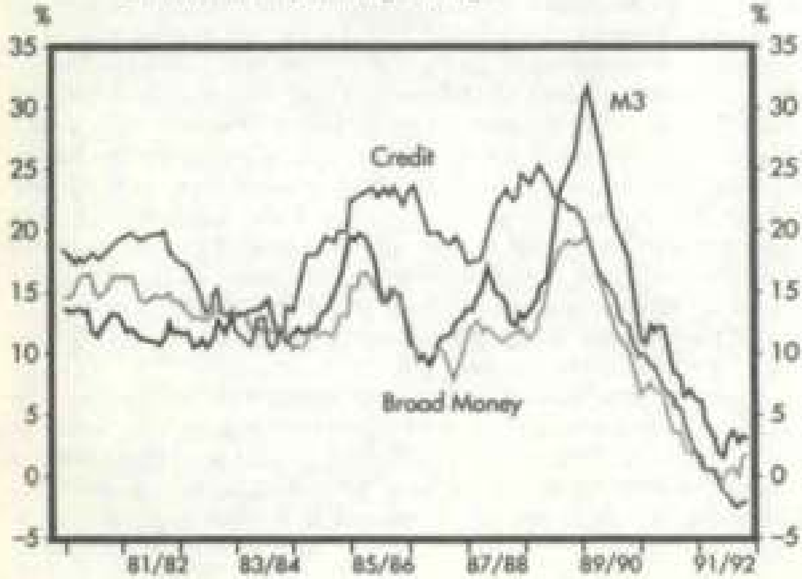
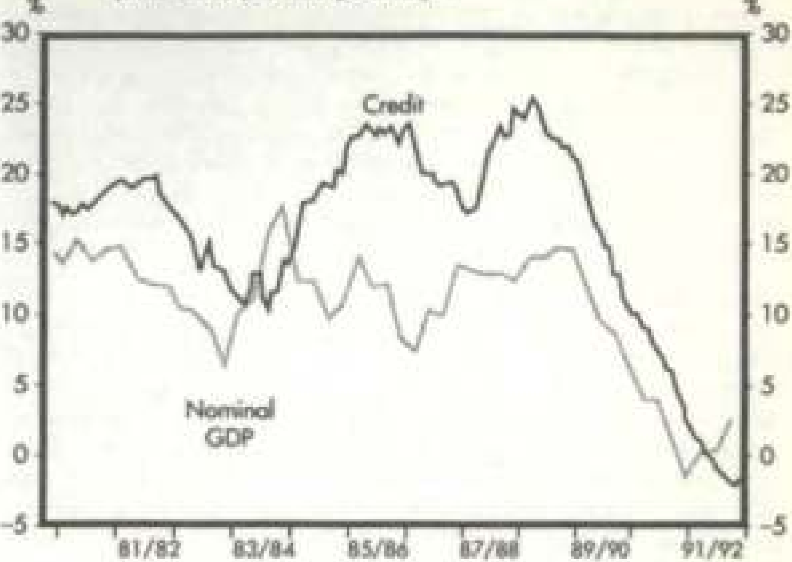


Figure 10: **Credit and nominal GDP**
year-ended percentage change



would have been very difficult to know which aggregate was giving any useful guidance. In the most recent data, all aggregates are growing at a more modest pace.

Where do we stand on all this now? We have focused much more on credit. This is perhaps an unsurprising result of deregulation. The idea that there was one single concept of 'money' on which the whole of the economy and the price level would depend certainly doesn't make much sense in a deregulated world where finance is supplied by a variety of institutions and a number of different means of payment are available. The focus on credit is also consistent with the use of the cash rate as the operating instrument: changes in interest rates induce changes to loanable funds and nominal activity. It is not surprising that we have gone further in the direction of seeing credit as the important aggregate, as it is a measure of the *overall* financial intermediation in the total financial sector.

There are, however, a number of problems with credit. The first, and this is a problem with all financial aggregates, is that the credit figures exhibit considerable month-to-month, even quarter-to-quarter, variability such that they may be difficult to interpret at any particular point in time. Furthermore, definitional changes and statistical breaks are common. One recent difficulty has been that the credit figures reported by banks are net of write-offs and specific provisions; these have increased in recent years and so have lowered the 'book' value of credit. **Second**, the relationship between credit and activity appears to have fundamentally changed twice over the past decade, as **Figure 11** shows. It is difficult to distinguish changes in credit due to changed behaviour in the demand or supply of credit itself and changes which reflect underlying economic conditions. **Third**, as shown in **Figure 12**, credit has often lagged economic activity and so it would not have been a useful, timely guide to policy. The location of credit in the current cycle has also varied, with credit leading the recession but appearing to lag the recovery. This underscores the unreliability of credit as an intermediate target.

Interest rates. Interest rates are a possible candidate for guiding monetary policy. Their deficiency as an intermediate target is apparent when we look at the imprecise relationship between interest rates and final objectives such as nominal income or prices. Whatever variant is used — nominal interest rates, real interest rates or the shape of the yield curve — they have neither the simplicity nor the precision required of an intermediate target. The experience of 1988/89 shows that interest rates can be raised very substantially without any quick impact on activity (see **Figures 13 & 14**). There are three other problems with using interest rates to guide policy. The first is that interest rates are a 'high profile' variable which is hard to move upwards when this becomes necessary — no-one, it seems, likes high interest rates. So there is a danger that they become stuck at an inappropriate level. There is another problem if we, literally and exactly, targeted a particular level of nominal interest. This presents a danger that the text-books call 'dynamic instability'. Let me spell it out. If the economy was hit by an inflationary shock, this would lower the real rate of interest, encourage more expenditure, and make the inflation shock worse.

In practice this is not a serious problem because no-one has suggested that we should target a particular nominal interest rate without regard for what else was happening in the economy. But it is one more reason why targeting interest rates in a precise way would not be a satisfactory answer. The third problem is that it may be misleading to interpret the operating instrument of policy as an intermediate target of policy.

All that said, there is a lot of information in interest rates which is obviously important in assessing the stance of monetary policy. One useful measure of the stance of policy might be the shape of the yield curve — whether it is 'inverse' or 'normal', that is, positively sloped. **Figure 15** shows the 'normal' curve at January 1988 and the shape of the curve in July 1989, after policy had operated to shift the short end of the

Figure 11: **Ratio of credit to GDP**

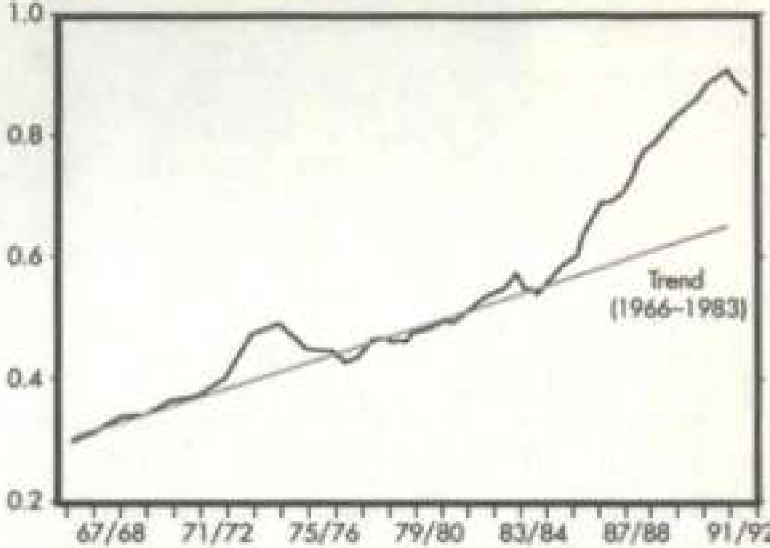


Figure 12: **Credit & real private final demand**
12-month-ended percentage change

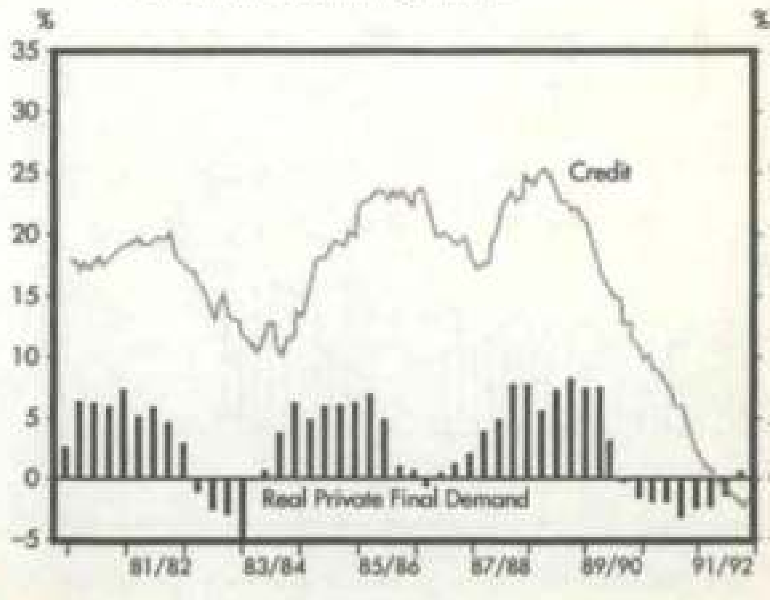


Figure 13: **Prime rate & real private final demand**

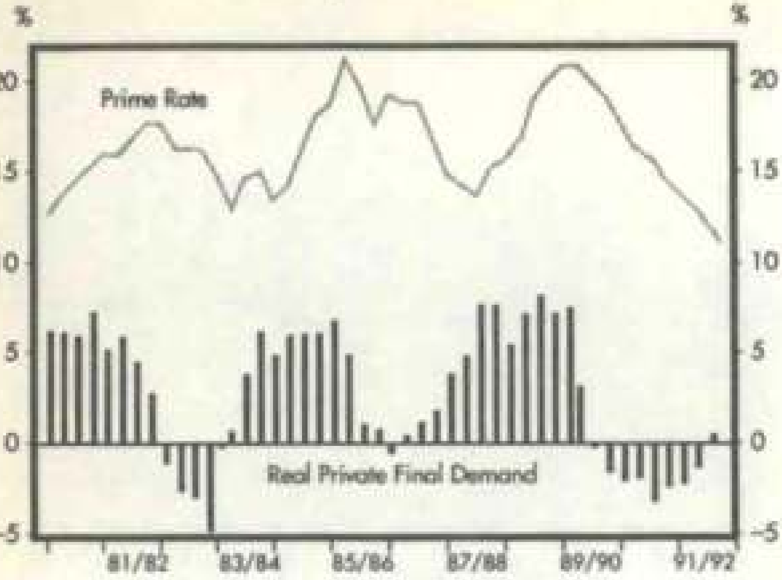
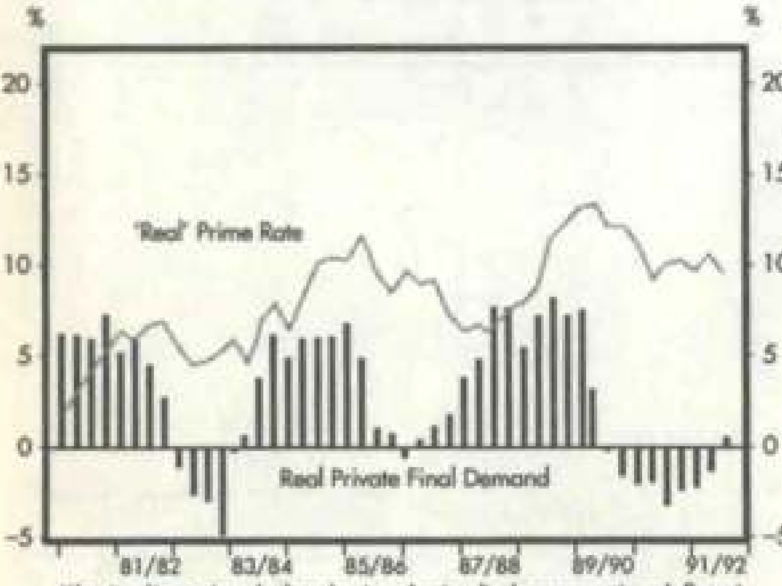
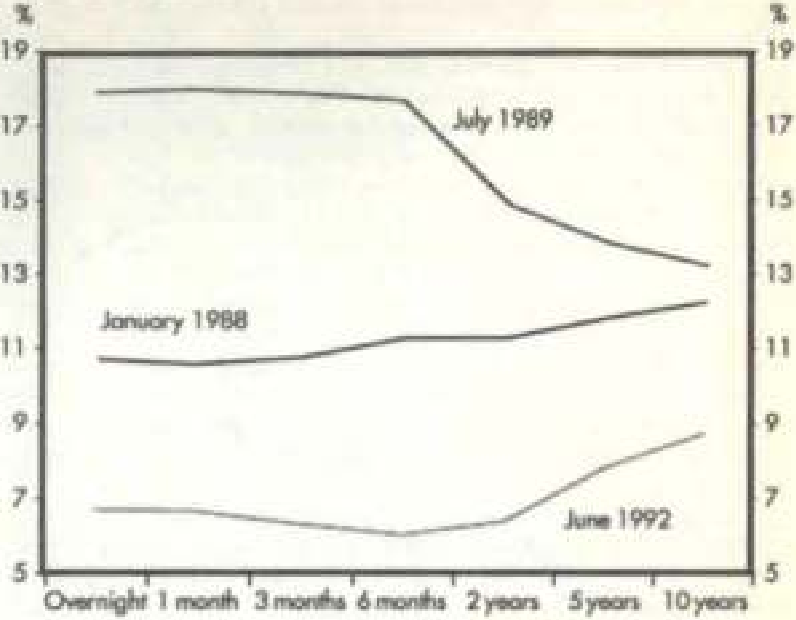


Figure 14: **'Real' prime rate & real private final demand**



(The 'real' rate is calculated using the implied consumption deflator)

Figure 15: **Yield curve**



curve upwards. But other things may also influence the shape of the yield curve, such as changes in liquidity in the various financial markets, so it is not an unfailing guide.

The exchange rate. Is the exchange rate a suitable intermediate target? In the days of the fixed exchange rate, maintenance of the external value of the currency provided a simple goal for monetary policy. When foreign exchange reserves were falling, policy was tightened; when reserves were rising, policy was eased (and of course this tended to happen automatically through the influence of foreign exchange reserves on money formation). I might note in passing that this simple rule is relevant to the EMS currencies.

Is there an equivalent to this in a floating-rate world? When the exchange rate is under upward pressure, this might be a signal to ease monetary policy. However, monetary policy is by no means the only influence on exchange rates. For example, the experience of 1987 shows the importance of the terms of trade. There is too much ambiguity in the links between money and the exchange rate, and between the exchange rate and the ultimate targets, for this to be a satisfactory intermediate target.

While I'm talking about exchange rates, I should divert for a moment to talk about the exchange rate as a transmission mechanism of monetary policy.

When I talked about the transmission of monetary policy via interest rates, I was specifically talking about an economy with no external sector. So I should say something about another possible channel of monetary policy transmission — via the exchange rate.

One side effect of higher interest rates is to raise the exchange rate. This forms a further channel of transmission of monetary policy to activity. The textbooks (and common sense) say that when the interest rate rises, the exchange rate will appreciate. When tight monetary policy is used to slow an overheated economy, the effect of higher interest rates on the exchange rate causes relative prices to switch to make imports cheaper in terms of Australian dollars, thus causing some domestic demand to 'spill' overseas. The exchange rate rise also makes it less profitable to export, so some of this production adds to domestic supply. This makes the current account worse but buffers the domestic economy from inflationary pressures.

This mechanism has been particularly important for Australia, because a number of times our inflationary problems have been caused by external shocks in the form of an improvement in the terms of trade which has inflated incomes and set off a boom in demand. With a floating exchange rate, an improvement in the terms of trade will tend to push up the exchange rate, redistributing the benefits of the terms of trade improvement, and, more importantly, introducing a larger volume of well-priced imports which will tend to combat inflationary pressures and absorb the extra demand coming from higher incomes, augmented by terms of trade improvements.

Movements in the exchange rate may directly affect the final objectives of price stability and income. For example, a fall in the exchange rate may exert upward pressure on prices and this must be taken into consideration in the setting of cash rates. At the same time, the intermediate objective must not subvert the ultimate objective. The aim is price stability, not a fixed exchange rate. Furthermore, the central bank would be selling snake oil if it sought to use its one instrument to achieve 'desirable' outcomes in all economic variables.

Focus on Ultimate Target

In the absence of an obvious candidate for an intermediate target, the focus has shifted to the more complex links between operating instruments and the ultimate objectives — income and price stability.

It is difficult, in a day-by-day policy context, to focus exclusively or directly on the ultimate goals: the lags between policy application and its effect on inflation are too long (remember Milton Friedman's 'long and variable lags'?). So the immediate focus has to be on variables which impinge indirectly on inflation or which are indicators of future inflation — how fast is real demand growing ? What are the pressures in the labour market ? What is happening to price expectations ? To put it in its simplest form, a pre-condition for inflation control is an economy which is growing within its productive capacity: the first task of monetary policy is to constrain the growth of demand to ensure this.

It is in this context of assessing how fast demand is growing that the monetary aggregates may again prove useful — not as intermediate targets, but rather as information variables. (So the implied sequence is not: policy —> money —> activity, but rather policy —> activity —> money.) The aggregates may tell us how the overall economy is going. Rather than assume some strong direct relationship between money and prices, monetary policy is seen as influencing interest rates and the exchange rate and this in turn influences the level of demand which is important, over time, for inflation. Even in this non-monetarist world, monetary aggregates might still give us a measure of how demand is going. This is especially the case with the financial aggregates which are based on currency or on bank data since the central bank has very timely information on these. However, even in this lesser role, they have not proved very helpful. Not only have the monetary aggregates had an unstable relationship with income, but the one which seems least distorted by balance sheet churning — credit — has in earlier cycles lagged economic activity, greatly reducing its usefulness as an information variable. Perhaps there is a link between the recent experience of slowing credit and the slower activity we now see in the real economy. But with no past history of such a leading relationship, it is an uncertain basis for policy (see **Figure 12**).

Once the idea of a firm, consistent money/prices relationship is abandoned, perhaps the most difficult issue is the calibration of monetary policy. The relationship between the operational objective — interest rates — and the ultimate objectives — inflation or nominal income — is uncertain and probably not constant. Even the first link in the chain — from interest rates to demand — is imprecise. The textbook idea that when monetary policy is tightened a notch, activity slows, and when it is tightened two notches, the impact on activity is twice as great, finds no parallel in the real world. Experience would indicate that successive tightenings may have no discernible impact, until some critical threshold level is reached, where policy may have an impact out of proportion to the proximate change. Market perceptions seem critical — eg as to how long the stance of policy will be maintained — and such a nebulous concept is difficult to incorporate in the policy-planning process. We can see why this is so if we look at the principal transmission channel. We see interest rates as being important in decisions about whether to spend now or later. When interest rates go up, those who want to borrow for investment are less inclined to do so, cutting back on demand. The simplicity of this can come unstuck in various ways. Demand for credit may not be very interest elastic; or, more likely, the decision is dominated by things other than interest rates — examples include general feelings of optimism or pessimism about the economy and cash flows. On top of that, the intermediaries' own actions may influence the relationship between interest rates and credit. The borrowers who are included in the demand for credit are only those who have passed the intermediaries' test of credit-worthiness. The intermediaries' credit-worthiness filtering system may change over time, and may even change during the cycle, shifting the effective demand for credit. It is possible that, as the cycle turns down and the demand for credit diminishes, intermediaries make their credit-worthiness tests more stringent.

Does this mean that we have come *full-circle* on monetary policy, and that we have some rough-and-ready rule of thumb like:

> 'When economic activity is running too fast, tighten: when it is running too slowly, ease interest rates.'

I think we're a bit more sophisticated than that. We understand how important price expectations are in giving continuing momentum to inflation, even when economic activity is not excessive. We understand, too, the need for a medium-term objective of reducing inflation. There are substantial benefits from low and stable inflation, notably from renewed focus on productive investment and from cost competitiveness. The issue here, though, is the cost of bearing down on inflation.

The critical factor determining just how high this cost might be is credibility. The issue can be put in terms of the expectations-augmented Phillips curve. If the economy is at the 'natural' rate of unemployment, on the long-run vertical Phillips curve, it faces a short-term trade-off. If inflationary expectations could be changed by decree, the economy could be shifted down the long-run curve to achieve lower inflation with unchanged real activity. But if inflation expectations cannot be changed by government statement or decree, there may be a long, painful, slow grind of gradually wearing down inflation expectations by having the economy run at higher levels of unemployment. Is there some institutional or operational change that would quickly convince the market of our anti-inflation credentials and lower inflation expectations at a stroke?

Monetary targeting was once seen as a way of establishing instant credibility, but it seems doubtful that this particular soufflé can be made to rise a second time. The problem is that credibility cannot be created from thin air. Will a sufficiently strong announcement of the intention to 'fight inflation first' do the job? Even in the United Kingdom in the early 1980s, with a tough and determined Prime Minister, credibility was not quickly established. All the evidence since then would indicate that credibility can only be obtained by established performance.

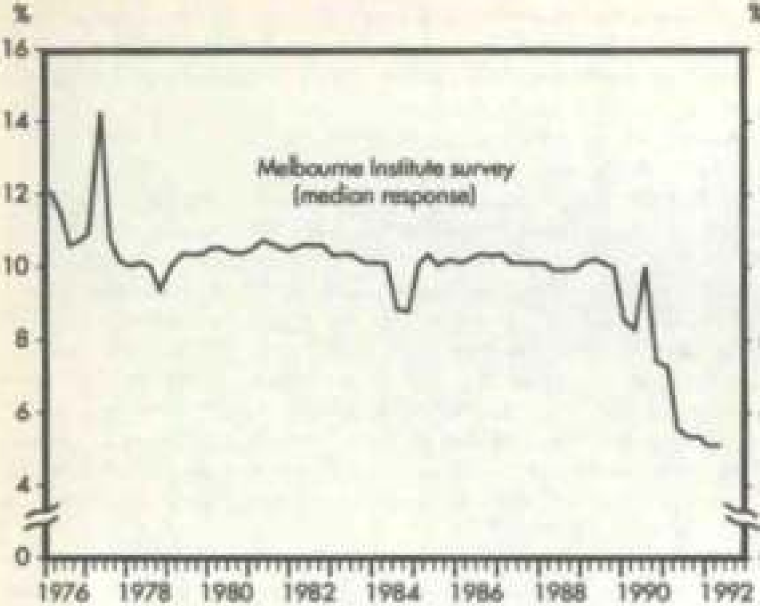
The fact that our principal focus is on the underlying trend of inflation does not, of course, mean that we simply keep interest rates high until the inflation objective has been achieved. Perhaps the recent experience is the best demonstration of our approach. Early in 1990, it was clear that the economy had come 'off the boil'. The very high interest rates which had been needed to rein-in the overheated economy of 1988 and 1989 were no longer necessary, as it was clear that the inflationary pressures of that time were abating. Between January 1990 and October 1990, we lowered short-term interest rates five times, by about 5 percentage points in all. In this period, there was no clear evidence that inflation was on the way down — the first significant sign of that came only with the release of the September quarter CPI in October.

How does this fit with our objective of getting inflation down? The answer here is that of course we also look at the level of activity, because the level of activity is one of the important factors influencing inflation. We also understand that there are quite long lags between the operation of monetary policy and its impact on activity and inflation, so we have to try to put policy in an anticipatory mode. Subsequent easings have been in response not just to the low levels of activity, but also the considerable falls in actual and expected inflation.

One point that should be very clear from this is that we do not regard falls in the nominal interest rate as signalling a loosening of monetary policy or an abandonment of the price stability goals. It is vital to assess the stance of policy against the level of real activity and inflation, actual and expected.

One way of looking at this is to imagine how interest rates would respond to the cycle if the only objective was to use interest rates to try to smooth the cycle as much as possible. In these circumstances, real interest rates would follow the periodicity of the cycle, being high when the economy was running too fast, and low when it was going too slowly. Even using interest rates in this way, it would not be possible to fill in all the troughs, and lop the peaks, of the cycle. But you can imagine a sequence of real interest rates which would help smooth the cycle to some extent. Now imagine that there is an additional primary objective of

Figure 16: **Inflationary expectations**



reducing the inflation rate. It is still quite appropriate to have interest rates vary over the length of the cycle, but the absolute height of the interest rates would be somewhat higher, throughout the cycle, than in the first example when the only objective of monetary policy was to smooth the cycle. The idea would be to exert downward pressure on inflation throughout the whole cycle (see **Figure 16**).

Of course, the exact setting of interest rates during the cycle will be a bit more complicated than this. The main complication comes from the need to shift price expectations, if long-term progress is to be made on the structural underlying inflation rate. For this, the central bank needs to build up credibility, in the eyes of the public, that it will maintain the discipline needed to attain and retain price stability. So this means that when the economy slows, the focus in reducing interest rates is not only on the state of economic activity, but also in ensuring that the market understands that the reductions in interest rates are not because of any change of view on the importance of price stability. The problem sometimes is that at this stage of the cycle, people can misinterpret the actions of the central bank and interpret a fall in nominal interest rates as signalling some weakening of resolve. So it is difficult to get the right balance throughout the cycle, but the objective is clear — to maintain a focus on inflation throughout the cycle. This is what we have in mind when we talk about the medium-term focus of policy. This does not mean that nominal interest rates are unchanging: just that price stability remains a principal goal throughout the cycle.

These issues are not easy to resolve in daily operational terms: but they are better understood than 10 years ago.

As well, we have effective operational techniques for influencing the critical price in the financial sector — interest rates — and for influencing the foreign exchange market.

The results are clear to see. The current cycle is deeper than foreseen: so, too, the progress on inflation is greater than anyone predicted. The underlying rate of inflation is now running clearly below 3 per cent. There seem good prospects of it remaining low. Price expectations have shifted down decisively. Productivity is always high in the upswing, and this will help rebuild profits without businesses having to increase their margins. We need a bit more historical perspective to judge the recent period, but it may well be that, in five or ten years' time, we will look back on it in the same way that Americans look back on the Volcker squeeze in the early 1980s — painful at the time but ushering in a significant period of good growth combined with low inflation.

Note

1 For our purposes here, a bank bill can be thought of as an IOU whereby a borrower agrees to repay the lender a certain sum of money at the end of a (usually relative short) period. Bank bills differ from the usual private IOU in that they are, in effect, guaranteed by a bank.

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4

FISCAL POLICY INCENTIVES, PRIORITIES VERSUS STABILISATION

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FISCAL POLICY INCENTIVES, PRIORITIES VERSUS STABILISATION

DR DON STAMMER

Too much is expected from the annual budget, particularly in terms of the contribution it can make to fine tuning the economy. In this, the so-called Keynesian revolution was too successful. Because of it, economists, politicians and commentators in the forties, fifties and sixties were too confident in their ability to manage an economy. Full employment and low inflation were assured, so it was said. There's now a lot more modesty about what the budget can do to manage an economy but the impact of the so-called Keynesian revolution still lives on. Of course, the so-called Keynesians are not the only group to have promised to abolish the business cycle. Such claims have also been made at various times by groups as diverse as:

- various groups of socialists, via detailed economic plans;
- the mechanical monetarists, via money supply rules.

But the so-called Keynesian revolution in economics left a more lasting effect: a generation or two of economists, politicians and commentators who were convinced that governments could actively and succesfully use the budget and monetary policy to stabilise the economy. This legacy is, I believe, still important in understanding what is expected from a government budget.

Over time, the shortcomings and limitations of trying to fine tune the economy through budgetary and monetary policy became clear:

- There were messy things called lags, which meant that attempts at fine tuning an economy could aggravate the business cycle, not reduce it. The most important — and most neglected — four-letter word in macroeconomics is 'lags'.
- Once people came to understand the commitment of governments to maintaining full employment, attitudes developed — particularly in the 1960s — that wage increases and price hikes wouldn't mean the loss of jobs or sales. Inflation and an inflationary psychology became a problem — in large part because of attempts to fine tune the business cycle. Removing this inflationary psychology has been a long and difficult process.
- The nature of unemployment has changed. A higher proportion of unemployment, in normal years, now reflects wage rigidities or a

mismatch of skills — types of unemployment which can not be reduced just through expansionary monetary and fiscal policies.

Fortunately, these shortcomings of fine-tuning policies are now widely appreciated. As a result, the settings of monetary and fiscal policy were not being eased as dramatically in the 1991 recession as in 1974 or 1982.

But a legacy from the heyday of fine tuning lives on: too much attention is still given to what a particular government budget can do to change the level of business activity and to change the level of employment; too little attention is given to the other important features of the annual budget.

Consideration of a government's budget should be much broader; it should cover each of the following criteria:

1. The budget's house-keeping role. A budget is the means through which parliament exercises its control over the government's spending and revenues. As with the budget for a household or a company, the government's budget needs to be based on realistic forecasts, to be detailed, and to show the medium-term implications of existing programs. The Australian budget has improved on these criteria.

2. The size of government. Australians generally see themselves as highly taxed. But on the best measure of the burden of taxes — government spending relative to GDP, Australia is equal (with the US) as the third lowest taxed country within OECD; only Turkey and Japan have a lower ratio of government spending to GDP. Decisions taken within the budget are, of course, a key influence on the size of the government sector

3. Priorities. A budget is a statement of the priorities within government spending. It gives a ranking of what are the priorities of government spending — whether these are determined through a painstaking analysis of priorities, through casually-made decisions, or even through processes of benign neglect. These priorities cover matters as diverse as:

- the claims of, say, aged pensioners versus low-income families with children;
- the priority given to education against health; and
- the priority given to recurrent spending by government over public capital spending.

There's not time in my talk today to investigate these matters — but I would note the enormous squeeze on public capital spending over the decade as governments have cut back the ratio of government spending to GDP. Some priorities have been ignored; we are running down much of our infrastructure.

4. **Redistribution of income and alleviation of poverty.** A budget can be a major instrument for affecting the distribution of income via:

- the level and pattern of taxes (and of tax deductions);
- the level and pattern of spending (especially of welfare spending).

Last year's budget in Australia included an allocation of $34.4b for social security and welfare — that's over a third of the budget or more than 8% of GDP. Clearly, redistribution/alleviation of poverty is a major objective of a budget. It's to the credit of the present government that there's now a comprehensive system of means testing and assets testing on most forms of government-provided pensions in Australia — this directs the social welfare dollar to groups most in need. But note that, if the $34b of social security was directed to the two million poorest Australians, that would be the equivalent of an annual payment of $17,000 a pension — or $68,000 a year to each family of four. Clearly, a lot of the social security vote is still not getting through to the really needy.

5. **Incentives.** For better or for worse, a budget also has a big effect on incentives — to invest, to save and to work. On this:

- incentives to invest are strongly influenced by the combined effects of the rate of company tax, dividend imputation, capital gains tax and investment incentives. With changes announced in February, Australia has a tax structure which, as far as longer-dated capital spending is concerned, is reasonably competitive with other OECD countries, though it's still not competitive against the tax structures of many successful Asian countries;
- incentives to save can be influenced by the level and mix of taxes — though empirical evidence here isn't convincing;
- incentives to work are particularly influenced by the level of marginal tax rates; marginal tax rates on the incomes of middle-income groups in Australia are extremely high.

6. **Structural change.** As we all know, Australia hasn't achieved a fast enough rate of structural change over recent years. The budget can play a small role — eg through allocations to retraining, multi-skilling programs and restructuring assistance and through its effects on capital spending. But more important than the budget are policies affecting competition and adaptability, especially adaptability in the labour markets.

7. **Saving.** Saving in Australia is too low. A budget affects saving, both directly and indirectly:

- it directly determines the level of saving/dissaving undertaken by government;

- the level and structure of taxes and — even more important it seems — the rate of inflation have powerful effects on the level of saving by companies and households. The budget has powerful indirect effects on saving.

Australia did well in the late 1980s to record budgets with surpluses. Over coming years, saving will rise as new superannuation arrangements come into force. But the need to boost national saving is urgent: the budget needs to make a further contribution to national saving — directly and indirectly.

8. **Debt.** A huge build up in government debt over the 1970s and early 1980s occurred in many countries. This increased the attention that's directed to the impact the budget has on the level of outstanding government debt. Australia doesn't look too bad on a world comparison of outstanding government debt — but there's a need for discipline in the budget over coming years.

9. **Inflation.** Low inflation is again a high priority of most governments. Maintaining low inflation — and keeping inflationary expectations under check — is mainly a task for monetary policy. But the budget affects inflation:

- by its (lagged) effects on demand;
- by its indirect influence on inflationary expectations;
- and via changes in taxes, especially indirect taxes which impact directly on measured inflation.

Again, discipline is crucial. It's easier for a budget to do harm to inflation than to do good.

10. **The budget and the economy.** As I've argued, the hey day of attempts to fine tune the economy have passed; nonetheless, the budget does have an impact on the economy and it's necessary to look at:

- the effect that tax changes included in the budget will have on the level and pattern of demand;
- the effect that changes in spending have on the level and pattern of demand;
- the effects on the economy of decisions on how to finance the deficit (or how to make use of any surplus);
- most importantly, it's crucial to allow that most effects from the budget on the economy are felt with long lags. The budget in any year is more likely to affect business conditions the following year than in the year the budget is introduced.

My listing of the ten important criteria for judging a budget deliberately left to the last the effects of the budget on the economy. Of course, these effects are more important than is suggested by the order I've chosen. I'm emphasising the point that too much attention is still given to what a budget can do to fine tune an economy — and not enough attention is given to analysing the characteristics of a budget as a statement of government priorities, its effects on incentives, its success in alleviating poverty etc.

Too much attention is still given to what the budget means for the economy — and too much confidence in the capacity of a budget to fine tune the economy is still excessive.

5

TRENDS IN BUSINESS AND ECONOMICS EDUCATION IN AUSTRALIA

COLIN DUNN

PRESIDENT
BUSINESS EDUCATORS AUSTRALASIA INC. (BEA)

Colin Dunn is President of Business Educators Australasia Inc. (formerly the Australasian Commercial and Economics Teachers' Association – ACETA). Colin has been a practising teacher in the Victorian and ACT education systems and has now moved into educational administration. He is the Deputy Principal of Lake Tuggeranong College in the ACT and wrote *Let's Plan a Business* (1991 ACETA) as a workbook to introduce the student to the principles and practices involved in the process of examining whether to invest in and commence a business. He is also the author of *Business Basics* (1991, CCH) a textbook for the NSW Year 11 business studies course.

TRENDS IN BUSINESS AND ECONOMICS EDUCATION IN AUSTRALIA

COLIN DUNN

Changes to the National Association

At the recent Australasian Commercial and Economics Teachers' Association (ACETA) annual council meeting in Sydney some major changes were made to ACETA. ACETA became the Business Educators Australasia Inc. (BEA) and as such will be much more able to influence the national debate in curriculum and thereby provide a greater level of support for teachers and students in our subjects. It is important to understand that the use of the word 'business' in the new title is in its generic sense. All the subjects that fell under the original ACETA banner and now fall under the BEA banner are related to the activities of 'business'.

The executive of the BEA has been expanded to include two vice-presidents. In addition, the new Association has an executive officer and a secretariat located within the Victorian Commercial Teachers' Association. The expanded executive will enable new initiatives to be planned and embarked upon and the fact that the personnel involved in the executive are from a range of States and Territories means that a greater level of national representation can take place.

The new executive consists of:

Colin Dunn	President (Secretary — Canberra Commercial Teachers' Association)
Virginia Frost	Vice President (Vice President — Economics and Commercial Teachers' Association of NSW)
Gabrielle West	Vice President (President — Queensland Commerce Teachers' Association)
John Glasson	Secretary (President — Victorian Commercial Teachers' Association)
Chris Fowler	Treasurer (President — Canberra Commercial Teachers' Association)
Mike Rowland	Executive Officer (Vice President — Victorian Commercial Teachers' Association)

Contact can be made with the executive of Business Educators Australasia through the Executive Officer — BEA, c/o PO Box 361, Abbotsford, Victoria 3067, Tel 03 4199622, Fax 03 4191205. The President can be contacted directly through Lake Tuggeranong College, Cowlishaw St, Tuggeranong ACT 2900, Tel 06 2056222 or Fax 06 2056202.

As a result of the success of the ACETA publication *Let's Plan a Business* (1991), the BEA now has an expanded revenue base and is able to provide more resources for the furthering of accounting, business, commerce, economics, information management, legal and work-related education. This work-book will be produced once again this year for 1993 and will be in an upgraded form with new graphics. It will be available in November.

The **National Schools Business Plan Competition** has been a success once again in 1992 with sponsors of the calibre of the Australian Bankers' Association, Commonwealth Development Bank, IBM, Ansett Australia and Japan Airlines. In the coming years we hope to be involved in other activities, including the facilitatation of teacher exchange with industry at the national level and the co-ordination of a greater range of national professional development activities.

We hope to be able to provide a greater level of support for accounting, business, commerce, economics and legal education but also offer teachers of information management and work-related education, support on a national basis.

National Curriculum

The activities of the national association in the 1991/92 period have been dominated by the national curriculum agenda and there is no question that ACETA has been able to influence significantly the debate in relation to the development of a statement for the studies of society and the environment curriculum areas. Economics has always been included in the brief for the preparation of the statement but as a result of our pressure, a document is now emerging that enables business studies to have a home as well. The final brief is about to be released, with the statement and profile to be completed in June 1993.

The Finn and Mayer Reports

The **Finn Report** on Post Compulsory Training recommended six key areas of competence that should be developed in the post-compulsory years:

- language and communication;
- using mathematics;
- scientific and technological understanding;

- cultural understanding;
- problem solving;
- personal and interpersonal.

The Mayer Committee was asked to undertake further exploratory work on the Key Competencies with a view to assisting the development of a national 'standards framework' for Key Competencies. All Mayer requires is that the competencies be developed and reported upon in the last two years of schooling and that every student who leaves school is entitled to a report on their level of competence.

The Mayer Committee identified seven competency strands which could be developed within each of the areas of competence:

- collecting analysing and organising ideas and information;
- expressing ideas and information;
- planning and organising activities;
- working with others and in teams;
- using mathematical ideas and techniques;
- solving problems;
- using technology.

What are the implications of Mayer recommendations for post-compulsory schooling, ie what are schools being asked to do?

1. Take some strong but not foreign directions in curriculum, building on work which has been under way both formally and informally for years, for example:

   'To provide young people with better preparation for initial employment.' This is not new! But then to 'identify the competencies which are essential for participation in work' indicates a more formal process than previously envisaged. The development of 'nationally-consistent approaches to assessing and reporting on young people's achievements' is quite foreign and will be difficult to achieve in any uniform and detailed manner as will be 'to improve the capacity to report nationally on the outcomes of education.'

2. Develop and measure what a student can do in certain areas of competence (performance and competence). The Committee in defining competence recognised that performance is underpinned not only by skill but also by knowledge and understanding, and that competence involves both the ability to perform in a given context and the capacity to transfer knowledge and skills to new tasks and situations.

3. Pay attention to those essential things a student needs to do to be able to participate effectively in work ie employment-related key competencies. These competencies are generic and focus on the capacity to apply knowledge and skills in an integrated way in any work situation. Their generic nature also means that they are essential for effective participation in other social settings and also have use and value for young people entering further vocational education and training for higher education.
4. Develop and demonstrate these essential competencies in work and work-related contexts (see the key competency strands above).
5. For each student, assess each of these key competencies on a three point scale (Performance Levels 1, 2 and 3). These are not far removed from assessing unit/module/course objectives on a five point A–E scale.
6. Report upon each individual's performance on all the key competencies on a 'record of performance'. Questions that arise here are: will one aggregate a score for an individual? What about an aggregate for two-unit versus three-unit economics? Does an aggregate have meaning? What does Mayer have in mind?
7. Use certain agreed principles in developing/compiling these individual 'records of performance'. For example: this record 'should be made available to students/trainees at any point at which they exit from a school programme at Years 11 and 12'; 'assessment should be consistent with nationally-agreed principles'; 'records of performance should be based on a common format'; and there will be consistency in the provisions regarding 'confidentiality and the maintenance of data-bases and records'. Will this reporting be in addition to current reporting or will it be embedded in changed reporting arrangements?
8. Collect data from a sample of the population rather than the whole population to satisfy the need for public accountability and to provide an improved basis for evaluating the effectiveness of the programme. The idea of a 'standard assessment task' across Australia is likely to be rejected.

In NSW it will ultimately depend on the NSW Department of School Education and the Board of Studies and their method of approach to the implementation, but the keys to successful implementation will be to avoid massive disruption and to ensure that teachers are informed and supported in the implementation process.

Possible Implications of Mayer for the Teacher of Economics in NSW

Table 1 illustrates how the economics course could be set out in relation to the Mayer competencies. The 'X' would represent that the competency is developed in that particular topic. Because of different teaching methods some teachers may, for example, choose to emphasise 'working with others and in teams' in the elective components rather than in the core components of the course. Other teachers may emphasise the use of technology right through the whole course because the quality of the computer resources at the school may be such as to allow the development of the technological competence of economics students throughout the two years.

Note that each student will eventually be assessed against each competency strand and be awarded a performance level of 1, 2 or 3. This may mean, in relation to 'Introduction to the Australian Economy' in relation to 'collecting, analysing and organising ideas and information' for example, that if a student uses information from only one single source that he or she would obtain Performance Level 1 in relation to this strand of competence in this topic. If they were able to 'access, evaluate and organise information from a range of sources' in later topics, then the student may be reported as having achieved Performance Level 3 in relation to that topic (or even the course, if aggregation in a course is the method of reporting).

It is my belief that most teachers of economics would be either deliberately developing these competencies already in their classes or would be developing them through the use of good teaching/learning practices. Economics is very much a problem solving, research orientated, discursive and mathematical subject that is suited to technological learning methods.

The important thing for a teacher to do would be to ensure that over the length of the course that the competencies were developed within the context of the course and its requirements. This would be difficult in say the learning of Japanese or in the study of history, but in the study of economics I would envisage few problems.

The time frame for implementation of the Mayer competencies is as follows:

1993 — preparation for implementation;

1994 — implementation in Year 11;

1995 — full implementation.

Table 1: An approach to viewing the impact of Mayer competencies

Mayer competency strands NSW economics course topics	Collecting, analysing and organising ideas and information	Expressing ideas and information	Planning and organising activities	Working with others and in teams	Using mathematical ideas and techniques	Solving problems	Using technology
Core Content							
Introduction to the Australian Economy	X	X	X	X	X	X	X
Household Sector	X	X				X	
Firms Sector	X				X	X	X
Financial Sector	X			X	X	X	X
Government Sector	X		X			X	
Overseas Sector	X	X	X			X	
Contemporary Macroeconomics	X	X	X	X	X	X	X
Electives							
Labour Economics	X	X	X	X		X	
Industry Economics	X	X	X	X		X	
The Economics of Primary Industries	X	X	X	X		X	
International Economics	X	X	X	X		X	
Income and Expenditure Analysis	X	X	X	X	X	X	X
Development Economics	X	X	X	X		X	

More Reliance on Subject Associations for Support of Teachers

This is evident right across Australia, both from the level of attendance at conferences and in-services run by associations, but also from teacher surveys that have been conducted in 1991. Two Department of Employment Education and Training Surveys conducted on the east coast in 1991 indicated that teachers were looking towards their subject associations for the level and type of professional development required for their continued teaching. The BEA and its affiliated associations (and the EERC I am sure) will continue to provide quality support for teachers in our subject areas and deserve your continued support. As resources being provided to public school teachers from education departments diminish, there is an upsurge in the interest of teachers in their subject associations. However the professional development activities of these associations more often than not rely on the goodwill of a few keen members. It would be good to see education departments being more supportive of the activities of these associations whose professional development programmes are seen as both relevant and well-run!

BEA Conference in Canberra 1993

Keep Easter 1993 free for the first Business Educators Australasia Inc conference in Canberra. We anticipate having both overseas and local national experts at the conference and it will focus on the disciplines, but necessarily with a national perspective. It could be the opportunity for you to have a holiday in Canberra and to hear some top national and international speakers. This will be confirmed shortly and information will come through the affiliates of the BEA.

Changes in Student Choice

There has been a swing away nationally from economics and other 'commerce' subjects at the post-compulsory level. In South Australia, accounting is up by 13%, business studies by 63%, economics by 5% and desk-top publishing by 51%.

In Queensland in 1991 accounting had 22% of total Year 11 and 12 enrolments, and in Victoria between 1991 and 1992 there has been an increase of 38% in enrolments in business management. Enrolments in economics fell in Victoria between 1991 and 1992.

The trend towards business and legal studies in NSW is similar to that in other States and Territories with predictions of enrolments in business studies to be around 20,000 in a few years. A fall away in economics enrolments is also predicted.

The nature of enrolments in business studies is such that there is a much broader range of students from the highly competent and tertiary able student (who has strong maths etc) to the student who is more interested in using the subject as a pathway to employment.

Retention Rates

The increasing retention rates in Years 11 and 12 across Australia is forcing us to look at upgrading our pedagogical skills. The kids in Years 11 and 12 are not the teaching haven that they used to be. We are also being challenged to provide new courses for these students that is, ones that provide vocational orientation and the entry level competencies being demanded by the work-place.

Conclusion

I believe that the main national agenda items over the next few years will be the impact that the eight sets of curriculum statements and assessment profiles will have on schools and the impact on teachers and teaching (and schools) of the move towards competency based training.

In regard to the impact of the eight curriculum areas, for curriculum development purposes these statements could be most valuable documents. They will assist in the development of consistent courses across Australia, an eminently sensible thing. However problems may emerge in the resource considerations and in the profile or assessment stages. Already some schools have trimmed their faculties to eight and changed the nomenclature to reflect the national curriculum areas. Some faculty heads have lost their jobs! There will be sensitive issues that will need careful handling if there are attempts to make profiles too specific and lead to a form of national assessment. For example, there would be significant difficulties in agreeing on a common set of assessment guidelines in economics across Australia, ie. what would be the commonly expected outcomes for a student of economics as he or she walks out of the school having completed their HSC or VCE or TCE or SACE etc. economics course? The guidelines will be broad indeed, whilst we still have eight education systems with eight economics courses.

I have referred in detail to the possible impact of the introduction of the Mayer competencies and the key to the successful introduction into schools of these recommendations will be the staff. If the States, Territories and the Commonwealth do the sensible thing and properly resource the implementation process then there will be some hope for an effective and shared process of introduction, rather than an ineffective process of imposition and subsequent non-acceptance or non-compliance.

There are interesting times ahead.

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6

WAGES POLICY: THE ACCORD, DEREGULATION AND UNEMPLOYMENT

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His current research interests include employment composition in Australia; award restructuring in the Hunter Valley; and small business employment.

WAGES POLICY: THE ACCORD, DEREGULATION AND UNEMPLOYMENT

JOHN BURGESS

The 1991 HSC examination questions for Labour Economics had a bias towards macroeconomic issues, wage determination and current Australian policy developments. The questions were very broad in scope, full of difficult concepts, and difficult to answer in the available time. For 1992 more of the same can be expected, hence this paper will attempt to cover three areas that have a good chance of being examined in 1992:

- the direction and impact of the Accord;
- current trends in wage determination and industrial relations;
- unemployment, its dimensions: causes and consequences.

Has the Accord Been Successful?

This question has often been asked since 1983 and still generates divergent answers. To assess its contribution you need to assess its performance by set criteria. For example, up until 1989 the Accord was acclaimed for its contribution to employment generation but criticised for maintaining an excessive inflation rate. The reverse arguments could apply today. The difficulties in assessing the Accord are as follows:

- establishing what its aims are, especially given the range of policies associated with the Accord;
- agreeing on the criteria by which to assess the Accord — should it be real wage growth, the change in real unit labour costs, the share of wages in GDP at factor cost, the incidence of industrial disputes, the level of business investment etc?;
- establishing what would have happened in the absence of the Accord: how would wages have been determined? Would there have been more or fewer industrial disputes? Would the role of the IRC in wage determination have been any different?;
- separating the effects of the Accord from other policies and other developments in the economy — monetary policy, the terms of trade, the exchange rate etc.

With all these caveats and problems in mind, I will make a few observations and cite some studies that assess the Accord's effectiveness. In favour of the Accord the following evidence is cited:

- it has survived a decade despite the record of failure for incomes policies in Anglo-Saxon economies;
- employment growth in Australia for the period 1983–88 was well above the OECD average;
- real wages have been capped, real unit labour costs have declined and the profits share has increased since 1983 — there appears to be a record of wage restraint combined with a redistribution of income from labour to capital;
- there was a marked reduction in industrial disputes after 1983;
- it has facilitated the introduction of an extensive range of workplace reforms and led to a decentralisation of the wage determination process.

In Budget Papers the Accord generally receives full marks from the Treasury because it has delivered nominal wage restraint and allowed for policy forecasting on the assumption of wage outcomes that can confidently be predicted. In a macroeconomic sense, the Accord has delivered restraint, stability and predicability to the wages system. However, these are not the only criteria by which a wages system should be judged.

Against the Accord, the following evidence is cited:

- inflation rates remained above the OECD average till 1990;
- productivity growth has remained stagnant;
- non-wage incomes, especially executive salaries, remain unregulated;
- unemployment post 1988 has wiped out the employment gains generated prior to 1988.

A series of simulations were conducted to assess the impact of the Accord using a range of alternative macroeconomic models (Chapman, et al, 1991). The simulations were based upon a comparison of the outcome under the Accord with a projected outcome assuming the absence of the Accord. The broad conclusions of this exercise were that the Accord had (Chapman et al, 1991, 50):

- reduced real wage costs;
- increased both the labour force participation rate and employment growth;
- reduced the unemployment rate and the proportion unemployed in long term unemployment.

The authors qualify their findings as follows:

- similar or better outcomes may have been achieved by a different system from the Accord and that existing pre 1983 — see the arguments of Moore (1989) in support of a more decentralised wages system;

- the study neglected the impact of the Accord on workplace efficiency and income distribution.

On this last point there is evidence (Lombard, 1991) that the Accord has been associated with a growing skewness in the distribution of income, with the lack of controls over non-wage incomes and the increase in interest rates improving the position of the top income earners. Another equity issue in the late 1980s associated with the Accord is that a relatively high proportion of the jobs created were part-time jobs, many of these under casual award conditions. As a consequence there appears to have been an increase in the numbers of working poor in Australia (Saunders and Matheson, 1991). There is also evidence supporting the view that the success of the Accord in reducing labour costs has had a negative effect on labour productivity growth (Hughes et al, 1991). That is, the Accord has reduced the need for labour displacing investment since labour costs have declined relative to capital costs.

Analysing the impact of the Accord is an important policy exercise, but one that contains many problems. From the viewpoint of the government, the Accord is regarded as a success and as a crucial part of framing macroeconomic policy and microeconomic reforms. For the government, the Accord has been a framework for generating wage outcomes consistent with macroeconomic objectives. It is difficult to sustain the view that wages growth has been excessive and in turn has been a contributing factor to unemployment and inflation. It has been flexible enough to be renegotiated as the circumstances of the economy have altered. It has widened the agenda of wage determination to include the social wage and workplace reforms. However, a good report card from the government does not necessarily make it a success, nor do claims that better outcomes could have been secured under an alternative wage determination framework, make it a failure.

The Current State of Wage Determination and the Accord

The elements of the Accord Mark VI negotiated in 1990 were:

- income tax cuts from January 1991;
- a national wage increase tied to the September quarter CPI increase;
- a $12 per week increase by mid 1991;
- an extension of occupational superannuation by May 1991.

The income tax cuts were introduced. However, the recession and the low CPI increase (0.7 per cent) for the September quarter led to a deferral of the national wage increase. Subsequently, the ACTU and the government attempted to obtain agreement from the IRC on linking wage increases to workplace productivity increases. In its April 1991 decision the IRC rejected the $12 per week increase, and it deferred any decision on superannuation and rejected enterprise based productivity bargaining. It did allow for a 2.5 per cent wage increase conditional upon the implementation of the structural efficiency principle associated with award restructuring.

The April 1991 decision indicated that the IRC would not automatically endorse the Accord wage principles, and in the process it placed itself at odds with the government and ACTU, and placed some doubt over the viability of the Accord framework. Subsequently, these decisions were either reversed or circumvented:

- in the 1991/92 budget, the government announced the planned introduction of legislation to extend occupational superannuation across the workforce;
- in its October 1991 national wage decision the IRC announced that it would accept enterprise based wage agreements where such agreements were linked to productivity improvements.

Part of the justification by the IRC for its April 1991 decision was the slow progress in implementing the structural efficiency principle associated with the award restructuring process. Progress continues to be slow, and of the agreements approved under the structural efficiency principle, half are in the metals industry. A study (Wooden and Sloan, 1990) found that the pace and extent of award restructuring changes were determined by a number of factors:

- the presence of an enterprise bargaining structure;
- the number of unions at the workplace;
- the quality of management;
- the share of females in the labour force.

Progress was greatest in workplaces with existing bargaining structures, multi-union presence and qualified management. In workplaces with a high proportion of females there were few workplace reforms being introduced.

Green (1992) has also emphasised the slow progress in workplace productivity bargaining. By the end of May only around 100 agreements had been ratified by the IRC. He suggests that the reasons for the slow progress are:

- many agreements are over-award agreements which are outside IRC scrutiny, the suggestion being that over 500 agreements were reached by this means;
- the IRC's ratification role does not assist, but hinders progress;
- the effects of the recession curb the desire by unions to enter into negotiations because of their reduced bargaining position;
- the lack of mechanisms at the enterprise level for measuring, monitoring and negotiating over productivity — Green (1992) regards this as the major obstacle to progress.

The legislation to extend occupational superannuation across the workforce is currently before the parliament. At this stage it appears that the government's legislation will be passed in an amended version which will see the size of employer contributions reduced from 5 to 4 per cent of the wage bill, with the size limits for small firm employers who pay a lower rate (3 per cent) being increased from $500,000 annual payroll to a $1m annual payroll. The longer term aim of the government is to increase contributions to nine per cent by 2002.

The February Economic Statement (*One Nation*) announced that aggregate wages growth would be linked to the inflation rate in the major OECD economies (national wage targeting). The government also left the way open for a future wage-tax trade-off in 1993 with its plans to introduce income tax cuts. There remains a continued commitment to enterprise based bargaining with the indications being that the government will legislate to reduce the powers of the IRC with respect to vetting enterprise agreements. So the current shape of the wages system is as follows:

- monitoring and control of aggregate wage outcomes under the umbrella of national wage cases, with national wage targets being linked to inflation rates overseas (which countries, how weighted?) — the ACTU has indicated that it has deferred consideration on the timing and size of a national wage increase for 1992;
- extensions to enterprise based bargaining with reduced powers of intervention by the IRC;
- safety net procedures for lower paid workers such as across the board wage increases and improvements in the social wage;
- a continuation of negotiated wage trade-offs eg. income tax cuts, employer superannuation contributions.

The Alternatives

The Opposition see the wages system becoming increasingly decentralised, with greater emphasis upon enterprise bargaining. According to John Howard (1991), there are four fundamental principles behind their system:

- the need to allow for direct collective bargaining between employers and employees (voluntary enterprise agreements) without third party interference or ratification;
- the abolition of compulsory unionism (closed shop agreements);
- the need to allow for the formation of enterprise based trade unions;
- the retention of legal sanctions against trade union behaviour (eg section 45D of the Trade Practices Act).

The Opposition's policy is similar to that proposed by the Business Council of Australia (BCA), one of the strongest supporters of enterprise bargaining. Key aspects of the BCA reform proposals include (BCA, 1991, 9):

- rationalisation of trade union coverage at the workplace;
- abandoning national wage increases;
- allowing for fixed term agreements.

These reforms require considerable legislative changes. Awards as such would be terminated and the role of the IRC would be considerably diminished.

The move towards a decentralised wages system seems inevitable either within the present framework or under the programme outlined by the Opposition. There remain many problems and details to be worked out including:

- protecting low paid and poorly organised workers;
- developing mechanisms and procedures for distributing productivity gains by enterprise as opposed to industry or national allocations;
- redefining the role of the IRC in such a decentralised environment;
- accepting the possibility that there will no longer be predicability and stability with macroeconomic wage outcomes;
- developing the mechanisms at the workplace for such a system to operate.

The recent APPM dispute in Tasmania was seen as an indication by the ACTU of what may happen under such a decentralised system. Under the Opposition policy, the nature and function of trade unions would be significantly altered and potential managerial prerogatives with respect to wage and employment conditions will be extended. What is clear is that many trade unions are unlikely to accept what they perceive of as a threat to their role and power, while many workers are unlikely to accept what they perceive as a threat to hard won conditions.

Unemployment

The biggest policy embarrassment for the government is unemployment. Its reaction to the growing current account deficit of 1988 has been to precipitate an almost total collapse of the labour market over the past two years.

Some revealing indicators of the extent of the collapse are:

- over the past two years the unemployment rate for March has gone from 6.1 to 10.5 per cent;
- there are as many persons in employment now as there were two years ago;
- full-time employment numbers have declined continuously for the past three years, over 300,000 full-time jobs have been lost during the past two years;
- the average duration of unemployment approaches 48 weeks, while nearly a third of those unemployed have been unemployed continuously for over a year.

The official unemployment rate tends to understate the collapse of the labour market and the intensity of the recession. Labour force participation rates have declined while the number of involuntary part-time workers and discouraged workers increase. The unemployment rate is set to remain well above ten per cent for the remainder of 1992. All the recent job losses have been in full-time jobs, whilst part-time job numbers continue to increase despite the recession.

The average unemployment rate also hides the considerable differences in unemployment:

- across age groups, ethnic groups and regions;
- in terms of duration.

Around one-third of youth are unemployed while older-age male workers tend to have the longest duration of unemployment.

Unemployment is difficult to reduce in the short term since:

- the economy needs considerable and sustained rates of economic growth;
- labour force participation rates need to remain stable;
- labour productivity growth needs to remain low.

The above conditions are unlikely to be achieved.

The projections in the *Fightback* and *One Nation* packages both forecast considerable job growth, yet unemployment is still forecast to be above six per cent for most of the 1990s.

The government proudly announced that its *One Nation* package would create 800,000 jobs over the next four years. Given that the labour force can be expected to increase by around 200,000 per year, this is not going to translate into any reduction in the unemployment rate.

The high unemployment rate has generated considerable policy action, notably the economic statements in November and February. These saw additional fiscal stimulation to the economy together with additional funding for the range of training, search and employment programmes designed to assist the unemployed. While there is merit in improving the skills and credentials of the unemployed, such policies can only be effective in a growing economy with new job generation. While much attention has focused on the supply side through microeconomic reform, the demand side of the economy has remained neglected and deliberately deflated to control the current account deficit.

The Youth Unemployment Summit held in July 1992 by the government canvassed a number of issues including youth wage rates and traineeships. With respect to youth unemployment and the proposals that are likely to be canvassed, the following points should be considered:

- youth unemployment rates are always two to three times the national average, even in periods of economic growth;
- reducing youth wage rates may only lead to substitution of youth for older age workers — that is, the only effect may be to alter the demographic profile of the unemployed;
- training measures are of limited effect in an economy with net job contraction.

Persistently high unemployment rates have been present across most OECD economies for the last two decades. Even the prosperous Swiss are recording the highest unemployment rates since the Great Depression. Consequently there has been plenty of research on the type of policies that are likely to be most effective in assisting the unemployed and in reducing the unemployment rate. A recent study by Layard et al (1991) suggested the following mix of policies:

- linking unemployment benefits directly to labour market programs including training, wage subsidies and targeted job creation programmes;
- subsidised skills training, especially in depressed regions and industries;

- a national, corporatist type incomes policy;
- marginal employment subsidies;
- expansionary demand management policies to prevent unemployment from rapidly increasing.

Many of these policy proposals have been followed in Australia. There has been a concerted attempt to develop a range of more effective and better targeted labour market programmes in Australia (Jobtrain, Jobskills, Skillshare). The unemployment benefit system has been more closely integrated into labour market programmes. The Accord has been used to regulate wages and minimise the impact of wage growth on both inflation and unemployment. The Jobtrain programme of subsidies to private sector employers has been considerably expanded over 1991/92. However, the combination of tight monetary and fiscal policy over 1988–1991 has led to a collapse of the labour market and to a growing pool of unemployed. Given the growing average duration of unemployment and the growing proportion of the unemployed who are in long term unemployment, far more active demand management and job creation programmes are required if the unemployment rate is to diminish over the next five years. At the moment those caught in unemployment will find it difficult to re-enter employment since there continues to be an absence of job growth, and in turn the incidence of poverty and inequality across the community can be expected to intensify. Even though the government has provided a fiscal stimulus through its November and February economic statements, such actions are too little and too late in terms of their overall budget impact and their potential to generate additional jobs.

Even if the economy were to recover, past experience suggests that new jobs are often filled by those already in employment and by those outside of the labour force. The plight of the long-term unemployed is unlikely to improve in the short-term even with a recovery. Moreover, recent experience in Australia suggests that many of the new jobs are part-time jobs, in turn this will mean a growing underclass of workers receiving only a part-time income.

Conclusion

The Accord remains in place as a framework for facilitating workplace reform and for controlling national wage outcomes. Wages growth can be expected to be constrained over 1992/93 in the face of the recession and given the slow progress in implementing the structural efficiency principle. Industrial relations and wage determination remain central policy differences between the government and the Opposition, although the trend is towards a more decentralised industrial relations system with a reduced regulatory role for the IRC. Full-time employment continues to decline while the number of part-time jobs continue to increase. Unemployment can be expected to remain at close to double digits for the remainder of 1992 while the large number in long-term unemployment can be expected to remain there well beyond any economic recovery. The initial rationale for the Accord as a mechanism for creating jobs appears very distant in the light of the recent labour market history of Australia.

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7

RECENT DEVELOPMENTS IN INDUSTRY AND COMPETITION POLICY

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RECENT DEVELOPMENTS IN INDUSTRY AND COMPETITION POLICY

ROSS JONES

The past few years have witnessed some major developments in Australian industry policy. The microeconomic reform processes designed to improve Australia's international competitiveness and raise standards of living have placed primary emphasis on generating competition in Australian markets. Much of the thrust of industry policy has therefore been focused on improving the performance of those sectors most shielded from competition. Competition policy also plays a significant role in this process.

In this paper I would like to examine the most recent developments in competition policy and industry policy in Australia and to consider how such policies will impact on broader microeconomic reform objectives.

Developments in Competition Policy

In a major statement in 1991, the then Prime Minister Mr Hawke announced that the Trade Practices Act, Australia's principal legislative instrument of competition policy, would be widened in its coverage. The Prime Minister targeted Commonwealth and State public business enterprises and particular segments of the private sector, for example, the professions, as being areas where competition could be improved. It was stated that the benefits for consumers would be considerable and examples were given of opportunities for lower prices through improved competition in the road and rail transport industries, the electricity industry, and the professions. The proposal by the Prime Minister for a 'national framework of competition policy and law' has the potential to provide significant improvements in the efficiency of Australian industry in the same way as do the deregulation of markets and reductions in protection.

The *One Nation Statement* of the current Prime Minister Mr Keating re-emphasises competition policy as a major instrument of microeconomic reform. It is within this context that I would like to examine the proposal for significant changes in Australian competition and industry policy through the proposed changes to the merger provisions of the Trade Practices Act.

When the Trade Practices Act was introduced in 1974, Section 50 of the Act dealing with mergers prohibited mergers which resulted in a substantial lessening of competition in the relevant market. However, in

1977, the Fraser Government amended Section 50 so that mergers are prohibited only where the merger would lead to a corporation being in a position to dominate a substantial market for goods and services.

It was argued by the Fraser Government, when introducing this amendment, that the substantial lessening of competition provisions led to a large number of mergers being caught under the section, with consequent substantial compliance and enforcement costs. It was further argued that economic efficiency would be weakened by shielding inefficient firms from takeover, and reducing opportunities for economies of scale which may accrue from the merger.

Over the last fifteen years this view has been debated on numerous occasions, and a commonly held view was that there was insufficient justification for a change to Section 50. However the most recent inquiry into the issue, the **Cooney Inquiry**, concluded that Section 50 should be amended to prohibit mergers which would have the effect of substantially lessening competition in a substantial market for goods and services. Following a recent statement by the Attorney General, it appears likely that the amendments to Section 50 will be made.

Critics of the proposed change argue that a return to the substantial lessening of competition test represents a return to the structure-conduct-performance models popular in the 1950s and the 1960s. A particular feature of this approach is the assumption that a highly concentrated market structure will lead to collusive behaviour among the firms which will drive up prices and enable firms to earn monopoly profits. The influence of the structuralist approached waned during the 1980s as other factors besides concentration, especially market contestability, became important. Opponents of the change have also argued that a liberal interpretation of merger policy is necessary to ensure that Australian firms can become large enough through domestic mergers to enable them to successfully compete internationally. For example the Business Council of Australia has argued that the need for industry rationalisation and efficiency is critical in Australia and that legislation should not be enacted which increases barriers to development.

However, in recent years economists have again begun to express doubt about the need for domestic firms to dominate their home markets to ensure international competitiveness. The work of Porter (1990) has received considerable attention with regard to this issue. Porter's view is that industry structures in which one or two large firms dominate should be avoided because such firms frequently lack the domestic competitive pressures to encourage them to be efficient and to innovate. His empirical work suggests that successful export oriented industries are often characterised by vigorous domestic competition with the achievement of economies of scale in production through exports, not dominance of the domestic market.

In many cases those Australian firms which dominate their domestic market still produce only a very small proportion of world output. Efficient production may still require economies of scale to be achieved through exports, yet without domestic competition such firms may be inefficient and lack inventiveness to the extent that a successful export strategy is unlikely.

Of course, the international competitiveness argument is relevant only to mergers in the traded goods and services sector of the economy. There are substantial parts of the economy protected from the discipline of import competition. Where there is little threat from import competition and barriers to entry are high, the anticompetitive behaviour in a market dominated by one or two firms may be considerable.

In such markets, firms may adopt a 'live and let live' attitude with little competition between them. The small number of firms in the market may increase the potential for collusive arrangements between the firms while such agreements, if made, may continue for long periods of time because a dynamic and competitive environment does not exist. Competition may be too weak to generate pressures for firms to improve efficiency and become more innovative.

Such potential anti-competitive effects may be difficult to detect and may not be adequately prevented by other sections of the Trade Practices Act. It is probably more efficient from a regulatory point of view to prevent mergers in such markets, rather than applying other regulatory sanctions such as price surveillance after the merger has taken place.

It is also important to note that a return to substantial lessening of competition does not have to lead to restrictions of 'desirable' mergers. Mergers which would generate benefits through improved competitiveness in foreign trade need not be blocked. In their definition of the market, the Trade Practices Commission always considers the impact of international competition. If the firms proposing a merger were subject to considerable competition from imports in the Australian market, it is possible that the merger may still be approved even though it may lead to a domestic production monopoly for example. Similarly, if the firms proposing the merger largely competed in an overseas or world market when there was substantial competition then it is most unlikely that the merger would be blocked.

Remember also that authorisation will still exist under the proposed changes. Mergers which lead to a substantial lessening of competition might still be approved where there is public benefit arising from the merger.

There has also been one other important development in competition policy in recent months. After much deliberation, the government has indicated that it is about to increase the penalities under the Act. At present the maximum penalty for breaches of the Act is $250,000, the figure set when the Act was passed in 1974. In contrast the maximum penalty in New Zealand is $5 million and in the United States is $10 million (with triple damages provisions). The proposed Australian changes will see the maximum corporate penalty increased to $10 million.

In the remainder of the paper I will consider the most recent developments in industry policy.

Developments in Industry Policy

Over the past few years substantial across the board tariff reductions have led many people to believe that the protection/free trade debate which has existed in Australia since before Federation has been won by the free traders. However such a conclusion may be premature with politicians from both sides examining more interventionist approaches.

Australian tariffs have been decreasing for a number of years. In 1973 the government cut all tariffs by 25 per cent. In 1988 the government announced that over the following four years all tariff rates above 15 per cent would be phased down to 15 per cent, while those between 10 and 15 per cent would be reduced to 10 per cent. Certain industries subject to specific industry plans (such as passenger motor vehicles -PMV and textiles, clothing and footwear -TCF), were excluded but substantial liberalisation was anticipated in the excluded industries also.

The government's March 1991 Statement increased the pace of the reforms with the announcement that the majority of tariffs will be reduced to a maximum of around 5 per cent by 1996, and the PMV and TCF industries will face major reductions in their protection over this decade. When the 1991 programme is completed by the year 2000, the average effective rate of assistance to manufacturing will have fallen to 5 per cent while the average nominal rate will have decreased to around 3 per cent. The Industry Commission estimated that such reforms would lead in themselves to GDP increases of $1.5b per year (in 1988-89 prices).

The fact that the Hawke Government came to power in 1983 with an interventionist industry policy programme and then introduced Australia's greatest tariff reform during a period of continuing balance of payments problems is often overlooked. The proponents of the 'level playing field' in Treasury and at the Industries Assistance Commission (and its successor the Industry Commission) argued strongly for the neo classical, non interventionist approach and won the support of the government and the Opposition.

However there has been some dissent from the dominant non interventionist view. Supporters of a more activist industrial policy have used the theoretical work of Krugman (1987) and his development of strategic trade theory to support their case. An argument of strategic trade theory is that many of the perfect market assumptions behind free trade arguments are no longer valid. In many markets, especially those for high technology goods, there are significant barriers to entry caused by scale economies, advantages from learning by doing, especially accruing to those first into the industry, and the presence of a few large multinational firms. As a consequence of market failure it has been argued that firms in certain industries are able to gain monopoly power which can be exploited in international trade.

Of course such a conclusion does not support an interventionist industry policy, it merely points to flaws in the neo-classical non-interventionist approach. Further, for a small country like Australia, the opportunities to exploit a strategic position in a world market would be very limited. The one Australian industry where such an approach was partially utilised, the wool industry, does not provide much support for an industry policy based on strategic trade theory.

The IAC and the Treasury both discussed strategic trade theory and concluded that strategic trade theory was based on some invalid assumptions and reached unworkable solutions. Stanford (1992) however was less dismissive.

The other major development was the study by the Australian Manufacturing Council (AMC) a group made up of manufacturing interests, trade unions and government. Their report in 1990 accepted that the protectionist arguments for continued tariffs had been lost. Instead the report recommended selective intervention in industries, for example in industries with strong export growth potential.

The critics of this approach argued that this alternative was simply a variation of a discredited 'picking winners' approach which might lead to considerable mis-allocation of resources as governments chose to selectively assist particular industries.

Supporters of interventionist industry policy in Australia often argue that 'unfair' trade restrictions and subsidies by other countries justify domestic protection. That is, if foreign countries subsidise their industries then Australian should do the same. However it is important to remember the effects of such policies.

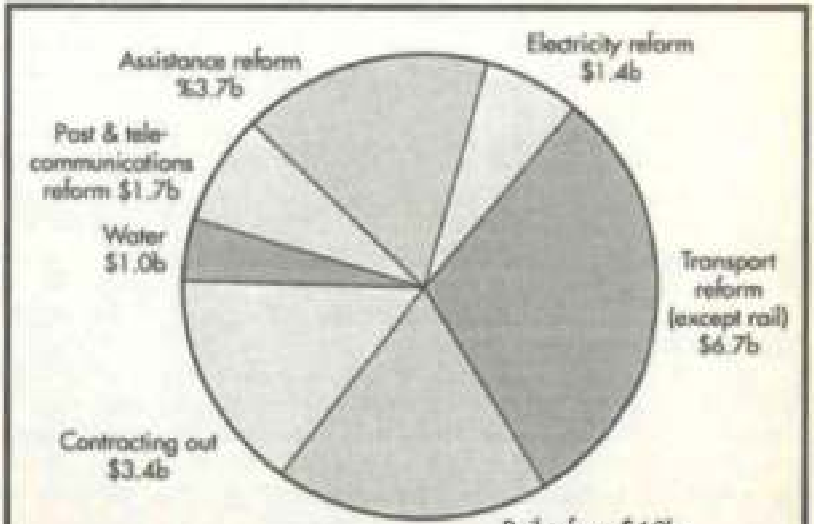
Policies which inhibit free trade penalise the consumers and/or the taxpayers of the countries undertaking such policies. European and American agricultural policies which push down world prices actually benefit Australian consumers of such goods. While Australian producers may be harmed by such policies, a more interventionist approach by Australia is not the appropriate solution. It is unlikely that Australia could afford to subsidise its affected industries to the extent that European or American policies would be changed. At the same time local producers and consumers would face higher charges and taxes to support such a scheme. A small country such as Australia cannot afford to undertake expensive interventionist policies regardless of what is being done overseas.

There is still much to be done in the microeconomic reform area. In the past few years the Commonwealth government has undertaken measures to improve economic performance in a number of sectors including aviation, the waterfront and telecommunications. However many of the sectors where the opportunities for improved efficiency are the greatest, are sectors where State governments are responsible.

In its 1989-90 Annual Report, the Industry Commission estimated the annual output gains from certain microeconomic reforms and came up with $22b per year from those reforms shown in **Figure 1**.

The Industry Commission* has identified industries such as energy, railways, water and road construction as areas of State government responsibility where performance could be improved. Already a number of State governments have instituted changes designed to increase

Figure 1: **Origins of annual gains from certain microeconomic reforms**



efficiency. However given the current budgetary constraints of many State governments it will be important to ensure that the States do not use public enterprises as a general revenue raising mechanism. For example, both NSW and Victoria have been criticised for port pricing changes which have added to the costs of some shippers.

The government has also given the Bureau of Industry Economics (BIE) a specific task in the microeconomic reform process. The BIE is currently undertaking a benchmarking study in a number of industries where Australian industries are compared with the world's best practice. Their studies on electricity and railways have been published and a study of port efficiency is currently being undertaken.

The government recently announced that the Industry Commission is to be moved to Melbourne. It is too early to say whether this geographical shift will lead to a shift in its policy prescriptions. However it would seem that the move, coupled with the appointment of a new chairman from manufacturing industry may lead to a softening of its previous non interventionist policy prescriptions.

Finally, I would like to look briefly at a recent example of the greater co-ordination of competition and industry policy.

The BHP Steel Takeover of New Zealand Steel

For many years BHP dominated the iron and steel industry in New Zealand and fought hard to prevent the establishment of a New Zealand steel industry. However strong political and financial support from the New Zealand government eventually led to the establishment of New Zealand Steel. However the company was in severe financial difficulty when the reformist Lange Labor Government decided to abandon support for the company in the mid 1980s.

In 1989, BHP made a bid for the company, which generated opposition from both sides of the Tasman. In Australia, the TPC was particularly opposed to the takeover as New Zealand Steel was one of BHP's few competitors in the Australian market. The TPC took action under Section 50 and was defeated in the courts. Under a compromise worked out later, BHP undertook not to inhibit New Zealand Steel from marketing products in Australia and to seek TPC approval before increasing its holding of ordinary shares above 31 per cent.

In early April 1992, BHP announced plans to take over New Zealand Steel. The Australian Steel Association, a steel users group made a submission to the TPC arguing that if the merger went ahead BHP should continue to abide by its agreement not to inhibit New Zealand Steel from marketing steel in Australia. By 1992 New Zealands Steel had increased its share of the Australian import market substantially, particularly as it was exempt from tariffs under the Closer Economic Relations Agreement between Australia and New Zealand.

The merger was approved by the New Zealand Commerce Commission which was satisfied that the merger would not result in the strengthening of a dominant position in the New Zealand steel market. In response to this decision the Australian government announced accelerated reductions of tariffs on certain steel products. Tariffs from developed countries were cut from 10 per cent to 5 per cent from July 1 while imports from developing countries are duty free.

In announcing the decision, the Minister stated that the rationale for the reduction was concern at the decreased scope for competition resulting from BHPs proposed takeover. The TPC announced it was satisfied that the tariff cuts would stimulate competition through imports and a few days later BHP completed its takeover of New Zealand Steel.

The outcome therefore was that in response to a possible increase in market concentration, co-ordination between competition and industry policy ensured an outcome which may generate greater efficiencies in the domestic and Australasian steel markets with enhanced competition from imports.

In this very brief overview I have attempted to look at the most recent developments in competition and industry policy and their inter-relationships. Both areas offer opportunities for Australia to improve the efficiency of economic activities and the rate of growth of output and living standards by targeting those sectors of the economy where competition is limited.

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8

FUTURE DIRECTIONS IN AUSTRALIAN TRADE

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FUTURE DIRECTIONS IN AUSTRALIAN TRADE

JANET TORNEY

I was pleased to see that international trade was maintained as the theme for the conference dinner. While Australia's external position was undoubtedly the focus of the economic debate in the mid-to-late 1980s, that mantle has now shifted to the recent recession, and specifically the labour market. This, however, should not be interpreted as indicating that trade and Australia's external balance are not issues. Indeed, Australia's relationship with the rest of the world will continue to be at the core of Australia's economic future and, therefore, cannot be ignored or down played, irrespective of the stage of the economic cycle.

The theory of and practical experience with international trade is such a diverse topic that it could not be covered even if the full two-day conference was devoted to it. I will, therefore, develop the theme of international competitiveness discussed by last year's dinner speaker, Carol Austin, specifically looking at how Australia is placed in the world trade environment and what are its future directions. Such a discussion will necessarily involve an assessment of Australia's economic integration with the Asian region.

The Importance of Trade

There is little doubt that Australia is very much a part of the global economic environment, being a small open economy heavily reliant on trade. The composition and direction of this trade, however, has resulted in us not participating in the growth in world trade to the extent that other similar sized economies or our major trading partners have done. Exports as a proportion of total economic growth of 17.5% compares with 21.5% for France, 35.9% for Sweden, 34% for Canada, 27.8% for New Zealand, and in Asia –197.3% for Singapore, 115.8% for Hong Kong and 57.1% for Taiwan.

Over the last decade, growth in world trade volumes has averaged 5.7% — up from 3% in the previous decade (1974–83). This increase has resulted from a greater degree of specialisation by individual economies, such that both imports and exports have expanded more rapidly. The Australian experience has been in contrast to this trend. Exports grew by 4.8% in the 1980s (6% in the 1970s) and imports exhibited average annual growth of 6.4% and 5% in the two periods, respectively. A rise in imports is often seen as a major constraint on domestic economic growth. Indeed, the rise in import penetration (ie. the proportion of imports in non-farm sales) in Australia from around 9% in 1980 to 13%, currently is often cited as a reason for our lack of international competitiveness. But if those imports feed into productive output, then rising import penetration could actually be a sign of a greater external orientation of the economy (see Figure 1).

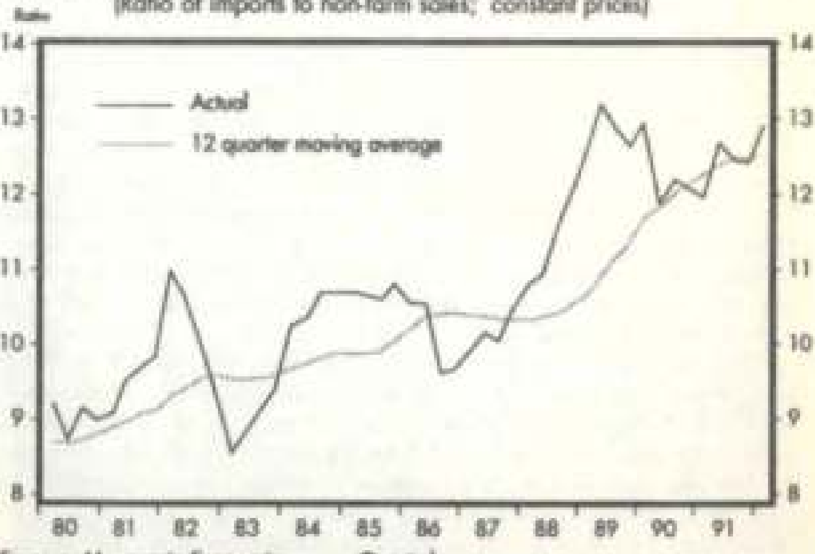
Composition of Trade

So why has Australia's trade performance not matched that of the rest of the world?

One reason is the composition of our trade. Australia no longer rides on the sheep's back. But it still relies very heavily on primary industries. Using 1991 data, mining exports comprise 46% of the total, rural exports 27% and manufactured exports only 21%. This heavy weighting in favour of primary industries is contrary to the general pattern of world trade. As **Figure 2** shows, the growth in world trade over the last two decades has been concentrated in manufactured products not rural or mining products.

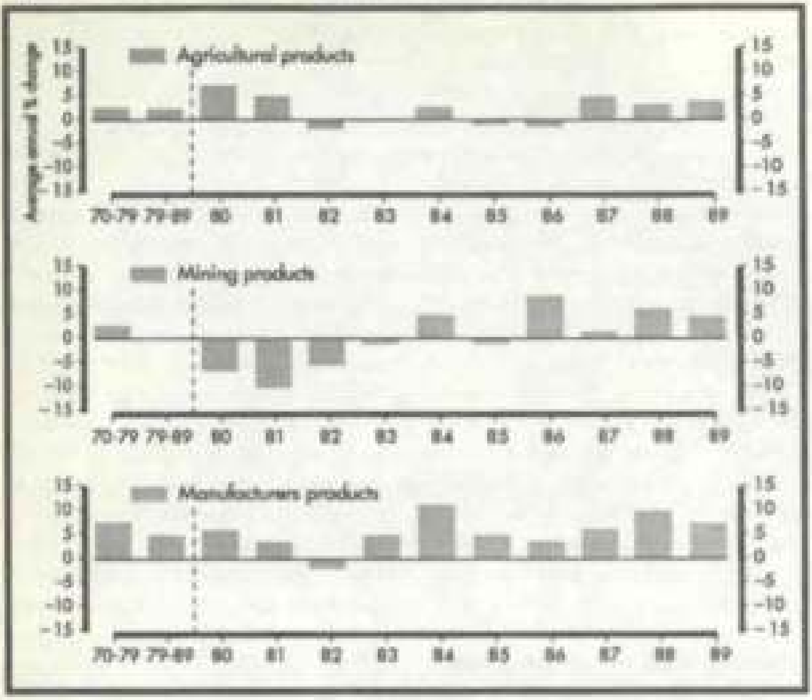
This much greater focus on trade in manufactured goods has major implications for the development of industries in Australia. The clear message is that manufacturing enterprises need to have an external orientation and at the same time be internationally competitive. I am by no means suggesting that Australia should ignore its natural endowments and try to manufacture everything. We have tried that and failed. What is necessary is to capitalise on and expand a number of our low cost and

Figure 1: **Import penetration**
(Ratio of imports to non-farm sales; constant prices)



Source: Macquarie Economics

Figure 2: **Growth in the volume of world trade**



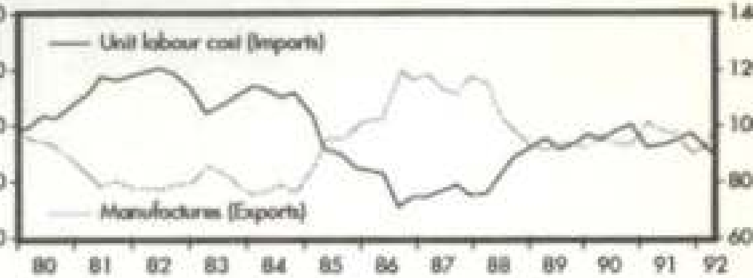
efficient primary industries, adding value at the early stages of production.

Australia has commenced the process of being viewed as more than just a farm and a quarry. The proportion of manufactured exports has increased sharply, from 18% in 1981/82 to 23% in 1990/91. It is important, however, to draw the distinction between simply transformed manufactures (STMs), such as raw iron, steel and other metals and elaborately transformed manufactures (ETMs), such as machinery, transport equipment and specialised equipment. The former category has remained fairly constant, at around 7% of total exports. ETMs, however, have grown from 11% to over 16% of total exports.

The rise in ETMs over the 1980s has suggested to some that this is an area where Australia has a comparative advantage. It should be noted, however, that almost 30% of these manufactured exports receive sizeable export assistance (for example, through the motor vehicle export facilitation scheme). If the recent growth in manufactured exports is to be sustained, industries must eventually be able to compete in their own right in international markets. The heavy level of assistance for ETMs may help to explain why competitiveness of these goods has not improved despite their growth far outstripping that of total exports over the last few years (see Figure 3).

Figure 3: **The competitiveness of Australian industry**

1st quarter 1980 = 100



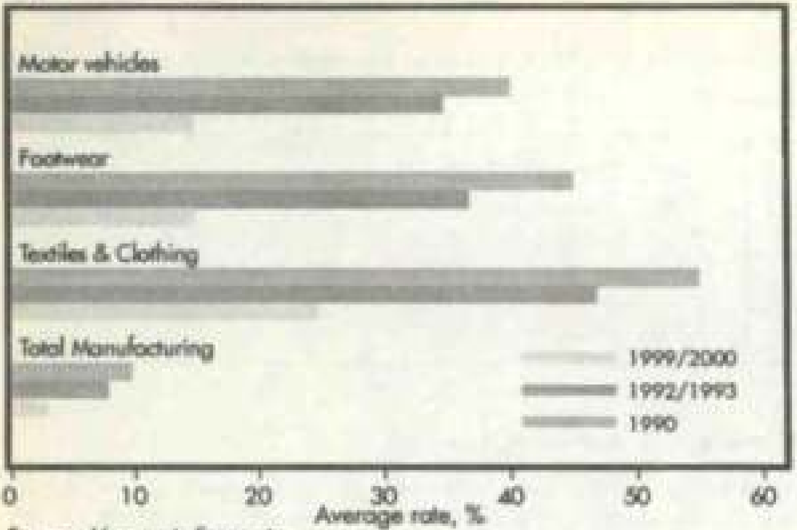
To Protect Or Not To Protect ?

Trade barriers, which include not only tariffs, but also bounties, quotas, export enhancement programmes and anti-dumping legislation, are not just an issue for Australia. Indeed, we can hold our head high on a global comparison. They impose a major constraint on world trade, particularly in the areas of agriculture and services. This is another reason, therefore, why Australia's trade performance has been relatively weak.

The General Agreement on Tariffs and Trade (GATT) was set up in 1947 to reduce trade barriers around the world. In the area of manufacturing, it has been fairly successful, with average global tariffs down to around 5% in 1990 from closer to 50% at GATT's inception. This has resulted in the twenty-fold expansion in trade in manufactures. But in the areas of agriculture and services it has largely failed because of non-cooperation by the major participants who place national interests at the fore. The current Uruquay Round is a clear example of how difficult it is to make inroads in breaking down tariff barriers. The Round commenced in 1986 with the aim of broadening the scope of the negotiations to services and achieving real reductions in agricultural protection levels. Six years later, little has been achieved because the US and EC have not been willing to compromise either on the magnitude of the reduction in export subsides or on the size of the cut in domestic support and access barriers for rural industry.

One trend that has emerged has been the regionalisation of trade arrangements. The EC's Common Agricultural Policy has been in place since the early 1970s. This has become more closely knit. Moreover, the US now has free trade arrangements with both Mexico and Canada. **Figure 5** (p97) illustrates this regionalisation of trade.

Figure 4: **Tariff protection**



Source: *Macquarie Economics*

This obviously places Australia in a somewhat insidious position for trade in certain commodities with these regions. Australia is a founding member of the Cairns group, which is a collection of non-aligned, small nations with fairly liberal trade policies. The hope is that the combined size (around 25% of the world economy) will give them an increased voice. But this will not provide a sufficient offset to the major trade blocs. Rather, Australia needs to optimise this trend to regionalised trade, concentrating more on trade within the Asian region. (I will come back to this later.)

I mentioned earlier that Australia has a favourable record on trade barriers. Specifically, the May 1991 Economic Statement extended and hastened the tariff reduction programme such that the average effective rate of protection for manufacturing will be only 5% by the end of this decade compared to nearer 20% in the early 1980s and 12% currently. Certain industries, however, still have significant industry assistance, notably passenger motor vehicles (PMV) and textiles, clothing and footwear (TCF) (see **Figure 4**). The conflict for Australia lies in the fact that we are fairly low cost, efficient producers in industries which face high global tariff barriers, eg rural industries, but maintain tariff protection/industry assistance in industries which are relatively freely traded in the global market.

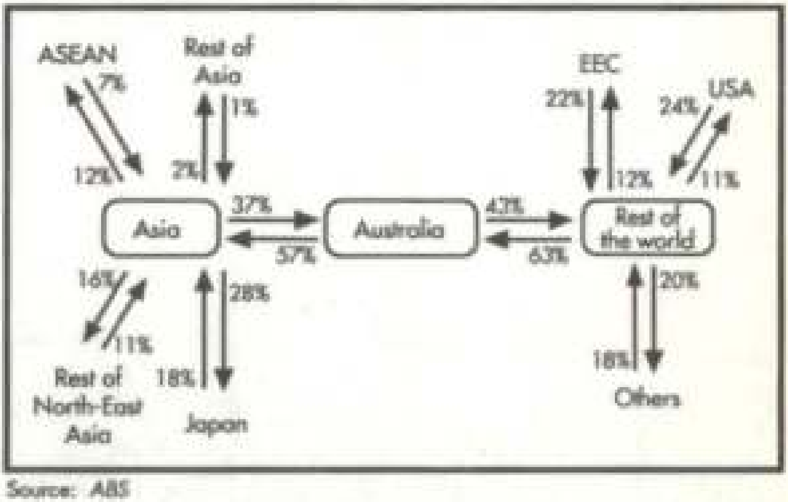
The answer to this is to develop markets that are relatively open and produce products where Australia has a comparative advantage. This sounds fine on paper. How is it translated into reality?

Trade . . . but with whom?

Given the regionalisation of the world economy into three major blocs — the Americas, Europe and Asia, it is logical that we look to become part of the growth centre closest to us. Most people are aware that Asia has increasingly become a larger trading partner. What is probably not realised is that on the basis of the 1990/91 data, it is Australia's largest trading partner (Figure 5). Around 40% of our imports are sourced from Asia and 57% of our exports are directed to Asia. Indeed, of our top four export countries, three are Asian, with Japan alone accounting for over one quarter of our exports. The growth of trade with Asia has been a recent occurrence. Ten years ago only 28% of imports were from Asia and around 30% of total exports went to Asia.

The real change, however, has occurred with the non-Japanese

Figure 5: **Australia's trade flows** 1990/91(% of total trade)



Source: ABS

economies. South-East Asia now accounts for 12% of our merchandise trade (7% in the early 1980s) while North-East Asia accounts for 16%.

By contrast, the decline in Australia's trade with the rest of the world has been fairly evenly spread. Of our exports, only 11% go to the US and 12% to the EC (including the UK), while 24% of our imports are from the US and 22% from the EC.

Proximity is not the only benefit for Australia increasing its trade with Asia. There is also a natural fit with the industry base.

- North-East Asia (excluding China) has very limited natural resources

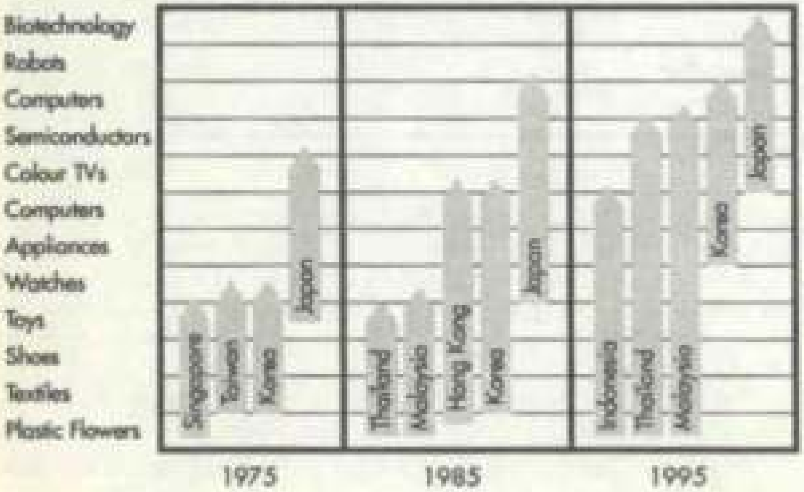
— the essential ingredient to their more developed industries — while those in the South-East Asian economies are still underdeveloped. With the ongoing expansion of the South-East Asian region, there is also wide scope for exports of basic manufactures as well as skills and technology.

- Thus, while primary commodities and basic manufactures may be a diminishing proportion of world trade, they are in strong demand by our close neighbours. Australia has an obvious import base in the Asian region. As labour is relatively cheap, especially in South-East Asia, it is rational to import labour-intensive manufactured goods which, if made in Australia would not be competitive.

The advantages of manufacturing such goods in South-East Asia have been recognised by companies such as Pacific Dunlop which over the last few years have essentially moved all their manufacturing offshore. This has been criticised by a number of commentators as being the first step in the decimation of Australian manufacturing. But rather, it should be recognised as the necessary reality of restructuring industry away from inefficient operations which cannot exist under Australia's wage and distribution systems and only with industry assistance, to those where value-added services can be provided.

It is frequently argued that industry is not able to change or mature. But the experience of Asia clearly negates this. Into the 1990s, it is likely to continue its move 'up market' (Figure 6). By this I mean that the less developed, cheaper labour economies of South-East Asia will specialise in

Figure 6: **Asia's move up market into the 1990s**



industries such as toys, textiles and shoes which were once the preserve of Singapore, Taiwan and Korea. These countries now focus on their comparative advantage in industries such as appliances, components and colour TVs. And with time they will move into the much more specialised, less labour-intensive industries such as semi-conductors, computers and biotechnics which are currently almost solely the domain of Japan and Korea.

The other major advantage for Australia becoming more closely

Table 1: **Asian economic outlook**

	Growth			Inflation		
	1990	1991 (e)	1992 (f)	1990	1991 (e)	1992 (f)
Korea	9.3	8.4	7.0	8.6	9.7	8.0
Taiwan	5.0	7.3	7.5	4.1	3.6	4.0
Hong Kong	3.0	3.9	5.5	9.8	12.0	10.0
China	5.2	7.0	9.0	2.1	2.9	7.0
Singapore	8.3	6.7	5.5	3.4	3.5	2.5
Malaysia	9.8	8.8	7.5	3.1	4.4	4.0
Thailand	10.0	7.9	7.5	6.0	5.7	6.0
Indonesia	7.4	5.3	5.0	7.8	9.4	8.5
Philippines	3.9	–0.1	3.0	12.7	17.7	12.0
Aggregate*	6.6	6.9	7.5	5.4	6.3	7.0

* The aggregate is a weighted average based on 1991 GDP/GNP. The greater weights of the North-east Asian economies lead to the faster overall growth rate.

(e) estimate (f) forecast

integrated with Asia is that it is the growth region of the 1990s (at least the early 1990s). Over the next few years, growth in Asia (excluding Japan) is expected to average 7%, well up from the prospective growth in the major OECD economies of 2–2.5% (Table 1). Moreover, exposure to the other major global economic centres is diversified through Asia. The North-East Asian economies are leveraged to the US economy while South-East Asia is much more dependent on intra-regional economic activity.

The Hawke Government's Asia Pacific Economic Co-operation (APEC) initiative and more recently Prime Minister Keating's visit to Indonesia and attendance at the South Pacific Forum were motivated by the recognition that Australia's future lay within the Asia-Pacific region. It is worth noting that the proposed APEC is not a trading bloc, but rather an Asian OECD, with aims to promote greater discussion and understanding in the region.

Which Industries?

The optimal composition of Australian industry is probably a more difficult issue than the direction of trade. The theory behind 'the level playing field' has had a sound battering over the last year or two. Certainly, there are distortions in the system which will prevent optimal market-delivered outcomes. But what is often overlooked in the discussion about industry assistance from government is that it implies that the authorities have a greater level of expertise than those involved directly in production. What is essential is that governments provide the environment such that firms have the opportunity to successfully compete in the global market. This harks back to the well-worn phrases of 'microeconomic reform' and 'structural adjustment'. They are, however, essential to the development of any successful externally-oriented industry. When I talk about microeconomic reform I am talking about more than just labour market reform. In the list I would include as a minimum a radically upgraded distribution system, a reformed tax system and more open product markets.

Given this framework, it is then feasible for industries to compete. This alone, however, will not make them internationally competitive. As Carol Austin pointed out last year, international competitiveness is not endowed, it must be created. Factor endowments are a necessary condition, but demand, related and support industries and firm structure and management are also crucial ingredients.

I was once asked if it was a problem that Australia was considered as a farm, a quarry and a university. My response was that if we could do all three well then we should be well satisfied. This assessment, however, should not be taken in its narrowest sense. Rather, I believe that Australia can be internationally successful in primary, secondary and tertiary industries. It is just that we cannot be successful in all industries within each broad group. Specifically, Australia has no benefit from being in highly processed manufacturing, but it can compete in manufacturing industries closely associated with either end of the industry spectrum. The challenges for Australian industry and trade are enormous. They supersede the economic cycle and, therefore, have the risk that they may be derailed. Unemployment, debt, lack of venture capital are but a few of the impediments that will arise. But if Australia is to have a strong medium-term outlook such challenges must be overcome.

9

ECONOMICS TEACHING: STRATEGIES AND RESOURCES

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ECONOMICS TEACHING: STRATEGIES AND RESOURCES

ANITA FORSYTH

Isn't it exhausting trying to be a 'whizz bang' economics teacher? Having taught economics for fifteen years and being involved in economics method in the Diploma of Education course for nearly as long, I think I can say that to teach economics well is extremely demanding and challenging.

Some of the reasons for this stems from the fact that we constantly need to keep up-to-date with changing conditions in the economy which is one of the main reasons for attending a conference such as this!

However, something that has concerned me as I talk to both student teachers and practising teachers is that one of the challenges of teaching economics is to try to start off new topics and lessons with students being actively involved and motivated rather than being passive learners.

This paper aims to give you a taste of some ideas you may find useful as introductory tasks for beginning units of work and lessons which hopefully:

(i) interest and involve students;

(ii) are student centred;

(iii) encourage students to look for answers without being told the 'correct' answer.

'Pre-tests'

Using a pre-test at the commencement of a new topic fulfils a number of objectives:

(i) it allows you to find out what students already know or feel or can do in relation to this topic;

(ii) it allows all students to be involved;

(iii) it provides a basis for stimulating further discussion.

Here are a couple of useful examples:

My thoughts on unemployment — appropriate as you begin a unit on unemployment. (See **Table 1**).

Examining attitudes to poverty — appropriate when commencing a topic on income distribution or poverty.

Table 1: **My thoughts on unemployment**

Complete each of the sentences below. Work by yourself and try to think carefully about what you really believe to be your opinion. Then be prepared to compare your answers with other people.

1. People who are unemployed are (what type)? ....

....

2. People are unemployed because (why?): ....

....

3a. Everyone should work because: ....

....

OR

3b. No-one should be forced to work because: ....

....

4. Persons receiving unemployment benefits are (what type?): ....

....

5. I think we could overcome some of the problems of unemployment if: ....

....

6. If my mum lost her job I'd feel: ....

....

7. If my dad lost his job I'd feel: ....

....

8. To be unemployed means:
   1. ....
   2. ....
   3. ....
   4. ....
   5. ....

9. If I was unemployed for a long time I would feel or act: (circle one word in each column)

bored	excited	freakish	confident
honest	violent	worker	harmless
lazy	rich	person	bludger
nice	tough	layabout	frustrated
happy	hard	slave	greedy
quick	quiet	thief	achievement
angry	selfish	embarrassed	

And I would spend most of my time: ....

Source: *The Work Kit* Social Science Press (1989) Resource Sheet No.136.

Examining attitudes to poverty

Here are some common views about poverty in Australia. To test your own views, place a tick in the appropriate column after each statement in **Table 2**.

There are a number of identified attitudes to issues like poverty and powerlessness in our community. The questionnaire which you have completed assesses two of these attitudes.

a. The individualistic attitude. Individuals are seen to be primarily responsible for their situation.

b. The structural attitude. The way society is organised is seen to be primarily responsible for people experiencing relative poverty, discrimination or powerlessness.

Scoring your answers

For each 'strongly agree' answer score 1.
For each 'agree' answer score 2.
For each 'neutral' answer score 0.
For each 'disagree' answer score 4.
For each 'strongly disagree' answer score 5.

Now add up your answers for questions 1, 3, 5, 7, 9, 11, 13. This will give you your score on the individualistic attitude. If you score 19 or less on this scale, it suggests a tendency towards an individualistic attitude towards poverty. Add up your answers for questions 2, 4, 6, 8, 10, 12,14. This will give you your score on the structural view of poverty. If you score 19 or less, it suggests a tendency towards the structural attitude.

Because these scales are not totally mutually exclusive you may find that you hold each of these attitudes to a varying extent. What explanations can you think of for this?

Source: Hollingworth, Peter (1990), *Australians in Poverty*. Brotherhood of St Laurence, Melbourne.

Simulations, Role Plays and Group Work

Simulations and role plays involving group work are an interesting way for students to begin an inquiry into a problem. The problems often concern questions such as:

- What is the nature of the problem?
- What are alternative solutions?
- Which would I choose and why?

Table 2: **Examining attitudes to poverty**					
	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
1. People are only poor because they are bad money managers.					
2. Society's failure to provide good schools for everyone contributes to the existence of poverty.					
3. Most people could improve their condition if they tried.					
4. The government should reduce poverty by taxing wealth more to increase pensions and benefits.					
5. Too many people receiving pensions or benefits spend their money unwisely.					
6. In general, people on higher incomes have little idea of the difficulties faced by low-income people.					
7. It is part of the natural order that some people live in poverty while others do not.					
8. In Australia there is one law for high-income people and another for people on low incomes.					
9. There are too many people receiving government benefits and pensions who should be working.					
10. Being wealthy in Australia has a lot to do with knowing the right people.					
11. When people are given things free, their initiative is destroyed and they become lazy.					
12. People in poverty generally lack the power to change their situation.					
13. People receiving unemployment benefits for more than a few weeks should be compelled to do some kind of community work.					
14. More often than not, people are in poverty because of circumstances beyond their control.					

- Who is right?
- Is one alternative clearly preferable or might people with other values choose differently?

An extremely comprehensive list of simulations is to be found in David Whitehead and David Dyer (Eds) (1991), *New Developments in Economics and Business Education*, Kogan Page, London.

To illustrate how well this type of approach works, here are some examples:

Topic: Income Distribution

[Source: Kenneth J. Neubeck (1979), *An Income Distribution Simulation* in D. Whitehead (Ed.), *Handbook for Economics Teachers*. Heinemann Educational, London.]

Here is a simulation appropriate for beginning a topic on income distribution:

Step 1

The teacher begins the simulation by giving the class a ten-question test. The best way I have found to do this is to set objective test questions on the theme of income distribution.

Step 2

The correct answers are announced. Students are allocated ten points for each correct answer. This represents the reward in dollars for work completed.

Step 3

The aggregate class score is computed and students are advised that this number represents the total income in dollars 'earned' by the class through its 'work' (on the test).

Step 4

The students' task is to decide how to distribute this income amongst all those present which encourages students to articulate and contemplate their values concerning economic inequality. Possible solutions include equal shares, productivity based allocation and guaranteed minimum incomes.

Step 5

The teacher divides the class into small groups. Each group must reach a consensus on one income distribution system and choose a representative to state and define their decision.

Topic: The Effects of Unemployment

[Source: S. Dillon and R. Stanton (1991), *Economics: An Issues Approach*. Heinemann Educational, Melbourne.]

This interview is appropriate when starting a topic which looks at the effects of unemployment.

An interview with 'George' aged 18 years, about his experiences of being unemployed:

Interviewer: How long have you been unemployed George?

George: It was about six months. But it felt like two years, it was so drawn out.

Interviewer: What happened?

George: I left school about half way through the year. I thought I'd get a job for a few months, get some money together to move out of home, and then go to Art School.

Interviewer: Did you apply for jobs?

George: It took a couple of weeks to start looking. At first it felt like a bit of a holiday because my parents were happy to look after me. After a few weeks, I started getting a lot of pressure from my family — and I mean every member of my family — to get a job. I started feeling really guilty.

I got a job in a screen printing factory. I thought it would be cool. It was the worst. I'd sit at this machine for what felt like six hours without even moving. It was intensely boring. The other people in the factory were really racist too. I did that job for about eight days. Then I left without collecting any money. I just left on the Wednesday and didn't come back.

I got another job moving furniture. It was good because you'd work maybe a 24-hour week, for about $11 an hour. Then I lost this job, and started to get really depressed. My parents said I couldn't hold down a job. At that stage I was so bored, I sunk to the lowest level I've ever been.

I got so lazy, I barely visited my friends. I'd sit around the house and watch TV. My sister and brother were also unemployed. We were all really bored. We'd fight constantly. Really intense fights. The days just faded into one another. It dragged on like this for ages.

Interviewer: How hard did you try to get other jobs?

George: I stopped after a while. I had this idea that there were no good jobs. I wanted to work but I had this pessimistic attitude about everything. I was feeling like a social outcast. I didn't feel like I had a place in society. I knew I was intelligent enough to do so many things, but I felt totally restricted.

Interviewer: Did you go to the Commonwealth Employment Service (CES)?

George: I did. I found it a pretty cold place.

Interviewer: Do you think you were too choosy about the sort of work you'd do?

George: Probably, but what's the point of living if you don't have any goals? At school, I had big ambitions. I didn't want to live my life in a screen printing factory.

Interviewer: Did you apply for Job Search Allowance?

George: No. There's a real stigma in doing that. Most of my friends who are unemployed haven't done it either. The thought of being on the dole is like you've given up. You're brought up to think 'dole equals bludger'.

Interviewer: Did you feel you were living in poverty?

George: In a way, I was lucky, because my parents supported me. If you don't have that, it's impossible. Still there were so many things I wanted to do, and I couldn't afford any of them. I couldn't afford to go anywhere outside Carlton. I know Carlton so well, I'm sick of it.

Interviewer: This week, you've gone back to school.

George: I was accepted for Art School. It's a bit like a dream. I'm still living in the haze of unemployment. I can't believe I'm finally doing something.

- Role play the interview in class. (Perhaps you could choose students and ask them to dress in the role of an interviewer, eg. 'Jana' and an unemployed person.)
- After the role play, divide the class into small groups and ask the groups to discuss the following:
  1. How unemployment affected George's life.
  2. Comment on George's attitude to accepting government welfare payments.
  3. Identify any factors which helped George get through his period of being unemployed.
  4. Comment on whether it was George's own fault he was unemployed or do you blame other factors?
  5. Discuss whether society should be concerned about how unemployment affects people like George.

Topic: Types and Causes of Unemployment

[Source: B Lee, [1989], *Sample Lesson Plan.* Printed in Compak VCTA, Volume 2.]

This activity may be appropriate when commencing a topic on the types and causes of unemployment.

Step 1

Teacher starts out lesson by saying that on the way to work today on radio talk-back someone said: 'All these people who are out of work are bludgers! The only reason they can't get a job is that they are too lazy to look for work!'

Step 2

Ask students if they agree or disagree.

Step 3

Students are asked to select a 'case study' and read it out to the class. Examples of these case study cards include:

- 'I've just left the Royal Melbourne Institute of Technology (RMIT) with an Accounting qualification. There are lots of jobs around. At the moment I'm having lots of interviews, but I haven't found a job yet.'
- 'I'm a welder — I used to work on an assembly line, but took time off to visit my family in Greece. When I came back, I had been replaced by a robot.'
- 'I was a chalkie at the Stock Exchange. They've just introduced computer trading of shares, so I've been retrenched.'
- 'I'm a wood cutter. Now that businesses have stopped investing in new building and equipment there isn't much demand for wood. I'm on the dole at the moment.'
- 'I'm a single mother with two children, one of whom is blind. I would love to work, but I can't leave the kids.'
- 'I once played a piano in a band. However these days all the bands which are popular use synthesisers, and as I can't use one I haven't been able to get a job.'
- 'I'm a home-maker. I used to work as a hairdresser years ago, but have been busy looking after my family. I'd love to get a job again, but feel out of touch with the new methods of cutting hair, perming, etc'.
- 'I was trained in the country I came from as a lawyer. However, my English isn't very good yet, and I would have to go back to University to requalify. That's difficult as I've got children at high school. So I'm working on the assembly line at Ford.'

Step 4

Teacher asks students to find and sit with other people who have similar reasons for being unemployed.

Step 5

Students form groups (loosely based on hard-core, frictional, seasonal, structural, cyclical unemployment).

In their groups they are asked to decide upon:

(i) a name for the type of unemployment;

(ii) a definition of this type;

(iii) some examples.

Step 6

Students are asked to report to the class what they have concluded.

Step 7

Each group asked to refer to a textbook to find the 'label' for each type of unemployment that economists use.

Topic: The Nature of Economic Systems

Simulation: Unequal Resources Game

(Source: *Mary Ruth Marshall* (1972), *Annual Handbook for Group Facilitators.*)

Purpose:

This game is designed to help players understand the feelings and actions of individuals and groups when resources are distributed unequally. It highlights behaviour when the job to be done becomes more important than the people involved, and gives an opportunity to observe the bargaining process. It is an appropriate teaching strategy when starting a unit on economic systems or what is economics about.

You will need:

1. Four copies of the Unequal Resources Task Sheet, one for each team.

   Unequal Resources Task Sheet

   Each team is to complete the following tasks:

   (i) Make a 7cm by 7cm square of white paper.

   (ii) Make a 10cm by 5cm rectangle of red paper

   (iii) Make a four-link paper chain, each link in a different colour.

   (iv) Make a T-shaped piece 7cm by 10cm in green and white paper.

   (v) Make a 10cm by 10cm flag, in any three colours.

   The first team to complete all tasks is the winner. Bring your completed tasks to the Game Director, who will check them for accuracy.

2. Four large mailing envelopes or paper bags, each one labelled with a team's number.
3. Resources for each team:

   Team 1:

   One pair scissors, one ruler, ten straight pins, three pencils, a stapler **but no staples**, one A4 sheet of white paper.

   Team 2:

   One pair of scissors, one bottle of glue, three 13cm by 13cm squares of coloured paper (one red, one green, one blue).

   Team 3:

   Six felt pens (one each red, green, blue, purple, orange, black) and two 13cm by 13cm squares of coloured paper (one orange, one purple).

   Team 4:

   One box of staples to fit Team 1's stapler and 6 x 13cm by 13cm squares of coloured paper (two red, one orange, one blue, one green, one purple).

   Do not exceed these allotments. Other colours may be substituted, but in the same proportions. The Task Sheet must be changed if other colours are substituted.

   Place each team's resources into the appropriate envelope or bag. Add a copy of the Unequal Resources Task Sheet. Seal or shut the envelope carefully so that the teams do not see one another's resources.
4. Chairs for each team. Place these as far apart as possible.

Playing the game

1. Divide the group into four teams and have them take their places.
2. Distribute the envelopes of resources, one to each team. Tell them not to open the envelopes until you give the signal.
3. Read aloud the following: 'Each team has different materials and tools but each team must complete the same tasks. The tasks are listed on the Unequal Resources Task Sheet, one of which is in each envelope of resources. The first group to complete the tasks is the winner. Open your envelopes now and begin'.
4. As the game goes on, observe as much group and bargaining behaviour as you can. Make notes of comments or suggestions overheard which will be useful in the debriefing session.
5. When a team declares its task completed and brings the items to you,

check each one for conformity to standards. Reject any which are not precisely the size requested. Teams which fail to meet standards may return to work.

6. Declare as winners the first team to complete all five tasks exactly as described.

Debriefing

(Use these questions first to help people express their emotions).

1. What happened in the game?
2. How did you feel about your team's resources?
3. How did you feel about the other team's resources?
4. Was there violence or conflict?
5. Between which teams was there conflict and how did it start?
6. How was the conflict resolved?
7. What helpful offers or bargains were made?
8. Who took the initiative in planning strategy?
9. Was there any individual or team you did not trust? Why?
10. Did anyone feel ignored or treated a with lack of consideration?
11. In the game, did you do anything contrary to your own values? How did you feel about this?

Discussion (use these questions after everyone has had a chance to talk about feelings and experiences)

1. What were the factors which helped the winning team to win?
2. What were the factors which helped the losing team to lose?
3. How was this game like life? How was it unlike life?
4. What nations are like Team 1? Team 2? Team 3? Team 4?
5. Which team is your nation most like? Why?
6. What groups in your society are like Team 1? Team 2? Team 3? Team 4?
7. What did you learn about economic power in this game?

The Newspaper

The newspaper is an essential source for economics teachers and students. However most of us don't have much imagination when it comes to using an article or cartoon from the newspaper. Generally we ask students to read and either summarise the material or answer some 'comprehension' type questions.

Perhaps some of the following ideas may be of use to you when you set tasks around a news item and want to engender interest in a topic and/or introduce a topic to students:

1. Headlines are an interesting focus for a newspaper item — often they are 'value' laden and/or provide a 'summary' of the main point of the article. Perhaps you could ask students to:
   (i) make up different headlines for different articles;
   (ii) fill in the missing word from a headline;
   (iii) write a different article for any of the selected headlines.
2. Sometimes newspaper photographs may have an economics slant. Why not ask students to:
   (i) make up a headline for a photograph;
   (ii) write a short news item explaining the events surrounding the scene in the photograph;
   (iii) write up the conversation that may be taking place in the photograph.
3. Editing the article may help students to focus on the important items in it. Ask students to:
   (i) choose the sentence in an article which best sums up the main ideas of the writer;
   (ii) write a summary of article.
4. Other ideas using the newspaper include:
   (i) write a letter to the newspaper as an individual or a class giving your views on any issues raised in the newspaper;
   (ii) write a response to any of the letters to the editor written up in the newspaper;
   (iii) make a visual collage using headlines, cartoons, photographs, graphs, etc, showing a range of views on a chosen topic and/or summarising views on a chosen topic;
   (iv) give reasons why you agree or disagree with the arguments put forward in an article;
   (v) for any issue, identify the number of different views expressed;
   (vi) consider which groups might hold views or opinions on an issue and why;
   (vii) prepare a feature article on a current issue for submission to the school newspaper;
   (viii) distinguish between facts and values as presented in an article;
   (ix) prepare some questions about an issue and interview different people about their opinions, reactions, arguments for or against.
   (x) circle all economic concepts in the newspaper item. List the concepts and devise a concept map.

Resources

(i) Sources which provide some further ideas on role plays, simulations and group work include:

- Davison, A.J. (1989), *Strategies and Methods: A Guide for Teachers of the Social Sciences*. VCTA, Collingwood.
- Dillon, S. and Stanton, R. (1991), *Economics: An Issues Approach*. Heinemann Educational, Port Melbourne.
- Joint Council on Economic Education (1984). *Master Curriculum Guide in Economics*, New York.
- ——— (1981), *Strategies for Teaching Economics*.
- ——— (1985), *Teaching Strategies — High School Economics*.
- ——— (1985), *Teaching Strategies — Consumer Economics (Secondary)*.
- Whitehead, David J. (Ed) (1979), *A Handbook for Economics Teachers*. Heinemann Educational, London.
- Whitehead, David J. (Ed) (1980), *Economics Education: A Second Handbook for Economics Teachers*. Heinemann Educational, London.
- Whitehead, David J. and Dyer, David (Eds) (1991), *New Developments in Economics and Business Education*. Kogan Page, London.
- Whitehead, David J. (Ed) (1988). *Trade offs: Simulations and Role Plays for Economics*. Longman, London.

(ii) It is always a constant battle to keep up-to-date about the state of the economy, changes to policy, etc. so I thought I would include for your interest a list of the publications other than 'proper' textbooks I use to keep updated!

(a) **Subscription Services**

- *Ecodate*. Warringal Publication, PO Box 336, Fitzroy, Victoria, 3065.
- *The Economics Education Review*, EERC, PO Box 92, St Leonards, New South Wales, 2065.
- *Economics Update Service*, Conifer Publications, PO Box 385, Ballarat, Victoria, 3353.
- *The Student Economist*, Anthony Kelly, South Pacific Publishing, GPO Box 1035 H, Melbourne, Victoria, 3001.

(b) **Bank Publications**

- *Reserve Bank Bulletin* and *Annual Report*, Box 3947, GPO, Sydney, New South Wales, 2001.
- *Business Indicators*, ANZ Economics Department, 7th Floor, 55 Collins Street, Melbourne, 3000.

- *Economic Newsletter*, Commonwealth Bank, GPO, Box 866J, Melbourne, 3001.
- *Facts and Figures*, National Bank of Australia, Public Relations Department, 24th Floor, 500 Bourke Street, Melbourne, 3000.
- *Market Insights*, Westpac Banking Corporation, 360 Collins Street, Melbourne, 3000.

(c) **Student Guides**

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COMPARATIVE ECONOMIC SYSTEMS: *PERESTROIKA* REVISITED

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Command planning with its State ownership of productive resources and a highly centralised management of the economy, was established in the Soviet Union by Joseph Stalin during his first Five Year Plan (1928–1933). For over fifty years, command planning had appeared to provide industrialisation and rapid economic growth but at the expense of political freedom and low levels of household consumption.

In December 1991, the Soviet Union's great experiment in command planning came to an end as the Union officially ceased to exist and was replaced by the Commonwealth of Independent States (CIS). The CIS embraced most of the former republics, including Russia — the largest and economically most significant republic. It was Mikhail Gorbachev, who had become General Secretary of the Soviet Communist Party in 1985, who virtually presided over the disintegration of the Soviet Union and its command planning economy. In this paper, I shall focus on three broad areas of the decline in command planning in the Soviet Union: *perestroika* and reform; the disintegration of the Soviet Union and the reform programme of Boris Yeltsin.

Perestroika and Reform

Reform of the command planning system in the Soviet Union and Central Europe had been attempted before (eg Poland in 1956, the Soviet Union in 1965, Hungary in 1968 and Czechoslovakia in 1981) without any real success in improving the performance of the system.

In the Soviet Union there had been a strong feeling of dissatisfaction with the performance of the economy for many years prior to Gorbachev's rise to power in 1985. Areas of dissatisfaction included the declining rate of economic growth, poor quality goods and services, chronic shortages, inefficient enterprises and the failure to match the technology and worker productivity gains of the major market economies.

Gorbachev began his economic reforms in 1986, and in 1987 began his call for *perestroika* or restructuring of the economy. *Perestroika* was seen by Gorbachev as a means of reforming command planning and making it work more efficiently — not of fundamentally changing it. The main reforms centred on the creation of 'superministries', quality control, prices, wages and the State Enterprise Law. *Perestroika* was given additional thrust by the Gorbachev plan of 1990 that did appear to attempt genuine reform on property rights with a move to diverse ownership and control of productive resources and, vague attempts to create a modern market structure. We shall now look at the main areas of reform under *perestroika* and later the Gorbachev plan.

The creation of superministries was designed to unify, in one structure, various aspects of one particular section of economic life. The most important superministry created was *Gosagroprom* (State Agro-Industrial Committee) which was much more powerful than any of the individual ministries which were combined to form it.

The reforms on quality control under *perestroika* brought in State inspectors in an attempt to raise the abysmal quality of consumer goods. However, there is little evidence to suggest that the reform resulted in a significant improvement in quality.

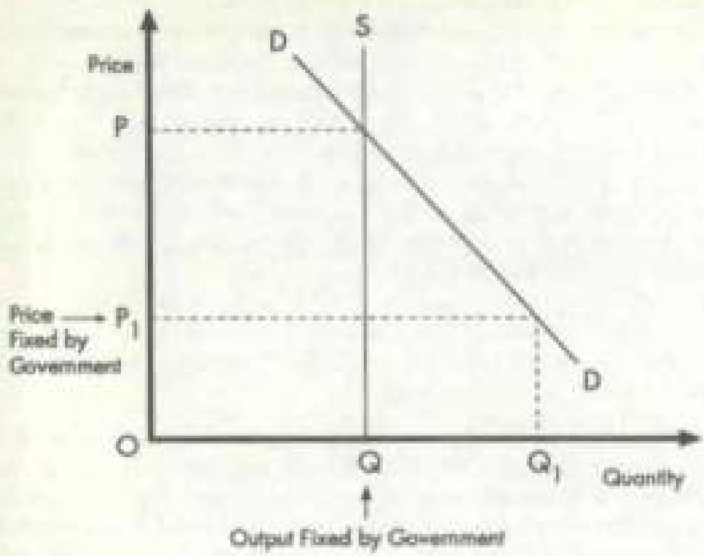
The *perestroika* reforms aimed to modify prices to enable them to more closely relate to the real costs of producing goods and the quality of goods. Under command planning there had been no market as nearly all prices were fixed by the central planners.

Wholesale prices had tended to serve primarily as accounting prices and played no real allocative role. They were established by the planning authorities and had been based on so-called average costs of production with a small profit mark-up. Reforms under *perestroika* were designed to create a genuine market for wholesale trading that would bring supply and demand into direct contact. However, what actually happened was that most of the wholesale trading between enterprises deteriorated into crude bartering with rouble prices becoming meaningless.

Retail prices had been designed by planners to clear the 'market', that is, to equate supply and demand. However, in reality, most prices had not changed for as much as fifty years and were, in most cases, well below market clearing levels. There were serious shortages (See Figure 1), with some goods unobtainable for very long periods, and seemingly endless queues for most consumer goods that were available. Under *perestroika*, retail prices were to more closely reflect production costs, quality and consumer preferences. Needless to say, these were virtually impossible aims without the operation of a real market. The *perestroika* price rises never took place, nor did those proposed under the Gorbachev Plan. Instead, more and more better quality retail goods were channelled into and found their real price levels on the illegal black markets.

Wages had been designed by central planners to have small differentials between occupations regardless of skill, productivity or relative scarcity, even though they were supposedly to play a significant allocative role. Under the *perestroika* reforms wages were to more closely

Figure 1: **The effects of price fixing under central planning**



With supply fixed at OQ by central planners and demand at DD, equilibrium price is OP. However if central planners set the price below equilibrium at OP_1, then a shortage of Q–Q_1 would result. This was often the case in the Soviet Union.

When some prices were freed in January 1992 they quickly rose to equilibrium levels or even beyond (if retailers set unrealistically high prices). As long as the market develops and output is no longer centrally planned, reformers expect that output will increase in response to higher prices and supply will become more elastic.

reflect productivity and scarcity. As well, the shedding of excess labour was to be encouraged, to increase wage flexibility and the profitability of enterprises. The reforms certainly brought about wage rises which, along with other factors including very loose fiscal and monetary policy, produced a 'roubles overhang' with the potential for producing hyperinflation.

The publicly owned enterprise was the basic unit of production in the Soviet Union. It was the creation of the government, who provided its assets. Its output was centrally determined. Most enterprises were very inefficient when compared with firms operating in Western market economies.

The reforms on enterprises (the State Enterprise Law of 1987) aimed to: improve their financial discipline (including procedures for enterprise debt recovery, liquidation and bankruptcy), shift the emphasis from output to profit and to make them more independent of the central planning authority.

Under central planning, the private sector had officially ceased to exist, except for small private plots on collective and State farms. Unofficially, there was a thriving black market that had become increasingly criminalised.

In 1987, Gorbachev introduced the **Law on Non-Socialist Enterprises** which encouraged the growth of co-operatives, joint enterprises, commodity exchanges and 'independent' or privatised State enterprises. The move to non-socialist enterprises was also accelerated by the Gorbachev Plan.

Co-operatives were staffed by shareholders, but were also permitted to hire workers. The co-operatives mushroomed and by 1990, there were over 200,000 co-operatives employing more than five million people. This appeared on the surface to be a private enterprise boom — but the reality was different. Over 80 per cent were affiliated with (or controlled by) State enterprises. In seeking higher profits and therefore prices, many State enterprises had turned some of their production facilities into co-operatives, producing the same goods with the same workforce and distributing them through the same State channels. As central government control over enterprises began to break down, the number of co-operatives in the former Soviet Union dropped back to around 150,000 by early 1992.

Joint ventures were aimed at involving State-owned enterprises with foreign companies by setting up a new independent company together. However, many joint ventures involved a State enterprise entering a joint venture with a foreign partner and then charging dollars for goods or services that used to be available in roubles. Evidence from Communist Party files since the August 1991 coup suggests that a lot of cash accruing to the Soviet partners was secreted away in foreign bank accounts by corrupt enterprise managers.

Commodity exchanges were developed as another private sector initiative. They began in 1990 and by early 1992 there were around 6,000 brokerage firms working in around 400 stock markets mainly in Russia. The commodity markets sell goods ranging from sneakers to computers and have provided direct competition to the former monopoly State supply system.

A fourth initiative has been the privatisation of existing enterprises — mainly through employee buyout. This initiative was on a very small scale with little achieved by Gorbachev. As we shall see later in this article, Yeltsin hopes to achieve a far higher level of privatisation.

Significant changes in the banking system have also taken place since 1987. Prior to *perestroika*, there were only six banks (plus the Central Bank) and the banking system was just the financial counterpart to the central planning system. Enterprises were allocated money from the government budget rather than borrowing from the banks. By early 1992, there were about 1,500 banks in the former Soviet Union and they were 'commercial' in the sense that cash must be raised for onward lending by attracting deposits and by earning profits in loans.

However, the new commercialised banking system is hardly comparable with those operating in Western market economies. Around fifty per cent of them have been established by enterprises in the same business in order to lend money to themselves. Thus, in early 1992 loans by many banks in the former Soviet Union were heavily concentrated and dependent upon changes in the business fortunes of their founders.

The move to privatisation has been most successful in agriculture. 'According to official statistics, there are 38 million private farmers in the ex-Soviet Union' ('The Wild East', *The Economist*, January 4th, 1992). Even though this figure includes the plots of collective and State-farm workers it represents over a third of the agricultural labour force. Anecdotal evidence suggests that there are 30,000 real private farms (ie. farms which provide the main or only source of income for the families that work them).

The Disintegration of the Soviet Union

As previously stated, *perestroika* aimed at reforming command planning to make it work more efficiently. Along with *glasnost*, *perestroika* was to bring a better way of life to the Soviet people, not to destroy command planning and the Union.

Perestroika was a complete failure. The new freedom in enterprises resulted in managers syphoning off enterprise income that used to go to the central government. The government tried to preserve social peace through bigger consumer subsidies and welfare spending. The budget deficit soared and the money supply grew rapidly, especially in 1991. The 'rouble overhang', associated with fixed prices resulted in many consumer goods (including good quality food) being diverted into free or black markets. There was rampant inflation while, officially, prices remained fixed.

The new freedom of *glasnost*, the apparent failure of *perestroika* and the grab for political power by the republics and other factors led hardline communists to believe that they must act to preserve command planning, communism and the Soviet Union. In August 1991, they staged an ill-planned, short-lived coup that ensured the disintegration of the old system. Even though Gorbachev survived the coup, Boris Yeltsin was the hero of the coup resistance. Gorbachev resigned shortly afterwards and in December 1991, the new Commonwealth of Independent States (CIS) which included most of the republics of the former Soviet Union came into existence.

The President of the Russian Republic, Boris Yeltsin, emerged as the dominant politician in the CIS. He advocated radical reform but with a high level of co-operation among the republics. We shall now look at the reforms of Yeltsin and some of the possible effects.

Yeltsin and Reform

As President of Russia within the old Soviet Union, Boris Yeltsin had been a strong advocate of the so-called '500 Day Plan' for the rapid reform of the Soviet Economy proposed by Professor Stanislav Shatalin in mid 1990. It was a comprehensive plan for radical reform with a strict timetable for a rapid change to a market economy. It proposed great changes in:

- ownership and control;
- prices;
- agriculture;
- the foreign sector; and
- Soviet/Republic relationships.

The 500 Day plan was rejected by Gorbachev, who, instead, moved to implement the less radical Gorbachev Plan.

With the formation of CIS, Yeltsin moved quickly along the path of reform in Russia. He appointed the Deputy Prime Minister, Yegor Gaidor, to head a group of radical young reformers. Within one month they produced a comprehensive package of measures based on the recent radical reforms in eastern Europe.

The basic reform plan centred on creating a stable, market-based monetary system. Other reforms stemming from this include:

- prices and wages being allowed to rise to market clearing levels, thus eliminating shortages and the rouble overhang;
- the rouble be floated (initially) to allow international trade to flow more freely and discourage internal trade in dollars;
- the rigorous tightening of monetary and fiscal policy to prevent the development of an inflationary spiral.

Russian reformers are well aware that as long as most enterprises are owned and controlled by the State, price reforms on their own are unlikely to result in large increases in output. Thus a major part of Yeltsin's reform programme embraces a serious attempt at the privatisation of many State assets. Russia's State privatisation committee plans to implement this reform in two stages:

- By the end of 1992, over 100,000 shops and most of the country's light industry is to be sold at auction;
- By the end of 1994, a further large slice of States assets (equivalent to an estimated 60 per cent of GNP in 1991) is to be sold.

Being well aware of privatisation problems in other parts of Eastern Europe, Russian reformers have tried to design a programme that is both quick and simple, even though there are no clear rules. The most important aim has been to move as quickly as possible to create a structure of property ownership that would be seen by most people in Russia as more or less just. The main features (so far) have been:

- For large scale privatisation (ie large enterprises) workers have been given up to 25 per cent of shares (free) but generally without voting rights;
- Also for large scale enterprises, managers have been able to buy up to 5 per cent of shares with voting rights;
- The general public will also probably be able to gain access to shareholdings in large enterprises through a voucher system. At the time of writing (June 1992), the details of the voucher system were unclear;
- Small scale enterprises are generally to be privatised through the auction of shares.

In general privatisation is designed to be quick and simple with:

- anyone (excluding foreigners) able to buy shares; and
- no complex auditing to be used to determine enterprise values. The book value is to be used to provide the opening bid for tenders or auctions.

There will obviously be great problems associated with such a strong bid for privatisation. Among these will almost certainly be the problem that the scheme relies very heavily on the existing bureaucracy for implementation. The second is that the plan has the dual and probably contradictory aims of reducing the role of the State through privatisation and also attempting to balance the budget. Thus problems over prices could stall the whole plan. Even so, as **Table 1** shows, privatisation is proceeding at an accelerating rate.

Table 1: **Privatisation in Russia**

	Applications to buy	Numbers of sales made
Total 1991	330	
1992		
by Feb 1st	1430	590
March 1st	3715	1615
April 1st	18000	n.a.
	(cumulative totals)	

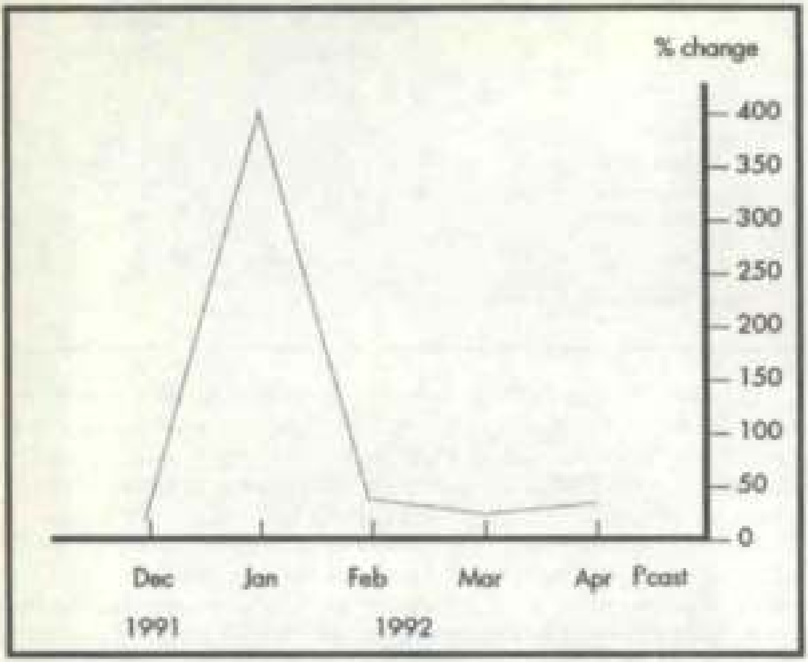
Source: *The Economist*, April 25th 1992.

Privatisation in agriculture appears to be proceeding most rapidly. In early 1991 about 97 per cent of Russia's farm land was occupied by 27,000 giant State-owned farms and 3 per cent by around 38 million private gardens. By April 1992, there were 70,000 family farms with the amount of land in private hands having doubled over the space of five months.

The reforms are in many ways similar to those implemented in Poland when, in early 1990, prices were freed and subsidies slashed. After an initial inflation of over 1000 per cent in early 1990, the inflation rate in Poland had dropped to around 70 per cent by 1991. Despite severe recession and widespread unemployment, there were some signs by early 1992 that the worst could have passed for the Polish economy. However, there were many in Poland who remained unconvinced that 'shock' price reforms were the best way to move towards a market economy. Despite the Polish reservations, the Polish model strongly influenced Yeltsin in his reform program.

Poland also suffered a steep fall in industrial output as it moved into the transition phase from command planning to a market economy. This alarmed many observers, but as Wieniecki has pointed out ('The Inevitability of a Fall in Output in the Early Stages of Transition to the Market', *Soviet Studies*, vol. 43, number 4, 1991), this should have been expected. In a command planning economy, State ownership of property rights gives rise to various forms of opportunistic behaviour by managers. These include the opportunity to shirk, steal and cheat with a very great temptation to cheat by falsifying actual output. Thus, even though output did fall in Poland, it is unlikely that it fell as much as statistics suggest, as some of the output probably never existed. A similar experience can be expected in Russia and other CIS countries.

Figure 2: **The price of the market**
Consumer prices, rise over previous month



Source: *The Economist*, 25th April 1992

The other major CIS countries, Ukraine and Belorussia, have shown strong support for the Russian program, by introducing similar reforms. Co-ordinated reform makes a lot of sense as the former Soviet Republics are extremely inter-dependent, with a very high level of inter-republic trade (eg 70 per cent of Belorussia's physical product is exported to other republics). By late February 1992, the Yeltsin reforms were being hailed by some as successful, by others as a failure. Certainly there has been rapid inflation with retail prices increasing at an annual inflation rate of well over 3,000 per cent in January (see **Figure 2**).

However, queuing had almost disappeared. By March, buyer resistance and increased supplies (attracted by the earlier rapid price increases) had begun to slow inflation from the frenzied rate of the previous month. As well, there was some deflation as goods that had been subject to panic buying and hoarding became more freely available. Even so, despite the changes, market prices have still not arrived because:

- many prices still are at least partially controlled by government; and
- retail outlets have no experience of arriving at the profit margins required to remain in business and there has not been significant time for supply adjustments.

As well, most of the economy is still in the hands of the bureaucrats and is stumbling along as a broken down command economy. There are enormous difficulties in enterprises obtaining sufficient supplies for normal day-to-day operations. This has not been helped by the severe accumulation of debt between enterprises.

Wages remain a major problem. Workers in industries that can sell their production for roubles, hard currency or other goods have been enjoying wage rises. However, many low wage earners with no capacity to increase their incomes are finding it difficult to survive. Pensioners, despite a pension increase in February, are also finding survival most difficult. As well, unemployment is beginning to loom as a significant problem.

Despite the enormous difficulties facing reformers and the people in Russia and other CIS countries, it is almost certain that command planning will continue to crumble and a market type economy will emerge. However, at the time of writing, reform had mainly taken place in the retailing and agricultural sectors of the economy, with much of the remainder of the economy still very much in the hands of the bureaucrats and existing as a decayed form of command planning.

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11

RECONCILING ECONOMICS AND THE ENVIRONMENT

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RECONCILING ECONOMICS AND THE ENVIRONMENT

DR JEFF BENNETT

Throughout eastern Europe the concepts of socialism and central planning have been shunned. It has been progressively recognised that the planning process is incapable of producing the level of resource use efficiency that can be achieved by a decentralized market based system. Not only did the process break down because, technically, the planning task was too difficult, but it was also found that the matching of incentives to goals was impossible and that the process was inherently susceptible to political corruption. This lesson in economics is possibly the most powerful yet delivered by the discipline.

It is one however which has not been accepted universally. Internationally, some economies stand by the socialist planning model — The Peoples' Republic of China for instance — and in our own predominantly market based economy, certain sections of the community argue strongly for an extension rather than a contraction of the planning/regulatory role of government. These sections are particularly vocal in the environmental debate and, for want of a better name, will be referred to as Greens. Their argument is, primarily, that so difficult is the task of allocating resources, given the complexities of the environmental impacts and inter generational concerns, that the simplistic market system cannot be trusted to 'get it right'. Furthermore, Greens have a belief that the actions of government will be able to secure resource allocations which satisfy their goals, notably the 'sustainability' of society. In other words, Greens believe that a system based on individuals seeking out their own best interests will yield a situation in which resources will be exhausted and environments irrevocably degraded so that further generations will be unable to enjoy the opportunities available to the current generation. They also believe that a sequence of government regulations and fiscal policies has the capacity to ensure sustainability.

In this paper, the twin beliefs of Greens are assessed, using an economic analysis of environmental resource allocation. Two fundamental questions are addressed:

- Can a decentralized market system effectively allocate environmental resources?; and
- What role can be played by government in the efficient allocation of environmental resources?

In conclusion, a way forward to a more efficient allocation of all resources, including the environment is suggested. It involves economics being used as a discipline which can aid in the analysis of environmental issues. For many, economics and the environment are seen as being diametrically opposed. It is proposed here that economic analysis can actually assist in achieving environmental goals. In this way, economics and the environment can be reconciled.

Markets and the Environment

The basis of the decentralised market system for allocating scarce resources is the mutually advantageous exchange of private property rights. For the system to function efficiently, these rights must be defined in law, be defensible in a judicial system and be available for trade without restriction. Nowhere in any economy do we find perfectly defined, defensible and tradeable rights. The existence of transaction costs in nearly every trading situation means that some restrictions apply. But for the majority of goods in our economy, the structure of rights is adequate for the vast majority of potential gains from trade to be realised. In the case of many environmental goods, rights are frequently ill-defined and as a result, trade cannot proceed and inefficient allocations result. The conventional economics literature classifies this as **'market failure'**; that is, the operation of markets will fail to produce allocations of environmental resources which are Pareto efficient.

A number of specific instances of 'market failure' arise when environmental resources are involved. The **first** arises when the actions of an economic agent involve the use of an environmental resource for which private property rights have not been defined. Because no one owns that resource, payment for its use cannot be secured and hence the opportunity costs of the action are not compensated. This is the case of an **externality**. Downstream users of a river remain uncompensated for the use of that river as a waste disposal site by a paper mill upstream. Without the payment of compensation for the opportunity costs, the paper mill has an incentive to create a level of water pollution which is greater than optimal. On a more global scale, the consumer of air conditioning who doesn't pay for the use of upper atmospheric ozone when the chlorofluorocarbons (CFCs) in the refrigeration unit are released, over-produces those CFCs and uses a larger portion of the ozone layer than is optimal.

The **second** form of environmental 'market failure' arises because the consumers of some environmental goods cannot be excluded from its use. Without the power of exclusion, no private entrepreneur has an incentive to provide the good as it is impossible to stop those who don't pay from using the good. These goods can also be provided to additional consumers at no extra cost to producers. The Pareto efficient price for their supply should therefore be zero. A positive price would prevent some people from experiencing a benefit from use which was available at no extra cost. This type of good is known as a **public good**. There is no private property right to a public good, and even if there were, policing violations of exclusion would be either impossible or prohibitively expensive. The enjoyment that people experience from the knowledge that an endangered species continues to exist (called 'existence value') has the characteristics of a public good.

The definitions of rights is also at the heart of the third type of 'market failure'. Greens argue that species have a right to exist beyond that defined by human beings. Markets, of course, operate on the basis of human involvement and property rights are defined in terms of human ownership. This argument therefore takes us out of a human based value system and requires the development of an ethic which incorporates an **'intrinsic value'** of species. The restriction of markets to an 'anthropocentric', or human centred base, precludes the incorporation of 'intrinsic values'.

Potentially as difficult to come to grips with as intrinsic values is the final 'market failure'. This involves the **rights of future generations**. Environmental resources have potential value for people who, as yet, are unborn. Market transactions are undertaken amongst the members of the current generation and will therefore provide resource allocations which reflect the value of resources to that generation. Furthermore, some uses of resources are 'irreversible' in that once a particular course of action has been chosen, it is impossible to reverse the consequences: once the Franklin River is dammed, the temperate rainforest and riverine ecosystems flooded are lost and can never be reconstructed. Similarly, with the Tasmanian Tiger rendered extinct, it can never be recovered.

These examples of 'market failure' appear to provide ample reason for dispensing with the market allocation of environmental resources altogether. To do so, however, would be akin to throwing out the baby with the bath water. First, it must be recognised that the market system is an extremely powerful mechanism for harnessing the energies of individuals in pursuit of their own self-interest to produce a socially acceptable outcome. These incentives are so great that if an alternative system seeks to counteract them, it is likely that a range of unintended consequences will arise. Secondly, attesting that markets have failed in these circumstances is not an entirely appropriate characterisation. Markets require an underlying institutional structure which ensures property rights are defined, defensible and tradeable. If that institutional structure is not able to perform this task, necessarily, markets will fail. It is therefore a matter more of **'institutional failure'** which renders markets incapable.

Both of these factors indicate that there is a need not to dispense with market allocation, but rather to develop ways in which the market system can be harnessed to allocate environmental resources efficiently. An immediately evident role for government is the development of an institutional structure which provides for a more complete definition of resource ownership and enforcement of that ownership. Undeniably, no matter how well a government can perform that role, there will still be circumstances whereby there are impossibilities in establishing a rights regime which is workable. What role can governments play in those circumstances and can we be confident that they will 'get it right'?

Governments and the Environment

Let us examine the *four* fundamental 'market failures' presented in the previous section and examine the likelihood of governments being able to institute policies which are able to succeed. This is necessary because along with the prospect of 'market failure', we must recognise the prospect of 'government failure', whereby the incentives faced by public policy makers cause environmental resource misallocation, which may even be on a scale greater than that created by market failure.

The most common form of government policy directed at the existence of externalities is the **direct regulation** of the activity causing the externality. In the context of pollution, this usually involves the specification of emission limits or technological standards. Land use zoning is designed to separate physically externality producing activities from those who are affected. Both of these policy approaches are unlikely to achieve resource use efficiency. The emission levels specified by governments are unlikely to be optimal. For them to be so, the government must be able to assess the marginal benefits and marginal costs of pollution control and equate them. Both are difficult to measure; benefits, because they are normally not marketed and so not readily valued and costs because polluters will be unwilling to divulge commercially sensitive information. The determination of the required level of pollution will therefore be more likely to be made at a political level. The incentives faced by politicians are more likely to involve re-election prospects than overall economic efficiency. Hence, lobbyists representing vocal minorities in marginal electorates are likely to have a greater impact on policy than the more politically reticent majority.

Even if optimal levels of pollution were determined and enforced, efficiency would not be achieved through regulation because all polluters are not equal. Some polluters can reduce their emissions more cheaply than others. Requiring all polluters to meet set standards ignores the advantages of specialisation in emission reduction. Additionally, regulatory controls provide minimal incentives for dynamic efficiency. Once controls are in place and satisfied, firms tend not to search for new and more effective ways of achieving the target level or less. This is particularly the case where specific technologies are enforced as the 'industry standard'.

Zoning regulations are also problematic when it comes to dynamic efficiency. Because zoning cements into place a structure of location, as economic and social pressures change through time, pressure to change the locational pattern builds until, through lobbying, legal action and even bribery, the zones are reallocated. The resources used in lobbying and litigation are effectively wasted to the society simply because of the zoning system.

The provision of public goods by governments is the most frequently applied solution to this form of 'market failure'. Hence, governments provide National Parks in order to satisfy peoples' demands for the continued existence of endangered species and ecosystems. Determining the optimal level of provision — like the determination of optimal pollution levels — is not simple and the political process is again the usual mechanism for this decision. The unpredictable and often capricious nature of the political process in this regard can have wider implications. An example of this is the decision by the Hawke Government to extend Kakadu National Park to include the site of a proposed gold mine at Coronation Hill, thus preventing the mine from proceeding. The forestry industry has sought to protect itself from this type of decision making through Resource Security Legislation. This legislation would effectively be a contract between the government owners of forests and the owners of proposed pulp and paper mills to secure woodchip supplies for the mills. The forestry industry has sought this legislation because of the fear that governments would bow to Green pressure to take out of production (for preservation) forests previously earmarked for logging. The legislation was defeated in the Senate in May 1992. Both examples provide concern regarding the security of property rights. If governments intercede effectively to seize a property right, the defensibility of rights is lost and the precedent so set.

The third 'market failure' previously mentioned, relates to the intrinsic rights of species and the solution proposed by governments — notably in the reports of the working groups established by the Federal government to report on ways of achieving 'sustainable development' — is a sequence of rules. These rules essentially preclude the possibility of species extinction through their requirement that if a development prospect threatens the continued survival of a species, it must be rejected. The implication of this type of rule is that any threatened species is of infinite value: no matter what costs will be borne, a species must not be allowed to become extinct. An example of the costs of avoiding species extinction can be found in the decision to ban the use of DDT. Because DDT concentrates up the food chain, it was thought that the reproductive capacities of predatory birds would be reduced to the extent that some species, (notably the American eagle) were becoming endangered. Banning DDT may have improved the prospects for the survival of these species, but it also had the effect of increasing malarial mosquito populations worldwide, with subsequent increased mortality rates amongst humans.

The lesson to be learnt from this is that absolutes are rarely optimal. It may, for instance, be that in the future, the survival of humanity is dependent on the sacrifice of another species of animal. Do we therefore continue to follow our sustainable development rule and submit to extinction? Furthermore, are we able to determine if 'natural' forces are at work to cause the extinction of a species. After all, the vast majority of species ever existing on earth are now extinct, independent of the actions of mankind.

Finally, there is the matter of the interests of future generations. Can governments be relied upon to care for the welfare of future generations? In considering this question, bear in mind that the most pressing incentive for the majority of politicians is to be re-elected at the end of the current term of Parliament, maybe three or four years into the future. This incentive does not exactly coincide with the long-term goals proposed by Greens. It can be argued that politicians are readily influenced by vested interests seeking their own immediate gain, potentially at the expense of not only their contemporaries, but also members of future generations. For instance, there is consistent political pressure on the Federal government to lower interest rates. A consequence of lower interest rates may be an increase in economic activity and a subsequent acceleration in the rate of resource use now relative to resource use in the future. Hence, a policy pursued to ensure the political survival of a government could have a cost to future generations.

The conclusion that can be drawn from these examples of government failure is that reliance on the planning approach will not necessarily be rewarded by efficient environmental resource allocation. To a substantial degree, the inefficiencies which have resulted from government involvement come from a combination of the inappropriate incentives evident in the political process and a neglect of the economic factors present. For environmental resource use efficiency to be improved there is a need for the recognition of economic forces: a reconciliation of economics and the environment can ensure improvements in environmental quality and economic wealth.

Economics and the Environment

Four specific aspects of 'market failure' have been established as reasons why environmental resources may not be allocated efficiently by the current regime of decentralised markets. But it has also been shown that current government policies are unlikely to produce efficiency. Each of these problematic areas will now be addressed to show how 'market failure' can be addressed through institutional reform and what role for government remains.

Externalities arise because of an inadequate definition of property rights. The first course of action to deal with the problem is therefore to extend the system of property rights to include all environmental resources for which rights can be defined. In other words, not only must the right be defined, it must also be possible to exclude non-paying users. Trade can then take place and like other resources in the economy, use requires payment. For example, if rights were established over waterways, anyone using that resource — for irrigation, waste disposal, recreation, domestic water supply — would have to pay for the right. The owner would establish the trade-off between alternative users by selecting the use with the highest marginal value and hence marginal willingness to pay. Trespassers on that resource — those who haven't paid — would be subject to legal actions. Exclusion may not be easy. Tracing the origin of chemical pollutants in a watercourse, for instance, may be technically difficult, but technological advances have been made and would be given further impetus if law suits were dependent upon it.

Other externalities, involving the use of resources which can not be excluded, cannot be treated in this way. Private ownership of the atmosphere above an industrial area, or the upper atmosphere of the world, cannot be made exclusive. The problems of policing such an ownership right are too great. Community ownership does afford the prospect of using economic instruments to ration the available resource more efficiently. For instance, once a community has decided upon the appropriate level of emission of particular atmospheric pollutants, rights to that total could be allocated using an auction system. In that way, polluters who have the lowest marginal costs of emission control will find it more profitable to clean up, whilst those whose process is not so amenable to control, will buy rights to pollute. A least cost solution is thus attained, with the added bonus that there is always in place an incentive to develop better and cheaper means of controlling emissions. This solution still involves the problems of potential government failure in determining the appropriate overall level of pollution — witness the difficulties involved in negotiating the setting of greenhouse gas emission levels internationally and the Montreal Protocol for the reduction of CFC production. It does however overcome the efficiency problems which beset the regulatory approach to pollution control.

The inability of a private owner to exclude users of a public good, render the use of private rights inappropriate in their allocation. However, it is rare indeed to find a pure public good. Mostly, goods have both private and public attributes. Take the case of species preservation. Many animals facing extinction at the hand of humankind are in that situation because they are 'unowned' and not because they are 'public goods'. They have private good attributes. Without ownership, there is no incentive for one person to refrain from harvesting. Ownership provides an incentive to care and to build up the species as a stock of wealth with the private attributes. The case of elephants in Zimbabwe is a classic example of a species nearing extinction being saved simply by installing a regime of private ownership for villagers. The ivory, meat and tourist values of the elephants were sufficient private attributes to ensure the continued supply of their public good attributes like existence values.

Whole ecosystems can be treated in this way. Private ownership of park land is accepted in the US, with organizations such as the Audubon Society and the Nature Conservancy aimed at mobilising the funds of people concerned about species survival to purchase ecosystems which offer existence values. Allowing conservation organisations in Australia to bid for areas, like Coronation Hill, against mining interests, would provide a real test for the relative strengths of preferences. Free-riding behaviour on the part of conservationists would be cause for some concern — people may not contribute to a 'Save Coronation Hill' campaign in the hope that others will pay enough to see the goal achieved at no personal cost. However, there appears to be remarkably little empirical support for the free-rider hypothesis amongst non-economists: churches are built, clubs function, etc.

The above examples show that humans will provide for other species' continued survival. The question of an intrinsic value for species thus boils down to whether there is a difference in extent between human values and intrinsic values. To a great degree, this is a question of ethics and cannot be answered simply. The contribution an economist can make here is to ensure that both intrinsic and human values are not included in a decision calculus because double counting would be involved. Furthermore economists can point out that all decisions — including those involving species preservation — give rise to costs.

More can be said about the interests of future generations. Surprisingly to some, the operation of the market now takes account of the interests of those as yet unborn. The price mechanism acts to ration scarce resources for users both now and in the future. For instance, a growing scarcity of a resource causes its price to rise. This signals to current consumers to reduce their use and to find substitutes. The incentive to develop substitutes yields dividends for future generations: investment in developing substitutes for petrol being undertaken by the current generation will yield alternatives, which may well be cheaper and cleaner, for future generations. Hence, the doomsday forecasts of the 1970's (and earlier) have proved incorrect simply because they failed to take into account the workings of the price system in rationing scarce resources. Just as past generations have used resources, but have also bequeathed a legacy of technical development which has opened up resource horizons for future generations, so too does the current generation. The time horizon of the market turns out to be for longer than that of the political process. The creation of 'sustainability rules' by governments runs the risk of subverting the actions of the market mechanism which aid future generations. Restricting the use of resources now may have the unintended consequence of delaying the development of technologies which will advance humanity in the future.

Conclusion

By analysing the complexities of environmental resource allocation, Greens have become concerned that the operation of the market system will be unable to ensure the sort of resource allocation they deem appropriate. This may well be true for two reasons. First, the goals of Greens may be very different from those of society at large and second, markets will not be able to function without an appropriate underlying rights system. Government intervention of a regulatory nature is largely unable to achieve efficient allocation of environmental resources for society, but it may be able to serve Green interests specifically. A more soundly based strategy for achieving environmental goals rests with a reconciliation of economics and the environment. This will involve addressing environmental issues with the tools of economic analysis. The prospect then is for both material and environmental goals to be more readily achieved.

Further Reading

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12

ECONOMICS IN NEW ZEALAND'S SCHOOLS

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Ken Baker is Executive Director of the Enterprise New Zealand Trust Inc, a charitable trust which promotes an understanding of business and economics in New Zealand schools. Specific programmes which support these objectives include the Young Enterprise Scheme and the professional development of teachers and secondary school principals. The Trust has widespread support from the corporate sector and makes extensive use of this support by running programmes which promote school - industry links. Originally a trained secondary school teacher, Ken was executive director of the New Zealand Finance Houses Association prior to joining the Trust.

ECONOMICS IN NEW ZEALAND'S SCHOOLS

KEN BAKER

In 1971 economics was introduced as an option in Form 7, the final year in New Zealand schooling. The syllabus was highly theoretical, using the then current edition of Samuelson as the basic text. This was perceived as an exciting and innovative development. Prior to this, the nearest to any economic content was contained in subjects such as commercial practice, social studies, geography, history and perhaps bookkeeping.

Several years later economics was introduced into Form 6 as a University Entrance subject. This was a more descriptive approach and contrasted with the theoretical Form 7 syllabus.

Continual pressure, particularly from the Commercial and Economics Teachers Association (CETA) and several school inspectors, led to the introduction of economic studies in Form 5. This, like the above introduction was an externally examinable subject and attempted to marry economics and the former commercial practice subjects. So Form 5 economics studies carried through the 1980s and into the 1990s as a hybrid; a mish mash of economic content and that of the former antiquated commercial practice.

Traditionally, in the New Zealand system, where the majority of students received a free education at State schools, the trend was for commerce to be the prerogative of students who were 'vocationally motivated' or even 'less able'. It is an interesting observation that business/economics education was, and still is, regarded as an area of study for the less 'academic' students — whoever they may be. Studying business or commerce at the practical level is often a subject for the work experience/transition class, students unable to gain jobs, or not likely to pursue tertiary education. It is absolutely critical that a more positive attitude towards commerce is taken.

During the 1980s increasing pressure was placed upon the Department of Education to appoint a curriculum officer to revamp the study of school economics. There was an obvious need for reform of economics based on sound curriculum developments. This appointment was made with the help of the Enterprise New Zealand Trust, whose then Director, Alan Simm, was an inspirational force in persuading the authorities of the need to promote the study of economics in schools.

An outcome was the national economics syllabus, covering Form 3 to 7 students. Economics is not compulsory as is mathematics, but any school teaching economics must follow the national syllabus guidelines.

Economics is defined as:

> 'The study of how people as individuals and groups choose to satisfy their wants by allocating and managing scarce resources.'

The curriculum is conceptually orientated and skills based. The syllabus defines the skills in four categories as follows:

- thinking skills;
- investigative skills;
- statistical skills;
- decision making skills.

These can be applied in varying degrees across the syllabus range.

The economics syllabus is structured as in Table 1.

Level 2 will be examinable from 1993. The introduction of economics and the new national curriculum into the schools has placed stress on teachers and the community.

Like The Economics Education Resource Centre, of which Tim Riley is the Director, the Enterprise New Zealand Trust has an interest in providing support to teachers and students. The Trust has a particular facility to tap into corporate sector resources to provide this support.

Surveys, undertaken by the Trust, suggest that maybe one third of all economics teachers have no tertiary study in economics or one year of university study only. Another third have a degree majoring in economics. Some 60 per cent of teachers have been teaching longer than ten years. What this implies for New Zealand students is that they are being taught by teachers whose economic knowledge, and even skills, are lacking in some way. This knowledge/skills gap is further intensified

Table 1: **Summary of New Zealand economics syllabus**

Level 1	Level 2	Level 3	Level 4
INDIVIDUAL	GROUPS	NATION	AGGREGATE
Economic Decision Making Economic Management Economic Participation ↓ Households	Production & Producers ↓ Industries ↓ The Market	ISSUES • Employment • Trade • Growth • Inflation • Inequality	Resource Allocation via the Market System ↓ Allocation via the Public Sectors ↓ Aggregate Economics Activity & Policy
Forms 3 & 4	Form 5	Form 6	Form 7

when it is considered that many of the teachers were brought up in, and taught within, the Welfare State. That is, you didn't teach for jobs. Teachers could be complacent in the knowledge that most pupils, irrespective of examination results or learning would be employed.

As you will be aware, the New Zealand economy, and indeed our school structure, has undergone dramatic changes. The Department of Education has been replaced by a Ministry of Education; primary and secondary schools are run by Boards of Trustees. In labour relations, the national awards are to be abolished and replaced by individual, or on site, contracts. There is talk of teachers' pay being performance related. Attempts to measure education performance on a quality assurance approach are growing.

State owned enterprises, for example in electricity, have been established with boards and run on commercial lines. Current electricity shortages are blamed on the Electricity Corporation and government for pursuing profit before consumer welfare.

In this environment, it is essential that teachers and students are supported in their knowledge update. In this process a more positive attitude towards economic and business studies is required — if not in Australia, certainly in New Zealand. As the Porter Project study on 'New Zealand as an Internationally Competitive Nation' pointed out:

> 'New Zealand's education system has not adequately prepared many New Zealanders to contribute to their own and the nation's well being'

(*Upgrading New Zealand's Competitive Advantage.* G. Crocombe et al., 1991)
The report noted that this was due in the main to the failure to install a spirit of competition or enterprise in our schools amongst teachers and students.

The Trust has recently researched and collated data on those students taking economics (economic studies) since the 1970s. It is ironic, and disturbing to say the least, to note what appears to be a significant decline in the numbers of students studying economics in secondary schools (see Table 2).

In 1983, participation peaked. The level of participation in economics in 1991 is back to the 1979 level.

This brings me back to one of my earlier comments. A knowledge of economics and business is a fundamental requirement of all citizens and not the preserve of a privileged group based on some educator's artificial categorisation. After all, an informed citizen is more likely to be a more responsible and enterprising citizen.

More effort is required to ensure that all of our students and teachers have an understanding of the economy and the workings of business.

Table 2: **Numbers taking economics in New Zealand secondary schools** (Selected years)

Year	Male	Female	Total
1974	1708	1000	2708
1979	32140	31766	63906
1983	40286	40511	80797
1988	39592	35717	75309
1991	33665	30072	63737

Source: Enterprise New Zealand Trust: Ministry of Education

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TRENDS IN INCOME AND WEALTH DISTRIBUTION

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TRENDS IN INCOME AND WEALTH DISTRIBUTION

JOHN MANGAN

Australia in the 1980s experienced an increase in income inequality amongst both males and females, with the largest increase in inequality being amongst male full-time workers.

In the initial part of the decade this growth in inequality was encouraged by government policies which constrained the incomes of wage and salary earners whilst removing constraints on the incomes of the self employed. The rapid but uneven growth in superannuation coverage was also a factor. In the latter parts of the decade, the recession impacted most heavily on lower income earners. Of course income distribution is a reflection not only of economic conditions but also of the social and political attitudes of a nation. It is important to remember that economics provides a mechanism for the distribution of income not a rationale. In Australia, over the last decade, the moves to reform the economy and increase economic efficiency have created greater income inequality to an extent that has outweighed traditional equilibrating forces such as social security. The present high levels of unemployment and other factors such as the rapid growth in part time employment and under employment are likely to see the trend towards greater income inequality continue in the short run as the labour market continues to segment. In the longer term, the unequal incidence of taxation, particularly upon single income family units and the growth in single parent families and falling percentages of home ownership, unless addressed by government policies, will see a long term trend in inequality entrenched.

Measuring Income Distribution

Attempts at measuring income distribution normally involve some form of inequality measurement, the most popular form of which is the Gini coefficient. This coefficient has some major disadvantages, most of which have been discussed at length (Mangan 1991). Its major advantage in terms of establishing time series measurement, is that a Gini coefficient has been calculated in Australia for the past 70 years and thus allows interesting historical trends to be established. **Figure 1** shows the latest ABS calculation of the Lorenz curve for the period 1989-90 for earned income by full time workers. Two main facts are derivable from this graph and the data that produced it.

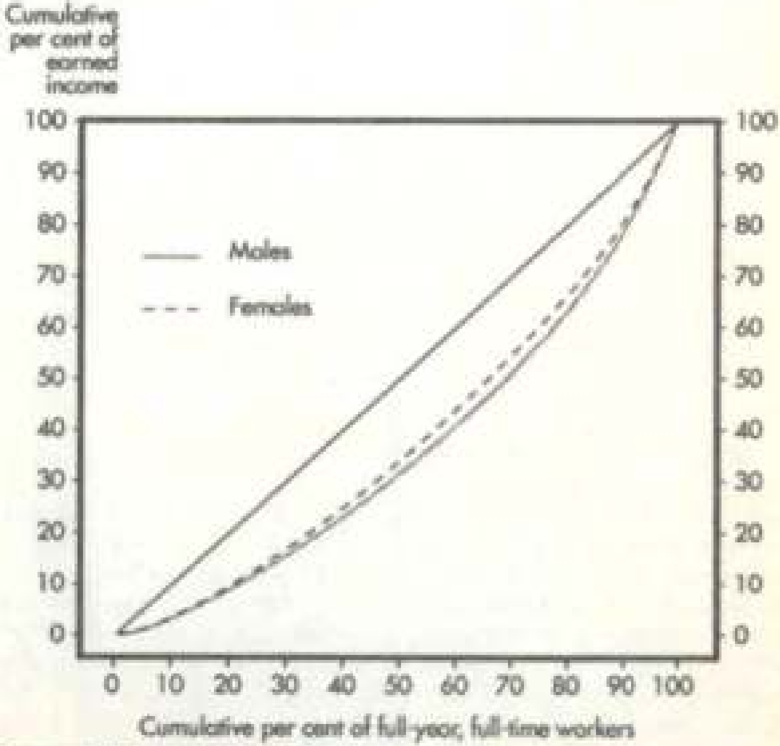
- An increasing inequality in earned income received by both male and female full year, full time workers over the period 1981–2 to 1989–90, with the Gini coefficient increasing by two percentage points for both males and females.

- The greater inequality amongst full-year, full-time male workers compared to female workers.

The trend over the last 75 years may be seen by reference to **Table 1**.

The most interesting thing shown in **Table 1** is how little income distribution has changed in Australia over the last seventy five years, despite the growth of the welfare State in the post war years. Most change has occurred amongst males and family units. The latter in particular have shown a substantial reduction in equality. This is due to the targeting of income transfer payments to non-workforce groups such as children, the aged and supporting parents. Moreover, recent work by McNabb and

Figure 1: **Lorenz Curve for full time workers 1989–90**



Source: ABS Cat. 6546.0, 1992, p.3.

Table 1: **Gini coefficients, individual income units**

Year	Males	Females	Persons	Units
1915–16	0.43	0.49	0.47	na
1933–34	0.49	0.40	0.50	0.49
1973–74	0.35	0.53	0.47	0.31
1979–80	0.35	0.48	0.44	0.31
1981–82	0.36	0.50	0.44	0.35
1985–86	0.36	0.49	0.44	0.35
1989–90	0.38	0.50	0.46	0.36

Source: Mangan (1991), ABS Cat. 6546.0.

Moss (1990) shows the importance of working wives in reducing inequalities in family unit taxation.

Superficial reading of the data would suggest that income inequality amongst females is slightly worse currently than it was 1916. However, several factors need to be considered here. Firstly, *fewer* females earned income in 1916, making inter-temporal comparisons difficult. Moreover the current propensity for married females to take part-time work adds to apparent income inequality when considered only within the female cohort. Joint male-female considerations, as in the family unit data, indicates that there has been, until the latest round of estimates, an overall trend towards greater income equality.

However, by most standards this trend has been modest. Economists often talk of natural rates in things such as unemployment and interest. The data in **Table 1** suggests that whilst there may not be a natural rate of income distribution, the prevailing level is remarkably resistant to government intervention.

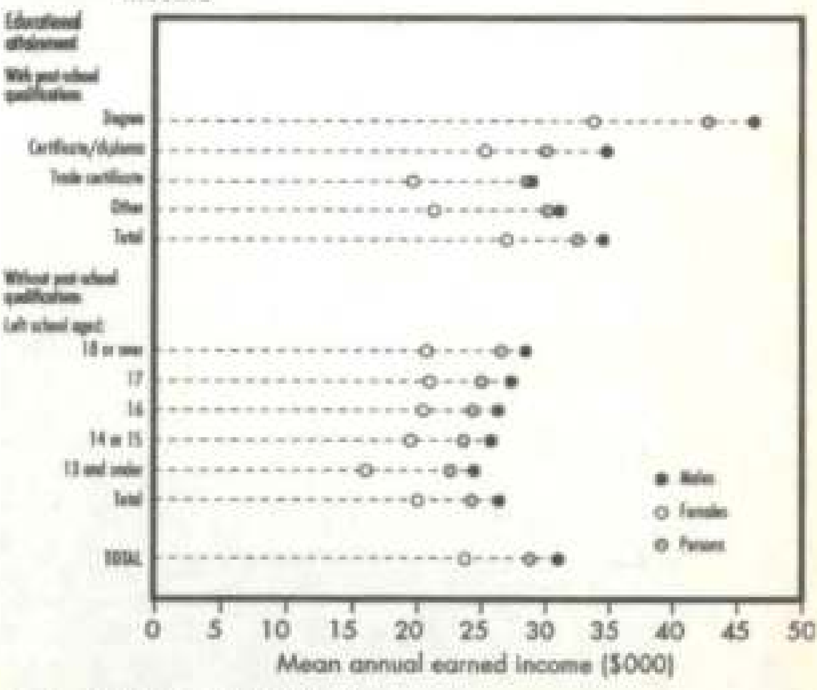
Factors Affecting Income Distribution

Education. Levels of human capital, traditionally measured in terms of formal education and training, have long been seen as contributing to income differentials (Miller 1984). The exact mechanism for this is under some debate. Traditional human capital theorists stress the productivity effects of education and training which then translates into higher earnings. More recently the screening hypothesis has seen education as a vehicle that employers use to ration jobs (King 1991). In either case, the empirical predictions are the same: possession of formal education and training will translate into higher earnings. Education then has a short and long term role to play in income distribution. In the short run, it would be expected that current wage differentials would in part be explained by educational differences. This appears to be the case. **Figure 2** plots earnings against gender and education. It is hard to tell which has the greater effect. In Australia in the 1980s it was important to have post school qualifications but maximum rent on these qualifications, could be gained by being male.

However, the long term role of education may be to reduce wage differentials. As the relative scarcity of post-school education is reduced, the rent attached to it may also fall.

For the year 1989–90 the mean annual earned income for those with post school qualifications was $32,610 compared to an average income of $24,520 for those without post school training. The comparable figures for the 1985–86 survey were $30,580 and $17,760 respectively. Whilst it is dangerous to comment on trends on the basis of two discrete periods, it seems that the education differential is less for the current period and the

Figure 2: **Educational attainment and mean annual earned income**



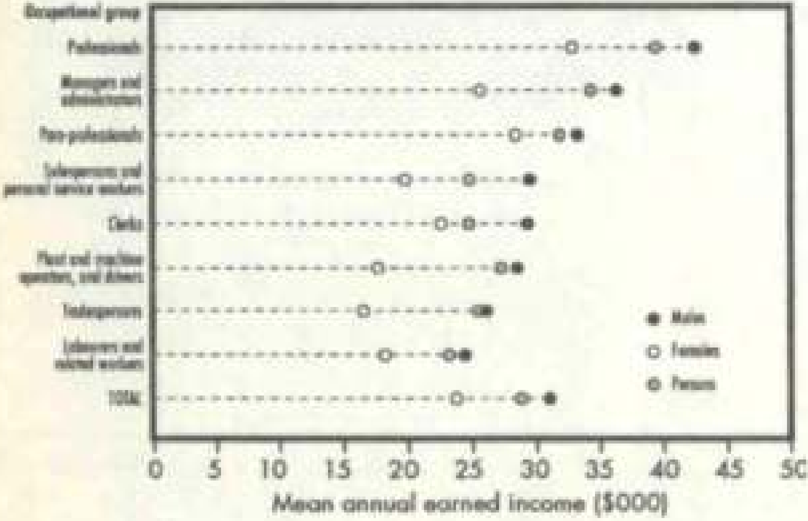
Source: ABS Cat. 6546.0, 1992, p.3.

rate of growth in income for those with post school qualifications has slowed. The long term trend in the wage value of human capital may be far less precise than in the past.

Occupation. Mean annual earned income for full-year, full time workers varied markedly across the eight major occupational groupings. The highest income groups were professionals, managers and administrators with incomes averaging $40,000 (1989–90) and the lowest paid were labourers and related workers at $23,000. This in part reflects educational differences but also is reflective of union coverage, demand factors and the skewing role played by wage fixing agreements such as the Accord. Income distribution by major occupational group is shown in Figure 3.

Gender. Males continue to earn, on average, more than females. In 1989–90 the average male (full and part time) earned income was $28,540 compared with $17,000 for females. However, both male and female workers experienced approximately a 37 per cent rate of growth in earnings from 1985–86. The male advantage is present both in rent on education, within occupational groupings and by age. Part of the reason is the greater concentration of females in part-time work. Another is the interruption of career paths, whilst there is some evidence of continued labour market discrimination against women. The level of female dis-

Figure 3: **Major occupation groups and mean annual earned income**



Source: ABS Catalogue 6546.0, 1992, p.4.

advantage has been reduced somewhat but like the presence of income inequalities in general, there is a remarkable stickiness to male-female differentials.

Future Trends in Income Distribution

The things that will affect future trends in income distribution are in many ways similar to those currently impacting upon it. From an economic point of view, the ability of the economy to provide work for its citizens is crucial. Neither the Australian economy, nor any western economy has been able to cope with the twin problems of technological change and rapid shifts in participation rates that have characterised the last two decades. Put more simply, the growth in the demand for jobs has outweighed their availability.

In Australia we have in part disguised the nature of the problem by, in our employment statistics, pretending that part time jobs are full time jobs and that the involuntary school attendees of Year 11 and 12 are not part of the work force. In the foreseeable future, the job market will not pick up to any great degree, although the natural rate of 6 per cent predicted by Keynes may be achievable. Things may not be as bad as that implied by a recent headline in *The Australian*, suggesting that the only hope for young Australians was to 'learn Japanese, head for the Gold Coast and make beds', but the job prospects for any school leaver is not good. From an income distribution point of view the main, problem with unemployment may be seen in the distinction between income and wealth via the stock and flow concept. Work produces income, some of which will be saved, for example in the form of superannuation or through the appreciation of purchased assets. This is the flow into the stock of personal wealth. Long term unemployment not only means current deprivation but also future deprivation by denying those affected the chance to build an asset portfolio.

If current economic trends continue, it is almost inevitable that the growth in income inequality seen in the latest survey will continue. The economic future will belong to the multiple income family, particularly those without children and those in secure employment. Single income families with children and single parent families and the long term unemployed will fall further behind.

Of course it need not be this way. Sustained economic growth necessary to facilitate the labour market aspirations of all groups would go a long way to removing gross inequalities. And it would allow governments to fund disadvantaged groups to a greater degree. Changes in taxation policies and greater targeting of welfare spending would also move to reduce inequalities.

Yet the prevailing wisdom at present is to cut personal income tax at the individual rather than the family level and to reduce the welfare budget rather than to increase it. In such circumstances, it might be expected that the 1993–94 income survey will see more growth in income inequality.

Income and Wealth

It must be stressed here that the discussion above has focused upon income rather than wealth. The two concepts are related, principally by the stock flow mechanism alluded to above. Yet far more is known about income distribution than wealth distribution. There are several reasons for this including:

- Income is taxable, wealth is not and hence government statistics are concentrated on measuring income;
- Wealth covers a large range of valuable and potentially valuable assets which are subject to major swings in value. In short, it would be difficult to know what to include in a register of wealth;
- People are secretive about wealth either for reasons of security or through fear of discovery.

In 1984 the then Treasurer Mr Keating set up a committee to introduce a wealth survey. This has yet to appear. Nevertheless work by Piggott (1984) and others indicate that wealth is more unevenly distributed than income.

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14

THE ROLE OF THE STATE: DEVELOPMENTS IN ECONOMIC THEORY SINCE KEYNES

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THE ROLE OF THE STATE: DEVELOPMENTS IN ECONOMIC THEORY SINCE KEYNES

DR PETER KRIESLER

In this paper, I want to look at the way in which economic theory has developed since Keynes, with particular emphasis on the implications of that theory, and the view of economists towards the State. Clearly this is an extremely wide topic, so you will have to forgive me if I 'paint' with a broad brush, at the expense of some detail.

Until relatively recently in the economic thought of the late nineteenth, and much of the twentieth centuries, the State was virtually treated as a sort of 'default'. There was a *prima facie* belief in the efficacy of markets. It was only on the rare occasions when the market was seen to be unable to deliver the goods that any role was given to the State. So, in looking at the role of the State, paradoxically, I need to consider the role and adequacy of markets, and, in particular, to consider the cases in which economic theory has identified the failure of markets to be able to deliver efficient outcomes.

Although the title of this paper stresses events after Keynes, in fact my starting point will be with the economists who immediately preceded him. This is, because, in order to understand Keynes, we need to understand the views he was reacting to. In addition, many of these views have been revived in various guises.

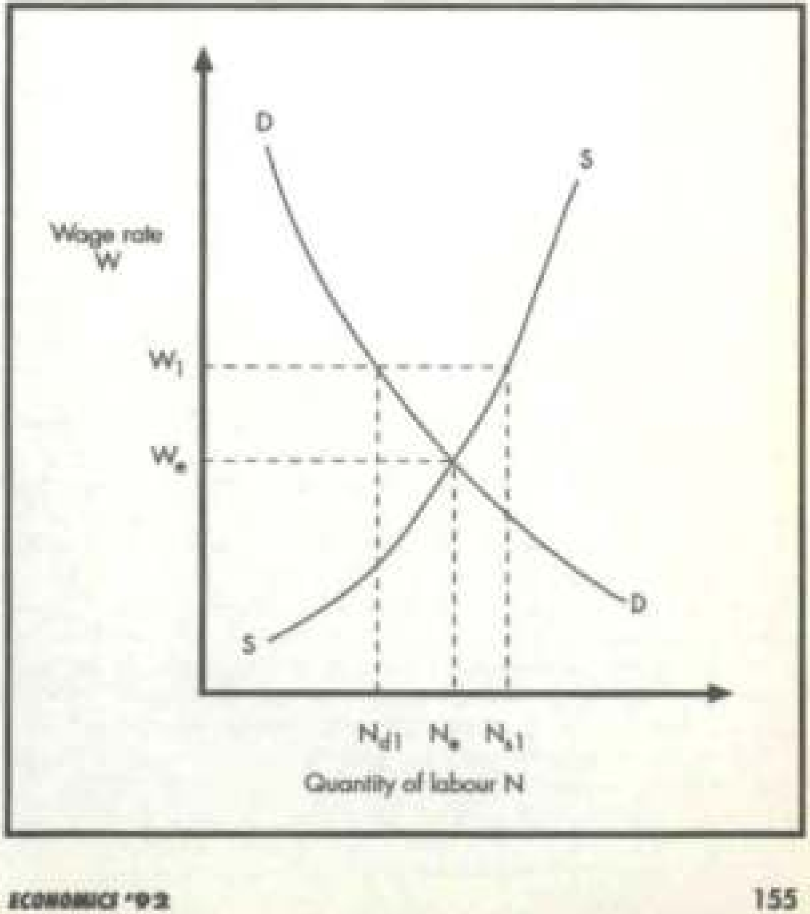
Neoclassical Economics

At the time Keynes was writing, mainstream economic theory had developed into what is sometimes called neoclassical economics. I will concentrate on the version which dominated in England, and was associated with Alfred Marshall, Keynes' teacher. Marshall divided the economy into a series of markets — in each market, price equates supply and demand, so that, under normal conditions, all markets will clear. I want to focus on two particularly important markets, namely the labour market, and the market for loanable funds.

In the labour market, the wage rate was seen as the price which equated the demand and supply for labour. As long as demand and supply schedules behaved in the conventional ways, a market clearing wage would be established, so that there would be no involuntary unemployment at that wage[1]. Unemployment could only be the result of an impediment to the market mechanism, which prevented the wage rate from adjusting to the equilibrium level. This is represented in **Figure 1**.

In **Figure 1**, W is the wage rate, and N the number of workers. SS, the supply of labour is represented as an increasing function of the wage rate, while DD, its demand, is a decreasing one. At the equilibrium wage rate of W_e, N_e is the quantity of labour both supplied and demanded, so that the labour market clears and there is no unemployment. If, for some reason, the wage rate is not allowed to adjust, so that it cannot fall below W_1, then the demand for labour will be N_{d1}, while its supply will be N_{s1}. The difference between these represents an excess supply of labour, or, in other words, unemployment. So, the labour market was seen as guaranteeing full employment, unless there were rigidities in the wage rate. Only in that event was there a role for government. For most economists, the role of government was limited to trying to eliminate the

Figure 1: **Supply and demand in the labour market**



rigidity, although there were alternate suggestions that the government may attempt to increase the demand for labour.

Once the level of employment was determined in the labour market, this determined the level of output, which was independent of saving and investment. To understand how this could be the case, it is important to look at the market for loanable funds. In this market, saving represents the supply of loanable funds while investment, the demand. The rate of interest is the price which equates saving and investment, in exactly the same way as any price equates supply and demand[2]. Underlying this is the view that the rate of interest is the reward for postponing consumption, so, if the reward goes up then so will savings.

As it is shown that the economy is always at full employment, then the market for loanable funds merely influences the division between consumption and investment goods, for given levels of output and employment. It is important to note that the causality runs from savings to investment. Changes in saving lead to changes in investment. It is not possible for investment to lead saving. This view is associated with the phenomena of crowding out. If there is a certain amount of saving, then any attempt by the government to increase its expenditure will simply reduce the saving fund, so private investment will be crowded out. So, the more that the government takes, the less is available for the private sector. It is for this reason that the early neoclassical economists argued that governments were limited in their ability to influence the level of employment, output or investment. With full employment resulting from the workings of the labour market, and investment determined in the market for loanable funds, any attempt by the government to influence the course of economic activity would have to be at the expense of private investment. Of course, the assumption that both markets behave in the conventional way is an extremely controversial one.

So far I have not said anything about money. For example, I have not specified whether, when talking about the wage rate, I was referring to money or real wages. The reason for this is that for the neoclassical economists, the price level is determined exogenously to the real sector via the quantity theory. As this is reasonably well known, there is no need for me to go into it in depth, except to remind you that, according to the quantity theory, the aggregate price level is determined by the exogenously given money supply. The money supply is regarded as being totally within the government's control, and is, therefore, determined outside the real sector of the economy. So, we have what Pigou called the 'veil of money'. Money is a surface phenomena, having no real influence except that it can hide the underlying real story[3]. Monetary variables cannot (for long) influence real variables.

So far I have been concerned with the overall neoclassical story, where, except for the case of wage rigidities, there is little explicit role for government intervention in the economy. However, there is an important exception to this, in a result derived from welfare theory. Pigou showed that an important condition for markets to allocate resources efficiently, was that there were no externalities. Externalities, sometimes called 'indirect effects', occur when economic agents not part of a transaction are affected by the transaction. The usual example in the literature is pollution, where individuals other than the consumers or producers of the relevant commodities are affected by it. Due to the fact that the welfare of agents not party to the transaction is influenced by the good's production or consumption, the market will not allocate the relevant good efficiently. Pigou argued that the existence of an externality led to a divergence between the social and private costs of goods, and this was the key to their inefficient allocation. His solution was government intervention in the form of taxation or subsidies in order to correct the initial distortion. So, for Pigou, the existence of externalities made it necessary for governments to intervene in the relevant market. It should be noted that this intervention was only in individual markets and only to correct distortions.

To summarise the pre-Keynesian position: the main macroeconomic role for the government was management of monetary policy to avoid inflation. Otherwise, unless there was some rigidity in the wage rate, there would be no problem with employment. If there were externalities, then the government should set taxes and subsidies to bring social and private costs into line.

The Economics of Keynes

Keynes, in 1936, published *The General Theory of Employment, Interest and Money*. In this work, Keynes both criticised neoclassical theory on certain fundamental points, and proposed alternative explanations of many important economic concepts. This is not the place to outline all of the ideas and controversies associated with the *General Theory*, so I will be brief.

Keynes' main criticism of the conventional theory was in terms of the fallacy of composition. In other words, he argued that it incorrectly extended results to the economy as a whole which were only true of individual firms. In particular, he applied this criticism to the labour market, arguing that, while it was true that a reduction in the wage rate would increase an individual firm's demand for labour, this was not true of a general reduction in wage rates. The reason for this is that when we are considering an individual firm, it is reasonable to assume that it can reduce its wages while the level of aggregate demand in the economy as a whole remains unchanged. However, if all wages fall, then the level of aggregate demand will also fall, and this will reduce employment. Keynes also argued that neoclassical theory was incorrect in portraying labour as bargaining for a real wage. Rather, the labour market bargain only determines the money wage. In other words, Keynes denied the quantity theory, maintaining that real wages are determined in the goods market where prices are determined.

As well as rejecting the quantity theory, Keynes also rejected the neoclassical version of both the labour market and the market for loanable funds. It was not the wage rate, according to Keynes, which determined the level of employment, but rather the level of effective demand. Effective demand was equal to the sum of consumption demand, investment demand, net government demand and net international demand.

Whereas for the neoclassical economists consumption was mainly determined by the rate of interest, for Keynes, in the short run, the main determinant of consumption was the level of real disposable income. Investment was determined by both income and the rate of interest. But, unlike the neoclassical theory where it was the rate of interest which brought saving and investment into equilibrium, with saving leading investment, for Keynes it was the level of income which brought them into equilibrium, with investment leading saving. The rate of interest was determined in the monetary sector by the demand and supply of money. For Keynes, monetary and real variables were inextricably linked. Government monetary policy would affect the money supply, but, unlike the neoclassical story, this would influence the rate of interest, and therefore the level of economic activity, rather than just the rate of inflation.

Keynes' central message was that there was no mechanism in a capitalist economy which could guarantee full employment. He explicitly rejected flexible wages as a solution, because he believed that the main cause of unemployment was insufficient effective demand, and a reduction in wages would not increase that demand. Although Keynes did **not** explicitly consider fiscal policy, his work was seen as providing the theoretical justification for governments using fiscal policy, in the form of budget deficits, as a way of increasing effective demand and, therefore employment.

It was as a result of Keynes' contribution to economics that governments, after the Second World War, believed not only that they could influence the level of employment, but also that they had a duty to implement policies to achieve full employment. In Australia, the United Kingdom and elsewhere, the maintenance of full employment became official government policy.

As a result of Keynes' writing, economics was substantially changed. Prior to Keynes, there was no distinction between macroeconomics and microeconomics. Rather the distinction was between real and monetary economics, with most real economics being concerned with micro-economic issues. Keynes put macroeconomics into the centre of economic analysis.

This brings us to the important question of how the profession reacted to Keynes. Although it is true to say that there were many types of response, the mainstream reaction was to accept Keynes' conclusion that unemployment was a real possibility, but to reject his method of argument. Instead, neoclassical theory attempted to achieve the same result within its existing framework[4], modified so as to make macroeconomics a separate study. So, we were left with a version of economic theory which is sometimes referred to as neoclassical Keynesianism, in which the basic neoclassical model is amended to include downwardly rigid money wages and interest rates (due to the 'liquidity trap'). Either of these, it was argued, was enough to generate unemployment, which would require government intervention in running fiscal deficits to stimulate demand.

This version of Keynesianism gained fairly widespread acceptance in the discipline throughout the early post war period. It envisaged a role for government macroeconomic policy mainly through varying the expansionary effect of budgetary behaviour to provide either expansionary or contractionary stimulus to the economy, depending on its position. Such policy was referred to as 'fine tuning' as it required the government to react, fairly swiftly, in response to changes in the economy's macroeconomic position. Monetary policy was relegated to a secondary role. The primacy of fiscal policy was reinforced by the Phillips Curve explanation of inflation, which was a natural extension of the neo-classical Keynesian argument. According to this theory, the government had a 'menu choice' of combinations of the inflation rate and rates of unemployment. It was simply a matter of choosing the most politically appealing option and setting the fiscal parameters correctly in order to achieve it.

Milton Friedman and Monetarism

During that time, there were few dissenting voices from the mainstream. One notable exception was Milton Friedman. Friedman's economics represented a return to the pure pre-Keynesian position. He believed in the efficacy of both the labour market and the market for loanable funds, as well as in a restated version of the Quantity Theory. For Friedman, the only suitable role for government macroeconomic policy was the careful management of monetary policy, not by attempting to fine tune the economy, but, rather by observing some simple rule. Fiscal policy could have no long run effect on the real economy, its only influence would be on inflation. The explanation for this lay in Friedman's modifications to the analysis of the Phillips Curve. According to Friedman the original analysis of the Phillips Curve had mis-specified the relationship between inflation and unemployment due to the omission of expectations. Once expectations were included, the trade-off could be seen to be a short run phenomenon, relying on money illusion. There was no trade-off in the long run. The pre-Keynesian theory was back and running. Government fiscal policy could have no real effect on the economy. If increased government expenditure was financed by increased taxation or by borrowing from the private sector, private sector investment would be crowded out. If, on the other hand, increases in expenditure were financed by monetary expansion, the only effect of this (via the quantity theory) would be inflationary. There could only be a trade-off if the 'veil of money' led agents into mistakes about what was happening to real variables. As they could only see the monetary variables, agents could be fooled in the short run, thus explaining the perceived trade-off. Unemployment could not be reduced, for long, below the 'natural rate' which was given by frictional and structural factors. The only way the government could reduce unemployment from this level was by microeconomic policy aimed at supply side factors within the labour market.

A basic tenet of Friedman's economics was the belief that too much government was undesirable. The issue was argued both from a philosophical view, and from the economic position that any increase in the size of government could only be at the expense of the private sector.

For much of the 1970s there was a debate between Friedmanite monetarists and neoclassical Keynesians as to the efficacy of fiscal policy, which hinged on the question of whether or not there was any sustainable trade off between inflation and unemployment. The monetarists, however, raised a telling blow against the arguments for fine tuning by emphasising the importance of lags, both in obtaining the information about the exact conditions of the economy, and the time taken for policy responses to work.

There was one serious problem with Friedman's explanation of the expectations augmented Phillips Curve, which was related to his explanation of the process by which expectations were formed. According to Friedman, economic agents formed their expectations solely on the basis of the past history of the relevant variable. The difficulty with this is that if inflation is accelerating or decelerating, then agents would be making persistently incorrect predictions on the basis of their expectations. In other words, the expectations formation process postulated by Friedman would lead to continuous error, and so could not be considered to be rational. This criticism of Friedman led to the Rational Expectations School of monetarism. According to this view, the assumption of rational maximising economic agents should be extended to the analysis of expectations formation. Expectations should be viewed as being formed rationally, not only on the basis of past information, but also in incorporating current information with a well informed understanding of economic theory. If this was the case, then economic agents would not suffer from money illusion, and, therefore, there would not even be a short run trade-off.

The Rational Expectations School

The Rational Expectations view has often been called Monetarism Mark 2, as its underlying model of the economy is that of the earlier version of monetarism, with rational expectations grafted on. However, the implications of this have rendered government macroeconomic policy totally ineffective. Economic agents, within the analysis, understand the immediate implications of government action and so act to neutralise their effects. In any case, unless government action is totally random, it will be anticipated by rational economic agents, and so will have no effect.

Monetarism Mark 2, by denying any short run trade-off, virtually postulates that we are always at full employment. Any measured unemployment is the result of labour supply decisions to substitute leisure for work. This has led to policy suggestions focusing on supply side considerations, to change taxation and benefits systems to make work more desirable relative to leisure.

The rise of the rational expectations school has been particularly prominent during the 1980s, especially in the USA. There have recently, however, been signs that its influence may be waning, with the rise of New Keynesianism, which moves away from the rather idealised assumptions of earlier neoclassical macroeconomic theory, such as perfect competition in all markets, and attempts to deal with perceived imperfections. It is still too early to judge their contribution, but the analysis attempts to revive a strong role for government macroeconomic policy.

Recent Developments in Microeconomics

Most of the discussion, so far, has concentrated on the issue of the desirability of government macroeconomic policy. However, at the same time as these debates in macroeconomics, there were important developments in microeconomics which had significant implications for the debate about the role of the State. The main developments in this area have come from general equilibrium analysis, which originated from the works of Walras, who was concerned with a problem that had fascinated economists and philosophers for centuries. The problem was whether the actions of self-interested individuals in a decentralised market could establish equilibrium with market clearing prices such that at those prices the total quantity offered for sale in the market would equal total demand. This is called general equilibrium because, as well as all quantities supplied and demanded being determined, so are all prices simultaneously. It is an amazing concept that thousands, indeed millions of greedy individuals can rush around doing their own thing, and, instead of total anarchy resulting, somehow the market leads to an orderly solution. Economists such as Adam Smith, who coined the term 'invisible hand' to describe the process, and Marx, were amazed by it. And Walras placed this problem into the centre of his analysis. The most important modern developments in this area have come from Gerard Debreu and Kenneth Arrow, as a result of which the analysis is often called the Arrow/Debreu model.

The main point of the initial efforts of Debreu and Arrow was to demonstrate the conditions required for the existence of *pareto optimal* market clearing prices in a competitive decentralised market. These conditions not only are not fulfilled in any known world, they could not be fulfilled in any imaginable world, even allowing for science fiction. Their observation has been used to argue for Keynes' important insight that a decentralised market system is unlikely to fully employ all resources in all markets.

The other relevant development came from the work of Coase, which led to a revaluation of the problems caused by externalities. Earlier I alluded to Pigou's analysis which argued for the necessity of government intervention to deal with externalities. Coase proposed an alternative analysis in which he showed that the market could efficiently allocate externalities unless either property rights are inadequately defined or transaction costs are positive. In any case, according to Coase, State intervention was not costless, and any benefits may be outweighed by the cost. This point has been taken up by Tulloch and Buchanan who have argued that the State is not a neutral referee as much economic theory has postulated. Rather, it is influenced by many coalitions of vested interests, so that it may not always generate socially optimal solutions to problems.

So, what are we left with? Economic theory has shown that markets do not necessarily work as efficient allocators of resources. Unemployment and inefficiencies may well result from the unfettered working of markets. On the other hand, State intervention is also less than perfect. Even if we leave aside the problems of knowing where the economy is, and of policy lags, governments respond to various interest groups, and so, often do not serve the welfare of the majority. In the final analysis, economics cannot give us general rules as to whether the role of the State should be expanded or contracted. Each case must be evaluated in its own right.

Suggestions For Further Reading

Barber, W. (1967), *A History of Economic Thought*, Penguin Books, Middlesex

Deane, P. (1989), *The State and the Economic System*, Oxford University, Oxford

Eatwell, J., Milgate, M. and Newman, P. (1987), *The New Palgrave*, The Macmillan Press Ltd, London

Notes

1 This required that, for both schedules, if the income effect was of the opposite sign to the substitution effect, its absolute value was smaller.

2 Again we require the income effect, if it is of opposite sign to the substitution effect, to have a smaller absolute value.

3 This role of money as a 'veil' hiding the real variable from view becomes very important in Milton Friedman's restatement of the neoclassical story in the form of monetarism.

4 To show that unemployment can be a rational result of its theory is something that many mainstream economists are still attempting.

ABBREVIATIONS

ABS	Australian Bureau of Statistics
ACETA	Australasian Commercial and Economics Teachers' Association
ACTU	Australian Council of Trade Unions
AMC	Australian Manufacturing Council
APEC	Asia Pacific Economic Co-operation
APPM	Australian Pulp and Paper Manufacturers
ASB	Australian Savings Bond
AWOTE	Average Weekly Overtime Earnings
BCA	Business Council of Australia
BEA	Business Educators Australasia Inc.
BHP	Broken Hill Proprietary Ltd
BIE	Bureau of Industry Economics
CES	Commonwealth Employment Service
CFC's	chlorofluorocarbons
CGS	Commonwealth Government Securities
CIS	Commonwealth of Independent States
CIS	Centre for Independent Studies
CPI	consumer price index
DDT	dichlorodiphenyltrichloroethane
EC	European Community
EERC	Economics Education Resource Centre
EMS	European Monetary System
ETM's	elaborately transformed manufactures
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GIO	government insurance office
GNE	Gross National Expenditure
GNP	Gross National Product
HSC	Higher School Certificate
IAC	Industries Assistance Commission
IBM	International Business Machines
IC	Industry Commission
IMF	International Monetary Fund
IOU	I owe you
IRC	Industrial Relations Commission
M1	narrow definition of money supply
M3	broad definition of money supply
na	not available
NIEF	National Industry Education Forum

NWC	National Wage Case
OECD	Organisation for Economic Co-operation and Development
OMO	open market operations
PAYE	pay as you earn
PMV	passenger motor vehicles
PSBR	public sector borrowing requirement
RBA	Reserve Bank of Australia
RMIT	Royal Melbourne Institute of Technology
sa	seasonally adjusted
SACE	South Australian Certificate of Education
SBSA	State Bank of South Australia
SRD	Statutory Reserve Deposit Requirement
STM's	simply transformed manufactures
TCE	Tasmanian Certificate of Education
TCF	textiles, clothing and footwear
TPC	Trade Practices Commission
TWI	Trade Weighted Index
US	United States
VCE	Victorian Certificate of Education
VCTA	Victorian Commercial Teachers' Association

GLOSSARY OF TERMS

Accord	a consensual incomes policy between the Federal Labor Government and the ACTU concerning wages, employment and elements of the social wage such as welfare spending and taxation arrangements.
anthropocentric	regarding man as the central fact of the universe.
budget	statement of a governments's expected revenue and expenditure for the financial year.
business investment	the accumulation of real capital goods by the private sector.
cash rate	interest rate on funds deposited with the short term money market.
co-operatives	a business undertaking owned and controlled by its members.
command planning	a system of socialist economic organisation whereby the government formulates and controls major economic decisions concerning production targets, prices, incomes and resource allocation.
commodity exchanges	privately operated firms in Russia selling a variety of goods and services to consumers in competition with the state monopoly supply system.
competition policy	microeconomic policy conducted by the Trade Practices Commission using the Trade Practices Act to examine the effects of mergers, takeovers and anti-competitive behaviour on the degree of competition in various industries and the economy as a whole.
coup	a sudden and decisive measure in politics, especially one effecting a change of government illegally or by force.
current account deficit	a situation in the balance of payments where total payments for imports of goods and services and income transfers remitted to the rest of the world exceed total receipts from exports of goods and services and income from the rest of the world.
deregulation	a process whereby direct government regulatory controls over market forces are removed.
dividend imputation	a system applying since July 1 1987 of taxing dividends paid by Australian resident companies. Dividends paid by resident companies which have paid sufficient Australian

	company tax carry a tax rebate entitlement for Australian resident individual shareholders.
economics education	system of learning where students are imparted with knowledge, skills and understanding about commercial and economic processes.
employment	the use of labour, natural or capital resources in the production process. Usually refers to the level of labour resources as a proportion of the total eligible population in paid full or part time work.
enterprise bargaining	negotiation of wages and working conditions between employees and employers within individual enterprises.
exchange rate	price of one currency in terms of another.
existence value	the utility that people derive from the knowledge that an endangered species continues to exist.
externality	an unintended cost or benefit incurred by others or the community as a whole as a result of a private activity.
Fightback	a Liberal-National Party policy document outlining a blueprint for reforming the structure of the Australian economy in order to promote economic growth and personal incentives. It contains plans for the introduction of a goods and services tax, significant cuts in personal rates of income tax and cuts in government spending.
fine tuning policies	macroeconomic policies (particularly monetary and fiscal policy) designed to stabilise fluctuations in the trade cycle eg additional government spending on infrastructure to boost employment during a recession.
Finn Report	written by Brian Finn on behalf of Australian Education Council Review Committee on 'Young People's Participation in Post Compulsory Education and Training'.
fiscal policy	refers to use of the federal budget by the government to influence the level of economic activity, resource allocation and income distribution. Changes in the level and composition of government taxation and expenditure are used as fiscal instruments to achieve these goals.
500 day plan	developed by Professor Stanislav Shatalin in mid 1990 for the rapid reform of the Soviet economy.

free riding	a situation where non paying consumers of some environmental goods cannot be excluded from their use.
free trade	the exchange of goods and services and capital without artificial advantages being bestowed on domestic producers or artificial restrictions imposed on foreign producers.
Gaidor Plan	plan for reform of the Russian economy named after Yegor Gaidor, Deputy Prime Minister of Russia in 1991.
GDP	the total market value of all goods and services produced in a country in a given period, usually a year. Gross domestic product is taken to be a measure of a country's national income.
Gini co-efficient	ratio of the area between the Lorenz curve and the diagonal line and the total area under the diagonal line itself.
glasnost	open exchange of information. The term was coined after the 1985 Gorbachev period in the former USSR to describe moves to openness of discussion of ideas for reform of Soviet political and economic life.
GNE	equivalent to gross domestic product plus imports of goods and services.
GNP	dollar flow of total product for a nation: the sum of consumption plus investment (domestic and foreign) plus government expenditure on goods and services.
Gosagroprom	superministry designed to unify in one structure, agriculture and industry matters. It was created under the Gorbachev reform plan and translates as the State Agro-Industrial Committee.
Greens	generic term used to refer to those sections of the community particularly vocal in the environmental debate who argue strongly for an extension of the planning/regulatory role of government in environmental matters.
hard currency	currency that can readily used as a medium of exchange and store of value. Particularly applicable to say US dollar balances held and traded in the black market in Russia and the CIS as the former rouble's value depreciates due to inflation and the general lack of confidence in the rouble's purchasing power.
income	the return from contributing to production and/or the receipt of welfare payments from the government.

income distribution	measure of spread of national income throughout the population of a country.
industry policy	microeconomic policy conducted by the government upon advice from the Industry Commission (IC). Recent IC recommendations have been a phasedown and eventual removal of tariffs and other forms of industry assistance to Australian manufacturing in particular.
inflation	refers to the general rate of increase in the general level of prices accompanied by a fall in the value of money.
inflationary expectations	measure of economic agents' price formations in the future.
interest rate	the cost of borrowing financial resources. Also the rental price of capital goods.
intermediate target	short run objective of economic policy targeted with intention of influencing an ultimate objective like price stability.
intrinsic value	inherent worth of a good or importance of environmental species.
joint ventures	establishment of a new independent company by two or more companies or enterprises eg joint ventures involving state owned enterprises in Russia or the CIS and foreign companies.
Keynesianism	school of economic thought based upon the legacy of the economics of John Maynard Keynes.
lag	tardy reaction time of economic variable or policy instrument to a change in economic circumstances such as a policy pronouncement or an upturn or downturn in the trade cycle eg employment tends to lag other variables or monetary policy changes act with a long and variable lag.
landuse zoning	separation of competing or different economic activities by local, state or federal governments eg residential, commercial, industrial, recreational, special purpose, defence and educational landuse zones.
level playing field	a situation where competitive advantages and disadvantagesbestowed on private or public enterprises are removed eg protection of some Australian manufacturing firms

	versus unprotected manufacturing firms or removal of tax exempt status for government trading enterprises.
Lorenz curve	a graphical portrayal of the pattern of income distribution at any one particular point in time.
M1	narrow definition of the money supply. It includes all notes and coin plus current account deposits with banks.
M3	broad definition of the money supply. Includes all notes and coin plus all bank deposits.
marginal tax rates	the change in tax payable as income changes, usually expressed as a percentage of income at a particular threshold level of income. In most OECD countries, marginal rates of taxation are imposed progressively ie not only does the amount of tax paid increase as income increases, but so too does the rate at which the tax is applied.
market economy	an economic system based upon private property rights, freedom of enterprise, the rule of law and free functioning product and factor markets.
market failure	a situation where private property rights may be ill defined and as a result, trade cannot take place and inefficient resource allocation may occur eg the absence of markets for some environmental goods. Market failure has often been used as a pretext for government intervention and provision but other literature suggests that it may be possible to create markets where private property rights can be established.
Mayer Committee	wrote report on behalf of Australian Education Council on 'Employment Related Key Competencies: a Proposal for Consultation'.
merger	the mutual combination of two or more business enterprises into one entity.
microeconomic reform	policies designed to improve the efficiency and productivity of various industry sectors by removing impediments to resource allocation and restoring incentives for economic agents.
Monetarism	school of economic thought inspired by Milton Friedman who argues for the adoption of money supply rules to contain inflation, a neutral role for fiscal policy and the free functioning of product and factor markets.

monetary policy	exercised by the federal government and implemented by the Reserve Bank of Australia via its influence on overnight cash rates with the intention of influencing the cost and availability of credit in the economy.
Montreal Protocol	an agreement by participating countries to reduce their production of CFCs in order to lessen global ozone depletion. The Montreal Protocol was signed in 1988 and was based on the stabilisation of CFCs based on 1988 levels by the year 2000 and a reduction in those emissions by 20 per cent by the year 2005.
Neoclassicism	school of economic thought that developed microeconomic analysis, in particular the use of mathematics and models to explain concepts such as marginal utility.
net exports	the difference between exports of goods and services and imports of goods and services.
One Nation	economic statement made by Prime Minister Paul Keating in February 1992 which announced new federal government spending programmes, a one off family allowance payment of $100 to reduce hardship caused by the recession and a commitment to tax cuts in 1993-94 for individuals as well as a cut in sales tax on new cars.
open market operations	sales or purchases of government securities by a central bank to influence the money supply and hence the rate of interest and real economic activity.
Pareto efficiency	an environment in which it is impossible by any economic reorganisation to make any person better off (in his own estimation) without making another worse off (in his own estimation).
Perestroika	term used to refer to the process of economic restructuring that took place in the USSR during the Gorbachev era.
Phillips curve	empirical relationship showing the supposed trade-off between unemployment and inflation in the short run.
picking winners	refers to a situation where the government gives selective assistance to those industries it considers to have future prospects for success in international trade.
private consumption	aggregate expenditure by individuals on final consumption goods and services.

private non farm stocks	inventories held by all private firms exclusive of farm stocks.
privatisation	action taken to sell off part or all of a public asset to the private sector. It can also take the form of competitive tendering by the private sector for the right to provide public services or contracting out of services previously provided by the public sector.
property rights	individual claims on resources or assets through legal ownership or payment of a contract price.
protection	any artificial advantage bestowed by government to give a domestic firm or industry a competitive advantage over a foreign producer.
PSBR	public sector borrowing requirement, which is the total volume of funds sought by all government and semi-government bodies from financial markets in one year. It is a measure of the total annual borrowing needs of the public sector as a whole.
public good	a good which is non rival and non exclusive ie it has no close substitutes and non paying users cannot be excluded from consuming the good.
Rational expectations	school of economic thought which emphasises that economic agents fully anticipate government action, thereby rendering such policy ineffective.
recovery	an upturn in the business cycle characterised by increasing spending, output and employment opportunities.
Resource Security legislation	federal government legislation designed to guarantee owners of proposed pulp and paper mills security of supply of woodchips from government owned forests. The legislation was defeated in the Senate in May 1992.
roubles overhang	oversupply of roubles in former USSR due to excessive growth in the money supply. Consequent inflation and loss of purchasing power in roubles as well as loss of confidence in the rouble currency which forced individuals to convert roubles into hard currency like US dollars on the black market at a higher exchange rate than the official exchange rate.
saving	that part of income not consumed or spent.

shortage	a market situation where demand for a good or service exceeds its supply, usually forcing prices to rise, or if prices are fixed, rationing by queuing or ration cards.
species preservation	the maintenance of the long term survival of a particular genus of plant or animal.
State Enterprise Law 1987	introduced in the former USSR in 1987 to improve the financial discipline of state owned enterprises by making them more independent of the central planning authority.
strategic trade theory	argument that free trade does not exist in many markets because they are dominated by a few large multinational firms which erect barriers to entry through scale economies and technological superiority. Suggested policy prescription is for governments to intervene and assist domestic firms to gain strategic positions in some world markets.
structural change	process whereby changes occur in the structure of production and employment of an economy over time. This may be due to a combination of technological change, changes in consumer preferences and the consequent decline in some industries and growth in others.
sustainable development	economic development which takes into account the renewal of resources and the needs of future generations.
Trade Practices Act	legislation enacted in 1974 outlining penalties for uncompetitive behaviour and provisions to prevent mergers and takeovers that might lessen competition in any sector of the economy. The Trade Practices Commission and Prices Surveillance Authority are the key regulatory authorities for the purposes of the Act.
underlying inflation	the fundamental inflation rate when seasonal, one off or policy induced influences on prices are discarded.
unemployment	refers to that percentage of the workforce willing and able to work but unable to secure employment. It is that part of the workforce not actually in full or part time employment.
wages	the return to labour for its contribution to the production process. Wages are the income to labour, the price of labour relative to other productive inputs and the cost to employers of labour relative to other factor inputs.

wealth	refers to the total stock of assets of a person or a country. Wealth is a stock concept as opposed to income which is a flow concept.
yield curve	curve plotting effective rates of return on various financial instruments with varying maturities. The slope of the yield curve is an indication of the stance of monetary policy.

LIST OF ATTENDEES

ATTENDEES

James Adby	Jesmond High School	NSW
Paul Angus	Xavier College	VIC
Jo-anne Bains-Finn	Rockhampton Grammar School	QLD
Jeremy Bennett	Monte Sant Angelo College	NSW
Ray Bloomfield	Laidley State High School	QLD
Vern Bonogofsky	Chisholm College	VIC
Jan Booth	Jesmond High School	NSW
Gary Brown	Melville High School	NSW
Heather Brown	Sefton High School	NSW
Phil Brown	Scots College	NSW
Basil Caldicott	Downlands College	QLD
Stephen Chapman	Goulburn High School	NSW
Andrew Davies	Centre for Independent Studies	NSW
Nick Dent	Katoomba High School	NSW
Rowen Dick	Emmanuel College	QLD
Chrystine Drummond	Berkeley Vale Community High	NSW
John Duncan	John XXIII College	WA
Colin Dunn	Business Educators Australasia Inc	ACT
Ken Dyce	Immanuel Lutheran College	QLD
Michael East	Sydney Grammar School	NSW
Stephen Faulkner	St Pauls School	QLD
Dan Fearns	Hawker College	ACT
Jacqueline Gilbert	Waverley College	NSW
Marie Harvey	Wenona School	NSW
Janise Haschek	Gloucester High School	NSW
Neil Hayford	Cabra College	SA
David Henderson	Dubbo Christian School	NSW
Bronwyn Hession	St Pius X College	NSW
Kerrie Holmes	Kambala C of E Girls School	NSW
James Horner	Oxley Secondary College	QLD
Jon Ireland	Unisearch Ltd	NSW
Peter Ireland	McKillop Senior College	NSW
Robert James	Newington College	NSW
Annette Jamvold	St Hilda's Anglican School for Girls	WA
Elizabeth Jeffrey	University of Sydney	NSW
Michael Jenkins	Forster High School	NSW
Peter Judd	Oxley High School	NSW
Vicki Kazacos	Birrong Girls High School	NSW

Eileen Kelly	Strathfield South High School	NSW
Barbara Kerr	Ravenswood School for Girls	NSW
Lyn Kirkby	Moriah College	NSW
Lyle Kirkwood	Queensland University of Tech.	QLD
Allan Kloiser-Jones	St Johns College	NSW
Vicki Knopke	Rosewood Senior High School	QLD
Peter Krahe	Turramurra High School	NSW
Brad Latter	Anglican Church Grammar School	QLD
Darryl Lawrence	Macksville High School	NSW
Michael Leete	Sydney Grammar School	NSW
Graham Leigo	Meriden School	NSW
Thomas Loreck	Craigie Senior High School	WA
Helen Love	Cranbrook School	NSW
Dr Vance Lowry	St Ignatius Riverview College	NSW
Martin Lyons	Kilbreda College	VIC
Robert MacCulloch		NSW
Christopher Mannix	Taylors College	VIC
Ian Mansell	Princes Hill Secondary College	VIC
Garry Mason	Willyama High School	NSW
John Nairn	University of Sydney	NSW
Jennie Niccol	Centre for Independent Studies	NSW
John Nicol	Knox Grammar School	NSW
Mary Nicolson	Radford College	ACT
Len Nixon	Barker College	NSW
Frank O'Dea	St Scholastica's College	NSW
Greg Parry	Penrhos College	WA
Andrew Poyitt	Redeemer Baptist School	NSW
Michael Pfeiffer	St Peters Lutheran College	QLD
Christine Reid	Australian Bankers Association	VIC
Ron Reilly	Insearch Institute of Commerce	NSW
Col Ridding	Cowra High School	NSW
Penny Riley		NSW
Tim Riley	Economics Education Resource Centre	NSW
Robyn Ringer	Meriden School	NSW
Elsie Rudken	Windsor High School	NSW
Helen Russell	Turramurra High School	NSW
Danielle Scott	Sydney Boys High School	NSW
Jennifer Smith	Aquinas College	WA
Catherine Snelling	Blackfriars Priory School	SA
John Snelling	Blackfriars Priory School	SA
Kay Stephens	Concordia College	QLD
Kevin Stocks	The Don College	TAS

ATTENDEES

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Leonie Swarbrick	Vic. Comm. Teachers' Association	VIC
Ross Thickett	Central Coast Grammar School	NSW
Jill Tuffley	Abbotsleigh School	NSW
Robert Van Houten	St Andrew's Cathedral School	NSW
Theresa Warren	St Joseph's College	NSW
Carole Wellham	Barker College	NSW
Kathy Wieffering	Brisbane State High School	QLD
Michael Wood	Anglican Church Grammar School	QLD
Margaret Ziebell	Holy Spirit College	NSW

SPEAKERS

Ken Baker	The Enterprise NZ Trust Inc	NZ
Dr Jeff Bennett	University of NSW/ADFA	ACT
Dr Ken Boston	Director General of Education NSW	NSW
John Burgess	University of Newcastle	NSW
Dr Chris Caton	Bankers Trust Australia	NSW
Colin Dunn	Business Educators Australasia Inc	ACT
Anita Forsyth	Monash University	VIC
Dr Stephen Grenville	Reserve Bank of Australia	NSW
Ross Jones	University of Technology, Sydney	NSW
Dr Peter Kriesler	University of New South Wales	NSW
John Paine	Lisarow High School	NSW
Professor John Piggott	University of New South Wales	NSW
Dr Don Stammer	Bain and Company Limited	NSW
Janet Torney	Macquarie Bank Limited	NSW

RESOURCE EXHIBITORS

Pheona Arndell	*The Australian Financial Review*	NSW
Tania Adami	Australian Bureau of Statistics	NSW
Max Berry	South Pacific Publishing	VIC
Paul Brock	McGraw Hill Book Company	NSW
David Conway	Effective Management Comm.	NSW
Terry Devin	Headstart Education	NSW
Maree Doyle	VCTA	VIC
Belinda Forest	McGraw Hill Book Company	NSW
Sue Furlong	Australian Bureau of Statistics	NSW
Kris Humphreys	Oxford University Press	NSW
Basil Kelly	South Pacific Publishing	VIC
John Keevers	Australian Bureau of Statistics	NSW
Harry Khoury	Maxwell Macmillan Publishing	NSW

Jennie Niccol	Centre for Independent Studies	NSW
Zoe Little	Sydney Futures Exchange	NSW
Danielle Ludowyke	Sydney Futures Exchange	NSW
Iain MacLennan	Campion Books	NSW
Andrew McLure	Campion Books	NSW
Greg Parry	Tactic Publications	WA
Michael Ramsden	Macmillan Education Australia	NSW
Tim Riley	Economics Education Resource Centre	NSW
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Doreen Vostinar	Heinemann Educational Australia	NSW
Lyne Waters	Australian Bankers' Association	VIC
Carolin Window	Jacaranda Wiley	NSW
Andrew Woodgate	Macmillan Education Australia	NSW

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The Operation of Monetary Policy

4 Dr Don Stammer, Bain and Company Limited
Fiscal Policy: Incentives, Priorities versus Stabilisation

5 Colin Dunn, Business Educators Australasia
Trends in Business and Economics Education

6 John Burgess, University of Newcastle
Wages Policy: the Accord, Deregulation & Unemployment

7 Ross Jones, University of Technology, Sydney
Industry Policy and Microeconomic Reform

8 Janet Torney, Macquarie Bank Limited
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9 Anita Forsyth, Monash University
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