THE BALANCE BETWEEN EQUITY AND EFFICIENCY IN
AUSTRALIAN PUBLIC POLICY

FRED ARGY
VISITING FELLOW, PUBLIC POLICY PROGRAM, ANU

Paper delivered to 25th Annual Conference of Economists
September 1996. The paper develops some of the ideas in an
earlier and fuller paper on Equity and Efficiency (IC 1995).

ISSN 1 030 2190

ISBN 0 7315 2525 6
Abstract

1. Australia has performed quite well over the last two decades in terms of real GDP per head; the GDP gains have not been fully reflected in other economic welfare measures (section 1).

2. Most economic reforms have important distributional effects, and these are often prolonged and enduring. Since distributional effects are an important dimension of economic welfare, they should be an integral part of the evaluation of policy reform (section 2).

3. How can this be done? Some policy guidelines are proposed in the paper. There are practical and conceptual problems in applying these guidelines e.g. some value judgments are inevitable. However, these problems are not decisive (section 3).

4. Two current policy issues (labour market reform and indigenous land rights) illustrate why it is important for economists to take distributional effects into account (section 4).
# Table of Contents

Introduction 1

1. Need for a broader welfare evaluation of Australia's economic performance 2

2. Why We Should be taking account of distribution costs in evaluating economic reform 7

3. Policy Guidelines which take into account of distribution costs 9

   Principal 1 9
   Principal 2 9
   Principal 3 9
   Principal 4 11
   Principal 5 11

4. Application to two current policy issues 14

   a) Labour Market Reform 14
   b) Competing Land Claims 17

5. Concluding Comments 19

References 20

Public Policy Program Discussion Papers 22
The Introduction

Many public policy economists view a reform as economically desirable so long as it offers potential gains in excess of potential losses, irrespective of who gains or loses - i.e. if it enhances average real incomes per head it is a good reform.

Yet we all know that economic reform is ultimately about improving economic welfare - and this encompasses much more than higher average real incomes per head. On a broader set of welfare criteria (including say quality of life and distribution), the justification for many of the major economic reforms of the last three decades is at least arguable.

My paper is principally about the distributional dimension of economic welfare and how it can be made an integral part of the analysis of proposed economic reforms.

It proposes a pragmatic set of guidelines for reconciling policy conflicts between equity and efficiency.

These guidelines are then applied to two policy issues - labour market reform and land rights for Aborigines.
1. Need for a broader welfare evaluation of Australia's economic performance

Purely in terms of real incomes per head - the conventional measure of economic performance - the Australian economy has performed creditably over the last two and a half decades. Real GDP per head increased by over 1/3 between 1972 and 1995 and this performance puts us somewhere in the top 10 in the OECD growth league. Over the last five years Australia's per capita growth performance ranks among the top five.

GDP per head is however a very crude measure of economic welfare: we also need to take account of associated changes in income security, quality of life, the natural environment, and inter-personal and inter-generational distribution. When this is done the story is less rosy.

It is evident for example that people perceive themselves to be more insecure - and they have reason to feel this way. With an underlying trend increase in unemployment (in part a reflection of improvements in labour participation rather than a slow-down in work opportunities) and increased use of part-timers, casuals and contract workers, many of the risks previously borne by owners of capital are now shared by workers.

Relative to the more reformist Anglo-Saxon countries, although not relative to continental Europe, Australia has performed poorly on unemployment over the last two decades. We also make greater relative use of part-timers and casuals.

It is also fair to say that the average quality of life (the non-market and non-material sources of enjoyment and happiness available to the population) has not improved in proportion with per capita incomes.

While the last two decades have seen improvements in mortality rates, life expectancy, nutrition, housing standards, and educational attainment, and while on most quality of life indicators, Australia still ranks very high in the world (Castles 1995, Gruen 1996), some aspects of our quality of life have definitely deteriorated - notably levels of noise, the incidence of child abuse and domestic violence, the suicide rate among our youth, the proportion of children suffering from asthma, the average hours worked per week by full-time employees, work satisfaction and morale, and the working conditions faced by part-time, casuals and out-workers.
On the basis of some broad indicators (the Human Development Index and the London Economist Nirvana), it appears that Australia's quality of life (measured by such things as life expectancy, literacy, longevity, school enrolment rates and crime rates) may have slipped relative to other countries. (On the Nirvana index we were ranked 3rd ten years ago and 7th now; and on the HDI we were ranked 8th and now we are 11th. However the data does not lend itself to such precision.)

Similarly, our performance in protecting and improving our natural environment has been uneven, with the most serious deterioration being in the quality of our soil, inland waters and rivers, forests, in the oceans close to our major cities, and in levels of bio diversity and greenhouse emissions.

And on the vexed question of whether we have been fair to future generations - or whether some of our improved GDP is at their expense - the jury is still out. I personally do not share the alarmist views of some, including the recent report of the National Audit Commission (1996), about the so-called fiscal burden we have been imposing on future generations (Argy, CEPR 1996). But it is arguable that we have allowed some of our economic and social infrastructure and human capital to run down, and we may not have made adequate income provision for future generations to compensate them for the exploitation of depletable natural resources.

Most importantly, what has happened to levels of inequality? If one focuses on market incomes since the late 1970's, inequality has clearly increased (Saunders 1994 and 1996, Nevile etc CEDA 1995, and Landt & Fischer 1996).

The causes of this are varied and complex and include an increase in unemployment and in part-time relative to full-time jobs; trade liberalisation; the globalisation of production and growing competition from low wage developing economies; changes in technology and their impact on the relative demand for unskilled workers; demographic factors such as the ageing of the population; family breakdowns and an increase in single-parent families (partly the result of growing inequalities); and the swing to enterprise bargaining and decline in trade unionism, with the associated increase in male wage earnings dispersion (although in this latter respect Australia has not gone as far as other countries, like UK and NZ).

Whilst increased inequality of market income has occurred in most OECD countries, the findings of the Luxembourg Income Study (LIS) - which does not allow for differences in home ownership - place Australia towards the higher end of income inequality (EPAC 1995).
When you look at *cash disposable incomes* i.e. after-tax and after cash transfers, the picture in Australia is a little more reassuring, at least relative to countries with more radical reform agendas such as NZ, UK and US. Australian governments have used the tax/transfer system to partly neutralise the effects of market inequalities (Deborah Mitchell, CEDA 1995), whereas in NZ, for example, changes in the tax/transfer system reinforced rather than alleviated the regressive effects of developments in the market place.

Even in disposable cash income terms, however, there has still been a slight trend increase in inequality in Australia (Harding 1996). It is almost certain that

- the incidence of relative poverty, with the poverty line defined as 50% of average equivalent disposable income, has been on the increase in Australia (Saunders 1996); and

- compared with other developed countries, Australia has a very high proportion of its children (14% according to UNICEF, Australian June 13 1996) living in families with inadequate incomes, and this situation seems to be getting worse.

The evidence that disposable cash incomes (gross private incomes plus government direct benefits less personal income and indirect tax) have become more unequal is still subject to controversy (see Gruen/ Saunders debate in CEPR Discussion Paper and Johnson, Manning & Hellwig 1995, pp.17ff).

But in any case this measure of income is incomplete. Improvements in *non-cash benefits* (the social wage), such as increases in government-funded family assistance, Medicare, child care and education, played an important role in the redistributive process in the 1980's.

Once allowance is made for the non-cash social wage, it appears that if anything Australia was a less unequal society in the early 1990's than it was at the beginning of the 80's (Johnson, Manning & Hellwig 1995), although such results must be treated cautiously at this stage.

So the shifts in income distribution over the last decade and a half do not on the whole provide cause for great alarm. However, it is likely that, in future the level of inequality will increase - for at least three inter-related reasons.
First, governments are becoming increasingly sensitive to the wishes and preferences of international fund managers and rating agencies because of the powers of international markets to destabilise the economy; international financial market participants understandably look for favourable developments on fiscal deficits, current account deficits, exchange rates, interest rates, inflation and asset prices; and are much less concerned about increases in unemployment and social inequality, or a deterioration in the quality of the urban and living environment.

Second, we are witnessing another and possibly decisive onslaught of fundamentalist economic thinking in policy-making in Australia, with its overriding emphasis on efficiency and competitiveness goals and on reduced government intervention as a means of furthering these goals, irrespective of the income or regional distributional effects.

Thirdly, in the new competitive jungle, we are seeing a hardening in community attitudes towards the disadvantaged and the unemployed - a "blame the victims" mentality.

These developments might not hurt the very poor (those in "genuine" need according to some economic fundamentalists) but, if NZ is to be our model (OECD Survey of NZ p.70/71), they will certainly have two other effects on inequality:

- the real disposable incomes of the lower income quintiles will decline markedly relative to the higher income quintiles; and

- the social wage will tend to decline rather than increase.

Consequently, unless there is an unexpectedly large improvement in unemployment, the effective distribution of welfare (allowing for tax, cash transfers and the social wage) will almost certainly deteriorate significantly in the next few years.

In this climate, the inadequacies of average real incomes as a measure of a nation's economic welfare will become increasingly evident to everyone.

There is now a recognition that an increase in GDP needs to be discounted if it is at the expense of the natural or living environment. It is high time we also recognised the need to discount GDP gains when they entail adverse effects on income and employment security and welfare distribution.
One think tank based in San Francisco has tried to devise a "genuine progress indicator" (GPI), which captures output not traded in the marketplace, allows fully for environmental effects and depletion of resources, and places a higher weight on income if it is evenly distributed. On this basis they claim that GPI in the US has declined steadily and dramatically since the mid 1970's (Economist 30/9/95).

I am not able to verify these estimates and from what I have seen I doubt that a similar conclusion would be reached in Australia (if one allows for the social wage effects); but they should make economists and governments pause and reflect whether we are approaching economic reform from too narrow an efficiency perspective.

This is not to question the merits of micro economic reform. It is obvious there have been very substantial net welfare gains from improvements in efficiency, market flexibility and adaptability; and "by and large, higher real incomes are associated with an improved and not a reduced quality of life" (Gruen 1996).

What it is legitimate to ask, however, is whether in future economic reform can achieve better overall welfare outcomes by giving greater weight to goals such as quality of life, lower unemployment and a more equal distribution of incomes, and trade off some real income per head against these other goals.
2. Why we should be taking account of distribution costs in evaluating economic reform

My focus is on the distributional costs of economic reform, so I want to spell out more fully why we economists should be taking account of these distribution costs.

That such costs exist few will deny. Most programs of economic reform, whether they involve labour market deregulation, commercialisation of the public sector, financial deregulation, fiscal consolidation or tax reform, can involve serious distributional costs. We know this on a priori grounds and we know it on the evidence of countries that have implemented such reforms.

Moreover, the distributional costs are not necessarily just a transient phenomenon: on the basis of US, UK and New Zealand experience, it is obvious that the poor remain worse off (in absolute and certainly in relative terms) for a long time.

Not only does reform have lasting effects on welfare distribution, but these distribution effects have in turn a very significant impact on aggregate economic welfare - for at least three reasons:

(i) if one accepts the common sense principle that the most basic needs are met first, it follows that a reform which takes $100 m. from low income families and gives $120 m. to higher income families does not necessarily increase total utility even if it increases total GDP;

(ii) relative poverty is usually coupled with unequal access to health, housing, education, the job market and the law; so it follows that increasing inequality produces increasingly unequal opportunity (and ability) to compete for market opportunities, which is not just a violation of basic freedom but also an economic efficiency distortion; a growing social gap also erodes trust and this too undermines the efficiency of markets;

(iii) in the long term the stability and cohesiveness of our society, and its willingness to accept further reform, can be undermined by growing inequality of incomes and opportunities; so a reform policy which is consistently and repeatedly insensitive to distribution effects has negative externality effects and might well be self-defeating (i.e it might fail to achieve even its limited objective of raising real per capita incomes) in the long term.
Many economists take the view that any economic reform which enhances GDP per head is good so long as

- you have fair rules and processes in place and

- it is possible for the winners from the reform to compensate the losers and still be better off than before.

For reasons I have just indicated, I completely reject this view. Fair rules and processes are a necessary but not a sufficient condition for welfare maximisation. Indeed fair processes depend in part on fair outcomes: you cannot have fair rules and processes, including equal opportunity and respect for the law, in a society with large and growing inequalities of incomes and wealth.

This does not mean that reform should always aim for distributional neutrality. Such an approach would be very stultifying for economic and social progress.

But we should make distributional effects an integral part of any evaluation of economic reform, with the aim of getting as close as we can to an "optimal" balance between efficiency and equity. But how?
3. Policy guidelines which take account of distribution costs

The approach I propose in my paper does not insist on distributional neutrality. It argues that some compromise between efficiency and equity may achieve a better welfare outcome than one focused solely on efficiency and that a reform which improves efficiency needs more analysis before a final judgment can be made (Little, 1960; Abelson, 1987).

This compromise approach to reform involves five steps or principles

**Principle 1:** the evaluation of a proposed economic reform should not be based only on a comparison of starting and finishing points; account must also be taken of significant intermediate adjustment costs and the longer term benefits must be appropriately discounted to allow for these costs. (The NZ reforms 1984-96 created such severe adjustment costs that, despite its strong economic performance in recent years, the NZ economy today has still not caught up with Australia relative to 1984.)

**Principle 2:** an attempt should be made to estimate the longer term effects of the reform on welfare distribution and in particular seek to determine if the effects are likely to be "regressive" in the sense of

- pushing a sizeable number of people below the poverty line (defined say as 50% of the mean equivalent family income); or

- increasing appreciably the level of income inequality
  i.e. the gap between top and bottom quintiles.

**Principle 3:** if the effects are likely to be regressive, an attempt should be made to provide rough compensation to those considered to be relatively poor (those in the lowest quintile) - provided this is feasible and it can be done in a way which does not completely nullify the efficiency gains from the original proposal.

What is an efficient and effective method of compensation? I would suggest that ideally five conditions must be met:

- the losers must be fairly easily identified, so that the benefits are not wasted on unintended "outsiders" (e.g. well-off landlords, managers and shareholders);
- the administration costs of the compensation process must be relatively low;

- the method of compensation needs to be transparent to ensure accountability and review;

- the instrument used must not generate too many by-product market distortions e.g. high effective marginal tax rates, which may seriously affect economic performance; and

- the compensation policies should not simply provide passive support but should aim to facilitate labour market adjustment i.e. development of the skills and characteristics required for labour market integration.

This points to the use of tax/transfer policy instruments, backed by active labour market programs as key instruments of compensation - in preference to the use of, say, regulation (whether of the financial system or wages) or protection, or cross-subsidisation of utility prices.

In the case of people thrown out of employment this may mean generous redundancy payments, adequate notice of retrenchment with adequate safeguards against unfair dismissal, personal counselling, job search, retraining and mobility assistance etc.

In the case of people affected by public utility pricing reforms, it may mean vouchers or direct social security supplements.

In the case of workers affected by lower wages and conditions, it may mean tax rebates or lump sum tax credits (guaranteed income) or improved community services (which have a strong equalising effect) or wage subsidies coupled with retraining and counselling programs.

In the case of tax reforms (e.g. a uniform GST), it may mean compensation through the welfare system.

None of these devices are completely free of efficiency costs. Generally however the efficiency losses they might involve are likely to be small relative to the overall potential gains of reform.

We come now to steps 4 and 5. These deal with the situation where compensation
- is not feasible (e.g. because it is difficult to identify the losers or because the benefits are likely to be captured by unintended people such as landlords or producers or because of community and political resistance to taxation) or

- is not sensible (e.g. because of adverse incentive effects such as an increase in effective marginal tax rates).

**Principle 4** assumes that the equity costs are high relative to the reform. In that situation, given that compensation is not feasible or sensible, consideration should be given to the adoption of "softer" variants of the reform program - e.g. phasing the reforms in gradually or introducing them only partially.

This is often the situation policy advisers face e.g. radical labour market deregulation has potentially severe equity effects, yet compensation is not feasible in a policy environment which is striving to achieve fiscal consolidation and small government. And even if it were feasible it is not clear that a method of compensation can be devised which is both effective in terms of its target group (low-paid workers) and at the same time avoids high marginal effective tax rates. So a compromise to labour market reform is needed.

**Principle 5** assumes that the equity costs are small but the efficiency gains overwhelming. Here it is justifiable for the Government to proceed with reform despite distributional concerns - on the grounds that the total cake available for distribution will be much larger and will make up for the distribution costs.

An example would be waterfront reform and reform of cabotage on coastal and trans-Tasman shipping and many forms of tax reform (e.g the replacement of the existing hotch potch of federal and state indirect taxes with a uniform GST).

The broad approach to economic reform outlined here - one which requires some efficiency benefits of reform to be sacrificed in order to avoid regressive distribution effects - is likely to be criticised from both ends of the ideological spectrum.

The five main criticisms of this approach would be:

- that it is too riddled with value judgments

- that it would interfere with individual freedom
- that compensation policies have so many nasty by-product effects (on incentives, efficiency, saving etc) that they would leave everyone worse off

- that it would slow down the whole reform process; and

- that the underlying social objective (i.e. to avoid any further deterioration in the present relative position of the lowest income quintile) is too modest.

The Right will tend to focus on the first four types of criticisms and the Left on the last.

These concerns are understandable, and deserve a considered response. Briefly:

- the proposed approach does involve some value judgments, but so does the "efficiency first" fundamentalist approach; at least under this approach the value judgments are transparent and open to debate and the government is better informed as to the nature of the trade-off and the options available for resolving them;

- the concern about freedom can be turned on its head: wide income and wealth inequalities and high concentrations of economic power are not consistent with equality of opportunity and access, and hence with true liberty of the individual and efficient markets (Rawls p.278);

- certainly, some compensation mechanisms (especially the use of regulation or increased tax progressivity) can be damaging for efficiency and incentives; but generally if the right instruments are used, the effects are not likely to be substantial enough to weaken markedly the net economic benefits of a soundly-based reform; where available compensation mechanisms are likely to seriously damage economic incentives, my guidelines in effect suggest that the Government may have to look for a slightly diluted version of the reform or proceed with the reform without compensation;

- as for delays to the reform process because of increased complexity of the policy formulation process, this is indeed a potential cost, but it must be weighed against the gains from improved transparency and understanding and from greater public acceptance of structural change;

- the last concern is in my view justified but the question of what is a "fair" distribution of incomes and wealth and what should be done to develop a more "just"
society is too complex and judgmental for a modest economist to attempt: it is a separate issue altogether from the one addressed here, which is the *incremental* social welfare effects of a proposed economic reform.
4. Application to two current policy issues

I now want to briefly apply my "pragmatic" guidelines to labour market reform and the issue of indigenous land titles.

(a) labour market reform

Labour market reform seeks to make room for greater flexibility in work organisation, in human resource management and in wage structures. It's ultimate aims are: first, to make it easier to clear the market for unemployed (mainly unskilled) workers; and secondly, to improve productivity and competitiveness. (A third objective of labour market reform is to minimise inflationary pressures but it is outside the scope of this paper.)

If governments want to achieve these aims they have four options (or some combination of all four):

(i) One option is to deregulate radically the labour market (including wages) without worrying at all about distributional effects.

(ii) A second option is to deregulate wages but introduce other economic reforms in tandem, so as to spread the gains and costs a little better e.g. more active labour market programs which assist the reintegration of disadvantaged unemployed persons into the labour force.

(iii) A third approach is to radically deregulate the labour market and accept the consequent increase in market inequalities, but partly compensate the working poor through the tax and transfer system and social wage e.g. through a guaranteed minimum income or income tax credit.

(iv) A fourth option is to adopt an incremental (rather than a big bang) approach to labour market reform i.e. go a partial way towards deregulation but maintain an industrial safety net and legal protection for trade unions, so as to limit the risk exposure of workers (such as to exploitation, abuse or a severe fall in living standards).

Option (i) is the course broadly adopted in the UK and New Zealand and it is one that Australia might well move towards in the future. It is built on a system of individual
employment contracts, without the countervailing power of either trade unions or the IRC, and subject only to a very basic set of minimum wage and employment conditions.

This option may do more for the economy than the other options. This is not because it improves factor productivity: both theory and the experience of countries like US, NZ and UK suggest that countries with deregulated labour markets do not achieve higher productivity growth. Rather it is because of what radical labour market deregulation does to the profit share, and hence the investment climate; and what it does to the inflation/unemployment trade-off.

Under the Hawke-Keating governments, Australia adopted a mix of options (ii) to (iv). Like NZ, it allowed major improvements in functional flexibility (human resource management) at the enterprise level. However, unlike NZ,

- Australia did not reduce and fragment the power of trade unions and force them to restructure on an enterprise basis; unions in Australia remained largely occupational or industry-based and retained a strong negotiating position; and

- Australia did not allow too much downward flexibility in pay and conditions; it maintained a strong award safety net, retained a regulatory body (the Industrial Relations Commission) to act as umpire and scrutineer, and relied for labour cost flexibility more on labour market programs (training, mobility assistance, wage subsidies etc) than on award wage flexibility.

Could these differences between NZ and Australia on wage flexibility account for the better NZ employment performance in the 1990's? A priori one would expect a wage structure which responds to shifts over time in the demands for different types of labour to be less prone to structural unemployment (mismatch).

And some OECD studies do back this a priori expectation: in the period 1980-1995, countries that have allowed a greater degree of wage dispersion (i.e. have allowed the relative wages of low-skilled workers to fall) have seen the smallest increases in unemployment (OECD 1996).

However, what is also clear from the literature is that wage flexibility works better if it is also associated with pro-active labour market policies which improve levels of education, training and job readiness, increase labour market information etc. (Economist 17/8/96).
Australia has relied mainly on pro-active labour market programs and only slightly on wage flexibility. NZ has relied mainly on a flexible wage structure and (at least until recently) only to a small extent on labour market programs. So one would expect the differences in labour market approach to account for some, but only a small part, of the difference in employment performance.

Whatever their direct impact on employment (i.e. from drawing marginal or low productivity workers back into employment), the NZ labour deregulation measures undoubtedly had important indirect effects on employment. In particular they tended to produce a sharp redistribution to profits, a very friendly response from financial markets, a stable and positive investment and economic environment and a burst of animal spirits.

In addition, the NZ labour market reforms, by deregulating the award structure and increasing the relative bargaining power of employers, helped, in conjunction with the increased credibility of monetary policy, to reduce inflation.

So more because of its indirect than direct effects, NZ's radical approach to labour market reform probably did have beneficial employment effects.

So there is no doubt that Option 1 offers some economic gains. But it has a social cost: it leads to an erosion of the living standards of a significant group of low-income workers, without any compensation. Even the OECD, in its Survey of the NZ economy, acknowledges that:

"In the ten years to March 1994, the real disposable incomes of both the lower and middle-income quintiles have fallen in absolute terms by 4 and 5 per cent respectively, and it is only those of the highest income quintile which have risen" (OECD 1996 p.70).

A reform which makes lower paid workers worse off and the rest of the community (especially higher paid workers, the self-employed, rentiers) much better off does not provide even the semblance of justice. Even in strict economic welfare optimising terms, the merits of such an approach are uncertain, given the costs imposed on those who are already relatively badly off. The political sustainability of the reforms in the long run can also be questioned.
The third option is theoretically the most appealing but may not be practical on its own in a world of fiscal balance, small government and concerns about high marginal effective tax rates.

In my view, welfare optimisation is more likely to be achieved and justice served through a combination of the last three options rather than relying mainly on the first, as in NZ.

It looks as if the present Government in Canberra has, like the previous one, rejected pure option (i); it is moving a little faster on incremental reform (option iv) but with less of (ii) and (iii) than the previous Government.

(b) Competing land claims

That a policy reform which enhances aggregate national production and incomes need not necessarily be welfare-enhancing can also be illustrated by reference to recent proposals to truncate by legislation the negotiating ambit and rights of Aborigines under the Native Title Act (NTA).

The aim of such proposals - to rule out unsubstantiated ambit claims and to give miners and pastoralists more secure tenure - is understandable; but there is a fine balance here between ensuring that the genuine land rights of Aboriginal people are fully protected and giving miners and pastoralists reasonable access. Where should the balance be struck?

To a fundamentalist - efficiency first - economist, the answer is clear. Preference should be given to miners and pastoralists because they can use the land more efficiently than traditional owners, and hence contribute more to GDP per head than Aborigines.

Even at the pure efficiency level, the issues are not clear-cut. The kind of government intervention being proposed may increase rather than reduce uncertainty (unless taxpayers are asked to indemnify all mining projects potentially affected by future land title claims, which would hardly be reasonable).

Again, if traditional owners are denied full property rights over non-land resources, it will have the perverse effect of making potential claimants less willing to allow mining to proceed since they could not hope to capture a share of the income from subsequent mineral exploitation. With full property rights, they may still decide, after
free and voluntary trade, to oppose mining; but if so it will be because they value the land for traditional uses more than it is worth for mining (Godden 1993).

But a welfare economist will have two further, more decisive, objections. Leaving aside issues of fairness and legality e.g consistency with the Racial Discrimination Act, forcible intervention by the state to weigh the balance of market power in favour of miners and to exclude mineral rights from land titles may well produce a sub-optimal welfare result.

First, action to override the interests of indigenous Australians would have regressive income and wealth redistribution effects, as the Aborigines are on average worse off and have a higher marginal utility of money income than the mine owners. This would throw doubt on the net welfare effects of such action.

Second, government intervention would have negative externality effects such as its impact on racial harmony and on our international reputation. Such externalities must clearly be taken into account in any overall cost-benefit assessment.

There are further complications. It is now clear that as a result of the Mabo decision, certain legitimate expectations have been established which if disturbed would require compensation of losers: this applies both to aboriginals and to holders of pastoral leases. In such circumstances it is surely more sensible to allow free trade and exchange to determine the outcome without government intervention.

The issues are complex, but they illustrate yet again that the fundamentalist efficiency school has too simplistic an answer to the really difficult social and economic reform issues of our day.
5. Concluding comments

Economic reform is about improving economic welfare. An increase in real per capita incomes is often a necessary but seldom a sufficient condition of improved economic welfare. The effect on inequality is crucial to any assessment of a reform proposal.

Beyond a point, labour market reform has a small and uncertain impact on economic growth but a major impact (at least in the short term) on inequality, social stability and cohesion. Economists should therefore be guarded about advocating radical reforms in the dogmatic way they do.

Similarly, constraining the negotiating powers of aboriginals over land rights can, beyond a point, involve a decline in economic welfare - no matter what it does to GDP.

The perspective of economics on economic reform needs to be widened to make distributional effects an integral part of the analysis.

If this sometimes involves value judgments, so be it. At least such judgments will be transparent. By ignoring distributional issues, economic fundamentalists are making interpersonal comparisons and value judgments too - but these are hidden.

Regrettably the new Howard Government, by relying heavily on spending cuts rather than tax increases to curtail the budget deficit, by clawing back labour market programs, by directly or indirectly reducing the social wage, and by reducing unemployment and other lower income benefits, is moving to implement at least some of the fundamentalist philosophy.

Perhaps it correctly senses the public mood. The "fair go, mateship" mentality is coming under increasing stress in a competitive market place which "produces a psychological environment of anonymity, indifference to others, mobility, lack of commitment, and autonomy" (Bowles, quoted in Harcourt 1992).
References


Falkingham, Jane & Harding, Ann, Poverty alleviation versus social insurance systems *NATSEM Discussion Paper 12 4/96*


Little, I.M.D. (1957), *A critique of welfare economics* Oxford University Press


*OECD Employment Outlook* 1996

*OECD Survey of NZ Economy*, March 1996


Richardson, Sue & Travers, Peter (1995) in John Nevile ed. *As the rich get richer*, CEDA Growth 43, 7/95


Public Policy Program Discussion Papers

The Public Policy Program publishes annually about six Discussion Papers by staff, students, visitors and others associated with the Program.

Enquiries should be directed to:
The Editor, Discussion Papers, Public Policy Program, Australian National University, Canberra ACT 0200.

Papers published thus far are:

<table>
<thead>
<tr>
<th>No.</th>
<th>Author</th>
<th>Title</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>Rolf Gerritsen</td>
<td>Making Policy Under &quot;Uncertainty&quot;: The Labor Government's Reaction to the &quot;Rural Crisis&quot;.</td>
<td>February 1987</td>
</tr>
<tr>
<td>4</td>
<td>Eleanor Moses</td>
<td>The Oil Price Fall of 1986.</td>
<td>July 1987</td>
</tr>
<tr>
<td>5</td>
<td>P J Forsyth</td>
<td>Productivity Measurements in the Public Sector.</td>
<td>August 1987</td>
</tr>
<tr>
<td>6</td>
<td>Rolf Gerritsen</td>
<td>What Do Budget Outcomes Tell Us About the Australian States?</td>
<td>September 1987</td>
</tr>
<tr>
<td>7</td>
<td>Rolf Gerritsen</td>
<td>Collective Action Problems in the Regulation of Australia's Common Property Renewable Resources.</td>
<td>October 1987</td>
</tr>
<tr>
<td>11</td>
<td>Roger Wettenhall</td>
<td>Overlapping Public Sectors; Notes on Foreign Public Enterprise Activity in Australia.</td>
<td>July 1988</td>
</tr>
<tr>
<td>14</td>
<td>Christine Fletcher</td>
<td>Isolated Aborigines and Road Funding Policies in Western Australia.</td>
<td>March 1989</td>
</tr>
</tbody>
</table>
No. 16 Deborah Mitchell, *Comparative Measures of Welfare Effort.* (January 1990)
No. 21 F G Castles & D Mitchell, *Three Worlds of Welfare Capitalism or Four?* (September 1990)
No. 22 Francis Castles & Michael Flood, *Divorce, the Law and Social Context: Families of Nations and the Legal Dissolution of Marriage.* (January 1991)
No. 25 Francis Castles, *On Sickness Days and Social Policy.* (July 1991)
No. 30 Adrian Kenneth Noon, *Determining the Fiscal Policy Time-Frame: the Dominance of Exogenous Circumstances.* (February 1992)
No. 31 Christopher John Eichbaum, *Challenging the Intellectual Climate of the Times: Why the Reserve Bank of Australia is Too Independent?* (January 1993)
No. 32 Joan Corbett, *Child Care Provision and Women’s Labour Market Participation in Australia.* (February 1993)
No. 35 Rolf Gerritsen, *“Authority, Persuasion and Exchange” (Revisited): The Public Policy of Internationalising the Australian Economy.* (August 1993)
<table>
<thead>
<tr>
<th>No.</th>
<th>Author</th>
<th>Title</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>36</td>
<td>Deborah Mitchell</td>
<td>Taxation and Income Redistribution: The &quot;Tax Revolt&quot; of the 1980s Revisited</td>
<td>Sept. 93</td>
</tr>
<tr>
<td>37</td>
<td>Kim Terrell</td>
<td>Desperately Seeking Savings, Performance and Accountability. Policing Options for the Australian Capital Territory</td>
<td>Sept. 93</td>
</tr>
<tr>
<td>38</td>
<td>Francis G. Castles</td>
<td>Is Expenditure Enough? On the Nature of the Dependent Variable in Comparative Public Policy Analysis</td>
<td>Feb. 94</td>
</tr>
<tr>
<td>40</td>
<td>Francis G. Castles</td>
<td>Testing the Limits of the Metaphore: Fordist and Post-Fordist Life Cycles in Australia and New Zealand</td>
<td>May 94</td>
</tr>
<tr>
<td>41</td>
<td>Louise Watson</td>
<td>Making the Grade: Benchmarking Performance in Australian Schooling</td>
<td>Aug. 94</td>
</tr>
<tr>
<td>42</td>
<td>Siwan Lovett</td>
<td>Evaluating Reform of the New Zealand Science, Research and Development System: New Deal or Dud Hand?</td>
<td>Sept. 94</td>
</tr>
<tr>
<td>43</td>
<td>Choon Fah Low</td>
<td>An Evaluation of the Impact of the ANU’s Graduate Program in Public Policy on its Student’s and Graduate’s Careers</td>
<td>Oct. 94</td>
</tr>
<tr>
<td>44</td>
<td>Einar Overbye</td>
<td>Different Countries on a Similar Path: Comparing Pensions Politics in Scandinavia and Australia</td>
<td>Aug. 95</td>
</tr>
<tr>
<td>45</td>
<td>Grant Jones</td>
<td>Games Public Servants Play: The Management of Parliamentary Scrutiny Before Commonwealth Estimates Committees</td>
<td>Aug. 95</td>
</tr>
<tr>
<td>46</td>
<td>Stephen Horn</td>
<td>Disagreeing About Poverty: a Case Study in Derivation Dependence</td>
<td>Aug. 95</td>
</tr>
<tr>
<td>47</td>
<td>Douglas Hynd</td>
<td>Concerned with Outcomes, or Obsessed with Process? Characteristics of Senate Committee Reports During the Period 1990 - 1994</td>
<td>Aug. 95</td>
</tr>
<tr>
<td>48</td>
<td>Pip Nicholson</td>
<td>Does the System of Appointing Australian High Court Judges Need Reform?</td>
<td>Nov. 95</td>
</tr>
<tr>
<td>49</td>
<td>Fred Argy</td>
<td>The Balance Between Equity and Efficiency in Australian Public Policy</td>
<td>Nov. 96</td>
</tr>
</tbody>
</table>