Editorial—

THE RULES OF THE GAME

During the 1970s there was a big increase in employment in the public sector, but only an insignificant increase in the private sector. From June 1971 to June 1979, Commonwealth Government employment rose by 17 per cent, State Government by 30 per cent and all Governments combined — Commonwealth, State and Local — by 26 per cent. Private sector employment increased by a mere 2 per cent.

Facts such as these have been used by some commentators (notably Kenneth Davidson of "The Age" (Melbourne) — an addict of neo-Keynesian, "simple arithmetic" economics) to suggest that if Government expenditure had been less, unemployment would have been more, and that the reduction of present levels of unemployment depends on increased spending in the public sector. Advocates of this view have contended that the Fraser Government’s efforts to curtail the growth of public expenditure have aggravated rather than alleviated the unemployment problem. Government expenditure, they claim, represents a significant source of demand for the goods and services produced by private enterprise and, therefore, higher spending in the public sector would contribute to an expansion of the private sector.

The argument is fallacious. The main reason why private sector employment has barely increased is precisely because public expenditure has been too high. If Government spending were further increased, taxes would have to be increased also, so what Government gave with one hand it would take away with the other.

With Government expenditure around its present levels (along with the imperative of keeping the deficit to a reasonable minimum in order to contain inflation) it becomes impossible for Government to create the kind of environment required for a strong expansion of the private sector. The funding of budgetary deficits puts official pressure on interest rates thus reducing investment opportunities in the private sector. By private sector we mean not merely the large corporations, on which attention tends to be focused, but, and even more important, the multitude of small enterprises, even businesses employing no more than one or two
people. The plain truth is that private enterprise will not grow, will not develop new fields of activity, unless the prospective reward is regarded as sufficient to cover the unavoidable risks. Nor, unless the anticipated reward, or profit (to use a much abused and misunderstood word) is adequate, will private enterprise have the means to expand. On the one hand it will not be able to attract growth capital from financial institutions or from individuals with savings to invest. And, on the other, it will not be able to earn sufficient profit to put back funds into the business for further development. Every businessman, big or little, knows this to be a fact of life, but many sections of the public, bemused by propaganda to the contrary and misled by some politicians, of all parties, with a vested interest in government expenditure, apparently do not.

The inescapable truth is that the “surplus” remaining to business, after all costs have been met, must be sufficient to attract risk capital (that is, substantially more than the 10 per cent and greater obtainable from secure investment outlets). Otherwise enterprise will stagnate and the private sector will grow much more tardily than is needed for economic health and progress. And for “economic health and progress” read rising employment and living standards for the community as a whole.

It cannot be repeated too often that good profits and the prospect of good profits for efficiently run business is the basic condition of better real wages and expanding employment. But as soon as profits show signs of recovery, this is used as an argument for an immediate increase in wages.

The idea that wages and profits are in conflict, that more going to the latter means less going to the former, is probably the most destructive and erroneous notion abroad in the community. Profits and wages are, for the most part, complementary. An improvement in profit prospects enhances the prospect for higher real wages. A deterioration in profit prospects damages the prospect for higher real wages. Those union leaders who would have us believe otherwise, are really perpetrating a gross deception on the public, and are indeed acting entirely contrary to the interests of those they claim to represent.

Another, and related, reason why the private sector is not developing as rapidly as might be expected, and thus providing jobs for those seeking work, lies in the continuance of rapid inflation around the double figure mark. Cost inflation inevitably introduces an element of disturbing uncertainty into all business calculations. Apart from the direct impact of rising costs on the profit “surplus” of many businesses, large corporations are less inclined to undertake big investment projects when it is impossible to assess with any reasonable accuracy what they will eventually cost and what, therefore, is the financial feasibility of a contemplated capital outlay. Cost inflation, of course, also impairs the competitive capability of import — competing industries and of industries seeking to expand exports. This, in turn, adversely affects the balance of payments and thus the overall level of economic activity and the capacity of the economy to provide employment.

The high and rising level of wages is, beyond argument, a major cause of unemployment among young people. Simply put, the youth of the nation are being priced out of jobs. Those who do not believe this should conduct a personal survey among small businessmen, from garage proprietors to small shopkeepers, even those employing only one, two or three people: they will soon change their minds. Tens of thousands of small
businesses will not employ young people at present wage levels simply because it does not pay them to do so.

Despite world-wide inflation in general, and skyrocketing oil costs in particular, the root cause of the failure to reduce the rate of inflation in Australia lies in the wage indexation mechanism. The adoption of this procedure in 1975 was based on the notion that it would introduce some order and certainty into overall wage movements and contribute to greater stability in industrial relations. It has undoubtedly succeeded in guaranteeing the "certainty" of continued high-level inflation. From the beginning there was little likelihood that it would do otherwise. Introduced at a time of soaring prices, wage indexation was a sure recipe for ensuring that rapid inflation would continue.

When examined closely, the indexation principle becomes so palpably absurd that it is hard to understand how a sensible community could continue to take it seriously. To compensate the wage-earner for a rise in prices, wages are increased. This pushes up costs, resulting inevitably in a further rise in prices which, in turn, leads to another wage increase to reimburse wage-earners for the price increase caused by the previous addition to their wages.

Wage-earners could benefit from this self-perpetuating process only if the incomes of the remainder of the community lagged substantially behind the rise in prices. But, in fact, it is not merely wages that are hitched to prices - as was possibly originally intended by the proponents of indexation - but most other incomes. All sections of the community, including politicians and senior public servants, now claim the right to indexation. If everyone is going to be compensated for inflation then there is nothing more certain than that inflation will continue at a rapid rate. At a time of soaring prices in the early 1950's, the Commonwealth arbitration authority, then a Court, with the overwhelming support of the community abolished the system of quarterly cost-of-living adjustments (which incidentally applied only to the basic wage) with dramatic effects on the rate of inflation. In the mid-1970s, in somewhat similar circumstances, the Commission did precisely the opposite with results which could have been confidently foretold. Moreover, indexation has not - as was hoped - reduced industrial unrest: in the last few years industrial stoppages have increased alarmingly.

There is only one sensible way of periodically adjusting the general level of wages, and that is to base increases on the old principle of "capacity to pay", of which the main constituent is productivity. This was for many years the fundamental criterion accepted by the senior wage-fixing tribunal. "Capacity to pay" really means the wage increase which can be paid without giving rise to a subsequent increase in prices. (It was defined some twenty years ago by a present Deputy President of the Commonwealth Arbitration Commission, J.E. Isaacs, as follows: "A general wage increase is within the capacity of the economy to pay if it does not conduce to unemployment or inflation").

The essential ingredients of the prescription for a healthy economy - that is for economic growth, increased employment, improving living standards and a sound balance of payments - have not altered with the passage of time. They are the limitation of government expenditure (and thus personal and other taxes) to a level consistent with adequate incentives for individual and corporate enterprise; the fullest practicable use of "market" principles for allocating
resources; incomes increasing in step with advances in productivity; and fiscal and monetary management to provide for a non-inflationary level of total demand. If these rules are not observed then we shall be afflicted with rapid inflation, slow economic growth, a serious shortage of jobs, and massive tax evasion and a "cash and barter" economy. That is exactly what we have at the moment; and is what we shall continue to have unless we are prepared to abide by the "rules of the game".

The Fraser Government cannot provide overnight the kind of environment needed for the restoration of economic health. But it is to be hoped that in the forthcoming Budget it will be taking strong and long strides in the right direction. It is to be hoped also that the Opposition will scale down it's absurdly extravagant expenditure proposals and that the States will show greater restraint than they have exhibited in recent years.
"If countries were lightened of their tax burdens, relieved of excessive bureaucracy and cured of administrative constipation, we could see a sudden outburst of real activity and enterprise".

C. NORTHCOTE PARKINSON (Author of the famous law: "Work expands so as to fill the time available for its completion").

Not so long ago, Australia was infested with rabbits. Today it is threatened with an infestation of bureaucrats.

The rabbit over-ran the country in such numbers that it came close to undermining the prosperity of our great primary industries. Today's ballooning bureaucracy, unless curbed, could have a somewhat similar effect on the prosperity of our national economy.

Rabbits and bureaucrats have one big thing in common. They are great consumers (Canberra is said to have the highest average standard of living in Australia) but, except in the proliferation of their own species, indifferent producers. The distinguishing mark of the bureaucrat is that he sits at a desk. So, it might be said, do great numbers of people in private enterprise. But there is a difference. The desk workers in private enterprise contribute, if only indirectly, to the production of those goods and services which make up our standards of living — food, clothing, housing, motor cars, medical services and the rest. Bureaucrats, for the most part, do not. Apart from everyday administration, their main output consists of reports, statistical records, and the formation of innumerable committees. Their primary task is not to produce, but to control, regulate, to transfer income from one section of the community to another and generally to administer and even establish the rules under which the processes of production and distribution take place.

To most people, "bureaucrat" has become a term of opprobrium. But, lest there be any misunderstanding, it should be made clear that, as people, bureaucrats are no different from the rest of us. They are just as decent, but also just as self-interested, just as alert to protect their private citadels of privilege, just as much enamoured of the mechanics and pleasures of power. They, like everyone else, are the products of the particular milieu in which they perform. If a person employed in private business joins the ranks of the public service, he soon becomes indistinguishable from his new colleagues. The famous Austrian economist, Von Mises — and there can be no more severe critic of bureaucracy — points out that it is not the bureaucrats who are at fault but the system. The system which breeds the disease of bureaucracy is the system which emphasizes Government rather than the market as the predominant motive power in the economy. "Big bureaucracy" is an inevitable accompaniment of "Big Government". *(see footnote page 30)*

The greater the range of functions which Government attempts to perform, the more laws will it be compelled to bring down, and the more orders and regulations will its administrative arm be constrained to issue. Bureaucratic interference with the lives and everyday activities of the people will inevitably
grow, and the cost to the community of the bureaucratic machine will inevitably increase.

All businesses have experienced the irritating, burdensome task of complying with an excessive number of government regulations and the filling in of endless printed forms. The cost to the nation is thus not merely the cost of running the huge bureaucratic mechanism but the additional cost imposed on business by the necessity of compliance with government demands, difficult to estimate but certainly running into hundreds of millions of dollars a year.

A Federal system of Government such as Australia's is particularly prone to bureaucracy. Not only is there an army of public servants ministering to the needs of the central Government, but each State must have its own not insignificant battalions to cater for its functions. And, to cap it all, there are separate and distinct bureaucracies required for the multiplicity of local municipalities. Indeed, "Canberra", while representing by far the most powerful section of the bureaucracy, may take second place in size to the combined public services of the States.

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A massive piece of research would be required to measure the growth of the bureaucracy in Australia. (It would be a study worth undertaking). One difficulty is that a high proportion of Government employees are not engaged in the kind of work we normally associate with the term "public servant" or "bureaucrat" — for example, teachers, railway employees, road maintenance and construction workers, policemen. In State Governments, administrative public servants comprise a smaller proportion of total Government employees than in the Commonwealth because the major public utilities such as electricity, gas, transport, water supply, generally fall within the ambit of the States. Nevertheless, the size of the bureaucracy as such tends to expand more or less in step with the growth of Government. (The table on page 36 sets out the increase in the numbers of Government employees over the last 40 years.)

Some indication of the growth of bureaucracy is provided by these figures of Commonwealth employees coming under the Public Service Act (excluding, prior to 1976, employees of the P.M.G.'s Department which has now been reformed into two independent statutory bodies — Telecom and Australia Post.)

In 1939 there were 11,977; in 1960, 76,965; in 1970, 123,406; and in 1979, 151,369.

Figures for some individual Departments over the last 10 years are indicative of the rapid growth.

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* From an historical perspective, let it be said, Australia has been well served by the public service. It's incorruptibility has been taken almost for granted — few scandals can be laid at its door. In it's higher echelons — particularly at the Commonwealth level — it has shown admirable dedication, sound judgement and, on occasions, the capacity for perceptive, and even brilliant, thinking on national economic problems.

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The giant size of Government is now an ominous feature of the structure of all the Western democracies. Even those political parties which have an ideological aversion to "big Government" have found its continuing growth difficult to halt and almost impossible to reverse.

There are a number of reasons why this is so, but certainly one of the most important is the powerful vested interest represented in the grossly swollen public service, what is now commonly called "the bureaucracy". The bureaucracy almost automatically resists cuts in Government expenditure, simply because that would mean a reduction of its own influence and authority.

Herbert Spencer in his prescient classic "Man Versus the State" (written around 1900) gives another reason (one, incidentally, which appears to be peculiarly apposite to Canberra). "Men who might otherwise reprobate further growth of officialism, are led to look on it with tolerance, if not favourably, as offering possible careers for those dependent on them and those related to them. Anyone who remembers the numbers of upper-class and middle-class families anxious to place their children will see that no small encouragement to the spread of legislative control is now coming from those who, but for the personal interests thus arising, would be hostile to it." Who of us living in the isolated magnificence of Canberra would do otherwise?

Canberra, indeed, gives rise to a special and rather virulent form of the bureaucratic disease and, as such, is worth a few comments. (Again, we warn that we are not criticizing the admirable people who reside in the national capital but rather the particular dangers to which its general environment almost inevitably leads.) The term "bureaucracy" is, in Australia usually associated with "Canberra" simply because it is the seat of the Australian Government and is a city comprised of little other than public servants and their families and of those who cater for their everyday needs.*

The business of Canberra is Government and, apart from the A.N.U., almost nothing else.

In Canberra, we are breeding a race of bureaucrats who, through no fault of their own, must necessarily have a restricted view of the world. The first generation of Canberra public servants lived part of their lives in other parts of Australia, probably mainly in Melbourne and Sydney. But we are now getting into the second and even third generation of public servants, large numbers of whom have resided only in the rather queer, remote, artificial environment of the national capital. Yet these people are dealing with problems which are overwhelmingly concerned with people living under entirely different conditions in the State Capitals and the rural centres and areas of a gigantic and diverse continent. This hardly makes for realistic and understanding administration.

On of the main characteristics of Canberra is, not surprisingly, self-importance. Canberra gives rise to the attitude that "all the significant decisions affecting Australia are made here. We are running the country in your interests. Only we have the knowledge and the facts at our disposal for the making of sensible, informed decisions. So leave us alone so that we can get on with it." Most of those who go to Canberra on business and interview prominent departmental officials will have sensed a trace of this self-righteous, rather patronizing

* Many however, would claim that the most reprehensible examples of bureaucracy are to be found at the State and municipal levels.
attitude. (It is, of course, an attitude displayed not merely by some public servants but also by politicians.)

But Canberra despite its intimidating buildings, its aura of power, its vast numbers of public servants, among whom is a high proportion of University graduates, even Ph. D’s, is not notable for efficiency in the performance of its everyday tasks.

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Broadly speaking, there are two aspects to the work of the bureaucracy. One is concerned with its dealings with the public; the other with its dealings with the politicians.

Long and bitter experience would suggest that the prospect for any pronounced improvement in the former is a rather forlorn one. Bureaucracy, by its nature, is ponderous, slow moving, remote, impersonal and too often unfeeling. The government department is compelled to operate according to rigid rules and regulations. Its employees are tied up in red tape. It is a brave bureaucrat indeed who will step out of line and act on his own initiative. He might make a mistake and that could be fatal to his promotion. Being human, the public servant, therefore, invariably prefers to play safe. Bureaucracy spells death to individuality. The public servant tends to treat people as units, not as individuals each with his or her own distinctive problems. For the most part he can’t do anything else; otherwise he would never get through his work. Those of us who have had dealings with Government offices, and, for that matter, with Government-run enterprises — and most of us have — will know how frustrating they can be, how hard it is to get an early, clear decision, and, having obtained a decision, to get it acted upon.

Bureaucracy can at times be catastrophically inefficient, as the recent over-payment of $235 million to chemists under the free medicine scheme demonstrates. Bureaucrats are wasteful, even careless, in the expenditure of money simply because (as Milton Friedman has pointed out) the money is not their own and the public purse is bottomless. They are extravagant also because, unlike the employees of private industry, they have little incentive to cut costs and show tangible results in their particular activity. One has only to peruse the reports of Auditors-General to realise that wastes in public service operations are legion.

What is the moral of all this? If we, the public who pay the bills, cannot hope for improvement, for better treatment and more responsible use of our money, what do we do about it? There is really only one thing we can do: that is to throw our weight on the side of limited Government, to look with suspicion on any proposed extension of Government activity or expansion of Government expenditure. We must accept the fact that Big Government is a disaster, not only because it encroaches menacingly upon our personal freedoms, but because it simply doesn’t work. The fault, as Von Mises insists, is not with the bureaucrats but with the system.

But there is a far more important and dangerous aspect of big bureaucracy than its inevitable inefficiency and the frustrations which it imposes on a long-suffering public. This concerns its relations vis-a-vis the politicians, more especially its relations with its political masters, the Ministerial heads. In pure political theory, democracy requires that the elected representatives of the people make the policies; the policies are then carried out by an impartial and dedicated public service. This conception of democracy no longer reflects the reality. In fact, while final decision rests with the Government of the day, the bureaucracy
has an enormous and often decisive impact on the shape and content of the policies pursued. Indeed, the attitude of many bureaucrats is that if only the politicians would keep their fingers out of the policy pie and leave it to them — to those who know — all would be well.

It would not be unfair to say that practically all public servants, whatever their ideological convictions, are, when it comes to the crunch, supporters of Big Government. It is a rare permanent head of a department who would readily acquiesce in a reduction in its budgetary allocation, let alone propose such a reduction himself. On the contrary, it can be taken almost as read that each year when the estimates are under consideration, the departmental head will do his utmost to persuade his Minister that an increased allocation is imperative. For one thing, a decrease would lower his personal status (as well as that of his department) relative to that of other permanent heads and departments with whom he regards himself in competition for funds. Moreover, this attitude communicates itself to his Minister. Ministers who, from an ideological standpoint, would favour a reduction in the overall size of Government, are seldom if ever prepared to go along with a reduction in the expenditure of their own Department. In fact they do the reverse: they invariably clamour for a larger share of the budgetary cake — a smaller slice could be taken to mean some loss of personal standing in the Government and that is the last thing that any ambitious politician wants. With every Minister seeking an increase for his Department, in practice it becomes very difficult for a Government to achieve an overall reduction in Government spending. There is thus an inbuilt, almost inexorable tendency for Government to expand. The national interest takes second place to the ambitions of permanent heads and their Ministers. The Treasury may fight like hell — as a good Treasury should — for fiscal responsibility and for Government economies, but the cards are stacked against it. It can apply a brake to the juggernaut; but it cannot change its direction.

Probably no Government in recent times has been more dedicated to cutting back expenditure than the Fraser Government — indeed, as a result of the Whitlam Government inanities, it was expected to do just that. But after four years of office it has barely made a dent in the Government monolith.

Too often the bureaucratic tail wags the Ministerial dog. (Too often, let it be said, the dog doesn’t seem to mind that much.) The public service has become a privileged structure with a vested interest in big Government. In the modern State it exercises a role which it was never intended to exercise and which cannot be justified by traditional ideas of how our system of Government is supposed to work or by acceptable democratic concepts.

The power over policy wielded by the bureaucracy is often claimed to be justified on the grounds that it alone has the expertise necessary for the successful functioning of Government in today’s complex world. Can this claim be substantiated? It is certainly true that top public servants possess a technical knowledge and a store of experience within their special field of activity which their Ministers can hardly be expected to rival. But apart from the few wholly exceptional public servants, this expertise and experience tend to be of a narrow, restricted character. The Canberra adviser is especially prone to this drawback because of his isolation and his limited every-day contacts with the outside world. Moreover, an expertise based on
technical, theoretical knowledge is only one aspect of the total body of knowledge which should be brought to bear on the determination of policy.

It is true that the wise Minister will take pains to seek advice from outside the public service. But this advice will invariably be referred to the Government's advisers for opinion. The public service thus acts as a filter through which all outside views have to pass and the filter will effectively take out the "impurities", that is, those ideas which conflict with the official opinion. Thus Governments tend to receive a distorted or limited view, not necessarily because of deliberate bias, but because of the inevitable narrowness of understanding brought to bear in assessing outside opinion. Governments have often no ready means of assessing the quality of public service advice; but the value of all other advice tends to be assessed by the public service.

Ministers almost inevitably tend to become part of a group composed of their senior officials simply because of the continuous personal contacts which exist at that level. The standards and views of senior public servants and, it might be added, the special interests of their particular department, thus tend to become absorbed by the Minister as his own. As a Government ages, Ministers tend to acquire an increasingly "blinkered" perspective on policy. A typical case is the Minister who urges higher spending or more Government control of one kind or another simply because that is the only kind of advice he can get out of his Department. This advice may be contrary not only to the national interest but to the political interests of the Government itself. The coalition Government in the immediate pre-Whitlam years seems to have suffered from this kind of public service pressure.

Perhaps even the present Government is in danger of giving too much weight to official advice and thus of falling into the same trap. Politicians have come to place too much reliance on the myth of expertise, to be too much influenced by severely narrow technical considerations. Too often they are failing to appreciate the wider social and political implications of policies to which they lend support.

Sir Walter Massy-Greene, one of Australia's greatest industrialists in the 1930s and '40s and, before that, an eminent politician, used to relate how he once sent his views on economic and financial policy to the then Treasurer, Sir Arthur Fadden. Fadden replied that his expert advisers were advocating measures precisely the opposite of those that Massy-Greene was proposing. Massy-Greene wrote back, "Sack your advisers and use your common sense".

Senior Ministers of course need the help which sophisticated detailed technical analysis can provide. But they need also the kind of advice which is the product of earthy common sense and which has its roots in unusual breadth of experience. (We are not referring here to the sort of advice proffered by self-interested pressure groups.) Heads of Government need wise philosophers at their elbow as much as, perhaps even more than, "blinkered" experts. This philosophical cast of mind, this wide-ranging experience, is much more likely to be found outside than inside the bureaucratic machine. The "shut-in" environment of Canberra is not exactly conducive to its production.

An institution as powerful and pervasive as the bureaucracy calls for some kind of counter-weight and attention needs to be given by Government to the development of some machinery for acquiring policy advice from outside the public service.
The traditional ideal of a politically neutral, permanent public service, objective, dedicated, independent, incorruptible, though never much more than "an impossible dream", was nevertheless closer of attainment in the era of limited Government than in today's "Big Government", and its bed-fellow, "Big Bureaucracy". The public service is now little different from any other institution in our society. It has become very much concerned with its own interests as a group, very much involved with political ideology, very much devoted to advancing its own power and privileges.

And how successful has it been? Not so long ago, the pay and conditions in the public service were much inferior to those applying in many areas of private enterprise. This was justified on the grounds that a public servant was immune from the sack (except as a consequence of grave misdemeanour) and that the public service was what its name implied, that it's concern was not with personal profit but with giving "service" to the community. Now the Australian bureaucracy has gained for itself superannuation and other benefits second to none — indeed little short of scandalous * — and a general pay structure little if anything below the best in private enterprise. A vast amount of public money has been poured into the national capital to make Canberra a virtual paradise for the bureaucratic elite. And today powerful public service unions don't hesitate to call strikes and make little attempt to conceal their political bias.

As Australia enters the 1980s the control of this huge "vested interest" has become a problem of almost terrifying proportions. The bureaucracy, like the giant industrial unions, is one of the institutional "monstrosities" of contemporary Australian society.

* A report of the Australian Government Actuary has suggested that the cost of the Commonwealth Superannuation Scheme is of such magnitude that no enterprise could remain self-sufficient in a competitive industry environment with such a cost handicap.
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HOW OUR LABOUR COSTS COMPARE WITH OTHER COUNTRIES

This article is based on a research project which is being carried out by C. D. Kemp and J. Abrahami.

The project is being financed by the Buckland Foundation administered by the Trustees Executors and Agency Co. Ltd., and is sponsored by the Australian Administrative Staff College.

The object of the project is to compare labour costs in Australian industry with costs in countries with which we compete, and to produce an index which will measure changes in our overall competitive position. The index is to be known as “The Buckland Barometer”. It is intended that the project should be on-going so as to provide up-to-date comparisons and eventually more detailed analyses.

Those interested in the technical and statistical aspects of the project may consult the authors.

The malaise of Australia’s manufacturing industry has been well documented. For example, we know that:

* In the ten years to 1977/78 employment in manufacturing industries fell by 166,000, equivalent to an annual rate of decline of over 1 per cent. During those years, manufacturing employment fell from 27 per cent to 21 per cent of total civilian employment.

* In the same ten years, manufacturing value added at constant prices grew at an average 3 per cent per annum compared with a 4 per cent per annum increase in Gross Domestic Product. The share of manufacturing output thus fell from 23 per cent of G.D.P. in 1968/69 to 22 per cent in 1977/78.

* Imports of manufactured goods increased from 17 per cent of the domestic market for manufacturers in 1968/69 to 24 per cent in 1976/77. In 1977/78 imports of manufactured goods exceeded exports by $5.6 billion. The balance of payments deficit on current account in 1978 was $3.4 billion.

* New fixed capital expenditure by manufacturing industry fell from 41 per cent of all new investment expenditure in 1968/69 to 21 per cent in 1978/79.

The crisis in Australian manufacturing industry is associated with a number of events in recent years. First, there has been the emergence of the developing economies as participants in world trade — a trend which has accelerated considerably since the early 1960’s and has resulted in increased import competition for some Australian industries. A second reason for the problems of manufacturing industry is the decline in the domestic growth rate of demand for manufactured goods. This is not simply because of the slow down in economic activity since 1974; it goes further back in time than the early
seventies. There has been, for many years, a tendency in all developed countries for the share of manufactured and primary products in total expenditure to fall. As income rises, the service industries absorb an increasing proportion of expenditure.

A third contributing factor to the malaise in manufacturing industry has been the increase in Government intervention in business activity.

The Prices Justification Tribunal, foreign investment controls and the National Companies and Securities Commission are but some of the "new" ways in which Governments have interfered in the operations of business enterprises. While some of these new regulatory bodies may have been set up with good intentions, some of their activities have tended to reduce business profitability, investment and employment. The pressure on profits results not only from limitations placed on business activities but also from increased costs imposed by the need to comply with government requirements. Companies are finding that their staffs have to spend increasing amounts of valuable time on either providing information to government agencies or ensuring that the company is complying with various government regulations (giving rise to heavy legal costs).

Finally, and perhaps most important, labour cost increases far beyond any productivity improvements have, in recent years, left business with inadequate profits for new, or sometimes even replacement, investment.

Despite this rather gloomy picture, it would be wrong to write off Australian manufacturing industry as a source of economic growth and employment in the future. Indeed, some of the features of manufacturing industry described above suggest hope for the years ahead.

A decline in employment in the manufacturing sector is not necessarily an indication of a weakening of that sector. A recent Australian study by the Industries Assistance Commission noted that "In terms of changes in manufacturing employment since 1968/69, losses of employment associated with increased competition are small compared with employment losses associated with reduction in unit labour requirement". In other words, productivity improvements reduce labour requirements.

The study also concludes that the net losses in manufacturing employment associated with increased competition from the developing Asian countries are generally very small compared with losses from other sources. Indeed, the rapid growth of developing economies need not be to the disadvantage of Australian manufacturing at all. While imports of manufactured goods from these countries have increased, with improving standards of living they have become potentially important markets for Australian manufactured goods. In fact, this is already happening. In recent years the proportion of Australia's exports directed to traditional markets in Western Europe, North America and neighbouring Pacific countries has declined while the relative importance of the developing Asian market economies and the Middle East has increased. A notable feature of Australia's exports to the expanding Asian market is the higher proportion of manufactured goods compared with exports to the other major markets such as Japan and the European community.

The developing Asian economies could be an important source of growth for Australian exports in the future with much of this growth coming from the manufacturing sector. The resulting job-creating potential in manufacturing has been described by the Minister for
Commerce and Industry as “one of the bright spots on the employment horizon”.

Already, in the past two years, there have been encouraging signs. Between 1978 and 1980 employment in absolute terms in the manufacturing sector increased, and is now at about the same level as in the late 1960s despite the fall in the percentage of total employment which it represents — a fall which, incidentally, is also occurring in other developed economies.

However, if the potential growth is to be fully realised then Australian manufacturing industry will have to become more competitive both at home and abroad.

* * * * *

Competitiveness in international trade, and in particular manufacturing, depends on many things beside pricing — for example, credit terms and the quality of products. Therefore, no single summary statistic can be expected to provide a wholly adequate guide to our competitive strength. However, since pricing is the single most important element and since labour costs are the most important component of the price of manufactured goods, Unit Labour Cost — that is, the cost of labour per unit of manufactured output — can be a most useful guide to competitiveness. C. D. Kemp and J. Abrahami are in process of developing an index of Australia’s competitive position, based on relative unit labour costs. Below are presented details of this index.

It should be noted that labour costs are very much more than just wages and salaries alone. Besides award, over-award and overtime payments, labour costs include bonuses, proficiency and attendance payments, payroll tax, workers’ compensation premiums, superannuation contributions, long service leave provisions, annual holiday loading, adjustment for time paid but not worked (sick leave, public holidays and annual leave) free or subsidised goods and services for employees (for example, meals) travel allowance, study help, social club provisions and the cost of advertising for staff.

Some of these items are fairly trivial but others add substantially to the cost of labour. Indeed, in isolated cases, the non-wage costs together may add as much as 70 per cent to wage costs. In practice, we have found it necessary to restrict ourselves to a consideration of five main non-wage labour costs items — payroll tax, superannuation contributions, workers’ compensation premiums, holiday loading and paid leave and holidays. In 1977/78 these items added on average almost 30 per cent to labour costs.

When considering proportional changes, the inclusion of additional elements however, does not matter, unless these items move at different proportional rates from the basic cost of labour itself. In fact, however, “non-wage” labour costs have, in general, increased at a rate proportionally greater than that of wages alone. Between 1970/71 and 1977/78 hourly wages and salaries in manufacturing industries increased by 18.1 per cent, whereas total labour costs increased by 21.6 per cent. Details of the year by year changes are given in columns (1) and (2) of the table on page seven.

An increase in the cost of a unit of labour will not itself impair the competitive position of Australian manufacturers if it is offset by one of three things: increased productivity, a devaluation of the Australian dollar, or increases in unit labour costs of our
competitors. These three elements need therefore to be incorporated in an index of competitiveness. Between 1970/71 and 1977/78, Australia manufacturing enjoyed a 32 per cent improvement in productivity — roughly the same as the average for its major trading partners. After making an allowance for this productivity improvement, the 216 per cent increase in hourly labour costs between 1970/71 and 1977/78 added only 138 per cent to unit labour costs. An index of the year by year changes in unit labour costs is given in column 3 of the table.

As noted above, for international comparisons account must be taken of exchange rate variations. This is done by expressing the unit labour cost indexes to be compared in a common currency — U.S. dollars in this study. The Australian index is presented in column 4 of the table. For the first four years of the 1970s the Australian dollar appreciated relative to the U.S. dollar, thereby worsening Australia’s competitive position. Thus in the four years 1970/71 to 1973/74 the Unit Labour Cost in Australian dollars increased by 86 per cent while Unit Labour Cost in U.S. dollars increased by 115 per cent. Since 1974/75 the Australian dollar has depreciated relative to the U.S. dollar, thereby improving our competitive position.

Ultimately, our competitive position can improve only if the costs, productivity improvements, and exchange rate variations of our trading partners do not offset any favourable movement in our own Unit Labour costs expressed in U.S. dollars. Thus, the indicator of our competitive position is a comparison of our index of Unit Labour Cost with the weighted index of unit labour costs, expressed in U.S. dollars of Australia’s major competitors. In the first four years of the 1970 decade Australia’s Unit Labour costs increased much more rapidly than the unit labour costs of Australia’s chief competitors. In the next four years the position was reversed and Australia’s competitive position improved. However, at the closing years of the decade our competitive position had still not recovered to the situation which existed at the beginning of the decade.

All the information discussed up to this point can be summarised in a single index. This index represents the ratio (with base year 1970/71) of the weighted index of Australia’s competitors unit labour cost to the Australian unit labour cost index, after expressing all the national indicators in terms of a common currency. Weights have been determined according to the relative importance in Australia of our chief competitors — U.S.A, Japan, U.K. and Western Germany. A falling line on the chart indicates a deterioration in our competitive position, while a rising line denotes an improvement.

Broadly speaking, the chart suggests that after the period of the early seventies, when Australia’s competitive position deteriorated badly because of sky-rocketing labor costs and an appreciating currency, we are now on the way to recovering the position we held at the beginning of the decade. The recovery is based on both a relative slow down in the rate of increase of Australian labour costs and a depreciating currency. Since we cannot rely on exchange rate movements always to work to our advantage, it is essential we endeavour to contain unit labour costs. We cannot afford to allow labour costs to rise above productivity improvement.

In particular, we should think carefully about any change in the working week. If
standard hours were reduced to 35, without accompanying productivity improvements, then hourly labour costs could, according to the Metal Trades Industry Association, rise by 33 per cent. Had an increase of this magnitude occurred in 1974/75, the year in which our competitive position started to improve, then recovery would have been delayed by at least one year and then it would have been only a recovery relative to 1974/75 but not relative to the early 1970s. This is a prospect we simply cannot afford.

MEASURING OUR COMPETITIVE POSITION.

<table>
<thead>
<tr>
<th>Year</th>
<th>1 Index of Hourly Wages</th>
<th>2 Index of Hourly Labor Costs</th>
<th>3 Unit Labour Cost Index</th>
<th>4 Unit Labour Cost in $U.S. Index</th>
<th>5 Weighted Index of Competitors Unit Labour Cost</th>
<th>6 Index of Australia's Competitive Position</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970/71</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>1971/72</td>
<td>110.4</td>
<td>111.8</td>
<td>109.7</td>
<td>114.2</td>
<td>107.3</td>
<td>94.0</td>
</tr>
<tr>
<td>1972/73</td>
<td>124.3</td>
<td>127.3</td>
<td>121.6</td>
<td>135.2</td>
<td>116.8</td>
<td>86.4</td>
</tr>
<tr>
<td>1973/74</td>
<td>152.3</td>
<td>159.4</td>
<td>144.1</td>
<td>187.2</td>
<td>131.2</td>
<td>70.1</td>
</tr>
<tr>
<td>1974/75</td>
<td>197.9</td>
<td>214.4</td>
<td>185.8</td>
<td>215.2</td>
<td>154.6</td>
<td>71.8</td>
</tr>
<tr>
<td>1975/76</td>
<td>227.4</td>
<td>255.1</td>
<td>212.2</td>
<td>233.3</td>
<td>177.9</td>
<td>76.2</td>
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<tr>
<td>1976/77</td>
<td>258.3</td>
<td>290.4</td>
<td>232.3</td>
<td>220.6</td>
<td>173.9</td>
<td>78.8</td>
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<td>1977/78</td>
<td>281.0</td>
<td>316.0</td>
<td>238.5</td>
<td>238.0</td>
<td>191.8</td>
<td>80.6</td>
</tr>
</tbody>
</table>

AN INDEX OF AUSTRALIA'S COMPETITIVE POSITION.
CAN WE FORECAST?

At the beginning of 1979, "The Age" published forecasts for the 1979 calendar year by 29 economists from banks, universities and industry. These forecasts covered the most important movements in the economy.

The following is a comparison of the average figures of the 29 forecasts with the actual outcomes in 1979.

<table>
<thead>
<tr>
<th>FORECAST ACTUAL</th>
<th>PERCENTAGE ERROR</th>
</tr>
</thead>
</table>
| G.D.P. GROWTH (%)
(IN REAL TERMS)   | 3.4              | 4.6              | 27% underestimate |
| INFLATION RATE
(C.P.I.) (%)     | 6.25             | 10.0             | 37% underestimate |
| UNEMPLOYMENT
(JUNE 30)       | 426,600          | 416,500          | 2% overestimate   |
| INTEREST RATES
(DEC 30) (%)    |                  |                  |                   |
| — Bonds         | 8.25             | 10.08            | 18% underestimate |
| — Overdraft     | 9.5              | 10.5             | 10% underestimate |
| BUDGET DEFICIT
($M)             | 3,110            | 3,478            | 11% underestimate |
| MONEY SUPPLY
GROWTH (%)       | 8.3              | 11.3             | 27% underestimate |
| CURRENT ACCOUNT
DEFICIT ($M)     | 2,850            | 1,837            | 55% overestimate  |

Nothing could more vividly demonstrate the difficulties of making useful — let alone anywhere near accurate — predictions of economic developments.

No single "authority" came even close to giving a reasonable picture of the actual 1979 outcome. If short-range, one-year forecasts can go so badly astray, what confidence could one place on longer range predictions?

Professor Hayek, in his address on receiving the Nobel Prize, said "Economists should not pretend to knowledge which they do not possess". The Institute of Public Affairs has frequently contended that all economic forecasts should be treated with great reservation.
THE KIMBERLEY REGION.

A member of the Institute's Council and former Chairman of the Executive Committee, Mr. W.A. Beattie, has spent three years studying the problems and economic potential of the vast area known as the Kimberley Region in Australia's North West. He has been assisted by Mrs. Marian de Lacy Lowe. Mr. Beattie and Mrs. Lowe are the co-authors of a book just published "Australia's North-West Challenge" which gives a fascinating picture of a relatively unknown part of the Continent which may assume immense significance in Australia's future development.

The Kimberley comprises that triangular area of the north of Western Australia which juts up into the Timor Sea. It lies north of the 20th parallel of latitude and is bounded on the West by the Indian Ocean, on the East by the boundary of the Northern Territory. Its northern shores are lapped by the Timor Sea.

It is three times the size of England, and larger than many of the world's densely-populated nations. It is virtually unknown to Australians, who, by and large, if questioned, vaguely write it off as a dry and arid land with nothing in its favour, except perhaps some vague idea that there is a huge dam called Lake Argyle (the Ord River Dam) which they consider a vast waste of tax-payers' money. If it were in some other area of the world it would qualify as an under-developed country and, as such, be eligible for United Nations supervision and grants.

Since World War II, significant discoveries have been made in the area. Minerals of many types, diamonds and other resources, with potential for energy production, and water everywhere, at present mainly wasting into the seas or desert voids. Some of the semi-desert soils may be capable of producing many food crops and also fruits, vegetables, seeds, nuts and fodder. Unless we develop all this huge potential in wise and balanced fashion, we stand a very good chance of losing the area to other hungrier and more energetic nations who are desperately short of all the raw materials and rich resources of this huge region, at present completely undeveloped.

The dangers of under-development and the Australian apathy for all things and this area in particular, were foreseen by the late Lord Casey, who, before becoming a distinguished Commonwealth Government Minister, had been Governor of Bengal and knew all the Asian leaders and their aspirations. He realised what was about to happen in South-East Asian spheres, and on the fringes of the Indian and Pacific Oceans. He had W.A. Beattie address both Houses of Parliament (thereby creating a precedent) about the potential and the vulnerability of the area, and then asked Beattie to write a book on the subject which would cover the problems and possible solutions, and awaken the Australian public to the reality of the situation before it was too late. Beattie was particularly well qualified to write such a study, having been intimately associated with the area since training with the Commandos there prior to fighting with that unit in Timor. Subsequently, he carried out many
commissions in his capacity as economic advisor to agricultural companies and foreign governments and, in his private practice, also had vast experience from his survey of the cattle industry of Australia for the C.S.I.R.O. Later he undertook various assignments in sundry parts of South-East Asia, the Philippines and India. Exactly three years ago he began to plan the field work for the study, and enlisted the help of Mrs. de Lacy Lowe as photographer and co-author.

The history of the North-west is peculiarly fascinating, and little-known to most, as it has never before been collated, until the writing of “Australia’s North-West Challenge” made it desirable to delve into various explorations both from land and sea.

It is to be hoped that the work done by Mr. Beattie and Mrs. Lowe will awaken interest in the little-known Kimberley area and will help to promote its wise and balanced development.
THE KIMBERLEY REGION
I.P.A. BOOKLET — A TEST OF CHARACTER — CAN WE BEAT INFLATION AND UNEMPLOYMENT — AND REDUCE TAXES!

Orders for the booklet, “A Test of Character”, which was first published in December last year, now total nearly 60,000 copies. This has necessitated several reprints.

The orders have come from about 300 companies from all over Australia — from banking, insurance, finance, mining, manufacturing and retailing companies. Many are from large organizations for one, two and three thousand copies; other from smaller businesses ranging from 10 to 100 copies.

Despite the highly satisfactory response to the booklet, we believe that many more companies should avail themselves of the opportunity to convey the important message it contains to their employees. Companies might also consider enclosing copies of the booklet with their reports to shareholders.

In these turbulent days when the economy of the nation is being disrupted by widespread industrial stoppages, it is of paramount importance to attempt to create a climate of common sense and moderation based on inescapable economic facts.

Communication with employees on such matters as:
- wage levels and inflation
- profits and employment

is often difficult for employers, since they are seen as having “an axe to grind”. It is far more effective if employees hear the things that need to be said, from an outside authoritative source.

In our view, some important things that need to be said are:-
- inflation and unemployment will not be cured so long as our individual incomes rise faster than our productivity;
- it is nonsense to demand lower taxes and increased government handouts at the same time;
- sound profits are the only lasting means of providing more jobs and higher wages;
- unless each one of us exercises restraint in demanding higher incomes, our problems will intensify.

Our booklet, “A Test of Character”, says all these things and more, and we commend it to you as being a worthwhile handout to each employee.

If you will arrange for the order form opposite to be noted with the number of copies you require and mailed back to us, we will supply them promptly, and invoice you accordingly.

The price per copy is 25 cents, less the following discount for I.P.A. contributors:
10 to 100 copies — 10%, 101 to 500 copies — 15%, Over 500 copies — 20%.
THE ADMINISTRATOR,
The Institute of Public Affairs,
289 Flinders Lane,
MELBOURNE,
Vic., 300.

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