Economic Governance and Microeconomic Reform

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Economic governance in Australia has undergone radical changes since the 1970s. Many of these changes are associated with the market-oriented policies collectively referred to as ‘microeconomic reform’. Broadly speaking, microeconomic reform can be defined as government policies or initiatives aimed at improving the performance and/or the efficiency of industries or sectors in the economy (Forsyth 1992). Remarkably, such a quest for efficiency was not a major policy focus for much of the twentieth century in Australia. However, since the 1970s, growing pressure on the economy, together with evidence of widespread inefficiency, saw microeconomic reform become a key aspect of economic policy in Australia.

The era of microeconomic reform in Australia may be divided into three main phases, with a degree of overlap. In the first, deregulatory, phase, the main focus was on rationalising public intervention in private sector markets, with the object of ‘getting prices right’. In the second phase, referred to here as the ‘privatisation’ phase, attention shifted to market-oriented reforms of the public sector, including corporatisation and competitive contracting as well as privatisation. In the third ‘competitive regulation’ phase, the idea of deregulation was replaced by regulation designed to produce, or simulate, competitive market outcomes (see also Parker this volume).

The central argument of the chapter is that each of these phases was associated with the prominence of particular institutions and with specific tendencies in economic governance. In particular, whereas the governance models associated with the privatisation phase, the private corporation was taken as the ideal model of public sector governance. By contrast, in the competitive regulation phase, governments have relied on increasingly intrusive systems of regulation to control both public and privately-owned monopolies.

Following a brief outline of the economic governance arrangements that prevailed before the onset of microeconomic reform the three phases of reform are described and briefly analysed.

Attention is then focused on the institutions that played a leading role in the successive phases of the reform process. Finally, the outcomes of microeconomic reform are assessed and likely future directions of policy are considered.

Economic governance before microeconomic reform

Much discussion of microeconomic reform in Australia begins with the ‘Federation trifecta’ (Henderson 1983) or ‘Australian settlement’ (Kelly 1992) consisting of early twentieth century moves towards tariff protection, industrial arbitration and the White Australia policy (seen, in this context, as a measure to protect Australian workers from immigrant competition). It is often claimed, implicitly or explicitly, that the current era of microeconomic reform represents a break from or a response to the Federation trifecta. The Federation measures were central to Australian economic policy between 1901 and 1939. From World War II onwards, however, they were displaced somewhat or at least overlaid by a social-democratic economic settlement based primarily on macroeconomic stabilisation (Smyth 1996, Bell 1997). The perceived success of macroeconomic stabilisation enhanced the prestige of government and bolstered support for a range of microeconomic interventions particularly with respect to social welfare and human services.

The centrepiece of the social-democratic economic settlement was Keynesian economic management, based primarily on the use of fiscal policy (variations in tax rates and public expenditure) to stabilise aggregate demand, supplemented by accommodating monetary policies designed to maintain a stable supply of credit at relatively low interest rates. The presumed capacity of Keynesian policies to guarantee full employment was the basis of a ‘wage-earners welfare state’ (Castles 1988) in which social security benefits were organised around the assumption that male household heads would be employed on a full-time basis, except for brief intervals associated with personal transitions and temporary economic downturns.

Industry policies, especially in the form of tariff protection, were central to the political debates of the Federation period and the notion that local industries should be shielded from import competition was not seriously challenged until the 1970s (Glezer 1982, Capling and Galligan 1992, Bell 1993). What stands out in the Australian experience is the way in which powerful protectionist instruments (eg tariffs, quotas) were used in an *ad hoc* manner and for a diverse range of purposes. For example, the idea of tariff protection as a guarantee of employment was regarded as obsolete in the Keynesian period, when it was assumed that full employment could be guaranteed by demand management. For much of the 1950s, import quotas were used as a macroeconomic tool to defend a fixed exchange rate. Overall, protectionism played a significant role in restructuring the economy and promoting a large and diverse manufacturing sector. However, there was a lack of oversight and accountability within the protectionist system. Protection was provided with no strings attached in the sense that recipients were not obliged to improve their efficiency or performance. In short, the microeconomic system of governance in this period was *ad hoc*, highly politicised and lacked a strong strategic focus. Widespread inefficiency was a key outcome.

Taken collectively, the policies and institutions of the Federation settlement and the post-war social-democratic economic settlement produced a substantial increase in 'state capacity'; understood here as the capacity to implement policies which shaped the economy (Evans 1997; Weiss 1998; chapter 5 this volume). Post-war full employment, for example, stood as a major indicator of the state's economic capacity in this respect.

By the 1970s, however, post-war notions of state capacity were being challenged. For example, two major enquiries in the 1970s (the Jackson and Crawford report) highlighted the weak and uncompetitive nature of the manufacturing sector. Also, by the time the Whitlam government was elected in 1972, it was becoming apparent that demands for public provision of goods, services and transfer payments were growing more rapidly than the capacity of the state to meet them. This mismatch was evident first with respect to the gap between limited tax revenue and growing demands for expenditure, referred to by O'Connor (1973) as 'the fiscal crisis of the state'.

At a deeper institutional level, there was a fundamental conflict between the role of the state as a Keynesian-technocratic economic manager and the residual *ad hoc* interventionism of the Federation settlement. The Federation settlement led naturally to the McEwen doctrine of 'protection all round', in which the state intervened piecemeal to stabilise the incomes accruing to all major sectors of the economy. By contrast, in the social-democratic economic settlement, the state was supposed to manage the economy so as to promote consistent social welfare objective. Attempts to resolve this conflict through more systematic and rational planning, represented most notably by the Vernon Committee (1965) had gone nowhere, especially in the face of resistance from Treasury (Whitwell 1986).

The fiscal crisis of the state was exacerbated by the collapse of the Bretton Woods system of fixed exchange rates and the end of full employment. The economic crisis of the 1970s (especially 'stagflation' or the joint occurrence of high unemployment and high inflation) simultaneously increased the demands on the state (for example, by raising demand for welfare benefits) and reduced state capacity to meet those demands. The result was a sharp reaction against the social-democratic settlement, which dominated the rhetoric, and, to an increasing extent, the policies, of the Fraser government and its successors (Bell 1997).

In this context, microeconomic reform may be interpreted, in three different ways. First, it may be regarded as a way of economising on scarce state capacity by withdrawing the state from peripheral commitments and employing quasi-autonomous market processes in place of direct economic management. Second, microeconomic reform can be seen as part of a broader neoliberal policy agenda aimed at reducing both state intervention and state capacity. Third, it can be seen as a response to the inherited problems of widespread inefficiency in the economy, in both the private and public sectors.

Three phases of microeconomic reform

Deregulation

The first phase of microeconomic reform in Australia commenced in 1973 with the Whitlam government's 25 per cent cut in all tariffs, and related cuts in agricultural assistance of which the most controversial was the abolition of a bounty on purchases of superphosphate. This deregulatory phase reached its climax in the mid-1980s with financial deregulation (floating the dollar, abolition of exchange controls etc).

The microeconomic reforms implemented by the Whitlam government also included the rationalisation of public expenditure proposed by the Coombs Commission (Royal Commission on Australian Government Administration 1976) and later by the Priorities Review Staff. These reforms were aimed at 'clearing the decks' for the expansion of the Commonwealth role in the provision of human and other services, represented by such initiatives as Medibank, the Commonwealth takeover of the university system, and a range of initiatives in urban policy.

It is somewhat paradoxical that the most interventionist government in Australia's postwar history was also responsible for the inauguration of radical free-market reform. The consensus in favour of 'protection all round' had marginalised both advocates of the traditional free trade alternative to protection and supporters of strategic industry policies and microeconomic planning. As a result, advocates of more comprehensive planning, such as Cairns (1971) initially made common cause with those who favoured extensive free-market reform. Both groups were classed as 'economic rationalists',[1] that is, advocates of rationally-designed policy, as opposed to the advocates of the *status quo* in which policy was driven by a mixture of historical precedent, lobbying, and *ad hoc* responses to crises.

Most economic rationalists at this time professed agnosticism about issues such as the appropriate balance between the public and private sector, regarding this as a question of social and political preferences about which economists, as such, could say little. The principal focus was on a market-oriented policy of 'getting prices right' and, in particular, eliminating policies that unnecessarily 'distorted' the production and consumption decisions of private firms and households.

The paradigmatic example of a 'distorting' policy was tariff protection. The gap between free-market and interventionist opponents of tariffs was bridged by the argument that, if a government wished to assist particular industries it should do so through subsidies, which did not distort the prices faced by consumers.

After the failure of Keynesian economic management to deal with stagflation in the early

[1] For further discussion of the genesis of the term 'economic rationalism' see Quiggin (1997a) and Schneider (1998).

1970s, the free-market element in microeconomic reform came to the fore. The most comprehensive statement of the free-market agenda in this period was that of Kasper et al.(1980).

Although the advocates of deregulation gained ground in the policy debate under the Fraser government between 1975 and 1982, their policy successes in this period were limited. The policy debate continued to focus largely on macroeconomic issues, and macroeconomic imperatives frequently overrode arguments for microeconomic reform.

For example, high unemployment in the motor vehicle and textile, clothing and footwear industries led to the imposition of quotas, which were equivalent to tariffs of more than 100 per cent in some cases. Thus, although the average level of tariff protection declined under Fraser, the variation between tariff rates within the manufacturing sector increased. Since the loss in economic welfare associated with tariffs depends primarily on the variability of tariff rates, a standard neoclassical analysis shows that policy became more distortionary during this period (Quiggin 1996). Moreover, the extension of *ad hoc* protection to declining industries lacked any strategic rationale (1993).

Similarly, the desire to control aggregate wages led the Fraser government to strengthen the Arbitration Commission. On the other hand, the extension of the Trade Practices Act to prohibit secondary boycotts (such as sympathy strikes and black bans) paved the way for subsequent attacks on unions.

The Fraser government laid the groundwork for much subsequent free market reform, most notably through the establishment of the Campbell Committee of inquiry into the financial system, which recommended deregulation of financial markets and a freely floating exchange rate (Commonwealth Committee of Inquiry into the Australian Financial System 1980). Similarly, the two-airlines policy was relaxed in 1977, with the abandonment of restrictions requiring parallel flights and fares. There were, however, frequent policy reversals. Most recommendations of the Campbell Committee were not implemented, and, just before the Fraser government’s loss of office, the two-airline policy was extended for five years.

The election of the Hawke Labor government in 1983 was a pivotal event in Australian microeconomic reform. In opposition Labor had been critical of deregulation in general, and of the Campbell Committee recommendations in particular. In government, with Paul Keating as Treasurer, however, Labor adopted and extended the Campbell recommendations, and subsequently moved to implement much of the deregulatory agenda proposed by the ‘economic rationalists’ of the 1980s.

The Labor government, and particularly Keating, used the contrast between Fraser’s cautious approach to financial deregulation and Labor’s embrace of the policy to represent the Liberals as captives of ‘old money’ interests reliant on a cosy system of intervention and mutual protection. These old money interests were contrasted with the energetic ‘entrepreneurs’, such as Bond, Skase and Holmes a Court who were seen as taking advantage of the opportunities created by financial deregulation to shake up a complacent management class. The classic example of this process was the attempted takeover by Holmes a Court of BHP, then Australia’s largest corporation.

The collapse of the entrepreneurial corporate empires after the stock market crash of 1987, amid revelations of widespread corporate fraud, produced significant disillusionment with financial deregulation. At a deeper level, the asset price boom associated with financial deregulation was widely seen as the main reason for the length and severity of the 1989–91 recession.

More generally, the Hawke–Keating government represented itself as opening Australia up to the world. The rhetoric of the Federation trifecta and the Australian settlement arose at this time in the context of retrospective attacks on the Fraser government (Henderson 1983) and advocacy of the Hawke–Keating agenda (Kelly 1992). The free-trade agenda in industry policy was presented as a response to the complacency of Australian industry.

In May 1988, the process of industry-by-industry tariff reform, based on an inquiry process, was replaced by a commitment to across-the-board tariff cuts. Despite high unemployment, this policy was extended in the Industry Statement of May 1991 with a general commitment to reduce all tariffs to 5 per cent by 2000. The 5 per cent target was achieved, with the exception of the motor vehicle and textile industries, The Howard Liberal government subsequently rejected proposals to reduce the general tariff rate to zero.

Labor also wound back or abolished many agricultural price support programs, including price stabilisation and underwriting for wheat and other crops. The case against agricultural price policies was strengthened by the collapse, in 1990, of the Wool Price Stabilisation Scheme, a grower-managed system of buffer stocks.

A range of other deregulatory measures were adopted. In 1990, the two-airline agreement was abolished and new operators were allowed to enter the market. The first two entrants, both using the name Compass, collapsed with heavy losses. Despite the loss of regulatory protection, the Ansett–Qantas duopoly was maintained until the entry in 2000 of Virgin Airlines (owned by British entrepreneur Sir Richard Branson and Singapore Airlines) and the decision of regional airline Impulse to offer services between capital cities. With the recent announcement that Qantas is to acquire the assets of Impulse, and the likelihood that Singapore Airlines will ultimately acquire both Ansett and Virgin, it seems that the restoration of duopoly is only a matter of time.

A partial exception to the general trend of policy based on ‘getting prices right’ was the adoption of indicative industry plans in industries undergoing restructuring as a result of market changes and tariff reform. The most important of these were the car and steel plans implemented by John Button as Industry Minister.

Within the Labor government there was a debate between advocates of a strategic industry policy who saw the car and steel plans as precursors to a general system of tripartite industry bodies and those who saw them as a, possibly regrettable but definitely temporary, form of industry assistance. By the time of the 1992 Industry Statement, it was evident that the latter group had won. The car and steel plans ended, and no similar initiatives took their place. Increasingly in the 1990s, industry policy has limped along as a kind of poor cousin behind the other main arms of economic policy (Capling and Galligan 1992; Bell 1993; Bell 1997).

Although deregulatory initiatives continued throughout the 1990s, particularly at the state level, the policy focus shifted away from deregulation after the mid-1980s. Even among advocates of reform, there was a general perception that the benefits of deregulating the private business sector had been modest. This perception led to increasing concern with reform of the public sector.

Privatisation

The first phase of microeconomic reform was driven by a combination of neoclassical theory and US models of deregulation. The second phase, beginning in the mid-1980s, was focused primarily on reform of the public sector and was based on policies adopted in the United Kingdom.

Pressures for reform of government business enterprises arose from a number of sources. First, Australian governments, confronted the fiscal crisis of the state, found it more and more difficult to justify financing unprofitable public enterprises. As fiscal pressure tightened, governments demanded steadily higher rates of return from public enterprises. The temptation to make cosmetic improvements to the budget balance sheets through privatisation also increased.

The push for privatisation may also be understood in terms of the concept of state capacity (Weiss 1998). Quiggin (2001a) argues that the crisis of the 1970s may be seen as the result of states' overreaching themselves, giving rise to a 'capacity gap' (Evans 1997). The movement towards privatisation was justified by members of the Labor government as a way of 'refurbishing' the welfare state (Castles and Shirley 1996) by minimising unnecessary obligations. However, some advocates of this argument subsequently joined the 'gravediggers' who used the economic difficulties of the 1970s and 1980s to argue for the abolition or radical retrenchment of the welfare state.

The movement towards microeconomic reform on market-oriented lines, which became general in the 1980s, was also important. Inefficiencies in publicly-provided infrastructure services were seen as obstacles to the development of competitive export industries. It was widely hoped that improvements in the efficiency of transport, electricity and telecommunications systems would enhance exports and reverse the rapid growth in the current account deficit that followed financial deregulation in the early 1980s.

Finally, it is important not to overlook the element of fashion. In the private sector, periods of enthusiasm for 'conglomerate' enterprises undertaking many activities have been succeeded by periods of divestment and downsizing, in which activities previously undertaken in-house are contracted out or separated and sold off. The same fashions make themselves felt in the public sector. In the 1980s, the Thatcher government, then credited with responsibility for an economic 'miracle', was the leading model for reforming governments. The appeal of the Thatcher model, and the popularity of outsourcing in the public sector led to the adoption of policies of compulsory competitive tendering in a number of areas (for example, Victorian state and local government, and information technology in the Commonwealth government) most of which were subsequently abandoned as unworkable or insufficiently flexible.

The most prominent policy initiative of the Thatcher government and its Australian imitators was the privatisation of public enterprises. However, privatisation represented only one of a range of policies designed to make the public sector more like the private sector and, as far as possible, to eliminate the role of the public sector in the actual production and provision of goods and services. An equally important role was played by policies of competitive tendering and contracting for the provision of public services.

In examining the structural reform of public enterprise, it is useful to consider a range of possible organisations with traditional government departments at one end of the spectrum (say, the left) and private enterprises at the other (say, the right). From the perspective of advocates of microeconomic reform, the object of reform is to move as far to the right as possible, subject to constraints arising from potential market failures or political restrictions. To develop the idea of a spectrum, consider first a traditional government department, providing services financed by some mixture of taxes and user charges. The quantity and quality of services to be provided, the way in which those services are produced and the charges, if any, to be paid by users are all decided politically, subject to the constraint that, if voters are dissatisfied, they may vote for a change of government.

Beginning with a public service model, it is useful to consider the following range of reform options:

(i) full cost pricing;

(ii) competitive tendering;

(iii) commercialisation;

(iv) corporatisation; and

(v) privatisation.

Each step along the reform spectrum involves an increase in reliance on profit as the primary guide to management decisions, and a reduction in direct public accountability. These two changes are directly linked: increases in profitability arise precisely because managers are not subject to constraints imposed through public accountability, and are therefore free to manage enterprises so as to increase revenues and reduce costs. The implications of market-oriented reform for accountability and performance are considered in more detail in Quiggin (2001b).

Competitive regulation

Free-market economists and other reformers initially hoped that the process of public-sector reform would be accompanied by the rapid emergence of competitive markets for infrastructure and other services previously provided exclusively by the public sector. In this context, corporatised or privatised public enterprises would operate just like other companies, requiring only general regulation regarding consumer protection, trade practices and the like.

Under the social-democratic settlement, public ownership and control in a range of infrastructure activities was justified by the assumption that these activities were ‘natural monopolies’ in which the most cost-effective arrangement was the provision of services by a single firm. Advocates of microeconomic reform claimed that the natural monopoly hypothesis was invalid, or that it had been rendered obsolete by technological advances such as those associated with the Internet.

A variety of regulatory arrangements were made in areas such as telecommunications and electricity, on the assumption of a rapid transition to a fully competitive market. The prime example of such a transitional policy was National Competition Policy (based on the Hilmer Report, 1993). In its initial formulation, the policy was, in essence, an agreement by the states to a comprehensive implementation of the deregulatory and public sector reform agenda, in return for a partial restoration of Commonwealth financial assistance grants. The payments were to be made on a fixed timetable reflecting the assumption that the entire policy would be implemented in a finite timeframe, after which no further intervention would be needed.

By the late 1990s, hopes for a fully competitive outcome had dimmed. Most notably, despite a variety of initiatives designed to promote a competitive telecommunications market, Telstra had maintained a dominant position in most markets. Moreover, a wave international mergers in the late 1990s, many of which took place in the infrastructure sector, made it clear that monopoly, natural or otherwise, would be the outcome of an unregulated market. Developments in the technology sector, where a profusion of small enterprises gave way to a market dominated by giants like Intel, Microsoft and AOL Time Warner, refuted the claim that natural monopoly was technically obsolete.

Even in private sector industries where there had been significant competition (at least in the sense of a large number of firms) merger proposals raised the prospect of duopoly or monopoly. The impact of this wave of mergers was particularly significant in sectors, such as banking, where deregulation had been premised on the assumption that new entrants would provide competition for the incumbent firms. Instead, governments were reduced to defending ‘four pillar’ and ‘six pillar’ policies restricting mergers between financial enterprises. In the absence of these policies, the financial services sector in Australia would rapidly be reduced to a duopoly. The four major banks would merge into two, each of which would acquire a large insurance company, and then mop up the remaining minor competitors. When this prospect is compared with the profusion of banks, building societies, insurance companies and other financial institutions that existed before deregulation, the idea that an unregulated market produces competitive outcomes looks increasingly untenable.

Moreover, although much industry-specific regulation had been swept away in the private sector, increasing concerns about the environment, public safety, sexual harassment and related issues resulted in an expansion of the role of regulation in the economy. The increasing formality of regulatory processes led to an even more dramatic increase in the physical volume of laws and regulations.

In these circumstances, it has become evident that regulation will be a continuing feature of economic governance in the aftermath of microeconomic reform, and is likely to grow in importance over time. In some areas, it is possible to discern the emergence of a stable pattern of regulation. For example, regulation of monopoly infrastructure enterprises has settled on a modified form of rate-of-return regulation, in which monopoly businesses are allowed to set prices yielding a given rate of return on their assets, with both the rate of return and the value of the asset base being determined by regulators. Details of this approach, with particular reference to the electricity industry, are discussed by Quiggin (2001c).

Institutions and governance

As noted above, the social-democratic settlement was implemented after World War II within the context of a modified Westminster system of governance. Each of the phases of microeconomic reform outlined above was associated with a distinct theory of governance, and with the rise to prominence of particular institutions. Deregulation, promoted by the Industries Assistance Commission, tended to sharpen the distinction between the public sector, assumed to deal with areas of the economy characterized by market failure, and the private sector, where government intervention was generally considered undesirable. By contrast, in the privatisation phase of microeconomic reform, driven by Treasury and Finance departments, public institutions were pressed to become more like private businesses. Finally, in the phase of competitive regulation, dominated by the National Competition Council and Australian Competition and Consumer Commission, the idea of government as an external regulator, not directly involved with the provision of market goods and services, became dominant. We examine these institutional and governance arrangements in more detail below.

Deregulation and the Industries Assistance Commission

The deregulation phase of microeconomic reform did not involve a fundamental challenge to existing systems of governance. In the short run however, deregulation could be seen as sharpening the traditional division between the private and public sectors, by eliminating intrusions of government into private sector activity. Moreover, microeconomic reform in this period was based on concepts of bureaucratic rationality, in which objective analysis of public policy was supposed to replace *ad hoc* responses to political pressures for tariff protection and regulatory interventions.

The role and independence of statutory corporations and commissions, already an important feature of the social-democratic settlement was expanded and systematised during this period. Statutory corporations and commissions were seen as bodies which could be run independently of day-to-day political interference in pursuit of a consensus-based notion of the public good. This institutional model was used both for the provision of goods and services, as in the case of Telecom Australia and Australia Post, and for long-term policy development.

The politicisation of the core public service, which commenced with the election of the Whitlam government, was not, in this period, directly related to microeconomic reform. The expansion of the size and influence of ministerial staffs, although much-discussed at the time, was broadly consistent with standard Westminster views about the responsibilities of ministers. Of greater long-run significance were the first moves towards political appointment of senior public servants.

The crucial institution of the deregulatory phase of microeconomic reform was a statutory commission, the Industries Assistance Commission (IAC) created by the Whitlam government in 1973 to replace the Tariff Board. In addition to tariffs, the IAC was responsible for reviewing assistance to agricultural industries and also undertook *ad hoc* inquiries into a wide range of policy topics (Glezer 1982; Bell 1993).

As a public agency with a clearly–stated and strongly–argued policy line, independent of the views of the government of the day, the IAC was a novelty in the Australian context. From the viewpoint of its opponents, the IAC was, in effect, a publicly-funded lobby group for free trade and free-market policies. Conversely, the IAC argued that it was obliged by its legislation to advocate 'efficiency' which it interpreted in the technical sense of neoclassical economic theory to mean pursuit of an optimal free-market outcome. The emergence of independent commissions both as policy actors and as participants in the policy debate has been a noteworthy feature of Australian economic governance since the 1970s (Argy 2000).

The influence of the IAC was greatly enhanced by the process of public inquiries into industry assistance. Although the inquiries were presented as a process of rational debate, and to some extent lived up to this image, the recommendations were effectively determined in advance, and invariably involved reductions in industry assistance. The reports were vetted by an internal group[2] to ensure consistency with the general IAC policy line. The hostile reaction of the industries concerned was equally predictable. The debate was often seen as one between 'jobs and dogma' (Warhurst 1982).

In 1990, the IAC was renamed the Industry Commission (IC) a reflection of the irony inherent in the name 'Industries Assistance Commission' for a body which invariably recommended reductions in the assistance given to industries.

By 1988, following the commitment of the Hawke Labor government, with the bipartisan support of the non-Labor parties, to phase out tariffs and abolish most national agricultural price stabilisation and support schemes, the Commission had worked itself out of its main job. Its most influential report during its incarnation as the Industry Commission was an analysis of National Competition Policy, in which it was estimated that 'Hilmer and related reforms' would raise national income by an amount equivalent to 5.5 per cent of GDP (Industry Commission 1995). This estimate was criticised by Quiggin (1997b) who argued that, after taking account of losses incurred by employees, the net benefit would be less than 1 per cent of GDP.

Following the election of Howard government in 1996, the Industries Commission absorbed

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[2] According to anonymous sources, this group was referred to within the IAC as the 'thought police'.

the Bureau of Industry Economics, created under the Fraser government, and the Economic Planning Advisory Commission, created by the Hawke government. The resulting organisation was named the Productivity Commission, but was, for all practical purposes a renamed Industry Commission. Since both the Bureau of Industry Economics and the Economic Planning Advisory Commission were created in response to demands for a more strategic industry policy, the merger must be seen as a victory for the free-market view represented by the Industries Assistance Commission and its successors.

Despite this victory, the Productivity Commission has played a peripheral role in policy debates compared to its predecessors, and particularly the IAC. Recommendations by the Commission for reductions in protection for the motor vehicle industry and for the abolition of the general 5 per cent tariff have been rejected by the Howard government.

Privatisation and Treasury/Finance

The microeconomic reforms associated with privatisation were designed to produce fundamental changes in economic governance. Whereas deregulation could be seen as clarifying the roles of the public and private sectors, the policy program associated with privatisation was based on the assumed superiority of the private sector and therefore represented a fundamental challenge to the social-democratic view of the role of government. The private sector, and particularly the large private corporation, was similarly seen as a model for public governance.

The most direct reflection of this view was corporatisation, that is, the conversion of statutory corporations or government departments into publicly-owned corporations. The adoption of private-sector models is the central feature of the process of governmental reform, sometimes referred to as the ‘reinvention of government’ (Osborne and Gaebler 1992).

Within the core public service, the process of politicisation extended steadily under both the Hawke–Keating and Howard governments, and has now reached the point where senior public servants hold office at the pleasure of the relevant minister. The outcome differs from that in the United States, where there is a fairly clear distinction between career public service positions and ‘patronage’ positions that are filled by the incumbent government at will. In the current Australian setting, the same position may be filled at one time by a political appointee and at another time by a career public servant. There is a corresponding ambiguity in the position of senior public servants. Some are clearly political appointees of a particular government or minister, and some are career public servants with no political affiliation, but there is a large intermediate group, more or less closely identified with one party and vulnerable to political removal by the other.

The indirect impacts of the corporate model were at least as important. The rhetorical hostility to government expressed by advocates of privatisation was not associated with support for checks and balances, whether those of the Westminster system of parliamentary accountability, or those of a Washingtonian separation of powers. Rather the corporate model of a leader with unfettered powers, subject only to removal for poor performance, was embraced.

A notable reflection of this viewpoint was the campaign for four-year parliamentary terms, which commanded almost unanimous support from the policy élite during this period. The main argument used in supporting four-year terms was that it would give governments the time to implement necessary but unpopular reforms, free from the pressure of impending elections, and then to seek re-election based on the positive outcomes of those reforms. The underlying assumptions that voters do not know what is good for them and that parliamentary checks and balances are an obstacle to good government were taken to be so obvious as not to need stating.

Another important innovation was the use of the doctrine of 'commercial confidentiality' to circumvent both parliamentary accountability and Freedom of Information legislation. There is an obvious potential efficiency benefit from allowing public sector managers to seek the most cost-efficient outcome without responding to external pressures, from parliament and the public. Advocates of reform have argued that this efficiency benefit is achieved without any cost in terms of accountability, since the accountability structures associated with corporatisation are superior to those associated with openness to parliamentary and public scrutiny.

The institutional consequences of the privatisation phase of microeconomic reform reflected the associated centralisation of power. Reform of the public sector enhanced the power of the central departments of government, especially Treasury and Finance, over departments responsible for the provision of services. The radical reforms of government business enterprises were also controlled, in large measure, by Treasury and Finance departments. The traditional role of these departments had been the defence of the budget balance against pressures for increased expenditure and lower taxes, though tax cuts were generally viewed as the lesser evil. More generally, the standard 'Treasury line" combined support for fiscal stringency with a general tendency to neoliberal or free-market views (Whitwell 1986). On the other hand, the central agency perspective associated with Treasury typically translated into support for a powerful, and highly centralised, executive.

At the Federal level, the Treasury role in resisting pressure from state governments for Commonwealth grants reinforced the strongly centralist views that characterised the Commonwealth Public Service as a whole. The preference of Treasury and Finance for centrally-imposed solutions was manifested in the disastrous IT outsourcing initiative, recently abandoned by the Howard government.

Governance and competitive regulation

The initial phase of regulation-based microeconomic reform was dominated by the introduction of the Hilmer inspired National Competition Policy (Hilmer, Rayner and Taperall 1993). This process was marked by the abandonment of the notions of transparency in governance that had dominated the rhetoric of the Industries Assistance Commission in the 1970s. Advocates of reform within policy circles used the Hilmer Report as the basis for a renewed push for public sector reform, centred around the Council of Australian Governments (COAG). By virtue of its reliance on inter-governmental negotiations and remoteness from open political debate, the COAG process permitted further extensions of the reform process to be presented as a *fait accompli*, embodied in the opaque legislation of the National Competition Policy Act. Popular disenchantment with reform was thereby sidestepped (Quiggin 1996). Marsh (1996, p. 7) agrees, observing that:

> The approach follows conventional wisdom about the best way to achieve major policy change. A nominally independent committee — in fact made up of members whose broad sympathies were well recognised and in line with ministerial and bureaucratic dispositions — was constituted. This committee was given the task of evaluating a policy area and suggesting changes. Consultation was confined to a call for submissions. Cabinet endorsed the report which was then negotiated, largely in private, with the immediately affected interests, in this case basically the States. There was minimal parliamentary attention to the process and minimal attempt to 'educate' interests who might be affected in the implementation phase.

Marsh goes on to observe, presciently:

> The absence of a broad based climate of opinion in favour of reform may yet prove a considerable handicap. As political disputes inevitably arise, the reform proposals will be able to draw on only a slender anchor in public opinion. Recent events in new Zealand also point to the potential for ill understood measures to attract a populist electoral backlash — as a kind of unintended consequence — and with possible unpredictable longer term consequences.

The backlash duly emerged, most notably in the Queensland election of 1998, in which electoral hostility to microeconomic reform in general focused on National Competition Policy. Resentment about National Competition Policy has been an important factor in subsequent political developments, including the unexpected defeat of the Kennett Liberal government in Victoria in 1999 and the persistence of support for the One Nation party.

Concern about National Competition Policy has been amplified by the role of the National Competition Council (NCC) in imposing a competitive reform program on state and local governments (or, in the view of the NCC, monitoring the compliance of the states with the agreements made in 1994). This process is still continuing and remains controversial. Nevertheless, the National Competition Policy agreements represent a fixed reform agenda, much of which has already been implemented.

The combination of National Competition Policy and the corporatisation of statutory authorities has, as planned, led to an outcome where government business enterprises operating in the market sector, such as electricity and water supply enterprises operate in much the same manner as private businesses. However, the expectation that regulation of such enterprises would fade away as competitive markets emerged has proved unfounded. Instead, enterprises in markets with natural monopoly characteristics have been subject to increasingly intrusive regulation. The need to set a rate of return on capital has implied a requirement for detailed assessment of the value of the capital stock and of whether particular investments represent an efficient use of capital.

As a result, attention in the public debate has increasingly turned to the continuing regulatory operations of the Australian Competition and Consumer Commission (ACCC). The operations of the ACCC at the Commonwealth level are paralleled by a range of state government organisations. With the exception of the Victorian Office of the Regulator-General, which has been vigorously attacked by private electricity distribution enterprises for setting lower-than-anticipated rates of return, these organisations have received relatively little publicity. Nevertheless, their collective regulatory impact is comparable to that of the ACCC.

The outcomes of microeconomic reform

Role of government

The era of microeconomic reform has seen important changes in the role of government and in the process of economic governance. The language and values of the market pervade the policy debate and have largely supplanted the notion of public service that previously dominated the public sector. Regulation of industry aimed at stabilising output and employment, or promoting growth in particular sectors is now seen as illegitimate.

Nevertheless, hopes or fears of a radical retrenchment in the role of government, or of a fundamental transformation of the nature of government, have not been realised. The ratio of public expenditure to national income has stabilised at a historically high level. Although competitive tendering and contracting has continued to increase in importance, there is an increasing tendency to impose public-sector accountability requirements and employment conditions on private contractors, thereby eliminating much of the cost difference between private and public providers.

Politically, moreover, neoliberalism is in retreat, at least in the English-speaking countries where its advances have been greatest. In particular, the seemingly unstoppable trend to privatisation has been almost completely halted by a series of electoral defeats for its advocates.

Productivity, growth, employment, equity

Assessment of the economic outcomes of microeconomic reform remains the subject of vigorous controversy. Popular support for microeconomic reform has never fully recovered from the impact of the recession of 1989–91. From a ‘peak-to-peak’ perspective, beginning at the last peak of the business cycle in 1989 and continuing to the present, the economic performance of the 1990s looks unimpressive (except perhaps by comparison with the 1980s, the first full decade of microeconomic reform). Moreover many of the improvements in measured productivity have been obtained through the use of competitive pressures in the workplace that have led to a substantial increase in the pace and intensity of work (ACIRRT 1999).

By contrast, advocates of reform, such as the Productivity Commission, have focused on high levels of measured productivity growth observed since the mid-1990s and on the length and strength of the economic expansion that commenced in 1991. The absence of any impact from the Asian crisis of 1997 is seen as evidence of economic flexibility arising from microeconomic reform. The validity or otherwise of this view will be clearer after the end of the current economic downturn, when it will be possible to assess the business cycle commencing in 1991 on a trough-to-trough basis.

Popular backlash

At least since the defeat of the Fightback! package in the 1993 election, there has been consistent evidence of a backlash against the changes in economic governance associated with microeconomic reform and 'economic rationalism'. The backlash has had several components. First, there has been the widespread view, noted above, that any benefits of reform have accrued to a small subset of the population located primarily in and around the central business districts of Melbourne and Sydney. Second, there has been hostility to the top-down and centralised nature of the process. Finally, there has been opposition, on a variety of ideological, social and practical grounds to specific microeconomic reform policies such as privatisation.

The backlash has been reflected in electoral outcomes, most notably the defeat of the Kennett government in Victoria. However, the Labor governments that have succeeded these neoliberal reformist administrations have yet to produce a clear alternative program.

Similarly, although the advocates of microeconomic reform are generally on the defensive in the public debate, no clear alternative to the neoliberal program and its associated institutions of economic governance has emerged. The most promising alternatives are centred around notions of human and social capital (Cox 1995; Quiggin 2001d; Winter 2000) based on the idea of a mutually supportive relationship between the state and civil society.

Outlook for the future

On the evidence available at present, the era of radical microeconomic reform is over. In some areas, such as tariff policy, the microeconomic reform agenda has been largely or completely implemented. In others, such as privatisation, the process of reform has been halted at different stages in different jurisdictions.

In the short term, it seems unlikely that there will be concerted moves either to reverse the microeconomic reforms or to define alternative directions for economic governance. Rather, it seems likely that the principal focus of economic policy will shift to areas such as education and public support for innovation, where the case for government intervention has been generally acknowledged, except by the most dogmatic advocates of free-market reform.

Within the domain of economic policy proper, the main concern will be on the continued development of regulatory structures appropriate to the economic environment in the aftermath of microeconomic reform and structural change. In the presence of strong tendencies towards the growth of monopoly, and the need to capture the benefits of scale economies while constraining monopoly power, this task will be a challenging one.

It is unclear how the era of microeconomic reform will appear in retrospect. On the one hand, dogmatic beliefs about the superiority of market processes have led to the adoption of policies such as compulsory competitive tendering that have eroded state capacity and produced generally unsatisfactory outcomes.

On the other hand, any coherent response to the gap between state capacity and demands for state action that became evident in the 1970s would certainly have incorporated some elements of the microeconomic reform such as the abandonment of *ad hoc* protectionist policy, and the rejection of the assumption that the entire public sector should operate on traditional civil service lines. To that extent, microeconomic reform may be seen as part of a necessary renovation of the institutions of the social-democratic settlement.

Concluding comments

In modern societies, governments are, above all, economic institutions. It is not surprising then that trends in economic policy are closely intertwined with approaches to governance. In this chapter, it has been argued that the process of microeconomic reform may be divided into three distinct phases. In the first, deregulatory phase, microeconomic reform was a subordinate element in an economic policy framework concerned primarily with macroeconomic issues, and policies of deregulation were seen as consistent with a model of economic governance based on a sharp distinction between the private and public sectors. In the second phase of microeconomic reform, based on privatisation, an attempt was made to restructure both public sector institutions and systems of governance using the private corporation as a model. In the third phase, governments have focused on the objective of competitive regulation. The result has been an increase in the independent power of government-appointed regulatory bodies such as the ACCC and NCC.

The central force driving this process has been the ‘capacity gap’ between the demands on government to ensure appropriate economic outcomes and the resources available to meet those demands. It remains to be seen whether current institutions of economic governance can close that gap.

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