

Comprehensive and Essential Guides to the Australian Economy?

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Two books are the subject of this review article. One is *A Guide to the Australian Economy: Structure, Performance and Policy*¹ which is described on the back cover as ‘the only comprehensive account of how the nation’s economy works’. It has five authors, Philip Lewis, Peter Drake, Johannes Jüttner, Keith Norris and Malcolm Treadgold. Lewis’s name is given star billing and, although not explicitly stated, appears to be the senior author and coordinator. The book is cited here as Lewis. The other is *The Australian Economy: The Essential Guide*² edited by Peter Kriesler and cited here as Kriesler. It has ten contributors, seven including the editor, at the University of New South Wales. The review attempts to explain to potential buyers what the two books offer. While comparisons are said to be odious, here they are unavoidable. The article proceeds by taking successive topics and assessing the material in each book. As I lay about me with some vigour in places it is appropriate to declare my own interest in this field – for example, as a joint author of the Australian editions of Paul Samuelson’s standard introductory economics textbook.

What is the Australian Economy?

Each book begins by asking this question. Lewis on page one writes that ‘the way economists view issues is quite distinct from the way other social scientists might look at Australia’. This raises expectations of some discussion of the distinctive feature of the economic relationships which comprise an economy. What follows is a statement that we measure the size of our

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economy by the GDP which is 'the total value of all the goods and services produced in the economy, with a caveat that only those goods and services which are bought and sold in markets are counted' and further on 'One of the major problems with measured GDP is that it totally ignores the non-market activities in the economy' (p. 2). Then comes Table 1.1 giving estimates for 1987 of the paid work, 252 million hours, and of unpaid work, 303 million hours, of which 209 million were performed by women. We then are told that leisure is not included in GDP, that the environment is important to our welfare and that 'using GDP as a measure of the standard of living is also deficient because it does not account for things such as the availability and quality of education or health-care facilities which directly contribute to the standard of living' (p. 3).

This opening section irritated me. The formal definition of GDP is incorrect and the commentary will give comfort to those populist politicians and sociologists who berate (patriarchal) economists for using the GDP as a summary indicator of the state of the nation's soul. The chapter proceeds to give some useful information about the composition of industry, the openness of the economy, the balance between the public and private sectors and so on, with appropriate statistics and comparisons to other countries.

The liberal use of the relevant statistics and the statistical appendix are valuable features of the book. However in some cases poor presentation (and some howlers) mars the material. For example in Figures 1.1, 1.3, 2.3, 2.4 and 2.5 one axis is labelled 'per cent' but what the values are percentages of is not indicated; Table 3.7 is headed 'Average Tax Rates' whereas the values given are changes in the average tax rates; Figure 5.3 shows Australia's major commodity exports but the vertical scale is labelled 'millions' instead of 'billions' so that Australia's annual exports of wool are apparently about \$3m. And so on.

Kriesler's opening chapter 'What is this thing called "the Australian economy"?' declares (p. 1) 'it is important to clarify exactly what is meant by "the Australian economy"'. Having boldly posed the question he skirts around it for a couple of paragraphs. He specially warns against reducing it to money and market transactions and concludes that 'notwithstanding a degree of "fuzziness"... it is clear that the size of the economy, as traditionally measured by the national income accounts, and how fast it is growing have important impacts on the level of our well-being ...' (p. 2). He uses the remainder of the chapter to give brief introductions to each of the topics discussed by the other nine contributors.

International Links

Chapter two in Lewis discusses 'Australia in the world economy'. The style of writing suggests a different author to the first chapter. The second chapter is a 'good read'. It begins with a historical cameo explaining the rise and fall of the Australian – United Kingdom trading links, the origins of the tariff, the Brigden Report and the Vernon inquiry. This is neatly tied into an account of standard trade theory, the changing pattern of Australian trade, the emergence of GATT and more recently of regional trading blocs. The latter part surveys the balance of payments and current policy issues including the significance of a current account deficit.

The equivalent chapter in Kriesler 'The balance of payments and international debt', written by Colm Kearney, is concerned with the topics in the latter part of the Lewis chapter. There is a much more sophisticated discussion of the foreign debt debate, which would be difficult reading for a person without at least a first year economics background. The chapter has a balanced account of the 'new view' (as presented by John Pitchford, for example) that the current account outcome has been given undue emphasis in the making of policy.

Growth

The second chapter in Kriesler, on economic growth, was written by Steve Dowrick. Lewis does not have a comparable chapter and the handful of references to growth there are concerned mainly with the short run variations in growth rates associated with the trade cycle. Dowrick provides a clear account of our present understanding of what explains growth of the Australian economy over the long term. He has appropriate warnings against viewing accelerated growth as either a magic cure all or an insidious destroyer of all that we should hold dear. The chapter is richly illustrated with statistical material and relevant international comparisons. The broad conclusions are that the Australian growth performance scores at least as a C+³. Dowrick believes that the further feminisation of work will operate to sustain growth, but without better industrial relations and a stimulus to both public and private investment growth may decline as the current expansionary phase of the cycle fades.

The Public Sector

Chapter three in Lewis surveys public expenditure and taxation. It covers much the same ground as is found in the standard introductory textbooks (such as the Australian adaptations of Baumol, Parkin and Samuelson).

The discussion of the scale and pattern of public expenditures gives useful current information. However, the section canvassing the arguments for and against public expenditure is limp. We are given the standard story about 'public goods, merit goods', and income redistribution and told, correctly, that these 'provide no clear guidance as to how large the public sector should be' (p. 49). Then follows material about the recent tendency in western economies for restraint of the growth of the public sector. There is no discussion of the public choice approach to these issues with its fruitful integration of economic and political elements. There is no reference to Friedman's view that whilst the objectives of many government actions are laudable, the actions do not produce the desired objectives and may produce perverse results. If Friedman were to be asked his opinion of the evidence before the NSW inquiries into the achievements of the government police force or of the outcomes of the current policies designed to reduce youth unemployment he could reasonably say 'But I told you so forty years ago in *Capitalism and Freedom*'. And if he, the advocate of the radical minimum income scheme, were to read the definition of monetarism in the glossary (p. 314): 'A school of thought which advocates, among other things, that there is no real place for government intervention in the economy', he could sue. (He does believe in public funded courts).

The chapter does give useful information about the taxation system. The standard reasons why economists are reluctant to pronounce on the effects of tax changes under the supply of labour are raised. On page 62 we read that 'the net effect [of a tax cut on wage income] cannot be predicted. Nor is the empirical evidence very clear cut'; then on page 63, 'The present [Keating] labor government has stated that the restructuring of the tax rate will reduce the 34 per cent and the 43 per cent marginal rates to 30 per cent, thereby improving incentives to work and save', without any further comment.

On page 62 we were told: 'The effect of income taxes on savings is much clearer. Income tax is levied on the interest payments received on savings deposits. Some part of people's income thus gets taxed twice, as income tax is paid upon earned income and again on the interest received on any income which is saved. Income taxes thus reduce the incentive to save'. This is a muddled discussion of a general issue of considerable relevance to the current debate about the level of national savings including issues such as compulsory superannuation and proposals for tax concessions for interest

received. The outcome of such schemes is complex. There are both income and substitution effects, involved as with real wages and labour supply. 'Savings deposits' and compulsory superannuation are but two forms of a possible overall portfolio and individuals, whilst increasing those particular forms of savings, may make offsetting reductions in other forms. Further, the 'double taxation' argument has much broader implications than is suggested by the 'savings deposits' story. For example, imagine a self employed plumber who has a surplus from her business and is considering whether to place it in a savings deposit or to purchase a drain-clearing machine which will be rented out to householders. Is not the double – tax story just as applicable to the rental stream as the deposit interest?

Lewis gives an account of Commonwealth-state financial relations along the familiar lines: composition of the sources of revenue of the three levels of government, 'fiscal imbalance' and fiscal equalisation. As with most Australian texts, there is no serious questioning of fiscal equalisation, nor of the consequences of Federal government imperialism in areas such as health and education.

There is discussion of broad based goods and services taxes such as those proposed by Treasurer Keating in 1985 and opposition leader Hewson in 1993. These taxes are compared with income taxes and found to be weak on equity grounds. This argument was used energetically by Keating in 1993 to derail Hewson's drive for the Lodge. Lewis (like Keating then), assesses the tax in isolation from any associated changes on the expenditure side. Even a tax on mothers' milk could be viewed as a 'progressive' measure if all of the proceeds were transferred to the least well-off nursing mothers.

The chapter concludes with an account of income distribution and poverty and some descriptive material about the social security system. Here, as in other texts, there is a simplistic treatment of poverty. The same books, which in an early chapter on national income, stress that leisure is an important element in living standards (as also are the streams of benefits from households assets), quite happily use household incomes (with minor qualifications) as the robust indicator of individual well being – and to identify who is in poverty. Thus when teenage tertiary students leave the family home on the North Shore to share a flat the number of households in 'poverty' goes up. When the garbage truck attendant cheerfully accepts the council's offer of a 'package' and uses it to buy a shack on the river and lives on social security benefits, the Gini coefficient worsens, and so on.

Real poverty is real hardship and any economist not concerned about it is a real bastard. But identifying real poverty is a hard task. The simplistic treatments of the past have given ammunition to social groups to win more from the national purse than an omniscient and benevolent Deity would

approve (and I, who have reached the age of the concessional train fare, would agree with Her). In the next edition Lewis will be able to give a more sophisticated analysis by drawing on recent publications such as Peter Travers and Sue Richardson, *Living Decently: Material Well – Being in Australia* (Oxford University Press, 1993) and Peter Saunders, *Welfare and Inequality: National and International Perspective on the Australian Welfare State* (Cambridge University Press, 1994). (Reviewed in this journal, June 1995).

Kriesler does not have a strictly comparable chapter covering both public expenditure and taxation. Peter Saunders discusses the growth of the Australian public sector in the post-war years, with particular emphasis on the changes between 1980 and 1992 and John Nevile has some pertinent comments in his chapter on fiscal policy.

Saunders clarifies the various measures of government expenditure and makes detailed comparisons between Australia and the other OECD countries. His Table 9.3 (derived from a source given there) is of particular interest. It shows the changes in the ratio of government expenditure to GDP during the 1980s for various OECD countries with a breakdown of the aggregates into the categories of public goods, merit goods, income transfers, economic services and interest on the public debt, with detailed comments by Saunders.

Readers will find the chapter full of interest – and wish that many topics had been further developed. One I put in that category was Saunders' discussion of the problems in writing contracts for public expenditures. His discussion is in the context of what he calls 'quasi-market reforms' in the supply of publicly-funded welfare services. But the issue is relevant to many other government services and to the privatisation of public enterprises. Governments (and the public) would dearly like to be able to write enforceable contracts specifying exactly what are to be the outcomes delivered in exchange for payments – just what is to be done to and for elderly people in nursing homes, infants in day care, students in universities, customers of basic utilities, inmates of jails and so on. If the outcomes could be defined precisely then all those activities could be put out to open tender and the government could accept the lowest bid. It is because we can not write such contracts for many activities that decisions about the degree of 'marketisation' must hinge upon judgements (and prejudgments) as to whether we can come closer to the desired real outcomes via the traditional public sector operations or by market operations.

John Nevile in his chapter on fiscal policy takes the opportunity to defend the levels of public expenditure. He points out that, by OECD standards, our expenditure on social security and health is 'not high'.

This league – ladder approach to determining the appropriate level of expenditure is common among economists. And it should not be. The use of global warm and fuzzy terms such as ‘education’ enables special interest groups to press for more spending on their particular activities (and those involved in tertiary education know that more expenditure on ‘education’ is akin to buying a gross of curate’s eggs). Public expenditures are in themselves, just statistics about sums of money spent. So too is the feed bill of the well – meaning philanthropist who pours best oats into his horses in order to benefit the sparrows he observes feeding on their droppings.

From Saunders’ Table 9.3 we learn that the percentage of GDP devoted to income transfers in Sweden, Netherlands, Austria and Denmark is three times that of Australia – and perhaps had he included France in the table it also may have been in that group. But what would we achieve by imitating these countries? And what costs and problems they confront would we incur?. The focus of economics should be upon the marginal costs of achieving the marginal benefits of defined outcomes, not upon expenditures per se. If in fact the current ‘reforms’ in the public sector are producing their declared aims of greater outcomes for given expenditures and/or better targeting of the outcomes we can happily drop further down the OECD ladder as we move towards a better society.

Microeconomic Reform

Kriesler has a chapter on ‘Microeconomic reform’ by David Clark, which has no counterpart in Lewis (although there are relevant sections scattered about in the book). This is an extremely provocative chapter which takes up many themes. Clark uses his limited space most economically and writes with real zest. Readers will probably wish for more. He stimulates interest with a historical sketch of the relative decline of Australia’s position when, after the 1890 (sic) debacle we adopted the ‘Fortress Australia’ mentality. He does not explicitly make the point, but readers will quickly see the parallels between those ‘protection all-round’ nationalist measures and their reincarnation in the programs of some of the smaller political parties.

He provokes the reader with his brief ‘did you know?’ shotgun statements. For example, that Japan’s M.I.T.I. advised Honda not to go into car production (p. 152), that during the first world war ‘the radical left, anarcho-syndicalist Industrial Workers of the World’ were strong opponents of our ‘already highly centralised and legalistic industrial relations system and made criticisms of it not dissimilar to those made by the H. R Nicholls Society in our times’ (p. 155), and that post 1890 Australia ‘introduced the widest range of government enterprises outside the Soviet Union ... [with]

government fisheries, fish and chip shops, butcher shops and pubs' (p. 148). I did in fact have some knowledge of the weird socialist experiments of the Queensland government in the 1920s but know nothing of the others – and until I check the sources (not given by Clark) I will keep an open mind. Clark's readers may be irritated but they won't be bored – and they are less likely to be seduced by his views than they may be by reading economists who can put the spin on their material and still appear clinical detached social scientists.

The Environment

Anthony Owen's chapter on the role of economic instruments in environmental policy in Kriesler gives a clear formal analysis of the nature of, and case for using, economic instruments in place of, or as a supplement to, direct regulation. He covers considerable ground in a few pages. A reader without some familiarity with such concepts as partial and general equilibrium analysis, wealth aspects and the Coase theorem could find it hard going; those with the necessary background will appreciate its clarity. Owen, in four pages, discusses Australian experience with eleven specific techniques (such as effluent charges, deposit refunds on bottles and tradeable pollution rights) drawing heavily upon a report by David James (1993) prepared for the Department of the Environment, Sport and Territories. The chapter would be extremely useful to non-economics students taking courses in environment topics.

Lewis does not have a comparable chapter but in a section on policy issues involved with mining (pp. 128-137) there is a discussion of Hotelling's principle as a guide to the rate of use of an exhaustible resource and other matters.

Industry Studies

Lewis has chapters on 'Manufacturing and Services' and 'Agriculture and Mining'. The first is used to introduce material on market structures, competition, monopoly, contestable markets, corporate objectives and ownership and control which are standard fare in the basic textbooks. These concepts are illustrated by many topical examples and references to relevant sources for the reader to follow up. The second of these chapters also introduces standard micro textbook material: the 'farm problem', farm terms of trade and schemes to stabilise farm prices or incomes. This material is more of a catalogue of these concepts than an analysis. There is informa-

tion about our international markets and the consequences of the trading policies of the European Community, Japan and the USA and of international attempts to reduce protective measures. The material on mining discusses the major influences upon the foreign demand for Australian products and, in turn, the significance for the Australian economy of the performance of the mining sector. The chapter does not give any details of the (widely different) significance of mining in the individual states.

Monetary Issues

Both books have chapters on the financial sector. In Lewis there is an elementary survey of the nature of money and the relevant institutions. Many things are touched upon but few are analysed. The reader is told here that there are 'swaps and options' but not why they emerged and what functions they serve. On p.153 we are told that the RBA prints our notes and 'care must be taken to supply the right amount of currency so as to not contribute to inflation or to create a liquidity shortage. For example, more currency is issued prior to Christmas, to match the increased demand for it'. In fact the physical supply of currency is a mundane task requiring no more skill than the daily distribution of our newspapers. If only the control of inflation were so simple.

By contrast Ross Milbourne's chapter on money and monetary theory in Kriesler is a neat essay with less institutional material but far more general insights. The nature and consequences of regulation and deregulation are discussed in a well-balanced way. There is a useful documented summary of the debate about prudential regulation with an airing of the case for 'free banking' and an explanation of how a bank could actually have a less risky asset portfolio by taking individual risky assets, but with negatively correlated returns; however on the RBA approach that would require a higher capital ratio.

The second theme in Milbourne's chapter is monetary theory and policy. The discussion covers alternative approaches in a succinct and balanced manner. A survey of recent empirical evidence is used to assess alternative theories. There is no concealing the cold facts that no theory is dominant nor that policy making is extremely difficult.

Neville has fewer doubts about the efficacy of fiscal policy. He early states that 'since recessions are caused by too little aggregate demand, fiscal policy can be very important in determining the health of the economy'. Then follows a concise account of the simple Keynesian model, which is modified and developed to take account of the 'crowding out' effect, the significance of budget deficits, the relationship between budget deficits and

current account deficits and concludes with a thumb-nail sketch of fiscal policy over recent decades. The material is clearly presented but it does not give appropriate weight to alternative views of fiscal policy. For example some economists argue that while most recessions (not all, there are supply side and excessive real wage causes as well) involve inadequate demand, sometimes the inadequate demand has its origins in inappropriate fiscal policy. Many of the problems associated with monetary policy discussed by Milbourne apply also to fiscal policy. Another of Nevile's colleagues at UNSW, David Clark writes (p. 142) 'Across the western world over the 1980s, macroeconomic policy did not live up to the claims of most of its academic advocates- the vulgar Keynesians' faith in fiscal policy fine-tuning proved deficient. In the late 1980s, the biggest cut in government spending and borrowing in our history did not produce an automatic rise in unemployment'.

Inflation, Unemployment and Labour Markets

Kriesler has separate chapters on 'Inflation', by Bill Junor, and 'Unemployment', by Trevor Stegman. The first discusses the nature and costs of inflation, the Australian experience and the attempts to assess the trade-off between inflation and unemployment. The conclusion is that 'the evidence is inconclusive on the relative output costs of inflation and unemployment and therefore on the desirability of anti-inflation policy it is difficult to disagree with Norton when ... he observed that "now that inflation is down, the best policy is not to let it rise again"' (p. 159). Stegman explains clearly the meaning of our official measure of unemployment, surveys our post war experience of unemployment, the changes in the pattern of unemployment by age and sex (but not by state and region), the different explanations offered for the increased levels of unemployment and concludes with a discussion of current policy.

In Lewis inflation and unemployment are covered together in chapter nine and there is a separate chapter on the labour market. Chapter nine covers the topics well at textbook level. One oddity is the introduction without explanation of the conventional aggregate demand/aggregate supply diagram to analyse the causes of inflation. This is the only use of a formal theoretical apparatus in the book. Whereas the comparable chapters in Kriesler cite the numerous sources used, the Lewis chapter does not propose to survey the literature but simply to tell the story.

Lewis's chapter on the labour market gives a very clear account of the extraordinary changes in the supply of labour and also in the pattern of demand for workers. It also covers the costs and returns to education and

training, the changes in the industrial relations system and discrimination in the labour market. It is well illustrated by empirical material.

Lewis also has a chapter on private spending which more or less mirrors the chapters on consumption and investment in the standard texts and it concludes with a chapter on macroeconomic policy which attempts to draw the material from the earlier chapters together.

Summing Up

The opening paragraph in Lewis is: 'This is very much an applied economics book. It is concerned with such issues as what drives the economy and the policy issues facing the economy, rather than economic theory. However, concepts will be used that are covered in introductory economics courses and some new ones will be introduced as they arise' (p. 1). That opening gambit reads oddly against the definition of applied economics given in the glossary (p. 305), viz: 'The application of economic theory to practical situations in an attempt to solve economic problems'. Lewis meshes into the sequence of topics covered in the standard texts. However it focuses upon descriptive and institutional material and has very little economic analysis. The quality of the chapters is uneven, as is the editing. It is more likely to be useful to beginning economics students seeking to find their bearings as they, for the first time, strive to understand what the economy is.

Kriesler will have more appeal to readers of this journal. It is written at a level comparable to that of the Index *State of Play*, produced by the same publisher. However where *State of Play* (also prepared by a team) integrates the material and reads as if written by one author, Kriesler offers a set of essays – each a well written succinct account of the state of play in a specific field. Kriesler does not give a comprehensive cover, having relatively little on microeconomic aspects. There is no attempt to draw the themes of the separate chapters together. If each author were in turn to present his chapter to an audience of his co-authors there would be some lively interchanges. Readers of the book will, correctly, conclude that there are many unresolved issues. The book will stimulate them to think about the problems. Lewis will give them information relevant to the problems.

Notes

1. Published by Longman – Cheshire, Melbourne, 1994 and priced at \$22.95 (RRP).
2. Published by Allen and Unwin, St Leonards, 1995 and priced at \$17.95 (RRP).
3. That is on the pre-Dawkins scale; adjusted for 'grade inflation' that equates to an A- on the post-Dawkins scales.