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O N T H E D R Y S I D E

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RICH LAND : POOR LAND

Self-justification is a favourite professional pastime; it is therefore no surprise that Arnold C. Harberger, sometime economic adviser to the United States, Canada, India and several Latin American countries, should say that politicians who listen to economic advisers govern better than those who don't. However, this apologist offers evidence. He lists thirteen warnings used by nearly all economic policy advisers and then compares these with the analyses of twelve economists, each of one of twelve economies.

Each warning is no more than the most conventional of economic wisdom but at some stage almost every one has been ignored by the good and the great of every country. However, those governments which ignored them least, as in Taiwan and Japan, increased their people's living standard most; and those which ignored them most, as in Britain, increased living standards least or even reduced living standards as in Ghana and Uruguay.)

The thirteen warnings, with relevant Australian reminders in brackets are :

- Don't rely on detailed technical projections. (Remember how the resources boom was about to fix the fiscal problem.)
- Don't lose control of the budget. (Remember 1973, 1982 and 1984 budgets.)
- Keep inflation down to the rest of the world. (Australia has been over the OECD average most of the time since 1973.)
- Take advantage of trade. (Need I comment ?)
- Keep all rates of protection about the same. (Some Australian effective rates exceed 100%; some are negative.)
- A government which won't reduce import barriers should offset them with export subsidies. (This would cost Australian taxpayers at least $5,000 million per year.)
- Keep taxes as simple and non-distorting as possible. (Australian income and payroll tax by these tests are bad taxes.)
- Avoid excessive income tax rates. (Australian rates are among the highest.)
- Avoid tax incentives (like the Investment Allowance.)

- Avoid price and wage controls. (The Prices Justification Tribunal once fixed maximum prices and the Arbitration Commission sets minimum wages.)
- Avoid quotas, licences and similar quantitative restrictions. (Import quotas, Two Airline Agreements, taxi plates etc. abound.)
- Make public enterprises behave like private enterprises charging and paying market prices and never bale them out with public money. (Telecom, ANL, ANR, TAA and others don't come close to meeting this test.)
- Avoid arbitrary confiscation (like Paul Everingham's recent confiscation of Federal Hotels' casino interests.)

I'm not sure we deserve to pass Mr. Harberger's little examination but let us none-the-less award ourselves a C; some other countries aren't so smart either.

Not only are these warnings the stock in trade of most economic advisers but they have no heavy political overtones and should be as acceptable to Social Democrats as to Christian Democrats; Conservatives as to Labourites; Democrats as to Republicans; Australian Laborites as to Liberals.

Of the twelve nations Ghana was the most tragic failure, and provides the clearest negative object lesson. In the early 1950s Ghana was still under British rule, her economy was quite open and she had one of the highest living standards in Africa. Although by that time Britain was already determinedly set upon her own ruin, to her credit, to this day, she has not imposed her worst habits on her colonies. By 1980 Ghana's living standard had fallen by nearly one quarter.

"The story of Ghana's debacle is partly the story of discredited theories of development, especially the 'big push' and import substitution approaches... " Ghana is a model of central planning and industrial development protected by trade barriers. By the late 1960s fiscal deficits were ranging from six to nine percent of GDP, were reduced in the early seventies, but are now ten to fifteen percent. (Australia is now about seven to eight percent.)
A combination of minimum wage legislation, controlled interest rates, an over valued exchange rate, and investor incentives, including duty free import of capital equipment to an otherwise protected market, conspired to make labour expensive and capital intensity cheap. Negative effective rates of protection for several export industries and over 200% positive protection for several import-substituting sectors

crippled trade. (Although Australia is in much better shape than Ghana, it is not because we have not followed the same path, but merely that we have followed it less far.)

At the other end of the scale of twelve was Taiwan. Until 1954 Taiwan followed the same path as Ghana later followed - high trade barriers, inflation and low real interest rates. Since then trade barriers have been jettisoned so that trade has increased thirty-five-fold; inflation has been controlled and interest rates have been high so that domestic savings are now over 30%; and the real living standard has increased more than four-fold.

Of the industrialised countries, Harberger writes : "the experience of the more advanced countries is simply that, viewed from the standpoint of economic criteria, governments can grow too big .... not that large and pervasive government should necessarily be avoided, but rather that large and pervasive government carries with it a significant cost."

Governments have goals which are not economic and there can be no doubt that cabinets may ignore any advice, but there is also no doubt that they ignore some advice at considerable cost to their people. Economic advisers are not always right, but so long as they stick to economic questions they will be right far more often than laymen.

Power is heady wine and intoxicated by it ministers, instead of explicitly accepting the economic costs of rejected economic advice, insist that the advice itself is wrong and seek out an adviser who will tell them what they want to hear. They back their own judgement against an established discipline and two hundred years of accumulated knowledge - surely an act of hubris meriting the wrath of the Gods.

A civil servant who offers conventional advice based upon his special expertise serves his country best. A policy adviser who makes it too easy for his ministers by offering them a range of increasingly politically soft options, in the long run, serves his country ill. Cabinets of all political colours who are not sufficiently humble to listen to the advice of the policy professionals cost their countries dearly. In Australia, the worst mistakes have been made against Treasury, Reserve Bank and IAC advice.