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Economic liberalism: fall, revival and resistance

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Introduction

Until the last quarter of the 20th century, it seemed reasonable to interpret modern political history in terms of the fairly steady advance of socialist and social democratic political ideas and policies. From the mid-1970s onwards, however, this trend was halted and at least partially reversed. Socialist and social democratic ideas, previously dominant in policy debate, were displaced by market-oriented ideologies variously referred to as Thatcherism, economic rationalism, neoliberalism and the Washington consensus.

As usual with dominant ideologies, these labels are most commonly used in a pejorative sense, by opponents of the dominant view. Supporters of the dominant viewpoint have commonly preferred to avoid any ideological label, and to treat their policy approach as self-evident 'common sense'. Perhaps the most popular term used in favorable descriptions of the free-market approach has been 'economic liberalism', and, because this term is also reasonably accurate as a description, it will be used in this chapter.

There are differing views on the extent and significance of the re-emergence of economic liberalism. Henderson (1995, 1998) sees economic liberalism as the 'hero of the story' of policy reform since the 1970s, and presents Australia, during the 1980s, as one of the leaders in the adoption of economic liberalism, though somewhat behind the United Kingdom and New Zealand. By contrast, Keating (2004) downplays the influence of economic liberalism, particularly in Australia, and argues that the adoption of market-based policy instruments is a pragmatic political response to the combination of limited state capacity and steadily growing demands for state services.

There are elements of truth in both views. It will be argued, however, that the influence of economic liberalism has passed its peak and that the more pragmatic approach described by Keating is increasingly dominant.

The chapter is organised as follows. Section 1 is a historical survey of the fluctuating fortunes of economic liberalism from its eclipse after 1914, to its resurgence in the 1990s, and ending with evidence that economic liberalism has lost ground since the late 1990s, particularly in the English-speaking countries. Section 2 describes the ideology and rhetoric of economic liberalism. Sections 3, 4 and 5 deal with specific aspects of the policy framework of economic liberalism. Section 6 provides a brief assessment of the outcomes generated by economic

liberalism. Finally, some concluding comments are offered.

1. History

1.1 The fall of 19th century economic liberalism

The world economy in the period before 1914 was one of untrammelled global capitalism. Politically, this was the golden age of classical liberal capitalism, which was the dominant ideology of the era, especially in Britain. By 1914, however, the global economy of liberal capitalism faced external and internal stresses which seemed likely to result in major structural changes. The rising economic powers, Germany and the United States, pursued protectionist trade policies, providing an apparent counter-example to the liberal belief in the optimality of free trade.

A more fundamental challenge arose from the socialist movement. Although initially allied with liberals in struggles for democracy and against various forms of arbitrary power, socialists generally favoured large-scale government intervention, particularly as the extension of voting rights raised the prospect that the working class would be able to elect governments that would serve its interests.

The result was a split within liberalism, reflected in the different usages of the term in, for example, Australia and the United States. Some liberals maintained their alliance with socialists and social democrats on economic issues, distinguishing themselves by a greater focus on questions of civil liberty. Others joined the conservatives they had previously opposed (Dangerfield 1935).

Australia was an early example of the shift away from classical liberalism, towards a set of interventions variously characterized as ‘socialism without doctrines’ (Metin 1902, 1977), the ‘Australian settlement’ (Kelly 1992) and ‘the wage-earners welfare state’ (Castles 1994). Key features of the Australian model in the early 20th century included the Arbitration system, tariff protection and substantial reliance on public enterprise. All of these policies were adopted in the early years of Federation and remained in place until the neoliberal reforms that began in the 1980s.

1.2 The rise of Keynesian social democracy

The question of whether the global economic system could have survived these stresses was rendered academic by the failure of the political system to prevent the outbreak of the Great War in Europe, which led to the abandonment of the gold standard and a collapse in world trade. The Great Depression, which followed the stockmarket crash of 1929, ended hopes of a return to the 19th century system. More than this, the Depression discredited liberal capitalism, seemingly forever.

The most effective theoretical challenge to the free-market system was Keynes' (1936) analysis showing how unemployment could remain high indefinitely because of inadequate demand. The most effective practical challenge was Roosevelt's New Deal, which showed that government intervention could yield substantial benefits. Support for Keynesianism and for more extensive systems of economic planning was greatly enhanced by the experience of the wartime planning between 1939 and 1945.

In terms of economic policy, the crucial new element after 1945 was a commitment to full employment. Confidence in the feasibility of this goal was boosted by the comparison between the success of economic planning during the war, and the failure of orthodox free-market policies during the Depression, a point stressed in the White Paper *Full Employment in Australia* (Commonwealth of Australia 1945).

The achievement of full employment was the basis of a broader consensus. All parties agreed on the need for comprehensive systems of social welfare, and on the need for government intervention in the economy, including, in most countries, public ownership of basic infrastructure (roads, electricity, telecommunications and so on) and public provision of human services (health, education and other community services). Although socialist parties formally advocated complete nationalisation of industry, in practice they accepted private ownership of primary industry, manufacturing and wholesale and retail trade.

The result was referred to as the 'mixed economy', and was put forward as a 'third way' in the debate between the polar alternatives of laissez-faire and a Soviet-style command economy.

The adoption of Keynesian economic management in Australia and the associated expansion of the welfare state was overlaid on the existing policies of the Federation period. The result was a policy framework in which the older elements like tariff protection played, at most, a supporting role. Advocates of economic liberalisation, such as Kelly (1992), have commonly ignored this, and argued as if the policies they criticised were uniquely Australian. However, as Smyth (1998) and others have argued, it was the Keynesian-social democratic settlement, and not the residual elements of Federation, that was crucial in guiding policy during the decades of postwar prosperity.

The crisis of Keynesianism in the 1970s

For the developed countries, the period from 1945 to 1970 was unparalleled in the history of capitalism as one of full employment, rapid economic growth and increasing equality of opportunity and outcomes¹. By 1970, however, the strains that would lead to the breakdown of Keynesian social democracy were already evident.

¹ Despite the exceptional nature of this 'golden age', only limited research has been undertaken into the factors that made the 'golden age' possible and the reasons for its breakdown.

The crucial problem was the failure of Keynesian economic management to control the combination of high inflation and high unemployment referred to as stagflation. The crucial event was the collapse of the Bretton Woods system of fixed exchange rates between 1970 and 1972, in the face of inflationary pressures driven by rising wages and US budget deficits.

The collapse of the Bretton Woods system began a process of international financial deregulation, which created intense pressure for deregulation of domestic capital markets². This was accompanied by the abandonment of Keynesian macroeconomic policies, and their replacement by the monetarist ideas of Friedman (1968), and his ‘new classical’ successors.

Monetarism proved little more successful than Keynesianism as a response to stagflation, and policies of monetary targeting were abandoned by the early 1980s. By the 1990s, macroeconomic policy was based on eclectic mixture of ideas, predominantly Keynesian as regards the short run, and classical or monetarist as regards the long run.

By contrast with the relatively transient reign of monetarism, Friedman’s (1962) microeconomic policy program, which was a restatement of 19th century economic liberalism, was far more successful, and formed the basis of market-oriented reforms adopted throughout the world in the 1980s and 1990s.

Although it is usually a mistake to overestimate the intellectual influence of any single person, and the theories of classical liberalism provided an obvious alternative to Keynesian social democracy, there is no doubt that Friedman was among the most persuasive advocates of economic liberalism, being both more insightful and less dogmatic in tone and content than other leading figures in the free-market camp. Friedman’s visit to Australia in 1976 marked a turning point in the Australian policy debate: from this point on, economic liberalism was the dominant position in both microeconomic and macroeconomic policy debates.

1.3 The resurgence of economic liberalism 1975–1990

Although the breakdown of the Bretton Woods system was the starting point for an international resurgence of economic liberalism, this was not a uniform global process. The shift away from social democracy and towards free-market policies occurred in different ways and at different times, in different countries, as did the subsequent popular reaction against economic liberalism.

In the space limitations of this chapter, it is impossible to describe the national variations in detail, and attention will therefore be focused on the Australian experience. Some international

² Contrary to the claims made by many writers on globalisation in the 1990s, it was this process of policy change, rather than technical developments in telecommunications and computing, that was responsible for the growth of international financial markets. The deregulation of the 1970s restored the freedom of capital

comparisons will be presented later.

The resurgence of economic liberalism in Australia began with the re-opening of the tariff debate. Tariffs were the most prominent example of the regulatory state that emerged after Federation in 1901. Over the course of the 1970s and 1980s, the critics of tariffs broadened their views into a general critique of government intervention. The case for free trade merged with arguments for deregulation, largely derived from the United States (where airline deregulation was generally seen as a major success) and for privatisation (largely derived from the Thatcher government in the United Kingdom).

The resurgence of liberal economic ideas was confined, almost exclusively, to economic and policy elite groups. Influential advocates of economic liberalism included government agencies such as the Industries Assistance Commission (later the Industry Commission and now the Productivity Commission), private-sector think tanks such as the Centre for Independent Studies, and financial and political journalists, including Paul Kelly and Gerard Henderson.

Liberal economic reform proceeded slowly under the Fraser Liberal–National government from 1975 to 1983. In 1983, the Hawke Labor government, was elected on a fairly traditional interventionist platform but soon adopted much of the resurgent liberal ideology. The crucial event in this process was the decision in December 1983 to float the Australian dollar. The broader microeconomic reform agenda of financial deregulation, privatisation, free trade and reductions in public expenditure and taxation followed inevitably, frequently justified by the perceived need to maintain the goodwill of international currency markets.

There were however, important countervailing policies, most importantly the Prices and Incomes Accord between the government and the Australian Council of Trade Unions, under which unions accepted reductions in real wages in return for influence over government policy in social services and other areas. This agreement encouraged other interventions such as the reintroduction of Medicare, a public health insurance scheme.

It has been argued (Keating 1999; Pierson and Castles 2001) that the Hawke and Keating Labor governments presaged the idea of the Third Way, which was presented in the late 1990s as a new policy approach, transcending the old debate between social democracy and neoliberalism (Giddens 1999). As always with Australia, this claim must be interpreted, in the manner of Metin (1908), with reference to practise rather than explicit doctrine, a point made by both Keating and Pierson and Castles. Moreover, there are elements of the Third Way program, such as communitarianism, which were not much in evidence under Hawke and Keating, though it may be doubted how much such things have influenced the practise, as opposed to the rhetoric, of contemporary proponents of the Third Way. Nevertheless, there were important respects in which the policies of the Hawke-Keating government foreshadowed those of the Blair

movement that had prevailed in the 19th century.

government in the United Kingdom and of other advocates of ‘modernised’ or ‘reformed’ social democracy.

1.4 Popular resistance to ‘economic rationalism’ after 1990

Even at the high point of the reform era in the late 1980s, few microeconomic reform initiatives gained strong popular support. Nevertheless, the popular mood in the 1980s was one of acquiescence. After the crises of the 1970s and the 1982-83 recession, there was general acceptance that ‘There’s got to be a better way’³. Moreover, the economic recovery seemed to validate many of the claims made by reformers regarding the benefits of a more flexible, liberalised economy.

Adverse popular reaction began with the recession of 1990 and crystallised around the term ‘economic rationalism’ (Pusey 1991).⁴ The strongest expression of this reaction was the election of 1993, in which the key issue was *Fightback!* (Hewson and Fischer 1992), a radical package of free-market reforms, put forward by the Liberal Opposition, under the leadership of economist John Hewson. The unpopularity of the Keating Labor government, due both to poor macroeconomic management and to Keating’s own position as the leading proponent of free-market reform during the 1980s, was such that the election was widely described as ‘unlosable’. Nevertheless, the Liberals lost, and voters waited until 1996 to vent their anger at Keating and the Labor government.

It was clear by this point that microeconomic reform was highly unpopular with the electorate. Even on issues like privatisation, where there was no clear consensus in the 1980s, opposition to reform hardened steadily (Kelley and Sikora 2002). Support for tariff protection, initially strong, become somewhat stronger, though Norton (2004), argues that public attitudes on this topic are more flexible than is commonly supposed. Most notably, the tax revolt of the 1970s and 1980s faded away, with steadily increasing proportions of respondents to public opinion surveys preferring improvements in public services to tax cuts. (Wilson and Breusch 2003).

The initial response to what was called ‘reform fatigue’ was not to slow the pace of reform, but to seek top-down devices that would impose reform without requiring public debate on an issue-by-issue basis. The most notable instance of this process was the National Competition Policy Agreement, reached at a meeting of state and federal leaders in 1994, and involving commitments to comprehensive microeconomic reform, subject to a set of financial incentives and penalties applicable a decade or more into the future.

3

This was the title adopted by Douglas (1980), expressing some of the views that led him to become the main architect of radical free-market reform in New Zealand.

4

National Competition Policy contributed to a more virulent popular reaction in the form of Pauline Hanson's One Nation Party, which combined hostility to Asian immigration and multiculturalism with violent opposition to microeconomic reform, and particularly to National Competition Policy.

Since the late 1990s there has been a general retreat from economic liberalism at both state and national levels, partly in response to popular hostility and partly reflecting increased scepticism among policy elites. The Howard government has pursued free-market reform only intermittently, with frequent lapses into older styles of 'nation-building' rhetoric and policy. As regards industrial relations, the general focus has been on supporting employers against workers, unionised or otherwise, rather than on liberalisation or deregulation. Although a few items of outstanding business, such as the implementation of a Goods and Services Tax, and the privatisation of Telstra were addressed during the government's first three terms in office, the general tendency was one of drift rather than radical economic liberalism. It remains to be seen whether the unexpected removal of a significant barrier to reform, the Opposition majority in the Senate, will lead to more radical action once the government attains majority control of the Senate in July 2005.

At the state level, Labor governments have returned to their traditional view of the state as a 'vast public utility' and have sought, with varying degrees of success to present themselves as more reliable and pragmatic suppliers of public services like health and education than their conservative opponents. Both dogmatic economic liberalism and attempts to formulate a coherent 'Third Way' have been abandoned. To the extent that any ideological viewpoint characterises today's Labor governments, it might be described as 'modernised social democracy'.

1.5 International comparisons

The Australian experience of economic liberalism was broadly similar to that of other English-speaking countries, which followed the lead of the United Kingdom.⁵ As in Australia, economic liberalism lost popular support during the late 1990s. In the United Kingdom and New Zealand, and to a lesser extent in Canada, centre-left governments elected in the 1990s have moved away from the radical economic liberalism of their predecessors in favour of policies variously described as 'Third Way' or 'modernised social democracy'. In practice this has

For a history of this phrase, see Quiggin (1997).

5

Economic liberalism had a relatively modest impact in the United States, largely because social democracy had never really taken hold there. Most obviously, the privatisation movement had little impact in the United States because there was very little to privatise.

meant accepting most of the policy changes introduced in the period of economic liberalism, such as privatisation, though some of the more egregious failures have been reversed.⁶ However, the central role of the state in the funding and provision of health and education services has been maintained and expenditure on these services has increased relative to national income.

In the developing world, and particularly in Latin America, the policy agenda of economic liberalism is commonly referred to as the ‘Washington consensus’, a phrase coined by Williamson (1990) with reference to its Washington-based proponents, the World Bank, the International Monetary Fund and the US Treasury.

A third element of the push towards economic liberalisation arose from the collapse of the Soviet bloc. Many, though not all, formerly communist countries in Europe embraced policies of ‘shock therapy’, involving large-scale privatisation and a radically reduced role for government, compared not only to the central planning of the past but to the social democratic systems of Europe.

After dominating policy developments throughout Latin America in the 1990s, the Washington Consensus is now, to a large extent, discredited. In part, this is due to severe economic crises in countries that adopted the Washington consensus. The most severe of these crises affected Argentina, the country that had gone furthest along the path set out by the Washington consensus, to the extent of establishing a currency board with the task of maintaining a fixed exchange rate with the US dollar and thereby fighting inflation. When foreign investors lost faith in Argentina, the ensuing crisis produced a depression in which output and national income declined by 20 per cent.

More generally, the adoption of liberal economic policies has not produced the promised results in Latin America (with the partial exception of Chile) or in other poor countries. Economic growth has been weak, and the distribution of income has become more unequal, leaving the poor worse off than when the reforms began. As a result, movements towards privatisation, and other reforms advocated by economic liberals, have stalled and, in some cases, been reversed. Similar tendencies have been apparent in a number of Eastern European countries, and particularly in Russia, where many of the ‘oligarchs’ who benefited from privatisations under the Yeltsin government have been expropriated by the Putin administration.

The core members of the European Union (EU) have been most resistant to economic liberalism. As a result, economic liberalism is still advancing in the eurozone at a time when it has passed its peak in most other countries. Most EU member countries still faced unresolved fiscal problems associated with unfunded retirement income systems, and adjustments to resolve

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Examples include the renationalisation of Air New Zealand and Railtrack, the UK rail system operator.

these problems will inevitably involve significant reductions in benefits, and probably increased reliance on private provision of retirement income. Nevertheless, the basic structures of social democracy have remained unchallenged and have, in many respects, been strengthened by the creation of common EU institutions.

2. The ideology and rhetoric of economic liberalism

As has been noted, the shift from social democracy towards economic liberalism occurred in different ways and at different times, in different countries, as did the subsequent popular reaction. This is reflected in the many different names that have been attached to the process, including ‘Thatcherism’, ‘economic rationalism’, ‘the Washington consensus’, and, most commonly in critical discussion, ‘neoliberalism’.

As both names imply, economic liberalism or neoliberalism is a descendant of classical liberalism. Its defining features are the fact that it is a reaction against social democracy (a point captured in part by the ‘neo’ in neoliberalism) and the fact that the primary focus is on economic policy.

In considering the relationship of economic liberalism to classical liberalism, it is important to observe that social democracy also draws heavily on the liberal tradition, and has, arguably, inherited the bulk of the political support that once sustained 19th century liberalism. The US use of ‘liberal’ to mean ‘social democrat’ reflects this point.

Economic liberalism places more weight on economic freedom than on personal freedom or civil liberties, reversing the emphasis of classical liberalism. Indeed, it is fair to say that on matters of personal freedom, economic liberalism is basically agnostic, encompassing a range of views from repressive traditionalism to libertarianism. The shift in emphasis is clear in the work of Hayek, the leading representative of economic liberalism as a philosophical viewpoint. Both in his theoretical writing, notably Hayek (1960), and in his support for the Pinochet regime in Chile, viewed as a transitional dictatorship necessary for the restoration of economic liberalism (Quiggin 2005), Hayek placed little emphasis on freedom of speech and thought as compared to freedom of economic action.

In terms of economic policy, economic liberalism is constrained by the need to compete with the achievements of social democracy. Hence, it is inconsistent with the kind of dogmatic libertarianism that would leave the poor to starvation or private charity, and would leave education to parents. Economic liberalism seeks to cut back the role of the state as much as possible while maintaining public guarantees of access to basic health, education and income security.

The core objectives of economic liberalism are:

- (i) to remove the state altogether from ‘non-core’ functions such as the provision of

infrastructure services;

(ii) to minimise the role of the state in core functions (health, education, income security) through contracting out, voucher schemes and so on;

(iii) to remove regulation of economic activity, or, where this proves impossible, to adopt 'light-handed' and market-friendly approaches to regulation; and

(iv) to reject redistribution of income except insofar as it is implied by the provision of a basic 'safety net'.

2.1 Rhetoric of economic liberalism

Just as the successes of Keynesian macroeconomic management during and after World War II increased the credibility of the case for government intervention in the economy, the decline of Keynesianism in the 1970s was accompanied by more general disillusionment with the role of government. Initially, the reaction was confined, in large measure, to the English-speaking countries, and much of the associated rhetoric focused on what were seen as specific national failings: the 'British disease', the 'Australian settlement' and so on. However, similar arguments were made with respect to economies as diverse as those of Sweden (Lindbeck 1997) and the East Asian 'tiger economies', in both cases following economic crises that cast doubt on previously successful models.

A common theme in discussions of this kind was a focus on international comparisons, almost invariably to the detriment of the country in which the comparison was being made. The general theme was that, because of its excessively interventionist institutions, the country in question was being left behind by competitors. This trend could only be reversed by the introduction of free-market policies, typically in the form of a 'short sharp shock'. In Australia, claims about relative decline focused on the idea that, in the absence of economic reform, Australians would become the 'poor white trash of Asia' (Scutt 1985), a claim criticised by Quiggin (1987). Although arguments of this kind were sometimes used to promote interventionist industry policies, based on models such as that of the Japanese Ministry of International Trade and Industry (MITI), the dominant trend was towards free-market policies.

Another striking feature of the rhetoric of economic liberalism is its generally negative tone. Although some advocates of economic liberalism point to the positive benefits to be expected from a free-market economy, the dominant tone is that of stern necessity, epitomised by Thatcher's dictum 'there is no alternative'. Even if the policies of economic liberalism do not produce desirable outcomes, proponents of globalisation argue that any country that rejects them will be crushed by the 'thundering herd' of global financial markets (Friedman 1999).

3. Economic liberalism and the state

Economic liberalism is defined, above all, by a critical view of state involvement in economic

activity. The most obvious manifestations of state involvement in the economy are, in qualitative terms, the range of goods and services directly provided or funded by the state and, in quantitative terms, the share of national income absorbed in taxation and redistributed as public spending. A central objective of economic liberalism has been to reverse the qualitative and quantitative expansion of state economic activity that characterised the first 75 years of the 20th century.

3.1 Growth in government during the 20th century

The growth of the state over the course of the 20th century resulted from a combination of qualitative expansion of the functions undertaken by the state (mainly before 1950) and of structural change leading to growth in the share of income devoted to publicly-provided services such as health, education and risk management (mainly from 1950 onwards). Although the role of government did not change much in qualitative terms between the 1950s and the 1970s, quantitative measures of the size of the public sector, such as the ratio of public expenditure to GDP, increased steadily.

A number of factors contributed to the growth of the public sector. The most important was the growth in the human services sector, encompassing ‘social infrastructure’ services such as health, education, police and welfare services. The demand for human services tends to rise with income, and to increase as a proportion of total demand as income rises. On the other hand, productivity growth in the human services sector has been limited. The growth of the services sector was first analysed in these terms by Baumol (1967), who argued that labour productivity grew more slowly in the services sector than in other sectors such as manufacturing. Hence to maintain output in the services sector at least as a constant proportion of total output, it was necessary that resources should be progressively transferred towards the services sector.

3.2 The fiscal crisis and the tax revolt

By the early 1970s, the combination of growing demands for government expenditure and increasing difficulty in raising tax revenue produced what O'Connor (1973) described as ‘the fiscal crisis of the state’. This reflected an overextension of commitments during the 1960s, exacerbated by the slowdown in economic growth from the 1970s onwards.

The tax revolt was the name for, and symbolised by, the Proposition 13 referendum campaign in California in 1978. Proposition 13 was a citizen-initiated referendum which required the government to make substantial cuts in property taxes (the main source of funding for public schools and other local services), and to freeze tax rates thereafter. Substantial cuts in public expenditure followed, notably in relation to education, and California’s state and local governments have suffered periodic financial crises ever since, most recently resulting in the recall of governor Gray Davis in 2004, and the election of Arnold Schwarzenegger to replace him.

Although attempts to reproduce the tax revolt in Australia and elsewhere were only moderately successful in mobilising popular opposition to taxes, there was no doubt about the strength of resistance to further increases in taxation. Concern about higher taxes was the biggest single source of popular support for economic liberalism. The most notable success of the Australian tax revolt was the abolition of inheritance taxes, beginning in Queensland, and then extending to other states and the Commonwealth.

3.3 Attempts to roll back the state

Economic liberals made strenuous efforts to reverse the steady growth of state economic activity, particularly during the 1980s. In the long term, however, these efforts have met with limited success.

The Thatcher government in the United Kingdom voiced a strong commitment to reversing the growth of the state. In Australia, the Hawke government, elected in 1983 on a program of expanding public services, went to the 1984 election on the basis of a 'trilogy' of commitments, requiring no increase in the ratio of tax or public expenditure to GDP, and a reduction in the budget deficit, expressed as a proportion of GDP. These commitments logically implied a reduction in the ratio of public expenditure to GDP. In the United States, the Reagan Administration introduced large-scale tax cuts, in the expectation that this would 'starve the beast' of public expenditure. Many of these policies were later modified or abandoned.

The Thatcher government also sought to reduce the scope of public sector activity, most notably through the privatisation of public enterprises such as British Telecom. This policy was emulated by the Hawke government in Australia and, on a more radical scale, by the Lange-Douglas Labour government in New Zealand.

In qualitative terms, economic liberals have been moderately successful in cutting back state activities. In many countries, the state has withdrawn from large areas of economic activity through privatisation and the withdrawal of public services. The change has been most notable in relation to infrastructure industries, such as energy and telecommunications.

In addition, many 'special' services originally established to meet needs that were not being adequately met by the private sector have been scrapped or absorbed into larger agencies as part of a process of cost-cutting and 'rationalisation'.

Despite these successes, the ratio of public expenditure to GDP has increased in most developed countries, though the rate of increase has been greatly reduced. Except in relatively peripheral areas such as public ownership of utilities, economic liberals were unable to produce coherent and politically saleable alternatives to public provision and funding of services. The growth in demand for core public services more than offset the contraction of the state achieved through privatisation and withdrawal of peripheral services. As a result, despite dominating the policy process for twenty years, economic liberals mostly failed to reduce the relative size of the

public sector.

These global trends explain why it is possible for the Labor Opposition to taunt the Howard government with being 'the highest-taxing government in Australia's history'. The government countered with a definitional argument about whether the GST should be treated as a state or federal tax. A more reasonable response might be to observe that, if the current government is not the highest-taxing in Australia, it should be. Demand for the main services provided by government, including health and education, is rising more rapidly than income. In the absence of large-scale privatisation of these services, an optimal allocation of resources requires increased expenditure and therefore higher rates of taxation.

State capacity

The fiscal crisis of the state and the attempts of economic liberals to reverse the growth of the state may usefully be understood in terms of the idea of 'state capacity' (Mann 1988). The state retains a substantial capacity to intervene effectively in the economy (Weiss 1998). However, that capacity has not grown in line with the demands implied by the range of responsibilities taken on by governments in the postwar period.

The crisis of the 1970s, then, may be seen as a result of states overreaching their capacity, producing a corresponding overreaction in the 1980s and 1990s. The resurgence of economic liberalism was, in part, an overreaction to this crisis. Economic liberals saw the crisis as evidence that the state needed to be cut back substantially. The rhetorical dominance of economic liberalism was enhanced by the fact that realistic supporters of the social democratic settlement recognised the need for retrenchment and rearrangement of priorities.

In Australia, economic liberals and modernising social democrats co-operated in the market-oriented reforms. This co-operation concealed divergent ends. Economic liberals saw state intervention as harmful, and sought to reduce the capacity of the state to override the market. By contrast, modernising social democrats sought to improve the effective capacity of the state through the adoption of new methods of public sector management, and to economise on the use of scarce state capacity through a more rigorous approach to the setting of priorities. The conflict between the two groups became more evident in the 1990s, as economic liberals sought to cut back core areas of the welfare state.

Because the growth in public provision of human services represents a response to real social and economic needs, attempts by economic liberals to reduce the level of provision and the role of government have not, in general, been successful. As a result, the fiscal crisis of the state has been followed, not by fundamental change, but by a prolonged period of 'muddling through'.

In some respects, market-oriented reforms have enhanced state capacity. While claims of a reinvention of government (Osborne and Gaebler 1992) are overstated, the attempt to make governments more market-oriented has, in many cases, increased the capacity of the public

sector to provide services efficiently and with lower budgetary costs.

4. Microeconomic reform

State economic activity need not involve direct government provision of goods and services. Governments can and do influence and constrain private economic activity through a range of measures including tariffs, taxes and regulations. In one form or another, these interventions modify the prices faced by private economic actors and therefore provide them with different incentives than those that would arise in a market equilibrium. In the rhetoric of economic liberalism, these differences in incentives are regarded as ‘distortions’, to be minimised wherever possible.

The general label ‘microeconomic reform’ has been used to describe a wide range of initiatives aimed at minimising the distortions imposed on private firms, and also at making public enterprises behave more like private firms.

4.1 Tariffs and the regulatory state

In the early phases of microeconomic reform, much attention was focused on ‘getting prices right’, and, in particular, on eliminating policies that unnecessarily ‘distorted’ the production and consumption decisions of private firms and households. The paradigmatic example of a ‘distorting’ policy was tariff protection. The case for tariff reform was bolstered by the argument that, if a government wished to assist particular industries it should do so through subsidies, which did not distort the prices faced by consumers.

The first big instance of deregulation in Australia was the deregulation of financial markets in the 1980s, following the recommendations of the Campbell (1981) and Martin (1984) Committees of Inquiry and the decision to float the Australian dollar in 1983. Deregulation of the airline industry, and the abandonment of the long-standing two-airlines policy, followed in 1990.

4.2 Microeconomic reform and government business enterprises

A second strand of microeconomic reform focused on improving the efficiency of government business enterprises. One of the first, and most successful, instances was the creation of the statutory authorities Australia Post and Telecom Australia from the former Postmaster-General's Department, a public service department under direct ministerial control. More generally, the reform of government provision of marketed services may be seen in terms of a spectrum (Productivity Commission 1998). At one end is the traditional departmental structure of national, state and local governments. At the other end is a privatised firm, subject only to normal commercial regulation. The points on the spectrum include:

- (i) full cost pricing;
- (ii) competitive tendering;

- (iii) commercialisation;
- (iv) corporatisation; and
- (v) privatisation.

Each step along the reform spectrum involves an increase in reliance on profit as the primary guide to management decisions, and a reduction in direct public accountability. These two changes are directly linked: increases in profitability arise precisely because managers are not subject to constraints imposed through public accountability, and are therefore free to manage enterprises so as to increase revenues and reduce costs.

From the perspective of advocates of microeconomic reform, the object of reform has been to move as far towards privatisation as possible, subject to constraints arising from potential market failures or political restrictions. Under National Competition Policy, traditional arrangements are considered, *prima facie*, to be anticompetitive, and governments are required to consider options such as commercialisation and corporatisation.

4.3 The new era of regulation

For much of the 1980s and 1990s, it seemed that movement along the reform spectrum led inexorably to full privatisation. By the late 1990s, however, political resistance to privatisation had hardened, and the process of privatisation had largely drawn to a halt. At the same time, the hope that privatisation would lead to the emergence of robust competitive markets had proved overoptimistic in many cases. The result was a shift back towards regulation, with the distinctive feature that the objective was to mimic, as far as possible, the outcomes that would prevail in a competitive market.

Although privatisation was advocated for a variety of reasons, economic liberals saw it as being inextricably linked to a movement towards greater competition. Most favoured a short-lived period of light-handed regulation of privatised monopolies, in the expectation that the removal of barriers to entry would lead rapidly to full competition. In fact, monopoly power has remained strong, and the scope of regulation has steadily expanded. State and national regulators, the Australian Competition and Consumer Commission, National Competition Council, Essential Services Commissions and so on, now play a larger role in the economy than at any previous time.

Reforms to telecommunications and energy markets in the 1990s are also commonly referred to as 'deregulation'. In these cases, where a politicised regulatory regime, based on publicly-owned statutory monopolies subject to direct ministerial control, has been replaced by a complex set of price controls and access undertakings, administered by independent regulators and designed to facilitate competition, 'reregulation' might be a more appropriate term. Continued use of the term 'deregulation' reflects, in part, the idea that the new regulatory structures are interim measures, paving the way for the emergence of a fully competitive market.

5. Labour markets and income redistribution

Economic liberals have generally been hostile to trade unions and critical of high levels of taxation. Some Australian supporters of the liberal microeconomic reform agenda, particularly those associated with the Labor party, retain a strong commitment to egalitarian income redistribution and, in some cases, support for some role for trade unions. However, the dominant tendency is not only anti-union but anti-egalitarian.

Trade unions overreached themselves in the last stages of the Keynesian long boom, both in terms of social disruption (frequent strikes, often over frivolous or unjustifiable claims) and in terms of the level of real wages reached through collective bargaining and arbitration. When the era of full employment ended abruptly in the 1970s, unions found themselves in an invidious position, lacking both the bargaining power to enforce favorable bargains and the political support to protect themselves against counter-attacks by employers.

The reaction against unionism has been the biggest single success of economic liberalism, particularly in the English-speaking world. Union membership has declined sharply relative to the size of the workforce and sometimes also in absolute numbers. The decline in union coverage and union power has been accompanied by the replacement of full-time wage employment based on awards or union contracts by various forms of individualised, contingent, contract-based relationships between workers and owners of capital.

In Australia, the most important trends have been the growth of casual employment, particularly for part-time workers, and the increasing proportion of workers employed on an annual basis without fixed weekly hours or eligibility for overtime pay. Attempts to shift employees to individual contracts or Australian Workplace Agreements represent a sharper break with the standard employment relations of the 20th century. As yet, however, these alternatives have not accounted for a large proportion of total employment.

Many of the changes in employment relationships achieved in the period of economic liberalism appear irreversible. However, there are important countervailing trends. Long working hours and the intensification of work during the microeconomic reforms of the 1990s have produced high levels of dissatisfaction among workers. This is particularly notable among craft and professional workers alienated by the increase in the implementation of policies aimed at increasing managerial control of workplaces. Large-scale retrenchments have eroded the loyalty of workers to employers. Conversely, public attitudes to unions have become significantly more favorable since the 1980s (Evans 1996) and there are signs that the decline in union membership has been halted.

There has been a substantial increase in the inequality of market income in most English-speaking countries since the 1970s. This increase has reflected redistribution from labour to capital, and an increase in the inequality of labour incomes. However, Australia has experienced

less growth in the inequality of market incomes than other countries. Moreover, changes in tax and social welfare policy have, in aggregate, tended to offset growth in the inequality of market incomes in Australia; the opposite has been true in other English-speaking countries.

This was particularly evident under the Hawke–Keating government where the general effect of changes in taxes and transfers was mildly progressive. By contrast, in other English-speaking countries, regressive changes in tax-transfer policy have reinforced growing inequality in market incomes. The Howard government has introduced a number of regressive measures, including concessional treatment of capital gains and tax cuts biased towards high-income earners. However, assessment of recent changes in income distribution is complicated by the fact that policy has generally favoured families at the expense of single workers and childless two-income couples, and by the generally progressive effects of continued economic expansion.

6. An assessment

Economic liberals commonly claim that their domestic and international policy package is a proven success. During the 1980s and early 1990s, they contrasted the supposed success of radical free-market reforms in English-speaking countries including New Zealand, Australia, the United Kingdom and the United States with the supposedly sclerotic performance of the European social democracies.

In fact, the example of New Zealand provides no support for the *laissez faire* model. Following disappointing economic performance for most of the period since World War II, successive New Zealand governments imposed radical economic reforms after 1984. Although the reforms won the admiration of neoliberals around the world, New Zealand's economic performance deteriorated. Growth in New Zealand since 1984 has been well below the OECD average, and also slower than in Australia, which faced broadly similar conditions but which adopted less radical reforms (Quiggin 1998).

More generally, claims for the success of economic liberalism made in the 1980s (the period of the 'Thatcher miracle' in the United Kingdom and Rogernomics in New Zealand), proved premature, as early gains were wiped out by recessions around 1990, common to all the English-speaking countries, but particularly severe in Australia, the United Kingdom and New Zealand.

Since the early 1990s, however, the United Kingdom and Australia have enjoyed sustained economic expansions, and the United States has had generally strong economic performance, interrupted only by the relatively mild recession of 2001. However, this strong performance has been accompanied by the growth of large deficits on trade and current accounts.

On traditional views regarding trade and the macroeconomy, current account deficits in excess of 5 per cent, and low or negative rates of national saving, evident in all the English-speaking countries, would be seen as evidence of an unsustainable consumption boom, driven by

excessively expansionary monetary policy. Economic liberals, however, take a more positive view of such tendencies, focusing on the fact that a current account deficit is the necessary counterpart of a capital account surplus. The willingness of overseas investors to lend at low rates of interest is seen as a sign of confidence in future strong growth.

Although current account deficits can, in principle, be sustained indefinitely, exports and imports must balance in the long run (Quiggin 2005). One way or another, the trade deficits observed present in the English-speaking countries including Australia, must return to balance fairly soon. The success or failure of economic liberalism may be judged, in large measure, by observing whether this adjustment takes the form of increased exports, driven by higher productivity, or of reduced imports driven by a contraction in economic activity.

Concluding comments

Economic liberalism has dominated policy debates in Australia and elsewhere since the 1970s. In large measure, the goal of economic liberalism has been to reverse the achievements of Keynesian social democrats in building up a mixed-economy welfare state, particularly in the period after 1945.

Viewed in this light, economic liberalism must be seen to have failed. Of the major social welfare systems introduced in the era of social democracy, from universal public education to national health systems to old age and disability pensions, hardly any have been scrapped altogether (the nearest approach has been the radical reforms to the Temporary Assistance to Needy Families welfare program in the United States) and many have expanded. Government enterprises have been privatised in many countries, but, in most cases, they have been replaced by private monopolies that require regulation almost as intrusive as outright public ownership. The possibility remains open that economic liberals will make more progress in coming years. On the whole, however, this appears unlikely. Radical versions of free-market reform, from Rogernomics in New Zealand and economic rationalism in Australia to the Washington consensus in Latin America, have fallen from favour with the public, and even, to some extent with former supporters among the political and economic elite. Most obviously, the wave of privatisation appears to have run its course in many countries and even to be ebbing in some. However, no clear alternative has emerged to replace economic liberalism. For the moment, governments appear to be ‘muddling through’, dealing as best they can with the problems posed by unbounded demands for public services and strictly limited willingness to pay for such services through higher taxes.

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