

PRIVATE ENTERPRISE

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In February 2009, when a financial crisis had developed, a prominent Australian politician wrote an article that included the following statement:

“FROM time to time in human history, there occur events of a truly seismic significance, events that mark a turning point between one epoch and the next, when one orthodoxy is overthrown and another takes its place. The international challenge for social democrats is to save capitalism from itself.”¹

No surprise that the prominent politician was Australia’s then Prime Minister, Kevin Rudd. His scribbblings displayed a lack of historical knowledge when he wrongly promoted government as the principal saviour from the global financial crisis. Rudd portrayed US President Roosevelt as an example because he acted quickly to pull the US out of recession in the 1930’s with a large increase in government expenditure and other government interventions. But Roosevelt failed to recognise the importance of private enterprise. Indeed he attacked big business and encouraged unionism.² This undoubtedly contributed to the US being the only country to have a double dip recession in the 1930s. By contrast, Australia cut government spending and between 1931 and 1939 quite strong growth returned with lower unemployment.

Rudd’s portrayal of saving capitalism from itself also overlooked the fact that many financial crises, and recoveries therefrom, occurred before capitalism became widespread and well before governments adopted policies to save us all. History also shows that countries adversely affected by such crises showed the strongest economic recoveries when the structure of their economies was based on private enterprise. Calculations by expert economist Angus Maddison of growth in incomes per head from 1820-1992³ show that, over that period, the four mainly private enterprise economies of the US, Canada, Australia and New Zealand did best in increasing their incomes per head 17 fold. The more government oriented 12 major European countries increased theirs 13 fold and, at the bottom, the more tribal 10 African countries by only 3 fold.

My thesis is that, although subject to fluctuations and recessions, economies perform best where private enterprise is greatest. By “perform” I mean socially as well as economically. I

¹ “The Global Financial Crisis”, The Monthly Essays, February 2009. According to Wikipedia while “there is no consensus on the precise definition of capitalism... there is ... little controversy that private ownership of the means of production, creation of goods or services for profit in a market, and prices and wages are elements of capitalism ... The designation is applied to a variety of historical cases, varying in time, geography, politics and culture. Capitalism, as a deliberate economic system, developed incrementally from the 16th century in Europe ... became dominant in the Western world following the demise of feudalism ... and in the 19th and 20th centuries, it provided the main means of industrialization throughout much of the world.”

² Shlaes, Amity, “The Forgotten Man”, 2007

³ “Monitoring the World Economy” 1820-1992 published by the OECD.

have reached that conclusion after my experience of 28 years as a federal Treasury officer and from my over 20 years experience in the world of think-tanks following my resignation from Treasury in 1987. The circumstances of that resignation and my move to think-tanks are highly relevant to any consideration of the relative virtues of private enterprise.

When I started in Treasury in 1958 I had a somewhat romantic belief that active interventions by governments in both economic and social relationships had considerable potential to improve society. But I soon realised that measures designed to improve the economy and society do not necessarily work out in practice as they were supposed to do. I also came to understand that governments attracted many people whose objectives are directed less to promoting the national interest and more to their own more narrow personal and political interests.

Let me give you one or two examples. The Whitlam government came to office with a bunch of ministers with no experience in governing but with each having plenty of ideas about what they believed could be achieved through government. That produced a very large increase in government spending in 1974-75 (20% in real terms) and in 1975-76 (15.7%) but it also produced a slowing in growth in the economy (to 2.0% in real terms in 74/75 and then 3.0%) and a large increase in prices (17.0% and 15.1%) that clearly indicated an economy out of control. The Rudd government's very large increase in government spending in 2008-09 (13.5% real) in response to the global financial crisis was also followed by only a relatively small improvement in economic growth in 2009-10 (2.3% cf 1.4% in 2008-09) and, in some ways more important, serious doubts about the usefulness of much of the spending.

Now we face an almost complete reversal by the government of that spending splurge, with a promise to limit the increase in government spending to no more than 2% pa in real terms and a commitment to achieve a budget surplus in 2012-13. Many other countries also have programs to reduce spending and deficits because of their debt problems, although the recent re-emergence of financial uncertainty may limit this so-called fiscal consolidation. President Obama has said that his latest proposed tax cuts and spending increases⁴ will be fully funded but recent political disagreements in Washington will make this difficult to achieve.

Although the Howard government experienced the Asian financial crisis of 1997, and although it did implement a big increase in spending in one year in the early 2000s, government spending fell over its whole period in office. But that was entirely due to the fall in interest rates and the consequent cost of servicing government debt. Despite the Liberal Party's stated belief in small government, Howard failed to seize the opportunity to reduce other spending even though the economy was growing strongly and unemployment fell from 8 per cent to just over 4 per cent. And even though his government did make tax cuts, the overall burden of taxation in real terms actually increased slightly - in other words the tax cuts were simply returning to taxpayers the increase in taxes due to inflation. The Howard government has a good story to tell about the rate of economic growth⁵ but that story could have been much better.

Why have I focused attention on the size of government and its spending when talking about private enterprise? The basic reason is that the relative roles of the two raise questions fundamental to considering the kind of society we have or should have. Yet many

⁴ About \$US 447 bn, which is equivalent to about 3% of US GDP.

⁵ On average income per head income increased by 2.4% pa

governments seemingly fail to accept that it is predominantly private enterprise that determines how well the economy operates. That failure is evident around the world today and is reflected in the emergence of the Tea Party movement in the US. I believe, incidentally, that some say the “Tea” in Tea Party stands for “taxed enough already”!

My experience in the Treasury and in working in US think-tanks led me to decide that there would be better opportunities for promoting the cause of private enterprise if I moved out of the public service into a think-tank. And that is what I have been doing since I resigned from Treasury in 1987.⁶ The public choice theory⁷ developed in the US provides a basis for arguing that there is a need to respond to the inbuilt tendency in our political systems for politicians to increase the size of government. How is this said to occur? The thesis is that politicians are able make promises to marginal voters - but without upsetting the electorate provided the cost of implementing such promises is relatively low. Hence, it is argued, there is an upward creep in government and a tendency for policies based on promises to fail.

A striking example of government failure was the mess produced by the attempts at economic planning in Eastern Europe and the old Soviet Union. But on a smaller scale we Victorians also experienced government failure in the 1980s. I became closely involved then in the debate on government activity when I organized a group of Victorian business associations to form a group identifying desirable reductions in the role of government. The policies that group advocated had a significant influence on the Kennett government reforms from which we are still benefiting.

The recognition that government manipulation of the economy is also much harder than Keynes thought in the 1930s has reduced the number of proponents of the thesis that there is a fundamental flaw in capitalism. Even the idea that increases in government spending are needed once a recession actually arrives seems to have taken something of a hit. In 2009 both the US and Europe experienced large falls in GDP (-2.6% and -4.1% respectively) and each responded with large increases in government spending (3.2 and 3.9 percentage points of GDP respectively). But “normal” or average growth has not been restored and the underlying problem of excessive debt in both the public and private sectors remains.

I should add here that, in considering the financial crises over the past 80 or so years, the role of central banks must be assessed. Those banks are government agencies and, as such, are subject to government influence.⁸ But central banks are supposed to exercise control over both inflation and the extent of borrowing. In my view they failed to exercise sufficient constraints on the extent of private sector debt and share much of the blame for the global financial crisis.

Private Enterprise Supports Income Redistribution

⁶ In May 2005, for example, I was invited by the Australian Chamber of Commerce and Industry to examine the scope to reduce Commonwealth spending. My assessment was that there was scope to save \$19.5 bn, a cut of 8.2% then equivalent to 2% of GDP.

⁷ Public choice theory is based on the idea that political decision-making can result in outcomes that conflict with the preferences of the general public. For example, many advocacy group and pork barrel projects are not the desire of the overall democracy. Despite this, it may pay for politicians to support such projects if it will benefit them and be difficult to organise substantive opposition.

⁸In Australia the Reserve Bank Board decides on levels and changes in interest rates but within a economic framework set by the government that focuses primarily on preventing high rates of inflation.

My support for private enterprise does not mean that I seek a completely laissez-faire situation in which government plays little role outside the operation of defence and police forces. As an advocate of private enterprise I certainly favour allowing markets and competition to operate more freely than at present. But that still means governments have a role in regulating both the economy and society including by using the taxation and social welfare system to effect some redistribution of income. But there is now widespread recognition that this redistribution has gone too far.

In a modern society with a relatively high degree of education, individuals should be relatively free to pursue their own interests and should be better able to look after themselves. A better balance is needed between the equity of assisting those on low incomes and the equity of rewarding individuals for their economic contribution.

The perception that the "fairness" of society would be improved by reducing inequalities is part of the supposed Australian culture of egalitarianism – the idea of giving everyone a "fair go". This is also reflected in the popular criticism of business chief executives being paid salaries or their equivalent of \$5 million a year and in some cases more than that.

Theorizing by academic and other economists also favours wider distribution and surveys of economists generally show a majority supporting actions to reduce existing levels of inequality. This is typified in the recent report that the leader of the UK Labour Party has suggested to his colleagues that their summer reading should include a book by two academics entitled "Why Equality is Better for Everyone".⁹ However, such theorizing fails to recognize the desirability of maximizing the use of the most intelligent and physically capable in society. Football teams do not win with equalization policies!

In Australia since 1994-95 the proportion of disposable household income going to those categorized as receiving "high" incomes has increased from 37.8% to 40.2%.¹⁰ However the ABS acknowledges that its survey underestimates incomes in the lowest income quintile, which indicates that this apparent increase in inequality is overstated. It also needs to be recognized that this is a snapshot in time and that most people move up the income scale during their working lives.¹¹ Incomes at almost all levels also generally increase in real terms except in recessions and the low income group in the ABS survey increased its income by 25% over the period from 1994-95.

But what about the calculations showing that up to 20 per cent continue year after year to live below the poverty line? These poverty line figures are highly misleading and do not in fact mean that we are stuck with a large number living in perpetual poverty. The poverty line is constantly being raised at about the same rate as national income, which means that the

⁹ The full title is "The Spirit Level: Why Equality is Better for Everyone". The thesis, apparently, is that that equality produces happier people and better-functioning societies. Another theoretical justification for greater redistribution is the notion that those on low incomes get more satisfaction from spending an extra dollar than do those on high incomes. Adoption of a policy designed to equalise all incomes would, however, be a sure recipe for revolution!

¹⁰ ABS Household Income and Income Distribution, 6523.0, 2009-10. The mean income of those in the highest income quintile was \$88,608 pa and in the lowest quintile was \$16,328 in 2009-10, an increase of 25% on the figure for 1994-95. It should be noted that the ABS explanatory notes indicate that the survey underestimates incomes in the lowest income quintile and states that "It can therefore be reasonably concluded that many of the households included in the lowest income decile are unlikely to be suffering extremely low levels of economic wellbeing. Income distribution analysis may lead to inappropriate conclusions if such households are used as the basis for assessing low levels of economic wellbeing." For that purpose it suggests a better guide can be provided by examining expenditures by income groups.

¹¹ A UK Government report on *Households Below Average Income 1994/95 - 1997/98*, for example, showed that only 4 per cent of households were stuck in the bottom income quintile for the whole of the period covered by the report (The Economist, 23 October 1999).

standard of “poverty” becomes ever-higher and that, while the population increases, there will always be *growing* numbers of “poor” as defined.

Of course, believers in private enterprise do agree that governments should assist those on low incomes and that higher income earners should be net contributors. But they are also concerned to minimize the many adverse effects from government involvement in redistributing incomes.

One major problem is the growth in welfare dependency. The proportion of the working age population on income support has increased to around 20 per cent and now extends to over 2.7 million people.¹² At the end of the 1980s only 15 per cent received income support and in 1969 it was only 4 per cent. This increase has occurred while incomes per head have risen strongly in real terms and the principal reason for it is not increased need or poverty. It is action by political parties that make it easier to obtain benefits – *and* for politicians to obtain votes! If we count in education and health benefits, households with incomes in the top two quintiles receive over 30 per cent of government benefits and allowances.¹³ As it is these households that pay most of the taxes, the effect is that many of them pay taxes with one hand and receive back benefits with the other. This is called churning and illustrates dramatically what is called “middle class” welfare and where there is potential for reform.

Competition, Privatisation and Monopolies

Ensuring a competitive environment is another issue where private enterprise believers have no in principle difficulty in supporting government regulation and intervention. Preventing monopolies or at least regulating them helps to protect consumers and to level the playing field for those who want to be competitors.

This of course also means support for the privatization of monopolistic public sector enterprises. Such action will expose the enterprises to competition of various kinds and is most likely to produce a more efficient use of resources that provides a better quality service. There is no doubt that Victoria has benefited from the privatization of electricity under the Kennett government and the resistance up to now to such privatization in NSW has basically reflected the strong connections between the Labor party and the union movement in that state. World- wide there have been over 15,000 privatisations in recent years, including even under Labour in the UK.

Some complain that privatizations mean that low income groups have to pay a market price. However if politicizations want customers of former state enterprises to have access to their services at lower prices, this can be achieved by providing low income consumers with subsidies either directly or through the enterprise. Such subsidies are in fact quite widely available although the need for them is dubious given that those on low incomes are provided through the social security system with the purchasing power needed to allow the basics to be obtained.

¹² An estimate made by the Department of Family and Community Services for the July 2000 report on *Participation Support for a More Equitable Society* by the Reference Group on Welfare Reform put the figure at 22 per cent. The estimate was not published in the report and covers direct benefits only.

¹³ “Commonwealth Spending (and Taxes) Can Be Cut – And Should Be”, A Discussion Paper by Des Moore, commissioned by the Australian Chamber of Commerce and Industry, May 2005. This paper shows that the benefits received in 1998-99 by households with incomes in the top two quintiles were equivalent to 47 per cent of the taxes paid by them.

Supporters of private enterprise also acknowledge that competition from overseas should be accepted. This is a highly topical issue. The government is under pressure from unions to introduce measures to provide additional protection to manufacturers of cars and textiles from overseas competition because the increase in Australia's exchange rate caused by the boom in mining is having increasingly adverse effects on manufacturing (and other areas). Since 2008 employment in manufacturing has fallen from 9.9% to 8.7% of total employment but we are shifting resources into more "efficient" areas and economic growth is continuing. The relative decline in manufacturing and the growth in service industries has been happening for a long time and will almost certainly go further.¹⁴ Private entrepreneurs and their employees have to accept that over time changes will occur in the structure of the economy.¹⁵

Environment and Education

The environment and education areas provide further examples of the in-principle acceptance of government intervention by supporters of private enterprise. The basic logic here is that, while such intervention imposes costs on individuals or impinges on their individual freedom, it produces more-than-offsetting benefits for the community at large.

Government intervention is justified to ensure free and compulsory primary and secondary education because there are net "spin-off" benefits both economically and socially from having an educated community. However, on both economic and equity grounds limits to government assistance for higher education are needed: qualified individuals have ample incentive to invest in educating themselves as graduates generally earn higher salaries. There is also a case for having privately run universities and for supporting private schools and hospitals. It is not widely realized that Australia is one of the few countries in the world to benefit from having extensive systems of private schools and hospitals. These bodies not only save the taxpayer considerable sums but provide a competitive framework that helps lift standards.

Government intervention to regulate and control the level of pollution is also usually appropriate because individual factory or car owners have no economic incentive to limit the extent to which they emit pollutants and there would otherwise be excessive pollution. I hasten to add, however, that the government should not be controlling emissions of carbon dioxide on the false ground that they are some kind of pollutant that is causing dangerous increases in temperatures. The decision to apply such controls is based on faulty science.¹⁶

Industrial Relations

There is a similar objection to the high degree of regulation of employer-employee relations imposed under legislation implemented by the government and applied by the so-called Fair Work industrial tribunal. The perception that fairness requires such regulation is quite wrong. It reflects the false belief that, unless the government regulates the operation of the labour market, there will be a bargaining imbalance between employers and employees that will lead to exploitation of employees and a greater inequality in earnings.

¹⁴ Not so long ago 20% of employees were in manufacturing. In the US manufacturing provided one-third of all jobs in 1950 but that is now down to just above Australian levels.

¹⁵ A similar argument is occurring in Europe with the Germans refusing to move to having its own exchange rate partly because that would be higher than the euro and would initially cause losses in some industries. However, over time their economy would adjust to the changed situation, just as it has in Australia. If this isn't allowed to happen there will be continuing crises in Europe.

¹⁶ For a range of papers analysing this false science, see my web site at www.ipe.net.au

However, this idea is based on a widespread failure to understand that, with over 800,000 employers competing for the services of over 10,000,000 employees, there is little scope for employers to impose conditions on workers. The regulatory system imposes unnecessary costs on employers, seriously inhibits them from managing their businesses, and limits the employment of low skilled workers. For example, the setting of the minimum wage at a high level relative to the average wage has almost certainly kept out of employment many with low skills and earning capacity, convicting them to reliance on social security.¹⁷ It is also absurd to try to protect the wage levels of low wage earners when the majority of them live in households in the upper half of the income scale. It is the function of government social security, not wage decisions by tribunals, to protect the incomes of those in need.

Quality of Life

Finally, can private enterprise be blamed for the perception that the quality of life has declined? There is little evidence to support such a view. It probably reflects concern at the increase in competition and the associated perception of increased stress. Yet Australians have continued to become healthier, life expectancy has increased steadily and the death rate from almost all diseases (including cancer) has fallen.

Conclusion

I hope that what I have said will help explain my support for a bigger role for private enterprise. Perhaps I can list four main points. First, private enterprise does not mean a free-for-all laissez-faire system but it should mean a major reduction in government intervention in industrial relations, in the provision of middle class welfare and in policies designed to reduce the use of fossil fuels. Second, apart from their involvement in defence and policing, governments do have a role in instituting some form of redistribution of incomes and of the provision of education, as well as regulating monopolistic practices. Third, reduced government would improve economic efficiency and living standards. Fourth, there would also be an improvement in equity resulting from the elimination of government assistance to particular groups that have no needs basis for it.

¹⁷ In 1907, Justice Higgins became famous when he pronounced in the Harvester case the need for a minimum wage for an unskilled worker, his wife and three children. This allowed the Commission to portray itself as a protector of the low paid and a provider of social welfare. However, by setting the wage above market rates, employment was deterred.