



Economic efficiency and social harmony

Fred Argy

**Occasional paper
Brotherhood of St Lawrence
1998**

sambel oration

The 1998 Sambell Oration was delivered by Fred Argy, author of *Australia at the Crossroads* and one of Australia's leading economists.

Fred Argy is no stranger to the needs of practical decision-making. As a public servant he was secretary to the Campbell Inquiry into the Australian financial system; Australia's ambassador to the OECD; director of the Economic Planning Advisory Council, and a senior Treasury adviser.

Believing that economic policy should be about improving our society, Fred Argy argues that the issue for Australia is not whether we should be trying to improve economic efficiency through structural reform, but how we can do this with acceptable employment and social outcomes.

This is an important treatise for all Australians concerned with the social consequences of rapid economic change.

The G T Sambell Oration is an annual public lecture, established by the Brotherhood of St Laurence to commemorate the work of former Executive Director, Geoffrey Tremayne Sambell.

Archbishop Sambell's deep and longstanding concern for social justice led him to explore the causes and solutions to poverty which today form an important part of the Brotherhood's work.

Each August an oration is held to further the enquiry into social justice issues, following the tradition established by Geoffrey Sambell.

If you would like to be notified of future Sambell Orations please call Public Affairs at the Brotherhood of St Laurence on 9483 1383.

1998 - 13

Economic efficiency and social harmony

The seventeenth Sambell Memorial Oration

delivered by
Fred Argy

on
Thursday, 13 August 1998

at
State Film Theatre
1 Macarthur St, East Melbourne



BROTHERHOOD
of St LAURENCE

First published in 1998 by
Brotherhood of St Laurence
67 Brunswick Street
Fitzroy, Victoria 3065

© Brotherhood of St Laurence

Argy, Fred

Economic efficiency and social harmony: the seventeenth
Sambell memorial oration

Bibliography.

ISBN 1 876250 18 6

1. Structural adjustment (Economic policy) - Australia. 2.
Australia - Economic policy. I. Brotherhood of St.
Laurence. II Title. (Series : G. T. Sambell memorial
oration ; 17).

338.994

I am deeply honoured to have been invited to deliver the Sambell Oration. I share passionately the values and goals of the Brotherhood and admire the work it is doing to help those in need and to publicise their plight. From a professional viewpoint, I also find the product of your economic research extremely refreshing because it injects a badly needed social dimension. So I am very happy indeed to be here.

My talk focuses on an issue which, I am sure, has exercised the minds of most people here – how Australia can best balance its economic and social goals.

Economic efficiency is crucially important for the people we are trying to help. The smaller the national cake the less there is available to share around. And if governments can deliver their responsibilities more cost-effectively, the more resources they have available to spend on social and community services.

The issue is not whether we should be trying to improve economic efficiency through structural reform but how we can do this with acceptable employment and social outcomes.

Our post-war experience

Looking back on Australia's economic history over the last half century, one thing seems to stand out – Australia has been unable to consistently achieve good outcomes on efficiency, full employment and equity at the same time. The trifecta has eluded us.

In the first 25-year period (up to the early 1970s) we performed well on employment and equity but slipped behind the rest of the world on efficiency. This was the golden age of government interventionism but it was often the wrong kind of interventionism – high, tailor-made industry protection, pervasive regulation and

an undue presumption in favour of public ownership and operation of public services.

In the second 25-year period we saw a policy revolution. A judgment was made in Canberra (rightly in my view) that the old interventionary policies were no longer working well in the new cut-throat, integrated and technologically sophisticated world economy and that they were impeding our ability to compete internationally. This set the scene for the last fifteen years of economic liberalism.

Economic liberalism, while slow to impact, is now paying off handsomely for efficiency. Over the last seven years Australia has been out-performing the rest of the world in terms of productivity and per capita incomes growth.

But has the policy revolution produced a socially acceptable outcome? The answer is a mixed one. The good news is that, compared with other reformist countries, we achieved our good productivity outcomes at a much lower social cost. Until the mid-1990s income and wealth inequalities had not increased greatly in Australia. To this extent, we should feel a measure of pride.

The bad news, however, is that we have become mired in high unemployment and under-employment, and that we are now seeing vivid signs of a disturbing social malaise – growing earnings inequalities in the market place, declining quality of life in the workplace (increased casualisation, reduced workplace protection, longer and less predictable working hours and greater stress), growing regional disparities in jobs, incomes and services, and a deterioration in many parts of our social infrastructure (hospitals, schools, community services and public transport).

Some pain is always associated with structural change and reform but in my view more could have been done to alleviate this pain.

That it did not happen was due to three policy failures.

First, a failure to give unemployment the priority it deserves – both at the macro level (with an over-cautious view of the so-called speed limits of economic growth and the minimum sustainable rate of unemployment); and at the micro level (with timidity in investing adequately in labour market programs and human capital).

A second policy failure was that not enough thought was given by Ministers and their advisers to the second and third round distributional and quality of life effects of their reforms. Nor was enough done to address these distributional effects after the event.

Thirdly, there has been a failure to invest adequately in community services and to preserve a strong, viable public sector.

Whatever the reasons, the 1990s is proving a good decade for economic efficiency and growth (despite some hiccups at the moment due to Asian contagion effects) but one marred by increasing signs of an ailing society.

If one looks at the whole of the last half century, and one judges it in terms of human well-being, one would have to say that economic policy has fallen short of ideal (although it has performed quite creditably compared with many other countries). It has not achieved the trifecta of goals we all strive for. So it is not surprising that many people in Australia are looking for changes in policy direction.

The choices we face

To many the answer lies in radical surgery.

One commonly proposed radical response – which I call statism – would be to throw out economic liberalism lock stock and barrel and go back to the interventionist policies of the 1960s. It would effectively mean abandoning efficiency altogether and giving overriding priority to employment and equity. Such a course would almost certainly prove counter-productive in the long term – that is, we would end up with neither efficiency nor equity.

A second proposed response – which I call hard liberalism – would be to extend economic liberalism to its limit, with ever smaller government and ever increasing deregulation, especially in the labour market. If we went this way we might well improve efficiency and even reduce unemployment, but it would mean a much more unequal society. Equity would go out of the window and in the end this solution would be socially unsustainable.

These two responses amount to an admission of defeat – an acceptance that simultaneous achievement of all three policy goals (efficiency, full employment and equity) is unattainable. Of the two extreme policy directions, my book argues that the statist path (elements of which can be seen in Hansonism) is the least likely to secure majority support, once the issues are explained. Perhaps I am wrong (I finished my book before the surge in popularity of One Nation), but I believe a maverick political movement (outside the mainstream of politics) can only succeed if it has the financial, intellectual and moral support of the opinion makers in our society. Statism does not have that.

The hard liberal movement is in my view no less extreme and has no greater appeal in the community at large. But it does have

strong support in influential policy circles. So I believe it stands a much better chance of success in the long term. That is why in my book I treat hard liberalism, not statism, as the main foe.

So what am I proposing instead? It is something I call progressive liberalism. This acknowledges the need to trade off the three policy goals against each other, but instead of sacrificing one in order to single-mindedly pursue the others, it seeks to find an optimal balance between them.

This course does not require a major shift in policy direction. Unlike statism, it seeks no return to high protection; no significant re-regulation of the workplace or the financial system; and no back-flip to high public ownership. It has no in principle objection to the continued opening up of markets to competition. However, progressive liberalism differs from its hard line variety in two critical ways – in the management of employment and in the treatment of distribution.

On employment management, my book questions the logic of tying fiscal and monetary policy solely and rigidly to medium-term targets such as cash surpluses, public debt reduction, lower taxation and very low inflation. Apart from its regressive effects on distribution, this hard liberal approach to macro-economic policy minimises the role of government in a policy area where government clearly has a comparative advantage over markets.

I believe we must shake off this minimalism on macro-economic policy and strive towards:

- more public investment, especially in human capital;
- a much more flexible approach to budget and public debt management;
- a less doctrinaire and cautious approach to short-term demand management;

- a new incomes policy framework, to lessen the risk that inflation will accelerate out of control when we again approach a fuller employment situation, without having to rely on demoralised trade unions and tough industrial relations laws to keep wages under control;
- an internationally coordinated attempt to constrain the movement of destabilising short-term portfolio flows across national borders and to minimise financial and economic contagion effects, and
- a bigger role for government in correcting structural unemployment, including bigger outlays on labour market and regional programs, increased efforts to create jobs in labour intensive activities, especially community services, and measures to enhance labour mobility.

On the issue of distribution, I would part from hard liberals in making social and quality of life goals an integral and systematic part of economic policy formulation. This would mean giving much greater attention to adjustment assistance, trying to adopt reforms in tandem so that there are as few losers as possible, fully compensating losers who are already disadvantaged, and if such measures are not feasible, looking for alternative reform options (for example, more use of wage subsidies and training and employment programs and less use of wage deregulation).

I want to focus on the distribution issue and try to explain more fully what it is that divides me (and other progressive liberals) from the more hard line variety of economic liberalism.

The meaning of equity

The first issue which divides us is about the meaning of equity.

To me, striving for equity means avoiding increasing inequalities

of income and wealth across the population, ensuring the fruits of productivity growth are widely distributed, and gradually eliminating poverty.

To hard liberals, equity is not about distributional outcomes at all. It is about ensuring equality of treatment (fair rules and processes) and opportunity (horizontal equity). If governments go beyond this, it is said that they are interfering with another essential component of equity – economic freedom (allowing people to do their own economic thing and reap the full rewards of their efforts).

I question this view of equity. Apart from moral and spiritual considerations, you cannot have fair rules and processes and genuine equal opportunity in a society with large and growing inequalities of income and wealth. Why? Because in such a society there is no such thing as equal access to education, health, decent housing, the justice system, transport and other services essential to future success in the labour market.

Nor am I prepared to elevate economic freedom to the status of a primary national equity goal in its own right – on the same level, say, as the elimination of poverty.

But this is essentially a disagreement about goals and values. It is not about economics, which is concerned with means to ends. And one important aim of my book is to flush out and expose value judgments which masquerade as quasi-scientific truths.

Efficiency costs of redistribution policies

A second social issue which divides hard and progressive liberals relates to the efficiency costs of redistributive policies. This is an issue economists are more at home with. And it is crucially

important because just like good economic outcomes are unsustainable if they produce bad social outcomes, so too good social outcomes are unsustainable if they are associated with very bad economic outcomes.

The concern of hard liberals is that redistribution policies involve a high efficiency cost. This concern has three strands to it.

(a) market distorting effects

The first is that such policies lead to market distortions and big efficiency losses. It is true that, clumsily handled, redistribution policies can interfere with the market mechanism. However, this need not happen if we choose sensible policy instruments of intervention.

Sensible policy instruments are those which tend to supplement rather than replace markets and which are: well targeted; transparent and subject to regular review; involve low administration costs relative to the amount of compensation; have only minor by-product effects on economic incentives, and which seek not only to provide passive welfare support but to facilitate long-term adjustment (for example, labour market programs to support welfare). Given the right instruments, the market distorting effects need not be significant.

(b) incentive effects

The second concern of hard liberals is that redistribution policies require high tax rates, which in turn blunt the incentives to work, save and take risks. I believe this concern is greatly exaggerated. My answer to it is threefold:

(i) socially progressive liberal policies may well mean higher taxes in the short term but not necessarily in the long run: Piggott and Chapman (1995) have argued, for example, that many labour market programs pay for themselves in the long term;

(ii) if the right taxes are used (such as taxes on immobile capital, and income tax broadening measures to minimise tax avoidance and evasion), the work disincentive and resource misallocation effects are insignificant; and

(iii) in any case, high marginal tax rates do not seem to affect the work effort of the rich; work disincentives are mostly at the lower end of the income spectrum; since progressive liberal policies tend to reduce marginal effective tax rates at the lower end and increase them at the top end, they may well have positive effects overall on work effort.

(c) ineffectiveness

The third claim is that redistribution policies don't work. In its crudest form it simply refers to the continuing growth of welfare dependency and increasing inequalities as evidence that welfare policies cure nothing. But this tells us nothing about what might have been the situation if we had not had redistribution policies in place. At the very least we have spared ourselves the harshness of American society.

The ineffectiveness argument is also applied to active labour market programs (which are an important instrument of redistribution in the progressive liberal framework).

All in all, therefore, I believe redistributive policies can achieve their social goals without impeding efficiency and productivity. In fact I would go further. Large inequalities are counter-productive for GDP growth in the long term. They erode the competitive neutrality of the market place (as they make it hard for the poor to access transport, housing and education). They lead to under-investment in human capital (as financial markets tend to discriminate against people with good income prospects but poor collateral). They create social disharmony, which is bad for investment planning and confidence. As well, a "winners take

all” approach to economic reform stiffens resistance to future structural change and reform.

Empirically, it is clear that many countries in the world have consistently pursued egalitarianism without being the worst for it economically in the long term. I outline the evidence in my book. Australia’s own experience shows that, as far as efficiency is concerned, consensual policies have generally served Australia well in the 1980s and first half of 1990s. By and large we tried to insulate the poor and disadvantaged from the harsh effects of structural change and allowed many of them to share in the fruits of economic growth. Yet we also pursued ambitious economic reform and achieved strong growth in productivity and living standards.

Looking beyond Australia at the wider international experience there is no suggestion that socially progressive, consensual countries have been bad productivity performers. In fact, taking a long period such as 15 to 20 years, the top five performers on per capita growth among the developed countries were Japan, Austria, Netherlands, Germany and Norway – all consensual societies. Even if one looks only at the experience of the last seven years or so – a period when countries like Germany and Japan have faltered – many other progressive liberal economies (such as Austria, Netherlands and Norway) have achieved strong rates of economic growth and performed just as well on most of the economic criteria. And in that period countries adopting the full hard liberal agenda like the USA and New Zealand have not enjoyed great productivity gains.

All this is casual observation; but comprehensive international studies have found little systematic correlation between inequality levels and economic growth and indeed some of the evidence suggests that high inequality harms growth (Argy p.165).

One word of caution. It is often argued that past relationships no longer apply – that globalisation has changed all the rules of the game. In particular it is said that there are policy constraints (for example, on fiscal and tax policy) which did not exist to the same extent even a decade ago, and that an attempt to overcome these constraints would now bring instant and deadly retribution from the markets.

Like so many such claims, it has a core of truth. Given the increasing mobility of capital and skilled and professional labour, and given the obsession of financial markets with small government, large-scale redistributive policies may well be more economically costly than they were in the 1960s. And indeed there are ominous signs of a world-wide movement away from many of the socially progressive policies of the earlier post-war period.

But the message to be drawn from this is not that we should abandon redistribution policies in toto but that we need to pick our instruments very carefully, with due regard to their sensitivity to financial markets (for example, avoid using regulation and high corporate tax rates to redistribute incomes).

The employment effects of redistribution policies

I have argued above that if we injected a bit more egalitarianism and compassion into the design of Australian economic policy, it would not hurt efficiency and GDP growth. But would it impede the achievement of low unemployment?

I cannot see any strong theoretical reason why a combination of moderately flexible labour markets, strong welfare and worker protection systems and active labour market programs cannot perform as well on the unemployment front as an approach which

relies predominantly on wage deregulation and welfare cuts.

Empirically, the evidence is again inconclusive. Taking a longer period socially progressive countries have out-performed hard liberal countries on the employment front (over the long term the top employment performers are consensual countries like Japan, Netherlands, Austria and the Scandinavian countries (see Argy, Table 11.3, p.170; tables 2.2, p.21 and 14.2 p.198).

And even focusing only on the 1990s we should not get carried away with the strong performances of the USA, UK and New Zealand. Sure, they have among the lowest unemployment rates in the world – in stark contrast with the larger European countries and Japan. However, quite a few socially progressive countries (such as Netherlands, Austria and the Scandinavians) have also been turning out good employment outcomes in the 1990s. Hard liberalism is clearly not the only way to low unemployment.

In any case we must be careful not to focus all our attention on the 1990s. In that period, there have been special problems in France and Germany which distort the comparison – reunification in the case of Germany and a totally misguided “Franc Dur” policy in the case of France.

And there were many other factors besides hard liberal policies which produced the strong employment gains in the UK after 1991 – including, for example, expansionary monetary and fiscal policies and a favourable exchange rate. The recent rise in Sterling, and the adoption of a more independent Bank of England with a monetary policy more tightly targeted at inflation, seem to be producing a slow-down in the UK economy in 1998 and there is a suggestion now (*Economist* 25 July 1998, p.20) that the “natural” rate of unemployment is still above 7 per cent – hardly a great achievement, given the long and traumatic adjustment period in the early Thatcher years (1979-91).

Similarly, there is room for scepticism about the extent of the so-called New Zealand employment “miracle”. In the 1990s reductions in unemployment have not been extraordinary when one allows for the dismal starting point. Moreover, they have been at the expense of productivity growth. And to cap it all, New Zealand is not showing the same employment resilience as Australia in the face of the East Asian crisis.

It is also arguable that the current low unemployment rate in the USA has little to do with hard liberal policies. After all, most of the hard labour market and social welfare policies have been in place for decades. Although wage flexibility has increased somewhat in the USA, the gap between the USA and Australia in terms of organisational flexibility at the enterprise level has if anything narrowed. Yet the gap in unemployment rates between the two countries has widened. So one must turn in large part to macro-economic policy for an explanation of the sustained USA low unemployment/low inflation experience. The biggest factor seems to have been the willingness of the monetary authorities to test the ultimate limits of the cyclical expansion and adopt a “suck it and see” approach on inflation. This has led to a complete reappraisal of the minimum sustainable unemployment rate. As well, there have been fortuitous things like low commodity prices and a strong dollar.

Even the more sophisticated international studies have not been able to demonstrate conclusively that hard liberal policies intrinsically produce higher living standards and lower unemployment than progressive liberal policies (Argy p.165, p.100).

What about Australia? Isn't our experience with unemployment evidence of incompatibility between progressive liberalism and low unemployment?

Well not really. My book argues that our inferior unemployment performance cannot be attributed to a failure to implement the full gamut of hard liberal policies (including wage deregulation). Instead more plausible explanations of the rise in unemployment since the mid-1970s would include the following:

- our slowness in dealing with the structural effects of the oil shock and the compounding effects of wage-push in the mid-1970s;
 - poor management of incomes in 1981-83;
 - poor management of demand in 1989-91;
 - a gradual deliberate shift in priorities (or balance of risks) away from full employment to low inflation, small government, external balance and “sound public finance” – that is, a greater willingness by the policy authorities to take risks with unemployment; and
- 1 a slowness to address structural imbalances in the labour market, thus allowing growing cyclical and technological unemployment to turn into intractable long-term unemployment.

Overall, it is simplistic to attribute our relatively high unemployment predominantly to inflexible labour markets. It can be more plausibly attributed to over-cautious demand management and inadequate investment in labour market programs.

The issue of whether active labour market programs work as well as deregulation is a particularly relevant issue here. I argue in my book that, well chosen, such programs do work. The right choice of program depends on the circumstances – for example, on the stage of the business cycle.

In periods of relatively low and falling unemployment it is best to focus on training and retraining programs and wage subsidies for the long-term unemployed. In periods of recession it makes sense

to shift the balance towards job creation programs.

In my book I refer to various studies showing that such programs work well. Since I finished my book some new studies have emerged (Stomback, Dockery and Yin, Curtin University 1998). They confirm that wage subsidy programs like Job Start have a positive impact on the chances of getting people into work and they also show that job creation programs such as Job Skills and New Work Opportunities perform a lot better than previous studies seemed to suggest. On the other hand, surprisingly, they cast doubt on some job search training programs like Job Clubs and SkillShare.

I also argue in my book that regional policies have a rightful place alongside labour market programs.

The bottom line is that labour market and regional programs can be just as effective in reducing structural unemployment as labour market deregulation – no more and no less. This is hardly surprising, as both strategies are trying to achieve the same thing – that is, a cut in the cost of employing unskilled people with employment handicaps.

In both cases the employment response is muted. It takes a big reduction in relative wages of low paid workers to achieve a substantial improvement in long-term, structural unemployment. And it takes big subsidies to achieve the same result.

While all programs need to be reviewed regularly and bad programs abolished, the better labour market programs are almost certainly more employment effective than wage deregulation because they target more directly the long-term unemployed. Unfortunately, as I said earlier, Australia has only adopted a half-hearted approach to labour market programs. The previous Labor Government got on the right track after *Working Nation* but it stumbled on the

implementation and was out of office before it could finish its work. The new Government has not provided enough funding for wage subsidy and job creation programs and the long-term unemployed have grim prospects in the short term.

And the cross-country evidence does not show clear evidence that countries which fully deregulate their labour markets consistently perform better on unemployment than countries which prefer a mix of moderate deregulation and active labour market programs.

[Since I completed my book even a free market economist Judith Sloan seems to have arrived at a similar conclusion. She and Wooden conclude (in a 1998 paper for a Reserve Bank conference that “no definite conclusions” can be drawn about the relative employment performance of economies with decentralised wage systems and poor worker protection laws (like the UK and New Zealand) and economies with stronger wage and worker protection laws (like Australia and the Scandinavian countries).]

To sum up, a progressive liberal agenda can produce not only very similar outcomes for GDP per head as a radical free market agenda, it can also produce broadly comparable outcomes for employment. There need not be any significant economic sacrifice involved in treading a socially sensitive path.

The social costs of hard liberal policies

What of the argument that hard liberal policies are really quite benign socially and ultimately help the poor.

The centrepiece of hard liberalism is labour market deregulation (that is, total removal of minimum wage regulations, lower jobless benefits and a relaxation of worker protection laws). And the argument that it helps the poor is complex, but it is worth taking it step by step. It runs like this:

First, it is said, labour market deregulation policies help the unemployed, who are the poorest in the country. This is quite true but wage elasticities tend to be low – that is, you would need big wage cuts to make a strong impression on unemployment. As a result, my book argues, deregulation would make some unemployed better off but many low paid workers much worse off, with the overall effect being a decline in the living standards of this group as a whole. Sue Richardson and Ann Harding have recently tackled the same issue more systematically and come to a similar conclusion.

In any case, the issue is not whether we do something about reducing unemployment but how – and, in particular, whether we do it through deregulation or some other way. This “other way” I advocate in the book is active labour market and regional programs.

This brings me to the second claim – that such programs do not achieve good employment outcomes. I have already rejected this claim. In my book I argue that if judiciously selected to fit the economic circumstances, they are potentially at least as effective as deregulation in getting the long-term unemployed back into jobs.

So the issue boils down to who bears the costs. Under deregulation, the cost is met by low-paid workers (who have to accept lower wages to compete with the unemployed), welfare beneficiaries (as welfare benefits have to decline to avoid aggravating poverty traps). Under a regime of active labour market and regional programs the costs are, for a time, borne by taxpayers at large, that is, according to capacity to pay. I have no doubt in my mind which is more equitable.

Moreover, as already noted, the cost to taxpayers is probably short-lived as the programs pay for themselves in the longer term.

The final claim is that everyone gains in the long term. This is really hard to stomach. Hard liberals would like us to believe that the benefits of their policies would trickle down to everyone in due course. The experience of hard liberal reforming countries suggests that poorer families do not share at all in the benefits of economic growth. Countries like the UK, New Zealand and the USA, which adopted more radical reformist policies than Australia, have experienced much greater earnings dispersion (Sloan p.19), and even after tax and transfers, they are still worse off in absolute terms today than they were in the early 1980s (see, for example, on the UK, Argy, p.202).

At this point, hard liberals have a fall-back position. They say it's up to governments to take appropriate measures later if they become worried about rising inequality. However, the evidence suggests that later on is too late. Unless structural reform deals up front with short-term distribution effects, these tend to lock in a certain pattern of distribution, for example, concerns about budgets and about poverty traps make it difficult to take subsequent remedial measures through the social security system (Argy, pp.30, 172, 194).

The weights attached to social harmony and economic efficiency

What I have said so far suggests that:

- socially progressive economic policies do not involve a major efficiency cost;
- radical free market policies do hurt the poor, certainly in the short term, and even probably in the long term;
- pursuit of economic freedom does not ensure equity as we in this audience understand it.

Although I have put my views firmly about the relative efficiency and social costs of hard and progressive policies, I do accept that there is always a degree of uncertainty about such issues. Economics is not a precise science. So, in the end, the judgment must be made by governments. They must decide on the balance of risks. Do they take a risk with economic performance or with social harmony?

In reacting to this question, they should keep in mind Bishop Michael Challen's wise words of caution in his 1994 Oration. He said that in the public debate about economic issues and reform there is too much of a tendency for people to "perceive life as being shaped primarily by economics"; and there is a need to "widen the context within which economic issues are analysed and debated".

I wholeheartedly endorse this view and my book is a modest attempt to respond to his concerns. It argues that it is quite wrong to judge an economic reform simply in terms of what it does to GDP per head – that is, the size of the national cake. Suppose, for example, that (contrary to all my earlier arguments) hard liberals are right and their policies do produce better outcomes for GDP per head and even employment. Suppose also that, in order to achieve the better economic outcomes, hard liberals have to reduce wages of unskilled workers, reduce welfare benefits or further tighten eligibility, reduce the flexibility of trade unions, weaken workers' rights and standards (for example, on health and safety, unfair dismissals, equal opportunity and discrimination), lower the product protection available to consumers, allow business more freedom in polluting the environment, and so on. Would it mean a happier Australia? Would Australians as a whole be better off?

Bishop Challen is absolutely right to say we need to widen the debate to bring social goals explicitly into consideration. It means we must give social cohesion and harmony a much bigger place

in policy thinking – right up front and not as an after-thought. Where winners and losers can easily be quantified it means full compensation of people already disadvantaged (and a guarantee that the initial effects of compensation will not be later undone). It means being prepared to go for a “second best” reform option and to sacrifice a little efficiency for the sake of social harmony.

What does it all mean for social policy?

Governments should continue to set specific economic targets such as on GDP growth, inflation, external debt, competitiveness, fiscal deficits etc. But if they want to make sure that success on these fronts leads to genuine improvements in human well-being, the economic targets must be matched by a set of specific social targets covering reductions in unemployment and poverty levels and improvements in quality of life indicators relating to the natural, living and working environment.

Organisations like the Brotherhood can play an important role in helping governments to define the appropriate social goals. As well, there would need to be a broad-ranging implementation strategy encompassing:

- a social policy framework to deliver compensation and redress existing social injustices;
- an industrial relations framework to safeguard the bargaining power and rights of workers;
- a framework of labour market support programs to supplement passive welfare assistance;
- a framework of international cooperation to minimise the risk of competitive cuts in social and worker protection standards, treating such actions as equivalent to “dumping”; and, as parts of this framework would cost money, so there would need to be a financing plan, including provision for income tax base broadening measures and hypothecated

levies, and an education campaign to explain the need for these things.

The challenge for Australia

It is important to impress on governments that economic reforms are only socially and politically sustainable if they are consistent with social harmony. Once they breach the fine line of social legitimacy, economic reforms tend to get undone.

If we are lucky, “getting undone” may only mean an orderly retreat à la Tony Blair. At least most of the good bits of reform are retained. However, there are two other more worrying scenarios. The first is a severe electoral backlash which leads to a search for snake-oil economic remedies, with governments throwing out good reforms with the bad ones. And then we are all the poorer. The second and most dangerous scenario is a major increase in social tension and disorder, with the emergence of a “scapegoat” mentality – a society in which minority groups feel alienated and the rich become dependent, as in the USA, on a growing army of private security guards and so on.

The rise of One Nation illustrates both dangers.

The moral is that it is good economics to show social sensitivity. By being purist and insisting on first best all the time, we risk ending up with tenth best.

Conclusions

To sum up, let me leave you with five messages.

First, economic policy should not focus simply on economic outcomes. It should be about improving our society.

Second, our preoccupation with narrow economic issues poses threats for the fabric of our society. Although Professor Stuart Macintyre (1995) was right to remind us in his 1995 Oration that our fair go society was never an inclusive one (excluding non-whites, indigenous Australians and discriminating against women for a long time), we can still claim to have today a unique consensual, compassionate society. It is all at risk if we go down the hard economic liberal path.

Third, the hard liberal approach to economic policy is economically self-defeating in the long term.

Fourth, an approach to economic policy which gives as much regard to distribution, the quality of life and the ecology as it does to GDP and other economic indicators is perfectly consistent with strong economic performances and good employment outcomes (provided the right instruments of government intervention are used).

Finally, if we do have to sacrifice a small gain in GDP in order to ensure good social outcomes, then so be it. We will have preserved a decent society. And isn't that far more precious than a few decimal points of GDP

Glossary of terms used

“Economic liberalism” is simply a belief in the merits of a market economy relative to a centralised, government-run economy. “Economic liberalisation” means more of the market and less of government.

“Efficiency”, as used here, relates to how much output value the nation gets out of a given input of productive factors.

“Economic freedom” is about the degree of freedom people have to do their own thing with their property, provided they do not hurt others, and about how much of the rewards from their efforts and their property they are allowed to keep. Economic freedom is often viewed as a means to greater efficiency, but it is also seen as an equity goal in its own right.

“Vertical distribution” relates to the degree of inequality of incomes and wealth among households.

“Social harmony” or a “consensual society” is about ensuring no one section of the community is a consistent loser from the process of change and reform and that the concerns of all sections are given equal weight in policy deliberations. In such a society there is broad acceptance of the legitimacy of the policy making process, so that even those who disapprove of the outcomes accept that the policy processes are fair, honest and transparent.

REFERENCES

- Argy, Fred (1998), *Australia at the Crossroads: radical free market or a progressive liberalism?* Allen & Unwin.
- Challen, Michael B (1994), *Grand beliefs – radical responses*, Sambell Oration, Brotherhood of St Laurence.
- Macintyre, Stuart (1995), *What happened to Compassion?*, Sambell Oration, Brotherhood of St Laurence.
- Piggott, John and Chapman, Bruce (1995), 'Costing the job impact', *Economic Record*, no.71, December.
- Richardson, Sue & Harding, Ann (1998), 'Poor workers? The link between low wages, low family income and the tax and transfer systems', paper presented at CEPR conference 16-17 June.
- Strombeck, Thorsten, Dockery, Michael, & Ying, Wiwi (1997), *Labour Market Programs and Outcomes*, Centre for Labour Market Research, Curtin University, June.
- Stretton, Hugh (1996), *Poor Laws of 1834 and 1996*, Sambell Oration, Brotherhood of St Laurence.
- Wooden, Mark & Sloan, Judith (1998), 'Industrial Relations Reform and Labour Market Outcomes', RBA Conference, 9-10 June.

