

THE IAC REPORT

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The 1987-88 IAC Annual Report quantified the taxation effect of protection. This 'protection tax' is a huge 6.2% of household expenditure. 6.2% is an underestimate because some forms of protection are not yet analysed. It is mildly regressive. It is a most inefficient tax and the cause of a huge and needless reduction in living standards---more of that anon. Unlike other taxes, it does not appear openly in the budget, nor does it finance government expenditures, but is paid through higher prices to privileged groups in selected occupations. Thus the tax has been largely hidden from all but its beneficiaries. People who once accepted it but at the same time objected to other forms of consumption tax, such as Mr Keating's 'Option C', were, in short, hypocrites. Fortunately, there are few of them left.

The IAC has made similar calculations before, but for the first time the taxing effect of protection has become a source of outrage. There has been a fundamental change in public opinion. There is still a protection debate, but it is no longer about whether protection will be reduced---it has shifted to 'how soon' and 'how fast'.

The Report was able to discuss real progress. The 6.2% protection tax is expected to fall to 4.4% by the mid-1990s as a result of the current programs of assistance reduction. The protection from competition afforded industrial processes is measured by 'effective rates of assistance'. The effective rates for the manufacturing sector are estimated to decline from 19% to 11% by the mid-1990s and for the agricultural sector, from 11% to 9%.

Protection reduces living standards. For the first time, a report predicts that protection reductions that are already in the pipe line will make possible appreciable rises in living standards. (These may be traded for lower debts.) 'Simulations with the ORANI model of the Australian economy indicate that the combined effect of the May Statement and other phased reductions will be a real GDP gain of around \$1.2 billion per year by the mid 1990s'---i.e. about 15% of the annual current account deficit which will not have to be financed by limiting living standards.

However, the \$1.2 billion is a considerable underestimate. As the IAC points out, the model captures only the 'static' gains from reductions in protection, but not the 'dynamic' effects involving changes in the productivity of individual firms. The Report suggests that for every 1% gain in productivity, a further \$700 million is added to the GDP. Observations of other nations and other times suggest that the dynamic gains, including those arising from incentives to do things that have not yet been thought of, are more important than the effects that can be captured in models.

What explains the turnaround? Part of the explanation lies with the nature of the IAC. It is an unusual government agency in that it has no executive function and therefore does not have clients who 'capture' it; nor does it defend empires and past errors. In fact it has nothing but the quality of its argument with which to justify its existence. And that argument is as exposed to praise or ridicule as argument can be. By reporting to parliament, as opposed to the government, the IAC educates the public and is disciplined by it. The IAC has criticised government policy in public---indeed it has hardly done anything else. Armed with facts from a disinterested and therefore credible source, public opinion has changed and political opinion has followed public opinion.

Even so, the same report released a few years ago would have had some company managers and union leaders spitting pure vitriol. They were always able to ascertain enough of the facts to know that their arguments were, at best, special pleading. Why are they less emotive and less self-seeking now?

One of the reasons is surely that they have now experienced protection reduction and seen it in other countries. The sky does not fall in. They and their enterprises are far more adaptive than they thought they were.

Protected manufactures no longer feel that they are being singled out. They have experienced the advantages of bank deregulation---that is, the removal of the protection the big banks once enjoyed. They have watched as service improved, and banks prospered and found the courage to take on international markets. It is now understood that free traders are not just talking about the direct barriers to international trade, such as tariffs, but also about such indirect impediments to international competitive ability as the domestic airline agreement, coastal shipping costs, the Telecom monopoly and so on. The rural sector, once seen as the archenemy by manufacturers, is also accepting deregulation.

Another reason is that as the balance-of-payments problem has grown, the trade-off between living standards and a quiet life protected from competition has changed. In the past we had to contemplate living standards which would rise more slowly than those in other countries---that is, falling relative standards. Some of us accepted that. Now that 3 to 4% of all that we produce---20% of our export income---is spoken for to pay interest on net foreign debt, we face the likelihood of incomes falling in absolute terms. That is not

as easily accepted---the prospects offered by an inward-looking, sluggish economy have become just too awful.

The most pressing question now is can we, in view of our balance-of-payments problem, wait until the mid-1990s to reduce the protection tax by only one third, or must we press on with a faster rate of reform?

The debate about the costs of protection has been won. No-one any longer demands more of it or threatens politicians with mindless demonstrations. The IAC no longer operates from an intellectual bunker. When I visited it recently I felt that some of the staff missed the esprit de corps that came of being sniped at by people whom they knew were wrong. I wonder how Bert Kelly feels about being popular?

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