CEC100 AUSTRALIAN POLITICAL ECONOMY

CEC105 Social Organisation and Political Economy

CEC196 Economics 1A

COURSE MATERIAL 1987

DR PETER EARL

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CEC100 AUSTRALIAN POLITICAL ECONOMY

COURSE OUTLINE

Lecturer and Course Organiser : Dr Peter Earl

Tutor: Kaye Fenton

This course consists of 27 lectures and 12 tutorials. Lectures are on Thursdays at 9.00 a.m. and tutorials are at various times to be announced at the first Lecture.

Tutorials commence in Week 3.

The objective of this course is to provide students with an appreciation that there are a variety of different legitimate responses to continuing economic problems. The course examines a variety of microeconomic and macroeconomic problems in the light of alternative visions of the workings of the economic system.

Tutorials take the form of small group discussions led in turn by students who present papers on particular problems in the Australian economy.

Assessment

1.	Seminar paper plus performance at tutorials	10%
2.	Term 1 essay assignment	10%
3.	Term 2 essay assignment	10%
4.	Final examination (2 hours)	70%
		100%

Failure to complete the coursework satisfactorily may lead to exclusion from the final examination : note that you are required to attend at least eight tutorials and to obtain a total score of at least 12/30 for the essays and seminar paper.

Reading

This is a course in which your success depends a great deal on your knowledge of how different economists, past and present, address economic issues. So it is important that you read widely and keep in tune with current debates in the media (for example in 'quality' newspapers and radio and television current affairs programmes, of which ABC Radio National's 'Background Briefing' is especially helpful).

You should all buy and read from cover to cover during the course of the year

E.S. Phelps Political Economy.

This is a quite exceptional new textbook and one which you may also find very helpful on first and second year microeconomics courses. It is not my intention to lecture by 'going through Phelps' and you will see that my lectures do not follow Phelps particularly closely. Phelps' mode of exposition is very clear and he has far more space than I have in my 27 lectures. However, anything that you find baffling in Phelps you should raise in tutorials after the seminar paper discussions have finished (if there is time).

Another useful basic text which you might wish to refer to is

P. Heyne <u>The Economic Way of Thinking</u>

The ways in which economists see the world will be much easier to understand if you get a basic idea of the evolution of economic ideas by reading one of the following :

D.R. Fusfeld <u>The Age of The Economist</u>

W.J. Barber <u>A History of Economic Thought</u>
(I found Barber very useful myself as a first year student.)

During the course of the year you should also read some or all of the following cheap paperbacks (a good strategy is to form groups to buy and share these books) :

M. Friedman and R. Friedman <u>Free to Choose</u>

M. Barratt-Brown <u>Models in Political Economy</u>

J.K. Galbraith <u>The New Industrial State</u> (or one of his other books on modern capitalism, such as <u>The Affluent Society</u> or <u>Economics and the Public Purpose</u>)

B. Fine <u>Marx's Capital</u>

S.C. Littlechild <u>The Fallacy of the Mixed Economy</u>

R. Mendelson <u>Fair go : Welfare Issues in Australia</u>

As a source of material on the Australian economy, particular in macroeconomic matters, I suggest you buy

Indecs Economics <u>State of Play 4</u>

This should also prove very useful for other courses, and it means there is no excuse for being out of touch with recent developments in the Australian economy.

In the course of the year, and particularly in preparing your seminar papers, you may find it useful to browse in the library's stocks of the following Australian journals (both bound copies on level 4 and recent issues on level 2) :

Economic Papers (Especially accessible; published by the Economic Society of Australia)

Economic Record (For example, in the midst of other, far more technical material in the September 1984 issue you will find an article by J. Piggot, called 'The Distribution of Wealth in Australia : a Survey')

Australian Economic Papers

Australian Economic Review

Economic Planning Advisory Council Papers

Australian Left Review

Discussion Papers of the Australian National University's Centre For Economic Policy Research

For general world background, use The Economist. The London-based Institute of Economic Affairs has many publications that profess the virtues of a free-market system and are easy to read, including the Journal of Economic Affairs. Oddly enough, these include a series of pamphlets called 'Hobart Papers'!

In the outline of the lecture program given below, I provide a detailed reading list of relevant items related to each lecture. I do not expect you to try to read all or even most of these. A lot of them overlap - quite deliberately, so that the library should be able to cope if a lot of you do wish to do some extra reading in a particular area. However, I do expect you to do some extra reading and to display knowledge thereby acquired at pertinent points in the final examination. I tend to set exam questions that it is difficult to answer by simple regurgitation of lecture notes.

I do not always indicate which bits of the recommended texts relate best to my lectures - this is to try to force you into the habit of making use of indexes and contents pages. The particular view of political economy that I have is very much a personal construct, whose emphasis differs from the recommended readings in a variety of ways. Feel free to challenge me in lectures. Detailed Lecture Summaries are provided for each lecture.

Lecture Plan and Relevant References

1. **What is Political Economy?** (5 March)

   D. Whynes (ed) (1984) What is Political Economy?

   I. Stewart (1985) 'Political Economy, Classical and Modern : Review Article', Scottish Journal of Political Economy 32, November, pp. 343-6

   H.W. Arndt (1984) 'Political Economy', Economic Record 60, September, pp. 266-73

   A. Hocking (1980) Investigating Economics (2nd edn), Ch. 2

   W.J. Barber (1967) A History of Economic Thought, pp. 11-22

   D.R. Fusfeld (1982) The Age of the Economist, Introduction and Chapters 1 and 2

   J.V. Robinson (1973) Collected Economic Papers Volume 4, Ch. 3

2. **Economics as a Coordination Problem (1)** (12 March)

   Phelps, Chs. 1 and 10

   G.B. Richardson (1964) Economic Theory, Chs. 1 and 6

   M.H. Dobb (1966) Soviet Economic Development Since 1917, Ch. 1

   G.B. Richardson (1971) 'Planning versus Competition', Soviet Studies 22, January, pp. 434-47

   M. Tool (ed) (1984) An Institutionalist Guide to Economic Policy, Ch. 9

   Fusfeld, Chs. 3 and 10

   A.O. Hirschman (1958) The Strategy of Economic Development, Chs. 1-4

   F. Aarons (1984) 'Review of A. Nove, The Economics of Feasible Socialism', Australian Left Review 87, Autumn, pp. 54-7

3. **Consumer Sovereignty** (19 March)

   M.A. Utton (1982) The Political Economy of Big Business, Ch. 4

   F.A. Hayek (1961) 'The Non Sequitur of the Dependence Effect', Southern Economic Journal, reprinted in E. Mansfield (ed) (1971) Microeconomics : Selected Readings
   (The reserve section has xerox copies of the relevant passages by Hayek and the ideas of Galbraith that he is attacking)

J.K. Galbraith (1958) The Affluent Society

(1967) The New Industrial State

(1975) Economics and the Public Purpose

(all of these convey much the same message)

M. Friedman and R. Friedman (1980) Free to Choose, Ch. 7

D.K. Round (1984) 'Price-Informative Advertising in Australia', Economic Papers 3, pp. 49-58

E. Mishan (1969) Growth : The Price We Pay, Ch. 12

P.E. Earl (1983) 'The Consumer in his/her Social Setting : A Subjectivist View', in J. Wiseman (ed) (1983) Beyond Positive Economics?

4. **Economic Growth : 'Green' Economics? (26 March)**

M. Barratt-Brown (1984) Models in Political Economy, Ch. 9

E.J. Mishan (1967) The Costs of Economic Growth

E.J. Mishan (1969) Growth : The Price We Pay

E.J. Mishan (1972) 'Economic Grwoth : The Need for Scepticism', Lloyds Bank Review, No. 106, October, pp. 1-26 (in xerox collection)

R.P. Rutherford (1979) 'Economic Growth and the Environment', University of Tasmania Occasional Paper No. 20

D.H. Meadows et al. (1974) The Limits to Growth

W. Beckerman (1971) 'Why We Need Economic Growth', Lloyds Bank Review, No. 102, October, pp. 1-16

W. Beckerman (1971) 'The Desirability of Economic Growth', in N. Kaldor (ed) (1971) Conflicts in Policy Objectives

W. Beckerman (1974) In Defense of Economic Growth

J.K. Galbraith (1958) The Affluent Society

T. Scitovsky (1976) The Joyless Economy

F. Hirsch (1977) Social Limits to Growth

P. Harkness (1983) 'The Illusion of the Market and Economic Growth', Economic Papers 2, December, pp. 13-27

A. Ellis and K. Kumar (eds) (1983) Dilemmas of Liberal Democracies : Studies in Fred Hirsch's Social Limits to Growth

Simplify Living 1987

John Williamson 2nd [illegible]

R. Lecomber (1979) 'Economic Growth and Social Welfare', in W. Beckerman (ed) (1979) Slow Growth in Britain

M. Stewart (1983) Controlling the Economic Future, Chs. 9-11

P. Baran and P. Sweezy (1966) Monopoly Capital, Ch. 10

5. The Labour Market and the Political Economy of the Family (2 April)

M. Barratt-Brown (1984) Models in Political Economy, Ch. 8

H. Braverman (1974) Labour and Monopoly Capital

M. Freidman and R. Friedman (1980) Free to Choose, Ch. 8

J.K. Galbraith (1975) Economics and the Public Purpose, ch. 4

E. Applebaum (1979) 'The Labor Market', in A. Eichner (ed) (1979) A Guide to Post-Keynesian Economics, especially pp. 112-5

Phelp, chs. 14 and 16

A. Cairncross (1958) 'Economic Schizophrenia', Scottish Journal of Political Economy 5, February, pp. 15-21

6. The Growth of Big Business (9 April)

J.K. Galbraith (1967) The New Industrial State

R.T. Gill (1973) Economics : A Text with Included Readings (1st edn; Great Debate Three : Galbraith and the New Industrial State)

J.E. Meade (1968) 'Is The New Industrial State Inveitable?' Economic Journal 78, p. 372

J.R. Munkirs (1985) The Transformation of American Capitalism : From Competitive Market Structures to Centralized Private Sector Planning

M.A. Utton (1982) The Political Economy of Big Business

P. Baran and P. Sweezy (1966) Monopoly Capital, especially, Ch. 2

Fusfeld, ch. 11

Phelps, ch. 12

N.M. Kay (1984) The Emergent Firm

M. Barratt-Brown (1984) Models in Political Economy

A. Chandler (1977) The Visible Hand

7. Investment in Australia by Foregin Multinational Corporations (23 April)

K. Cowling (1985) 'The Internationalisation of Production and Deindustrialisation', Warwick Economics Research Paper, No. 256 (In Xerox collection)

T.G. Parry (1983) 'Arguments For and Against Foreign Investment in Australia', Economic Papers 2, December, pp. 28-40.

D.R. Richardson (1981) 'Foreign Investment : A Host country Perspective Using Australian Experience', Journal of Post Keynesian Economics 4, Winter, pp. 240-52

W.J. Samuels (ed) (1979) The Economy as a System of Power, Volume 2, pp. 139-213

N.M. Kay (1984) The Emergent Firm

R.J. Mallick (1985) '"To Serve Them All My Days" : Multinationals as "Tutors in Technology" in Indonesia' University of Tasmania Economics Discussion Paper No. 85-5

M. Barratt-Brown (1984) Models in Political Economy (see alternatively his (1974) The Economics of Imperialism, Ch. 9)

8. Case-Studies of Australian Big Business (30 April)

S. Sargent (1985) The Foodmakers

F.G. Davidson and B.R. Stewardson (1979) Economics and Australian Industry (2nd edn)

9. The Economics of the Arts (7 May)

C.D. Throsby and G.A. Withers (1979) The Economics of the Performing Arts

D. Netzer (1978) The Subsidised Muse

J.K. Galbraith (1975) Economics and the Public Purpose, Ch. 7

M. Blaug (ed) (1976) The Economics of the Arts

W.J. Baumol and W.G. Bowen (1966) Performing Arts : The Economic Dilemma

UNESCO-ANU Seminar on Public Support for the Performing Arts (1969) Volumes I and II

10. <u>Economics of Health Care</u> (4 June)

J.G. Cullis and P.A. West (1979) <u>The Economics of Health : An Introduction</u>

R. Mendelson (1981) <u>Fair Go : Welfare Issues in Australia</u>, Ch. 6

K.J. Arrow (1963) 'Uncertainty and the Welfare Economics of Medical Care', <u>American Economic Review</u> 53, December, pp. 941-73

M. Cohen, T. Nagel and T. Scanlon (eds) <u>Medicine and Moral Philosophy</u>, Part II

11. <u>Cumulative Causation Versus Equilibrium</u> (11 June)

G. Myrdal (1957) <u>Economic Theory and Underdeveloped Areas</u>

N. Kaldor (1978) <u>Further Essays on Economic Theory</u> (Ch. 5 'The Case for Regional Policies', which first appeared in the <u>Scottish Journal of Political Economy</u>, 1970; and Ch. 7 'The Irrelevance of Equilibrium Economics', which first appeared in the <u>Economic Journal</u>, 1972)

G.B. Richardson (1975) 'Adam Smith on Competition and Increasing Returns', in A.S. Skinner and T. Wilson (eds) (1975) <u>Essays on Adam Smith</u>

A. Young (1928) 'Increasing Returns and Economic Progress', <u>Economic Journal</u> 38, December, pp. 527-42

12. <u>Protection and Free Trade</u> (18 June)

R.E. Caves and L.B. Krause (eds) (1984) <u>The Australian Economy</u>

M. Stewart (1983) <u>Controlling the Economic Future</u>, Ch. 7

Phelps, Ch. 4

F.G. Davidson and B.R. Stewardson (1979) <u>Economics and Australian Industry</u> (2nd edn), Ch. 5

F. Cripps and W. Godley (1978) 'Control of Imports as a Means to Full Employment and the Expansion of World Trade : The UK's Case', <u>Cambridge Journal of Economics</u> 2, September, pp. 327-34

13. <u>Structural Change in the Steel Industry</u> (25 June)

J. Schultz (1985) <u>Steel City Blues</u>

J.N. Barber (1984) 'An Assessment of the Government Steel Plan', <u>Economic Papers</u> 3, March, pp. 11-20

R. Rowthorn and T. Ward (1979) 'How to run a Company and Run Down an Economy : The Effects of Closing Down Steel-Making in Corby', Cambridge Journal of Economics 3, December, pp. 327-40

F.G. Davidson and B.R. Stewardson (1979) Economics and Australian Industry (2nd edn), Ch. 3

14. **Development Economics and Assistance to Less Developed Countries** **(2 July)**

P.T. Bauer (1984) Reality and Rhetoric : Studies in the Economics of Development

P.T. Bauer (1971) Dissent on Development

P.T. Bauer (1981) Equality, the Third World and Economic Delusion

P. Singer (1985) 'Famine and Morality' Outcry (to be distributed in lecture)

M.R. Tool (ed) (1984) An Institutionalist Guide to Economics and Public Policy, last chapter

W. Brandt (1980) North-South : A Programme for Survival

15. **Economics as a Coordination Problem (2)** **(9 July)**

Phelps, Ch. 18

M. Stewart (1983) Controlling the Economic Future, chs. 3 and 4

J.V. Robinson (1973) Collected Economic Papers Volume 4, Ch. 1 (a reprint of a pamphlet in the Bliss Collection entitled 'The New Mercantilism')

J.V. Robinson (1960) Exercises in Economic Analysis, Part II, Ch. 2

G.L.S. Shackle (1959) Economics for Pleasure, Books III and V

J.V. Robinson (1937) Introduction to the Theory of Employment, Chs. I-III

Barber, Ch. 8

16-18 Unemployment and Inflation: A Post Keynesian /Institutionalist View (16, 23, 30 July)

J.V. Robinson (1937) Introduction to the Theory of Employment

J.A. Trevithick (1980) Inflation (2nd ed)

Fusfeld, Chs. 9, 11 and 12

Barber, Ch. 8

Heyne, Chs. 15, 18, 19

Phelps, Chs. 19-21

M. Stewart (1967) Keynes and After

A. Tylecote (1981) The Causes of the Present Inflation

M. Tool (ed) (1984) An Institutionalist Guide to Economics and Public Policy, chs. 4 and 5

19-21 Unemployment and Inflation: A Monetarist Perspective (as seen from a Post Keynesian/Institutionalist Standpoint) (3, 10, 17 September)

M. Friedman and R. Friedman (1980) Free to Choose, Chs. 3 and 9

M. Friedman (1975) Unemployment versus Inflation

M. Friedman (1968) 'The Role of Monetary Policy' American Economic Review 58, March, pp. 1-18, reprinted in his book The Optimum Quantity of Money and Other Essays and in Gill (1973)

Heyne, Chs. 16 and 17

J.A. Trevithick (1980) Inflation (2nd ed)

Phelps, Chs. 16, 20, 21

H. Sherman and G.R. Evans (1983) Macroeconomics : Keynesian, Monetarist and Marxist Views

22-24 Unemployment and Inflation: A Radical Perspective (as seen from a Post Keynesian/ Institutionalist Standpoint) (24 September, 1 and 8 October)

Barber Ch. 5

Sherman and Evans

J.V. Robinson (1966) An Essay on Marxian Economics

P. Sweezy (1942) The Theory of Capitalist Development, Part 3

A.G. Frank (1980) Crisis in the World Economy

E. Mandel (1980) The Second Slump

B. Fine (1979) Economic Theory and Ideology, Chs. 3 and 4

A. Gamble and P. Walton (1976) Capitalism in Crisis, especially Chs. 2,3 and 5

E.K. Hunt and K.J. Sherman (1975) Economics: An Introduction to Traditional and Radical Views, Chs. 28 and 31

25. **Business Cycles and Processes of Policy Formation** **(15 October)**

P. Mosley (1984) The Making of Economic Policy

J. Robinson and F. Wilkinson (1977) 'What Has Become of Employment Policy?' Cambridge Jounral of Economics 1, March, pp. 50-14

M. Kalecki (1943) 'Political Aspects of Full Employment', Political Quarterly 14, reprinted as Ch. 12 of his (1971) book Selected Essays on the Dynamics of the Capitalist Economy

26. **Prospects for the Australian Economy** **(22 October)**

M. Olson (1984) 'Australia in the Perspective of the Rise and Decline of Nations', Australian Economic Review, No. 67, pp. 7-17

M. Olson (1982) The Rise and Decline of Nations

J.A. Scutt (ed) (1985) Poor Nation of the Pacific: Australia's Future

Phelps, ch. 8

27. **Examination Technique** **(29 October)**

Essay Assignments

Term 1, to be handed in by 4.00 pm Friday 8 May

"In utopian-egalitarian communities, productivity and performance are not observed, so there is inevitable inefficiency. In capitalism, people's hours worked and the ease with which they earn are not measured, so inequality is unavoidable". Discuss.

(Taken from Phelps, pp. 153, but note also question 2 on the January/February 1987 examination paper.)

Limit your essay to about 1200 words

Term 2, to be handed in by 4.00 pm Friday 31 July

"Why are taxis regulated through a system of licenses (called medallions)? The classical answer is that such regulation is just one more instance in which producers have in the name of 'quality service' obtained entry restrictions that brought windfall gains to the initial generation of owners. The theory of rent seeking further suggests that in the competition to acquire a valuable license the rent seekers tend to incur costs equal to the value of the licenses acquired". Explain this classical view. Can you imagine a different view?

(From Phelps, p. 281)

Again limit your essay to about 1200 words

Note 1: Essays do not have to be typed, but they do have to be easy to read.

Note 2: Extensions beyond the submission deadlines will only be granted on medical grounds. Late essays will be marked but a mark will be deducted for each day the essay is late being delivered (the weekend counts as one day, so an essay delivered on the Monday after the deadline would get 6/10 if it would otherwise have got 7/10 having been delivered punctually).

Seminar Topics

Note : Seminars begin in Weeks 3 and 4, and at these first meetings students will select a topic from the list of ten provided below. No students in any one tutorial group will be doing the same topic unless, for some unavoidable reason, numbers in the group exceed ten - so students may need to be quick to stake their claims on particular topics. If a group has less than ten members, any spare topics will be discussed by the group as a whole on the appointed day.

In the second seminar slot, you should arrive prepared to discuss question A4 from the January/February 1986 examination paper (on the topic of consumer protection legislation), in the light of the attached extract from the Ninth Annual Report of the Consumer Affairs Council on Motor Vehicles Legislation and the Consumer Claims Tribunal.

Topics and Times

1. (Weeks beginning 13/20 April and 27 April)

   Woodchip Export Licenses

2. (Weeks beginning 4 May and 1 June)

   Ownership and Control of the Australian Media

3. (Weeks beginning 8 June and 15 June)

   Private Universities

4. (Weeks beginning 22 June and 29 June)

   Immigration Policy

5. (Weeks beginning 6 July and 13 July)

   Restructuring the Car Industry

6. (Weeks beginning 20 July and 27 July)

   The Fringe Benefits Tax

7. (Weeks beginning 31 August and 7 September)

   Trade Wars and Australian Agriculture

8. (Weeks beginning 14 September and 21 September)

   "Incentivation"

9. (Weeks beginning 28 September and 5 October)

   The Proposed LBS/SBT Merger

10. (Weeks beginning 12 October and 19 October)

    The New Right and the Unions.

Students are expected to write a paper of about 2000 words on their topic. They should present the essential arguments in a talk of about 20 minutes to the rest of their tutorial group, leaving the remainder of the time for group discussion. There will not be time for students to read their papers, nor is reading encouraged.

In addition, students are required to produce a summary of their paper, a copy of which they will give to each member of their tutorial group at the start of their presentation. This summary should be no more than about 250 words in length. (It is probably best to work from this, rather than from your full-length paper when doing your verbal presentation.)

Students will be assessed partly on the quality of the written paper and summary, partly on their presentation and partly on their participation in other seminars. In order to score well, the written work will need to be analytical and highlight conflicting economic viewpoints and their foundations, rather than being merely descriptive. Papers and summaries do not have to be typed, but they do have to be easy to read. Students who are due to deliver papers on a particular day and who fail to turn up and perform will receive zero mark for this part of the assessment unless they can produce an apropriate medical certifcate.

Students should use their <u>own</u> initiative when researching their topics - this will encourage an early familiarity with the cataloguing systems of the University Library (the State Library may also be worth visiting) and the paying of careful attention to cross references. Detailed bibliographies should be provided at the end of seminar papers.

MOTOR VEHICLES LEGISLATION

As stated previously the largest number of individual complaints with which the Council has to deal are complaints about motor vehicles. It has long been obvious to the Council that, in order to obviate many of the problems experienced by consumers, legislation is necessary to control the sale of motor vehicles, in particular second-hand motor vehicles. A recommendation to this effect was made to the Government in 1973.

The Government introduced a Bill to regulate the sale of second-hand motor vehicles in 1973 but this Bill was rejected by the Legislative Council. A second Bill was introduced in 1974 and was referred to a Select Committee of the Legislative Council in 1975. Some two years later the Select Committee tabled a report which attempted to entirely change the direction of the legislation requested and included an amended Bill as a recommendation of that Committee. This Bill with some very minor changes, was introduced into the House of Assembly in 1978. The Bill was debated but lapsed when Parliament was prorogued. The Bill has not been re-introduced at this stage. In the meantime, as can be seen by the Council's statistics, the problem has not disappeared.

What are the consequences of the lack of this legislation in Tasmania? Some examples will suffice to show the type of problems experienced by consumers which could be controlled if the legislation was on the Statute Books.

1. A consumer purchased a second-hand motor vehicle on which the odometer reading was 19 000 kilometres. As this reading was unusually low for a vehicle of its age, she discussed the matter with the salesman who, she claimed, did not advise her that the actual distance travelled was in fact 119 000 kilometres. Subsequent investigation by the consumer after she had agreed to purchase the vehicle revealed that the true odometer reading was in fact 119 000 kilometres. When the matter was taken up by the Council the company claimed that the consumer was told that the vehicle had travelled in excess of the odometer reading and that it probably would have been 'around the clock'. The Motor Vehicle Dealers Bill previously introduced into Parliament stated that the odometer reading should be disclosed together with other particulars in a notice attached to the vehicle being offered for sale. In addition, the dealer would have been required in the contract of sale to state that he believed the odometer reading to be true. Had the legislation been in operation, this particular dispute would not have arisen.

2. Another dispute involved a consumer who purchased a second-hand motor vehicle and claimed he was told that it had been reconditioned, and that the registration was current for approximately twelve months. At the time, the vehicle was not fitted with a registration sticker, this purportedly having been lost. The consumer later found quite a serious fault in the vehicle and, on obtaining a new sticker from the Motor Registry, noted that the registration was due to expire some two months after he had purchased it. During investigation by the Council, the dealer stated that the major fault was normal in the make of vehicle in question and he did not see why he should be responsible for the rectification. He also denied that the consumer had been led to believe that the registration was current for some twelve months after the purchase date. Both these points would have been covered if the Motor Vehicle Dealers Bill had been in operation because it would have been a requirement of the proposed legislation that the date of the expiry of the registration together with other particulars of the vehicle would have to be disclosed in a notice attached to that vehicle; furthermore, if the dealer chose not to offer a warranty on a particular defect, he would have been required to place a notice on the vehicle stating that the defect existed and also give a fair estimate of the cost of repairing or making good that defect.

It can be seen therefore that consumers are disadvantaged because legislation which is needed to protect them has not been passed by Parliament. Such legislation exists in every other State except Queensland, which imposes controls on dealers under existing legislation.

CONSUMER CLAIMS TRIBUNAL

It has long been recognised that where disputes between traders and consumers are concerned, particularly where the dispute concerns only a relatively minor amount in monetary value, the consumer is disadvantaged. While the courts are freely available for all, the procedures required to bring a case at law are cumbersome, formal, legalistic and costly. These factors, particularly cost, inhibit many people, particularly those in lower socio-economic groups, from taking or defending minor contractual disputes in court; thus the matters go unresolved to the consumers disadvantage.

After having studied similar systems in the other States of Australia and overseas, it was recommended that a special tribunal to be called a ' Consumer Claims Tribunal ' be established. This tribunal would have the power to deal with minor contractual disputes for both goods and services and would have the advantages of being simple, non-legalistic, direct and final. Only a nominal fee would be required to register a claim before the tribunal and costs would not be awarded to either party.

The Council first considered this problem in 1973, and recommended in 1974 to the Government that legislation be introduced. Following considerable further investigation and research the Government agreed in 1976 to introduce such legislation and a Bill was presented to Parliament in 1977. This Bill was passed by the House of Assembly but was referred to a Select Committee by the Legislative Council in September 1977. Since that time there has been no further action on the Bill and it now appears that any further action will not take place until at least 1980.

What is the Consumer Affairs Council attempting to achieve by recommending such legislation? An examination of the type of problem which consumers experience and which could be resolved speedily and effectively by a Consumer Claims Tribunal follows.

1. A consumer engaged a joiner to manufacture a cabinet. After the cabinet was completed he noticed large cracks appearing in the sides of the cabinet and that the doors were sticking. He approached the builder and asked him to take remedial action. Several unsatisfactory attempts were made but the cabinet obviously could not be repaired. The consumer then brought his complaint to the Council who approached the joiner. However, the firm's reply was received from a solicitor who, on behalf of his client, denied that there were any faults with the cabinet. After considerable correspondence a meeting was arranged at the consumer's home where the cabinet was inspected by officers of this Council, the joiner and his solicitor. As a result of this inspection it was agreed the cabinet would be returned to the builder and he would refund the money paid by the consumer. The consumer subsequently returned the cabinet but the joiner has not refunded the money. Despite several attempts to get him to do so, it appears that he will not. Of course the consumer has the right of recourse through the courts but the costs involved would completely outweigh any recompense he may obtain from the joiner.

2. A consumer placed an order on a florist for a particular type and colour of flower to be delivered to a friend. It was agreed between the consumer and the florist that if the particular colour of flower ordered was not available another colour could be substituted but it was specified that the type of flower was to remain the same. The consumer subsequently found that another type of flower had been delivered and the significance of what she was trying to achieve by sending her friend the flowers in the first place was lost as it depended on the particular type of flower. After Council investigation it was suggested to the florist that, as he had not supplied what the consumer had ordered and paid for, the consumer's money should be refunded. The florist agreed to this reluctantly but only on condition that the original flowers be returned. This was impracticable as not only had some time lapsed and the flowers been disposed of but the consumer would then have had to approach her friend and ask for the return of the flowers which would have been a highly embarrassing situation. The matter was unresolved. Again the consumer could have sued for non-performance of the original contract but because of the amount of money involved it was not worthwhile to take action through the court.

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(No. 77)

3. A concreting contractor was engaged to pour a small patio. The boxing for the patio had been completed by another building contractor, a carpenter, who assured the concretor that the boxing was correct. When the job was completed it was found that the patio had a considerable dip in one end. The concretor blamed the carpenter for this stating that the boxing could not have been level at that point. The carpenter, however, was adamant that it was the concretor's fault. As neither of the building contractors would accept any responsibility the consumer had to have the patio repaired at his expense. Again the consumer could have started the lengthy process of sueing either or both of the contractors, at a considerable financial cost to himself.

There are many other complaints examined by the Council each year involving relatively minor amounts of monetary value and loss or potential loss to the consumer where, if a tribunal was available speedy resolution could be achieved. Every other State and Territory in Australia enjoys such a tribunal or its equivalent and consumers in Tasmania are again disadvantaged because they do not have this procedure available to them. It is legitimate to ask why is it that legislation which would be of considerable benefit to all the consumers of this State has not been passed by the State Parliament? Is it that the interests of some pressure groups are given greater weight than the interests of consumers as a whole? The Consumer Claims Tribunal Bill has the support of the Law Society of Tasmania, one body whose opposition to the establishment of such a tribunal could have been expected as obviously it usurps some of the traditional procedures of the courts. Yet again Tasmania's consumers are being disadvantaged in not being provided by Parliament with the same protection available to their counterparts in other States.

Extract from "Ninth Annual Report of the Consumer Affairs Council, Year Ended 30 June 1979, Parliament of Tasmania, (No. 77).

An Example of a Seminar Paper Summary from 1985 (Courtesy of Ms Lisa Greenhill, Winner of 1985 APE Prize.)

PUBLIC SUPPORT FOR THE ARTS IN AUSTRALIA

NOTE : I have made a distinction between art and entertainment ie non-art TV and radio, and sport. Also my main emphasis has been on the performing arts with special reference to the contraversial case of the Australian Opera.

FUNDAMENTAL QUESTIONS

- Why should the taxpayer pay for the arts?
- Why shouldn't the arts be left to the free-market to support?
- Allegation that the present funding is elitist. Should we subsidize only arts and entertainment which have mass appeal?

REASONS FOR SUPPORT

1. The arts as public goods — therefore failing in the market place.
2. Attraction of business and tourism.
3. National Prestige
4. Redistribution of income — disputed as the arts are not in the same category as basics such as food, shelter and education and demand for arts among the poor is very low.
5. Subsidizing poverty-stricken performers — more rational to subsidize all poor people.
6. Baumols' Disease ⇒ productivity in the performing arts is essentially stagnant creating either price inflation or a growing deficit if prices are held down.
7. Market Failure — in making decisions for the public good + — a fall in quality because the market can often only sustain brief seasons.
8. Problems with private funding ⇒ disadvantaging low income earners.

(9) External Benefits — the interdependence of some art forms
— experimentation and risks ⇒ 'learning from mistakes'
In the high cost of failure would put
off experimentation.

(10) Arts as an acquired taste — cannot afford
mass media advertising ⇒ solved by subsidizing
education and 'out-reach' activities.

(11) The 'conservation argument' ⇒ preserving our
cultural heritage. Opposing argument says can
re-create arts if we let them go through
recordings and international performers / information etc.

* Case for distinguishing between 'high art' and
pop. art.

(12) Provide social comment and criticism.

(13) Arts as 'merit-goods' ⇒ should be encouraged
by public subsidy just because they are advantageous
to society ie One of main reasons for funding
the Australian Opera ⇒ value judgement.

HAZARDS

— subsidies raising the incomes of star performers
— inequality in organizations ability to compete for
subsidies.
— the 'bricks and mortar' approach.
— large institutions become 'hooked' on public support
ie Australian Opera until recently received 74%
of Music Boards $10 million budget
— now frozen at $4 million p.a.
— $2,600,000 deficit by 1987

* Are the benefits worth the expense of funding
a full scale opera?

* Can we ~~spe~~ justify spending more and more money
on a minority art form?

Pages: 1
Questions:
Section A: 5
B: 3

THE UNIVERSITY OF TASMANIA

EXAMINATIONS FOR DEGREES AND DIPLOMAS

NOVEMBER 1985

CEC100 Australian Political Economy

CEC105 Social Organisation and Political Economy

CEC196 Economics 1A (First Paper)

Time allowed: TWO hours.

Attempt THREE questions, TWO from Section A and ONE from Section B.

Answers are weighted equally.

Use separate answer books for each Section.

SECTION A

1. With which assumptions and postulates of neoclassical economics does J.K. Galbraith disagree? What are his reasons?

2. "The counter forces which are continually defeating the forces which make for economic equilibrium are more pervasive and more deeply rooted than we commonly realise" (Allyn Young). Discuss.

3. "The combination of unified financial markets and giant international firms bestriding them provides a ready mechanism for the processes of deindustrialisation to develop wherever the conditions for capitalist accumulation are weakened." Discuss this statement and its implications for Australian policymakers.

4. "No theory which ignores class struggle can adequately explain inflation." Discuss.

5. "Economics is about the role of information in resource allocation" (Neil Kay). Discuss this unusual definition of the subject, with reference to some major debates between "free-market economists" and their opponents.

SECTION B

6. Discuss Adam Smith's view of the role of the State in an economy. To what extent did he believe it was necessary for the state to intervene to prevent the operation of economic forces?

7. Explain what is meant by the term economic rent. Show that pieces of land of differing fertility and land in different locations may have different economic rents.

8. Use neoclassical techniques to discuss the problem of devising a suitable health care system for Australia.

Pages: 1

Questions:
Section A: 5
B: 3

THE UNIVERSITY OF TASMANIA

DEFERRED ORDINARY AND SUPPLEMENTARY EXAMINATIONS FOR DEGREES AND DIPLOMAS

JANUARY/FEBRUARY 1986

CEC100 Australian Political Economy

CEC105 Social Organization and Political Economy

Time allowed: TWO hours.

Answer THREE questions: TWO questions from Part A and ONE question from Part B.

Use separate books for each section.

SECTION A

1. "To the extent that modern capitalism appears to produce economic coherence rather than chaos, this is more the result of the 'visible hand' of corporate management rather than the workings of the 'invisible hand' of the price mechanism." Discuss.

2. "The monetarist model of the economy is fundamentally a revival of the old market model, with a new twist to turn the tables against what are said to be failed Keynesian policies" (M. Barratt Brown). Discuss.

3. "For a Keynesian, economic crises are the result of accident or mismanagement; for a Marxist, they are the means whereby the capitalist system modernises itself." Discuss.

4. "There is no need whatsoever for consumer protection legislation to guard against misleading advertising and unscrupulous sales practices, since such phenomena would provide an incentive for the establishment of businesses that specialise in selling advice to consumers." Do you agree with this statement? Explain your reasoning.

5. What is Political Economy?

SECTION B

1. Discuss the contribution made by David Ricardo to understanding of (a) international trade and (b) economic rent. To what extent do his ideas have relevance today?

2. Devise a health care system that avoids the problems created by an unregulated market system and a "free" government controlled system.

3. Outline the principal themes developed by Thorstein Veblen and explain how his economics differed from that of the neo classical economists of his day.

Pages: 1

Questions: 8

UNIVERSITY OF TASMANIA

EXAMINATIONS FOR DEGREES AND DIPLOMAS

NOVEMBER 1986

CEC100 Australian Political Economy

CEC105 Social Organisation and Political Economy

CEC196 Economics 1A (Third Paper)

CEC298 Economics 2 (Third Paper)

Time allowed: TWO hours.

Answer THREE questions.

1. Discuss the view that the main cause of Australia's balance of payments crisis is poor competitiveness due to unrealistically high wages.

2. "The Medicare system should be conceded to have been an expensive mistake, and Australia should return the provision of health care to the marketplace." Discuss.

3. How useful, as an indicator of the typical Australian's growth in well-being, is information on the growth of average "take-home" pay?

4. "The short-term attraction of agribusiness is beguiling. ... But the disadvantages of agribusiness are numerous" (Sarah Sargent, *The Foodmakers*). Discuss.

5. "The Invisible Hand, if it is to be found anywhere, is likely to be found picking the pockets of the poor" (Edward Nell). Discuss.

6. To what extent does the rise of "The New Industrial State" help overcome the "Richardson Problem" and make "realisation crises" less frequent?

7. What is the relationship (if any) between the rate of unemployment and the rate of inflation?

8. "An increase in the share of profits in National Income is necessary if employment is to be increased, but cuts in money wages are not the appropriate way of achieving this end." Do you agree with all or part of this statement? Explain your reasoning.

Pages: 1

Questions: 8

UNIVERSITY OF TASMANIA

DEFERRED ORDINARY AND SUPPLEMENTARY EXAMINATIONS FOR DEGREES & DIPLOMAS

JANUARY/FEBRUARY 1987

CEC100 Australian Political Economy

Time allowed: TWO hours.

Answer THREE questions.

1. "What's good for Elders IXL and the 'big Australian', BHP, is good for Australia." Discuss.

2. Discuss the view that "greater equality of distribution of income is only achievable at the expense of economic efficiency", a view which Neil Kay has argued to be based on two propositions, namely: (i) The free operation of the market leads to gross inequality of income; and (ii) The free operation of the market leads to highest attainable level of efficiency in the economy.

3. "The truth is that Australia cannot borrow its way out of the unemployment which was inflicted upon our country in 1974-75 - and again in 1982-83 - by a few particularly greedy and ignorant trade union leaders, abetted in some degree by some of their business counterparts and, not least, by the tribunals" (John Stone, shortly after resigning as Secretary to the Treasury, August 1984). Discuss.

4. "'Full employment capitalism' will have, of course, to develop new social and political institutions which will reflect the increased power of the working class. If capitalism can adjust itself to full employment a fundamental reform will have been incorporated in it. If not, it will show itself an outmoded system which must be scrapped" (M. Kalecki, writing in 1943). Discuss Kalecki's view from the standpoint of the 1980s.

5. "The decision to float the Australian dollar at the end of 1983 was a disastrous mistake." Discuss.

6. Discuss the economic rationale for subsidizing the arts in Australia.

7. What is the "Richardson Problem"? Does it have any bearing on the Marxian view that "realisation crises" can be sparked off by "crises of disproportionality"?

8. What are the main causes of poverty in the so-called "developing" nations?

CEC100 AUSTRALIAN POLITICAL ECONOMY

Lecture 1 Summary : What is Political Economy?

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1. Before one can get very far in understanding the ways in which economists have distinguished between Economics and Political Economy it is essential to be able to distinguish between positive economics and normative economics. Positive economics is concerned with explaining how economic systems work and with trying to anticipate the possible results of changes in policies that might affect the workings of the system. Normative economics is concerned with the prescription and advocacy of particular economic policies, i.e. with what should be done. The question of whether or not the introduction of, say, a wealth tax would hamper economic growth is an issue for positive economics. However, the issue of whether a wealth tax should be introduced, given its possible impact on economic growth, is a question of normative economics. A wealth tax might perhaps discourage the accummulation of capital and encourage current consumption at the expense of future consumption. Whether one wishes to advocate it or not will depend on whether one thinks less growth is good or bad, whether the change in income distribution is desirable, and so on : these issues are bound up with the values of the person proposing the policy, with how she thinks the world ought to be.

2. It might seem to follow from this that the training and professional concerns of economists should (a value judgment!) be confined to positive economics. The economist then is cast in the role of expert advisor to people who actually take decisions; the subject can then wipe its hands clean of value judgments and political issues, and assert itself to be a science. Unfortunately, matters are not that simple. Positive economics itself is not independent of the values of economists; their preconceived ideas about how things should be will affect the judgments they make about how things are and could be. All the evidence with which economists work requires interpretation and this requires a prior theory. We see what we want to see and may be absolutely blind to the attempts of others to show us the possible merits in alternative ways of looking at things. So, for example, an economist who believes in individual freedom will tend to find it very easy to admit resons why socialist systems may work in particular 'bad' ways and be very good at throwing up objections to socialist objections to her predictions about the workings of a free market system. Unless pressurised to do so, such an economist will not at all times keep alternative views in mind.

3. A related problem is that it is by no means easy to live with ambiguity about how economic systems do work even if one has been made aware of the ways in which the human mind biases how we see things. Policy makers, and undergraduate economists, typically want to know how the system does work, not the variety of ways in which it might. The former tend therefore to appoint as advisors economists whose positive conclusions will reinforce the policies that to which they are predisposed. Within universities, it is very common for teaching to be slanted in a particular way, partly to keep life easier for students and partly because the majority now in the faculty do not wish students minds to be distracted by material which goes against their ways of looking at things and gets in the way of teaching them.

4. Originally, the term political economy had nothing to do with issues relating to values and predispositions. Its origins in Greek are translated as State management (as distinct from economy which is 'household management'). Adam Smith equated the term both with 'the study of the nature and causes of the wealth of nations', and with the understanding of how the government might be provided with enought revenue to undertake public services. The first significant economist to write a major treatise simply on 'economics' was

Alfred Marshall. He equated the 'political' aspect with sectional interests, not with the economics of the system as a whole. In the early part of this century, the Swedish economist Knut Wicksell retained the 'political' label, but pointed to the difficulties of keeping political considerations out of the economics of the system as a whole :

> "As soon as we begin seriously to regard economic phenomena as a whole (as they affect all the community) and to seek for the conditions of the welfare of the whole, consideration of the interests of the proletariat must emerge; and from thence to the proclamation of equal rights for all is only a short step. The very concept of political economy, therefore, implies, strictly speaking, a thoroughly revolutionary programme."

5. Wicksell's comments have resurfaced in the modern work of the radical Left who claim that orthodox economics 'tries to show that markets allocate scarce resources according the relative efficiency' in contrast to their own political economy which 'tries to show that markets distribute income according to relative power' (Nell). The orthodox economist usually confines attention to scope for the rearrangement of resource use in a way which will benefit someone without causing anyone to lose out (what is known as a 'Pareto improvement', after another turn of the century economist who took a different line from Wicksell). The orthodox economist takes the starting point in terms of the distribution of wealth and skills as given, arguing that politcal measures to change such distributions by changing the distribution of power are outside the scope of economics. The radical economist argues that the existing distribution of wealth determines the kinds of changes to the system that can be made according to the rules of the system : the market system is seen as unjust and prone to perpetrate injustice, since influence goes to those who own the means of production.

6. A recent article by Arndt suggests that nowadays 'poltical economy' is :

   i) no longer an appropriate term for positive economic science, despite its pre-Marshallian meaning

   ii) not a sensible term for interdisciplinary studies by economists and political scientists

   iii) not really appropriate for describing attempts to theorise about behaviour outside the normal realm of economics, in terms of economic concepts. (Recently, economists have produced economic theories of democracy, bureaucracy - 'economising' politics as opposed to politicising economics!)

7. Instead Arndt suggests three legitimate uses of the term 'political economy'

   i) to describe principles for forming policies on occasions when economists feel inclined openly to avow their personal value judgements while still declining to advocate particular policies.

   ii) to refer to the study of power as a determinant of economic phenomena, particularly the distribution of income and wealth

   iii) to refer to expositions of comprehensive sets of economic policies based on the strength of normative underlying principles but Arndt says this is not a scientific activity and is hence inappropriate to a university curriculum.

8. For my own part, I see a course in political economy as serving to explain how economists come to differ in their view as to how the system does work, and in whose interests it works. Thereby I hope to encourage open-minded, critical thought about matters of public policy. This is not the same as point 7(iii).

CEC100 AUSTRALIAN POLITICAL ECONOMY

Lecture 2 Summary : Economics as a Coordination Problem (1)

1. Economic systems are without doubt complicated. The typical supermarket may have 10,000 brands of product on sale. These items are the output of production systems employing many thousands of distinct inputs, which are themselves outputs of other input-using systems. For example, steel may be used to make machines and to make machines made by steel machines. The finished machines may then be used by a mining pricess to extract iron ore for making steel. One might even regard ultimate consumption goods bought by workers as necessary inputs in their own production - after all, if the workers don't like what they are able to purchase as a result of working, they may withdraw their labour and less will be produced unless their employers appease them by offering more.

2. This input/output problem does not merely arise in relation to a single point in time (is today's set of outputs suitable as inputs for today's planned outputs?) It also has a time dimension : people have to make decisions about investments which will take a long time to come to fruition, and what one can do at a later date will often depend decisively on what one chooses to do right now (choices of careers, TV transmission systems and railway track widths are obvious examples).

3. If decision making is decentralised, the question naturally arises as to how one can avoid chaos in such a complex system, and whether things might be even better if the system were run according to some other arrangement. Proponents of 'free-markets' suggest that changes in relative prices guide people, like an 'invisible hand', to make decisions that are not only coherent but difficult to improve upon by changing to a centrally directed system. Free market economics is essentially the economics of supply and demand. If prices rise, people will turn their attention to buying relatively cheaper products, so sales of the newly expensive product will fall. This is shown graphically as a downward sloping 'demand curve'. For firms to produce more of a product they will need to obtain inputs. If the economy is fully employed, or if there are structural bottlenecks, firms will only be able to obtain resources by bidding them away from other users. So expansions of production may involve extra costs - firms will only wish to expand output if they expect to get a higher price per unit then they currently receive. This is shown graphically as an upward sloping 'supply curve'. Where supply and demand curves intersect is a price/quality combination at which there is no incentive to enter or leave the industry.

4. 'Free market' economists argue that profit incentives (i.e. anticipated excesses of revenue over expenditure) will attract people into markets. Extra output will push down prices of output, extra demand for inputs will raise input prices. The incentive for further entry is diminished as we move closer to the S/D intersection. In the input producing industries, similar processes will be at work, and similarly in the industries producing inputs for the input industries, and so on. Given a stable set of preferences for consumption goods, supply and demand might eventually come into balance across the whole economy without any government direction being necessary.

5. Unfortunately, this simple story misses some important difficulties. First we should note the 'Richardson Problem'. Richardson asked : how can a firm decide whether to enter a market if it can see, currently, an excess of goods demanded over goods supplied, or if it anticipates a growth in demand in a market presently in balance? Its scope for profit depends not merely on it being right

about demand for the product; it must also guess who else is going to try to produce it and whether the supply of inputs will actually be available at viable prices - which depends on investment in input-industries. All the other firms thinking of entering the market face the same problem. If no one enters, the existing producers may make fat profits. If lots of new capacity is created, huge losses could result - either because the product can only be sold at knockdown prices, or because a deficiency of input supplies means that many plants cannot operate at all.

6. Richardson argued that chaos would be most likely to occur in markets where the typical size of firm is small relative to the total sales and where entry is easy because the technology is simple. Agriculture is the classic example. If there are only a few firms who know of a potential profit opportunity and can act upon it we should not expect too many disasters, for the firms in question can more easily spy on each other. To ensure that inputs will be available they can cultivate regular arrangements (not necessarily formal contracts) with suppliers or, if all else fails, engage in vertical integration - producing inputs for themselves. An interesting implication of this view is that 'big business' might be a more efficient form of capitalism than having lots of privately run small firms - at least as far as avoiding coordination failures is concerned.

7. The views of Richardson suggest that current prices do not provide enough information to ensure that the 'invisible hand' works. It should also be noted that acts of vertical integration, to guarantee reliable supplies or distribution, actually involve the partial abandonment of the market as a means of coordinating activity. Someone in a firm <u>tells</u> a supplier what to do, <u>within</u> the firm. By extension we might consider the possibility of going as far as possible in the direction of abandoning the market, and have Central Planning, in which 'enterprises' are <u>told</u> what to produce and to whom they can deliver it at which prices. In such an arrangement perhaps the only 'markets' might be those where consumers bought the final product. State ownership of enterprises might well be necessary to ensure compliance with directives.

8. If the Central Planners had an accurate set of demand projections and data about the productive capabilities of the economy, they could, given a big enough computer, work out a set of relative prices and quantities such that no final consumer goods were left unsold or with waiting lists, and all the enterprises balanced their costs and revenues. Instead of fumbling around (cf. Dobb's dog/master pursuit curve analogy) for the right mix of outputs and wasting resources on the way, one could go straight there.

9. Central planning has its problems too. If firms are not allowed to make large returns from acting on their own initiatives and will not make losses if they merely do what is asked of them, what incentive have they to innovate? Hirschman argues that it may be inappropriate to see supply and demand imbalances as waste : these are the things that generate dynamism in the long run. Secondly, the complexity of the planning task means that planners, even aided by computers, have to take shortcuts, so unexpected events happen and people blame each other for the trouble instead of seeking to do something about it to generate market goodwill and long run profits. A <u>general</u> presumption in favour of <u>either</u> socialism <u>or</u> the free market <u>may</u> thus be rather unwise, though this is not to say that pragmatists will always get things right and that a mixed-economy is necessarily best.

CEC100 AUSTRALIAN POLITICAL ECONOMY

Lecture 3 : Consumer Sovereignty

1. This lecture aims to consider who in an economy has the power to determine what gets produced, in terms both of relative quantities and product characteristics. 'Free market' economists have for long argued that ultimately it is the consumer who is king. If they wish to make profits, firms will seek to produce the things that consumers wish to buy. They will engage in extensive market research, trial marketing operations, customer clinics and so on, all aimed at seeing how acceptable their products seem to prospective buyers. They can also attempt to draw inferences by experimenting with what they offer and by studying the fortunes of their rivals and trying to produce something better. They may not hit the mark first time round, but their reasons for missing arise from irreducible uncertainties, with which socialist planners would also have to contend. At least under free enterprise there is the fear of losses to ensure that firms see it is in their interests to deliver what customers want and try to satisfy them in the long run, so they keep coming back with rebuy orders.

2. A forceful critic of the free market view has been Galbraith. He argues that the idea of production being a means towards the satisfaction of consumer wants looks highly questionable once one recognises that there are very few wants which an individual left to her own devices would experience spontaneously : it is hard to think of examples beyong food, shelter and sex. Such thinking leads Galbraith to argue that 'As a society becomes increasingly affluent, wants are increasingly created by the process by which they are satisfied.' People either start wanting things because they come to see others consuming them, or because they fall victim to active strategies of want creation on the part of producers. Galbraith calls the hypothesis, that wants depend on the process by which they are satisfied, the Dependence Effect.

3. Hayek, a leading free market economist, has argued that the Dependence Effect simply doesn't follow in any precise manner. What firms seek to do by way of their design and sales strategies is but one aspect of the factors that may influence consumer choice. But one should not forget the cultural aspect of consumer behaviour. If one dismisses the importance of all non innate wants, then one is effectively saying 'that the whole cultural achievement of man is not important'. Wants for literature, for example, are not innate; an author had to create a book as a risk taking exercise. Readers did not commission it. A book's appearance as a novel product may result in wants spreading to read it. If we accept Galbraith's view we end up saying that literature is unimportant, so do we than say it is worthless, that it should not be produced?

4. Galbraith is certainly keen to suggest that firms can get consumers to buy intrinsically worthless products via their sales campaigns and, even if they cannot do so, we might still want to voice concern at the use of resources in attempts to generate sales. For example, suppose advertisements all cancel each other out. Those involved in these fruitless campaigns could be employed on 'worthwhile' projects. Consumers might also get products more cheaply. This latter argument is based on the idea that advertising has economies of scale (full page ads make bigger impacts than small ads, repeat ads are cheaper, and so on) so existing firms can use extensive advertising campaigns to keep new firms from entering the market and driving the price down. Additionally one can note that even in the absence of prospective entrants, any single existing firm may find it hard to cut back its campaign without losing out to rivals. (Ads <u>may</u> not enlarge a market for a type of product, but they may affect relative shares of market brands).

5. Free market economists would offer a variety of defenses of sales ploys used by modern companies, I now consider some of them and some counter-comments.

5.1 If firms try to mislead consumers about the properties of their products, in ways which would anger the consumers if only they know about them, then there is an incentive to enter the market for providing consumer information as a product in its own right. However, such information might be under-provided for a variety of reasons. First, it may be too easily passed on by potential purchasers, so there may not be enough buyers to make its production viable, even if many people actually used it. Secondly, it might be more lucrative to be <u>in</u> the business of misleading the consumer. Thirdly, in an age where consumers are being bombarded with masses of claims and counterclaims, it might require a very extensive advertising campaign to sell the service of providing accurate information. These arguments rather imply a possible need for a state agency to act for the consumer.

5.2 Much advertising is informative, trying to bring new ideas about choice to the mind of the consumer, so that she at least experiments with a product or seeks a demonstration. In other words, advertising is a means of entry into imperfect markets. Insofar as consumers do experiment with new brands, one result may be a downward pressure on prices of rival products. Informative advertising enables consumers more easily to make independent judgements, for instead of conforming with majority tastes, they can act in a deviant manner and defend themselves with arguments which they might not possess if less advertising existed. Against this view we may note Round's conclusion (<u>Economic Papers</u>, March 1984) : 'Based on our sample, manufacturing firms advertising in consumer magazines in Australia appear largely to try to persuade rather than inform the consumer, if the provision of price information is used as the objective numeraire for information. It can be argued that this represents the desire by firms to entrench brand preferences and encourage habitual buying, giving the firms some degree of monopoly power and resulting in resource misallocation. Non-provision of price information may also lead the consumer to make non-optimal decisions, especially if market search to discover the price of rival products is expensive or difficult for the consumer to undertake.

5.3 Firms cannot use advertising to force 'useless' products on to consumers. The might of the Ford Motor Company could not sell the Edsel car successfully in 1957-8 and millions of dollars were lost. Du Pont Chemicals similarly lost millions in the 1960s in trying to sell 'Corfam', a leather substitute. Nor could advertising campaigns prevent the loss of markets to products from Japan, Taiwan and Korea. Against this, a Galbraithian would reply that, armed with a knowledge of customer psychology, a firm may often be able to create 'spurious' wants and then sell products to meet them, on the basis of misleading presentations which consumers lack the specialist knowledge to challenge (cf. the deodorant example).

5.4 If consumers don't like being bombarded with advertisements, or the forms these take, they are, in a democracy, in a position to elect politicians who will change laws in their favour. It will be in the interests of self-seeking politicians to be aware of such feelings. However, economists of, particularly, the Radical Left, would argue that Big Business can exert substantial influence over the processes of government. Indeed, many of the Radical Left would argue that the ultimate deception of consumers concerns the ability of military industrial interests to get heavy armaments expenditures sold to the gullible populace (with the aid of ex 'B-movie' actors cast in new roles as ageing 'puppet' presidents ...).

Where There's Smoke, There's Money

By Robert Sherrill

THE SMOKE RING: Tobacco, Money, and Multinational Politics. By Peter Taylor. Pantheon. 328pp. $18.95.

PETER TAYLOR is the British television producer-reporter who did a documentary a few years ago called *Death in the West — The Marlboro Story*, in which he interviewed six American cowboys who had two things in common: they had been heavy smokers for many years and they were dying of lung cancer. The most memorable of the lot was the cowboy who rode the range with tubes running out of his nose to oxygen tanks strapped to his horse.

Philip Morris, makers of the cigarette, went bonkers when it heard its famous invitation, "Come to Marlboro Country", used to introduce these cripples, so it went to court and the documentary promptly died of injunctive emphysema. Except for a bootleg version, it has never been shown in the United States.

But Taylor does not give up easily, and here he returns to the attack with *The Smoke Ring: Tobacco, Money, and Multinational Politics*, a book that incidentally raises the question of how come British TV manages to find such literate personnel and our TV industry is so luckless in that regard.

Fear not; this isn't just another antismoking treatise. It is a sensible and altogether fair consideration of "why governments place wealth before health" and an examination of "the political and economic mechanisms of the power of tobacco". Taylor pursues his objective in a sprightly style, avoiding the medical soupiness and keeping his eye always on the hard-headed (and often wry, not to mention grotesque) political and economic practicalities.

We're talking big bucks. We're talking six giants who produce around 40 percent of the world's cigarettes (the rest are produced by state-owned companies, mostly in commie countries). The biggest of the lot is British-American Tobacco Industries (BAT), which employs a quarter million people and sells $10 billion worth of cigarettes each year in 78 countries on six continents.

When an industry pumps that kind of money into the employment-taxation pipeline, it's mighty hard for politicians to act as upset as you might expect from the fact that this same industry produces a commodity that, by Taylor's count, "has wiped out more people than all the wars of this century".

Politicians have counted the dead, have weighed them against tobacco's economic bounty, and have cold-bloodedly come down in favor of the latter. Taylor doesn't agree with the decision, of course, but he sympathizes. After all, tobacco is Britain's third biggest source of consumer revenue, and "an analysis of the cost of a packet of twenty cigarettes shows why governments hold tobacco so dear; the retailer gets roughly ten pence; the manufacturer fifteen pence; and the Chancellor of the Exchequer seventy-five pence". In the United States, tobacco's contribution is equally bountiful — $57 billion of the GNP, $14 billion of total federal tax revenue, $7 billion of total state and local tax revenues, and a $2 billion net surplus on the balance of payments. It creates jobs for nearly half a million people directly and 2 million overall.

It is hardly surprising that Congress and the president — any Congress and any president — buckle under so easily to the relative handful of members (tobacco is a major crop in only 27 of our 531 congressional districts) who front for the industry. Parliaments and prime ministers, we learn, are just as sympathetic to this deadly business.

But that is hardly the end of tobacco's moneyed influence. It spends $2 billion a year globally on advertising (by comparison, the American Cancer Society and the American Lung Association spend about $7 million on antismoking education) "to reinforce its own myth that smoking is a socially desirable habit," writes Taylor, and he is so rude as to notice that this outlay buys, if not always support, at least a congenial silence. Some of the popular magazines, such as *Ms.* and *Redbook*, that get as much as 16 percent of their revenue from cigarette advertising, carry a lot of health articles but none on the hazards of smoking.

Although their ads have for years been banned from television in both the U.S. and England, the tobacco companies have managed, especially in England, to buy their way around that proscription very nicely. They sponsor athletic events, everything from car races to cricket matches, where cigarette brand names are splattered all over the scenery — which is much cheaper and more effective than straight advertising. In a typical year, the BBC (its officials admit "we are being used") carries close to 300 hours of these cigarette-sponsored events.

And of course tobacco money reaches flood tide when the industry is scared by something like California's Proposition 5, which offered voters a chance to outlaw smoking in public places. At first it was given a 3 to 1 chance of passing, but the industry bought enough media space — spending more than the two gubernatorial candidates combined — to sink it.

This story is not wrapped entirely in pessimism. Not all public officials bow to the industry's demands. President Reagan may have promised North Carolina tobacco farmers that "my own Cabinet members will be far too busy with substantive matters to waste their time proselytizing against the dangers of cigarette smoking", but in fact when Richard Schweiker was Reagan's Health and Human Services secretary he supported Surgeon General Everett Koop's militant opposition to cigarette smoking. Indeed, North Carolina Senator Jesse Helms accused Schweiker of being guilty of "incipient Califanoism" — a nice backhanded compliment to one of Schweiker's predecessors, Joe Califano, whose antismoking zeal got him bounced from the Carter Cabinet.

Consumers, too, are coming to their senses. While America's 53 million smokers are spending more than ever on their habit, the number of smokers is declining — down 17 million since the U.S. Surgeon General's report in 1964. In England, cigarette smoking still kills eight times more than the number who die in auto accidents, but at the same time Britain can now claim twice as many nonsmokers as smokers.

These declines are more than made up, however, in the Third World, which is puffing up a storm. America exports nearly half of the tobacco it produces, and most of it is dumped on the Third World. Twenty percent of Thailand's individual income goes into cigarettes. Cigarette consumption in Pakistan is growing six times faster than in most Western countries; in Brazil, eight times faster. The lung cancer rate is, of course, also jumping. But what tobacco does to Brazil's lungs is nothing compared to what it is doing to Brazil's landscape. The province where 70 percent of Brazil's tobacco is produced was once heavily forested. Now its horizon is barren of trees. They were chopped down, at the rate of 1.5 million acres of forest a year, to burn for curing tobacco.

If that situation sounds just a bit irrational, it fits very well into much of this story, which abounds with people like the Philip Morris vice president who argued that eating too much apple sauce could be just as harmful as smoking too many cigarettes; with organizations such as the AMA, which, while certifying the deadliness of tobacco, held $1.4 million worth of shares in tobacco companies and gave political support to tobacco crop subsidies; and with consumers such as the 48 percent of lung cancer patients who begin smoking again shortly after leaving their tumors at the hospital.

The Smoke Ring says a lot for Peter Taylor's intelligence, but not much for mankind's.

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CEC100R AUSTRALIAN POLITICAL ECONOMY

Lecture 4 : Economic Growth : Green Economics?

1. Although supporters of free enterprise and of socialism disagree fundamentally over the apporpriate way to run an economy, they seem both to believe that economic growth is a good thing. Indeed, a good deal of the argument between them concerns the relative efficacy of alternative economic systems as means of increasing production. But there is a growing movement - popularly called the Greens or Greenies - who have called into question the idea that economic growth is a good thing. As this lecture will attempt to demonstrate, the Greenie perspective is not the only way of questioning what one might call 'growthism'.

2. Greenies argue that economic growth today raises grave difficulties for the future survival of life on earth. Non-renewable resources, such as coal, oil, metals and other ores, are in the process of being depleted rapidly. Worse still, the basis even of renewable resources is being eroded, possibly with disastrous effects on the climate in the longer term. For example, deforestation of the Amazon basin is replacing forests with grazing land (for beef cattle) of an area equal to the size of Germany every two and a half years. The loss of forests is argued to represent a lost reserve of climatic moisture for rainfall. In Europe, it is argued that sulphur dioxide fall out from chimneys is rapidly killing forests. The use of aerosols releases into the atmosphere chemicals that may distroy the ozone layer and let through lethal amounts of ultra violet light. As resources become scarce, international tensions may be expected to increase and with them the risk of nuclear war. The spread of technology also enhances this risk.

3. The arguments of the Greenies have been called into question by some scientists, as well as by politicians. For example, Greenies tend to be anti-nuclear, period. However, nuclear power stations might do far less to disturb the climate than thermal stations. Interestingly, there is disagreement over possible disaster scenarios here : one view argues that industrial air pollution will increase cloud cover and lead to a drop in world temperatures, whereas another view argues that carbon dioxide produced by combustion will raise temperatures and lead to the melting of the polar ice caps and a rise in the sea level producing worldwide flooding.

4. Many alarming conclusions about the physical reasons why growth is dangerous and can't continue are based on a static view of conditions of production, relative prices and knowhow. Extrapolation of trends with inbuilt compound interest will naturlly produce extreme conclusions. But, so the free market economists suggest, trends will be altered as people respond to incentives. Expected high oil prices will encourage exploration and encourage owners of existing known deposits to keep them in the ground. Such prices will also encourage attempts to develop substitutes or more economical uses of such inputs - wind, wave and solar power, insulation, smaller, lightweight cars, and so on. It is often forgotten that the price of oil fell steadily in much of the boom years period of the 1960s, as more and more deposits were discovered. OPEC has been somewhat taken aback by the extent of moves in the direction of energy conservation in the past decade. It may also be argued that economic growth tends naturally to result in the production of commodities that are increasingly knowledge- not resource-intensive, as well as of waste-reducing and recycling technologies.

5. Growth-pessimists are not unaware of such possibilities. Mishan, for example, concedes that in two hundred years we have moved from wood to coal to oil to nuclear energy, but says that 'a man would have to be recklessly optimistic to infer from these historical events that a future dearth of materials were without foundation'. He wrote this in 1972, at which time the US had 6% of the world's population and consumed 40% of the world's output - the idea that everyone might

be brought to US standards may look highly implausible in the light of such figures. Another of his examples was the rapid growth of air transport, but he might now have to concede that in many markets saturation of demand has largely set in, and that modern planes use less fuel, are less noisy and, being bigger, require the construction of fewer airports.

6. Hirsch took an entirely different line of attack in his book Social Limits to Growth, his emphasis being social, not biophysical. He observed how it was often argued that growth was the means by which a capitalist system could remove poverty and general economic injustice. Commonly it is suggested that a more equal distribution of income would decrease saving and increase current consumption at the expense of longer term growth and hence hold back the alleviation of poverty. However, Hirsch argued that for free market capitalism to work effectively as a means of removing injustice, the people within the system must behave with a sense of social obligation and morals - which will be absent if there is a feeling that the system is unjust. For example, if the rich avoid taxes legally because they can afford advice on how to take advantage of the law, the less affluent will be more inclined to evade tax payments and take disruptive industrial action. Pursuit of self-interest may result in a system of monopolistic firms that lack incentives to be dynamic. In general, Hirsch argued, the more we learn how to maximise our individual benefits, the more capitalism requires governent intervention to limit our behaviour, or else it will grind to a halt : the much extolled virtues of the free-market are unobtainable without fetters.

7. So far, I have not considered the question of precisely what is growing if there is 'economic growth'. Mishan, like Galbraith before him, has forcefully argued that published Gross Domestic Product figures tell us little about changes in consumer welfare in the recent past, quite apart from telling nothing about future disaster potential (they do not record depletion of resources). Externalities - spill-over effects of production and consumption - are not picked up as part of GDP since they are not marketed. For example, payment for air travel raises GDP but extra aircraft noise does not reduce it. The arrival of hoards of package tourists, similarly imposes an unrecorded loss of welfare on tourists who previously could find solitude, not noise and hotels, in distant locations. The costs of using the market and vagueness of property rights mean that losers are not compensated for their losses and/or cannot bribe people not to impose losses on them. GDP records the production of cars but not the stress of using them, the inconvenience of congestion, the 125000 motoring deaths each year, the pollution. We have private affluence but public squalor.

8. So far, I have also neglected to consider what people want out of life. The orthodox, anti-Galbraith view portrays consumers as having seemingly inexhaustible wants, playing down the role of experience and social interaction. Psychologists see things rather differently. They note that people have aspiration levels, targets that they revise up or down in the light of their attainments. If one doesn't expect much in the way of consumtion goods one may be much happier than someone who has more and expects even more than she has. Some psychologists argue that basically people are just trying to predict and control events, so their lives don't seem like an endless stream of impossible exam questions. Growth can help here, but may not - think of executive stress for example. Scitovsky argues that people get dissatisfied if they find life either too uncertain or too predictable (boring!). Modern comforts make life boring in many ways, he argues.

9. Hirsch (and, to some extent Mishan) argued that people were keen to consume more as a means of establishing their status relative to other people; so if everyone consumes more, no one may feel better off. And we can't all enjoy positional goods, such as servants or 'exclusive' holiday resorts (though note that congestion on holidays could occur even with entirely uniform growing money incomes).

CEC100 AUSTRALIAN POLITICAL ECONOMY

Lecture 5 : The Labour Market and the Political Economy of the Family

1. It is not merely in respect of matters such as pollution and resource depletion that GDP statistics may be misleading when used as indicators of changes in economic welfare. In the area of labour economics they also conceal a good deal of factors pertinent to well-being. First let us consider the question of what radical economists call worker 'alienation'. Worker discontent is often argued to result from changes in the production process that diminish the significance of the individual as marketed output is increased. The alienated worker, like the hero of Charlie Chaplin's Modern Times, feels like a tiny cog in an uncontrollable machine, and very distant from the end product of the process.

2. Worker alienation may result in trouble for employers if workers band together or neglect matters of quality control in retaliation or boredom, yet the radicals would argue that employers have strong incentives to create such dehumanising systems. The way for employers to get control over output rates for particular wage payments/hours worked is to use technology to destroy worker skills. By making worker tasks less and less complex, despite their seeming more specialised, the employers can seek to remove worker power : 'if you won't do this, there are plenty outside who could be shown how, with minimal training, and who would dearly like your job'. This deskilling process may be traced back to the rise of the factory system as an alternative to the use of outworkers, through the demise of apprentice-ships and the rise of mass production assembly line techniques, to current battles with craft unions over new technologies in the printing industry. Competition amongst employers has been a force behind this replacement of skills with technology, but in some cases competition has stood in the way of the process : newspaper print workers have been able to resist the deskilling process over a long period because of the perishability of the daily paper is such that employers face strong short term costs if they individually try to tackle small numbers of print workers who have cultivated support from less skilled colleagues.

3. To the extent that skills remain and are in relatively short supply, how is the employer to exert leverage over workers? The answer would seem to be via the use of an 'internal labour market' and pyramid-shaped hierarchy of promotion possibilities. The worker is not alienated by being totally insignificant, but is instead subject to the stress of trying to out-perform her peers if she wants advancement. Rises in income are achived only infrequently by moving between firms; instead, the worker must compete for higher status where she presently works. Internal competition replaces market competition, at least for those who can get relatively secure 'primary' jobs.

4. As well as failing to capture changes in worker stress and alienation levels, GDP statistics leave out any measure of the value of non-marketed labour services. Each household can be thought of as being a production system like a firm, and everything that takes place within a household is something that could be bought and sold in the market. Yet GDP statistics take no account of the value of do-it-yourself household outputs of meals, cleaning, gardening, entertainment, companionship, child rearing, and so on. Nor do they record barter transactions among households ('favours') which are exceedingly widespread (see R. Pahl (1984) Divisions of Labour). The closest most economists get to analysing this is to note, jokingly, that, if a man marries his housekeeper, GDP falls.

5. Inevitably, this state of affairs angers feminists. Once we start inputing a market value to services performed by women for their male breadwinners we see that it adds up to something that exceeds not merely what men give their wives from their wages, but also in many cases it will exceed the entire male wage :

women are exploited by their male counterparts. Now, of course, if all household activities were run on a market basis, one might expect pretty dramatic shifts in relative patterns and hours of work : to pay for their accustomed services men would need to work longer hours, and would tend to drive each other's wage rates down. Men might be more inclined to perform household duties themselves then pay their wives for doing so. But, at present female subordinacy facilitates the growth of male consumption.

6. This has not gone unnoticed by Galbraith. Modern advertisements depict women in the crucial role of homemaker, celebrating the power of women in the market, and yet real control over lifestyles is not exercised by wives choosing between cakemixes, but by husbands who enjoy the services their wives perform by way of household management and consumption preparation. Women are in fact cast in a crypto-servant role. (See <u>Economics and the Public Purpose</u>, Ch. 4)

7. Aside from the managerial requirements of increasing household affluence, one can see that capitalist development has generally been associated with the deskilling of women in the home; a process which leaves them ill-equipped for breaking out into economically independent lives. As early as 1911, Olive Schreiner argued that women were losing skills in the making of clothing, bread, beer, medicaments, and in the provision of nursing and educational services, as more and more household inputs came from factories and social services. They were being reduced to parasitic child-bearers and sex-objects. With modern gadgets and convenience foods, the woman is left with skills in dusting, cleaning and looking decorative, confined to her home and dependent on her husband unless she has established and maintained a career.

8. The discussion so far has emphasised the non-marketed nature of household production without seeking to explain the household/firm : female/male division of labour. The feminists are unimpressed with the orthodox economist's explanation, which runs in terms of efficient allocations of time and patterns of skills. This 'explanation' would suggest that, if women's acquired skills are geared toward the household rather than toward firms and government bodies, women will specialise in working at home and men in paid employment, owing to relative wage possibilities. But this 'explanation' clearly takes for granted the distribution of skills that feminists see as needing to be changed if women are no longer to be placed in subordinate positions. Unless one appeals to some crude 'biologism' it does not seem obvious why the sexual division of labour <u>should</u> go beyond reproductive roles. Present skill differences arise from attitudes that are self-reinforcing, given weak equal rights legislation : the payoff to investing in education seems lower for a woman, given current female wages, so women, even if not steered by teachers and parents into subjects that are not employment oriented, acquire less marketable skills. Higher female absenteeism rates, fear of resignation in pregnancy, or to move when the husband moves, leads firms not to train and promote women, so there are few women displaying high wages in responsible position.

9. From the standpoint of the (largely male) capitalist class, the coming out of females from the home to the market place, liberated in attitudes, or released by modern time-saving products, is problematical. The long run effects on the labour supply (if women have fewer children) and supply of passive, mobile executive wives and 'crypto servants' is one problem. In 1890, Marshall maintained that woman's employment is detrimental, because it tempts them to neglect their 'duty' of building up a 'true home' and investing their efforts in the personal capital of their children's character and abilities. On the other hand, female labour may be useful as a counter to male resistance to technical change and deskilling. If women are less attached to employment and possess fewer skills, they can 'justifiably' be employed in 'secondary' jobs, outside the promotion structures of internal labour markets, and easily laid off if demand contracts. By employing women (and racial minorities) in low status roles, firms can delude primary sector workers into being less aggressive about their own positions. So firms may have an interest in reinforcing sexism

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Lecture 6 : The Growth of Big Business

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1. The famous US business historian Alfred Chandler has characterised the growth of big business as 'the visible hand', meaning that increasingly the market mechanism is being replaced by internal managerial hierarchies as a means of coordination. Galbraith has claimed that a 'new industrial state' has emerged. But most economists continue to write as if nothing significant has happened. In this lecture, I consider the main points of Galbraith's thesis in turn, with orthodox criticisms and Galbraithian replies.

2. **Thesis** : The characteristic form of organisation is not the petty, family firm but the giant multiproduct corporation.
Criticism : It is not obviously any more appropriate to characterise the economy as General Motors everywhere, instead of family businesses, especially so in an increasingly service oriented economy. The economy is neither monopolistic or perfectly competitive.
Reply : Unlike orthodox economists, Galbraith is not trying to offer an all embracing model of the modern firm, but to focus attention on an important part of modern economic activity.

3. **Thesis** : With a few exceptions, the giant corporation is in no sense run by its owners, the common shareholders. The complexity of business and the costs of getting a mass of dispersed shareholders together means that top management is little influenced by shareholder attitudes : if a company is doing badly, shareholders may sell out, but they will not normally get together and appoint new managers. Important decisions are perforce made by a bureaucracy, organised as a series of overlapping and interlocking committees. The members of the bureaucracy are all experts in something and to some degree able to exploit their knowledge to suit themselves; they comprise the technostructure.
Criticism : Many large firms are actually likely to be run in owners' interests as a result of top managers possessing valuable shareholdings relative to their salary sizes, even if they each only own a fairly small part of the whole. Stock-option schemes help promote this, but a surprisingly large number of giant enterprises are still family-dominated. Market forces will constrain firms to strive for profit whoever controls them, and the sheer size of a firm does not mean it is immune from competition : small new firms might not trouble it, but it must beware of entry from established firms in related areas of business. The technostructure must look to the market, not to what suits their own interests.
Reply : Knowledge is power, any member of the technostructure who has some specialist knowledge is in a position to carve an empire of some sort to suit herself, without being discredited by a rival.

4. **Thesis** : The modern giant firm is a planning system which finds it both inconvenient and unnecessary always to respond to the 'dictates' of the market. With large, highly input- and output-specific plants shortages of supplies and customers are very inconvenient. The modern firm will avoid such problems by backward and forward integration (e.g. by buying raw materials suppliers or distributors or corporate customers) and by persuasive advertising and the lobbying of politicians. To escape from the fickleness of the stock market, the firm will set its prices so as to generate enough funds for investment internally. In general, it is in the nature of a highly capitalised bureaucratically controlled corporation to avoid risk.
Criticism : External financing by firms is far from trivial. In 1966, as Galbraith was writing his book, US non-farm non-financial corporate businesses used up $96 billion funds - $59 billion internal and $37 billion external. Moreover, one might argue that any tendencies to use internal funds is the

result of taxation policies that hit dividends more heavily than capital growth, rather than the result of risk-aversion by firms. Vertical integration is a dangerous business in a world of sudden changes in demand and technology. For example, Levis were fearful of unreliable supplies of denim cloth for their jeans but they still buy from other firms because they are also fearful of the fickleness of customers of fashion goods, despite their advertising campaigns and brand reputation. Neither sales staff nor consumers recognise that advertisements are decisive (see Lecture 3 for other arguments) and the evidence seems to sugest that consumer demand is very much a function of confidence in economic prospects, not of selling efforts - Katona's book The Powerful Consumer explores this at length in a direct attack on Galbraith.

Reply : (See lecture 3 on consumer persuasion.) Vertical integration certainly may be risky, but an alternative to it is for buyers or sellers to try to exert leverage not by ownership but by joining together (explicitly or tacitly) in forces of countervailing power (the theme of Galbraith's book American Capitalism) and this is more easily achieved the fewer the firms there are. The resulting bargaining situations are things that orthodox economics is poorly equipped to analyse. As for external funds, Galbraith should concede that some large firms very rarely issue shares, but some frequently issue them for cash or to buy up other firms. Mergers of firms may in fact be seen as a way of avoiding risks of catastrophe, since often they can permit very rapid diversification.

5. Thesis : The large corporation does not behave so as to maximise profits. Its over-riding goal is its own surival and autonomy. This requires a certain minimum level of profit, but once this is assured, its second priority is to achieve a suitably fast rate of growth of sales, which will not be altogether independent of profits since current retentions finance growth. Some members of the technostructure will press for policies involving the exercise of technological virtuosity. Large firms will tend to make wage-price spirals operate with a vengeance, since they have the market power to pass on wage increases in full, something that one would not expect from the standard theory of the firm.

Criticism : This is all rather curious - we have Galbraith simultaneously saying big business adds to inflation by pushing up prices, and pushes for unprofitable sales by charging lower prices. He concedes that growth of output requires profits, yet surely this means that to maximise growth in the long run a firm must maximise profits - something which it can't do without taking note of possible reactions by actual and potential competitors. (Overseas rivals who are not suffering wage increases can limit its profit rate and ability to pass on domestic wage increases and generate profits for investment.) Galbraith also seems to de-emphasise the disciplinary power of take-over raiders, looking for poorly managed companies.

Reply : The take-over mechanism, such as it is, seems to work in a highly perverse manner. Beyond a certain point, what distinguishes taken-over firms from take-over raiders is not profitability but size. The bigger a firm, the fewer the firms that can credibly put forward takeover bids for it. So to avoid being taken over, managers have every incentive to grow rapidly, even at the expense of current profits and they can achieve this by issuing new shares in exchange for victim's shares. Moreover, the bigger they make their companies, the higher the scales of remuneration they can offer themselves, on the justification that they have more people below them.

6. Thesis : The industrial system has made imperative and is supported by an 'educational and scientific estate', which supplies skilled personnel necessary to maintain the technostructure. Such personnel receive high material rewards - but are likely to end up bamboozling each other with their respective products and advertisements, despite cynical warnings by Galbraithian teachers ...

CEC100. AUSTRALIAN POLITICAL ECONOMY

Lecture 7 : Investment in Australia by Foreign Multinational Corporations

1. One characteristic of many large corporations is that their manufacturing interests are located in more than one country. The head offices, where key investment decisions are made, may be thousands of miles distant from the consumers and workers upon whom they impact. Such decisions may contribute to increasing homogenisation of cultures, along, particularly, the US model and to a loss of government control over the economy. Not surprisingly, the Left tend to be very keen to see controls over the operations of MNCs.

2. More specifically, the Left tend to raise the following objections to MNCs :

   (a) To the extent that their operations are footloose and not tied to natural resources or subject to high transport costs, MNCs can very easily threaten not to invest in a country unless given strong inducements to do so by the government. This may result in governments trying to outbid each other to attract large investments, subsidising the firms when they do not really need it.
   (b) Footloose firms can also exert pressure on recalcitrant trade unions, by threatening to invest elsewhere unless pay demands are reduced and productivity increased.
   (c) By having operations in many countries, a firm can seek to minimise the taxes it pays, through a carefully constructed set of 'transfer prices'. That is, it can 'sell' its export output from Australia to a head office at a knock down price in order not to make profits in Australia. The head office might be located in a 'tax haven' and the Australian goods could be 'sold' at 'unprofitably' high prices to its subsidiaries in other countries, so that all its profits are seemingly made in the tax haven. Not only does the Australian Treasury lose revenue, but Australia's earnings of foreign currency will be less than they need be.
   (d) Precisely how much an Australian subsidiary is 'allowed' to export will not be determined by local managers, acting in their own interests. Rather it will be decided by head office in the light of the overall corporate interest (note that this <u>might</u> mean that exports were artificially <u>high</u> as a part of a transfer pricing policy : unemployment need not result.)
   (e) An Australian subsidiary of an MNC may have to use expensive inputs from other arms of the firm, either for transfer pricing reasons or as a means for head office to keep these other arms viable.
   (f) High technology developments tend characteristically to be concentrated at head office, not in peripheral subsidiaries. The latter will be more concerned with adapting the technology to local conditions. Subsidiaries will tend to be some years behind in the application of new technology and hence vulnerable to closure if head office has to trim some of the firm's capacity throughout its empire.
   (g) Finally, and one hopes not an argument pertinent in respect of well-educated Australians, there is the suggestion that MNCs exploit gullible consumers and/or get them hooked on harmful habits. We have already mentioned the multinational tobacco industry, but the classic example concerns the sale of powdered milk (a costly and inferior substitute for mothers' milk) by the Swiss Nestlé enterprise in third world nations.

3. The Right, naturally, have arguments that stress the benefits of MNCs to host countries :

   (a) One can turn (2e) around and note that, if foreign firms have developed Australian subsidiaries as input suppliers, the Australian economy might enjoy much more secure export markets than if locally owned firms had to compete for sales on a world market.

(b) If Australia did not enjoy healthy capital inflows from MNCs, the balance of payments would be in grave trouble, for it is a surplus on the capital account that covers the current account deficit. Certainly, repatriations of profits may help contribute to the current account 'invisibles' deficit in later years, but one can't lay stress on this and at the same time argue that local profits are artificially deflated by transfer pricing policies. Moreover, profit repatriation is limited by the need to plough back earnings into investments, without which local exports would be lower in future and imports might be higher. It is far from obvious that MNC investment is typically costly to the Australian balance of payments over the short run (e.g. a 5% repatriation rate of profits would take 20 years to equal an initial inflow at constant prices) or even in the long run, if net exports are increased.

(c) There is evidence that, although 'peripheral' operations of MNCs may lack the latest technology, they tend to be more efficient than locally owned counterparts. To the extent that there is some mobility of resources between them, or simply observation of each other's behaviour, one would expect such 'imported' higher standards to 'rub off' on locally owned firms.

(d) If MNC investment were made prohibitively difficult, it is by no means obvious that Australian enterprise would step in with similar schemes, owing to a lack of managerial and technological expertise.

4. To understand how the Australian economy might develop if investment by foreign MNCs were severely restricted, one needs to understand why MNCs bother to invest in foreign countries at all : what are the alternative policies that they could consider? The most obvious alternative to local production of goods, for local consumption, is exporting. Australia's tariffs make this an expensive alternative for foreign firms, so local, small scale assembly plants are set up in this country. But one can have these plants without it being necessary for them to be <u>owned</u> by foreign firms. The foreign corporations can simply license out their product designs and productin technologies to Australian entrepreneurs, receiving royalty payments without having to sink resources into equipment on Australian soil. Regulations to curtail the allegedly undesirable practices of MNCs <u>might</u> see a substitution of franchising operations for direct investment : Australia could economise on imports without falling victim to transfer-pricing policies. (In South Africa, Japanese companies are prohibited from making direct investment, but Japanese licensees have 40% of the local car market.)

5. But licensing strategies, though by no means uncommon, are often far from simple to set up. A major problem with any licensing strategy is that the local operators may be able to turn the know-how to their advantage and escape paying a royalty on it. This is particularly the case with high-technology products that may have many spinoffs which would be impossible to anticipate in the fine print of a technology transfer license. Hence, direct investment is commonly preferred to licensing. Strict controls on MNCs might mean they didn't invest at all, for fear that a licensing deal would make too much of their specialist knowledge easily available for competitive applications. They might prefer to export limited quantities of finished high-technology products.

6. As far as direct investments by foreign firms in Australian mining interests are concerned, we should note that the alternatives may be to import minerals from Australian mining firms on short or long term contracts, or to go elsewhere. Direct investment by MNCs would seem to imply that they perceive some failure on the part of Australian entrepreneurs that contracts can't easily take account of (e.g. unwillingness to invest; supply unreliability) or, once again, a fear of needlessly lost pay-offs to investments in technology (e.g. an Australian mining firm might license a new tool and adapt it, royalty-free, to some other application). 'Investing elsewhere' might be the preferred alternative if the Australian Government imposed onerous restrictions.

CEC100 AUSTRALIAN POLITICAL ECONOMY

Lecture 8 : A Case-Study of Australian Big Business

1. This lecture draws very heavily upon Sarah Sargent's recent book on agribusiness, The Foodmakers. She discusses the behaviour of companies such as Elders IXL and the Adelaide Steamship Co., which figure prominently in Australian food issues even though most consumers seem oblivious of their role. It is also rare to hear the debt- and loss-ridden rural lobby lay much blame on agribusiness : instead they mention overvaluing of the dollar due to tariff assistance to manufacturing; the impact of unions on wage costs; rail costs; fuel; taxes; the burden of supporting a cumbersome expensive bureaucracy. Over the past thirty years, a third of farmers have left the land. Agribusiness, on the other hand has gone from strength to strength.

2. Some indication that farmers and consumers need to pay more attention to the operations of agribusiness is provided by the following : (1) Agribusiness spends 19% of Australia's advertising bill, mainly in pushing high energy, high fat, low fibre food at children; (2) In 1975, food processing accounted for 18% of the value of all world manufacturing; (3) the UN argues that the world's exports of cocoa, banannas, tobacco, tea, coffee, sugar, rice and wheat are largely controlled by fifteen multinational enterprises; (4) of the average dollar spent on food in this country, 27 cents go to the farmers, 5 cents to marketing boards, 12 cents to wholesalers, 28 cents to retailers and 28 cents to food processors. 'Greenies' might wish to highlight the soil erosion that results from farmers' attempts to get out of trouble by more intensive land working; the growth of factory farming; and the impact of pesticides. (In the long run, farmers would prefer not to use them, since pesticides promote the evolution of more resistant pests and a need for more pesticides; but in the short run, they provide a way of economising on labour costs and reducing the risk of a catastrophic loss of income due to a pest attack. Pesticide residues get concentrated in the food chain since few plants and animals can get rid of them.) Feminists would note that women are handing over control of food preparation to firms. As Sargent notes:

> "Magazines ceaselessly publish recipes that have long lists of ingredients, are illustrated with daunting pictures and require a great deal of time and skill to prepare. The message is : if you don't prepare elaborate food you are failing. So when advertisements for ready-made dim sims, boeuf bouguignon or Bavarian torte appear, it is hard to resist impressing family and guests by proxy... The art of preparing simple nutritious food is being under rated."

The third-world lobby would note that the exports of agribusiness are bringing the 'diseases of affluence' to poor Pacific nations, as well as balance of payments problems.

3. Sargent traces the rise of agribusiness to technological improvements - fertilisers, pesticides, faster growing chickens, bigger cows and so on - that greatly increased yeilds. Post war affluence, rapid population growth and increasingly cosmopolitan tastes (but not skills in food

preparation) lead to a receptive market for processed convenience foods. However, slowing of the inflow of immigrants and the closing off of EEC markets made the Australian food market become static. If the firms in the industry wished to grow it had to be either by using technology in product development, opening up the market for 'edible gimmicks', or by stealing the market share of rival firms by more aggressive marketing or simply taking them over. John Elliott, who masterminded the creation of Elders IXL, takes the view that 'The only way to gain market share growth and avoid price ward was by acquisition. By buying out your competitors and rationalising the two operations you get a quantum jump in growth.'

4. The role of takeovers in the concentration of agribusiness is readily apparent. The familiar brand Edgell was once that of a family firm that diversified into canning on finding that outside owners weren't reliable enough (products were often faulty, processing slow and wasteful) to can their surplus asparagus once they had catered for the Sydney marked. Edgells were taken over by the Petersville food processing company in 1961, but not before Edgells had themselves taken over by the Australia brands, including Birds Eye. By 1982, by which time Petersville had been taken over by H.C. Sleigh (1980-1), and again by Adsteam (1982). Petersville produced Peters Icecream, creams, yoghurts, teas, pies, smallgoods, imported gormet food and so on - Edgells canned and frozen vegetables had become relatively insignificant, except for attempts to hand on to the family farm image as a sales ploy. The rise of Elders IXL is even more extraordinary. Brilliant management consultant John Elliott borrowed $10 million to buy the stagnant jam company Henry Jones IXL. Early in 1981, Elliott offered to merge his company with Elders to fend off a 49 percent bid by the Bell Group. This move was partly financed by Carlton and United Breweries (and had long been planned by Elliott). CUB ended up with 49 per cent in the new Elders IXL. In December 1983, Industrial Equity Limited tried to raid part of CUB and Elliott, after raising $690 million from three banks in thirty six hours, offered to buy CUB outright for $970 million.

5. The diversity of giants such as Elders IXL has enabled them to prosper whilst firms that have 'put all their eggs in one basket' only to find themselves in trouble have provided a ready source of assets at knockdown prices. It has been argued that the giants are great rivals : size is not a threat to the consumer. However, the Left would argue that competition between them is limited by implicit collusion (for example, when the Whitlam Government reduced tariffs on agricultural machinery by 25 per cent, there was no significant decrease in prices of the equipment supplied to the farmers by the oligopolies; in livestock selling, the Prices Justification Tribunal ordered a reduction in the commission rate charged by the British Group Dalgety Farmers - and this despite the fact that this is an easy entry industry with a lot of small stock and station agents competing with the giants). To the extent that competition seems aggressive, the Left would argue it mainly involves unnecessary product proliferation, as appendix A for <u>The Foodmakers</u> graphically attempts to illustrate.

6. Agribusiness should not be seen merely as concerned with food processing; the big 'pastoral houses' provide to farmers comprehensive input services and dispose of much of their produce. Elders have practically become the main bank for many farmers : they draw cheques on Elders; smaller rural firms engage in foreign currency hedging through Elders (to the tune of over $12 billion a year): importers and exporters and rural property developers and firms get credit, mortgage and leasing finance from Elders. The merchandising network of the few pastoral houses is so well developed that even the large chemical companies have to reach the farmers largely via supply agreements with the pastoral houses - whose bargaining power is far greater than that of scattered farmers. Some of these suppliers are actually owned by the pastoral houses (e.g. Roche Maag is a fully owned subsidiary of I.E.L.).

7. Rather than buy up the pastoral farmers, the giant firms make big money ($20 million a year in Elders' case) from insurance. However, they are moving into the rather more controlable industries such as irrigated crops and factory livestock farming. Elders IXL and Adsteam have both invested heavily in integrated piggeries, and have negotiated supply contracts with retail chains, in the process excluding family farms from a large part of the fresh meat market. In the poultry industry, the individual farmers provide electricity, water and the battery sheds, whilst the three dominant firms provide the birds, food and veterinary supplies. Again, large-scale supply contracts exist : Inghams (who own Golden Poultry jointly with Amatil) supplies Kentucky Fried and Woolworths.

8. But we should be unwise to assume that the position of the existing giants of the food industry is an assured and cosy one. The woolbroking business has largely narrowed to comprise Elders IXL, Dalgety Farmers (UK controlled) and IEL, but Elders' have recently been facing a tough time in Queensland and NSW as the smaller Primac company has doubled its market share. The cooperative movement also provides a chance for independent farmers to group up against the bargaining strength of the giants. But the case of SAFCOL must provide some sobering thoughts. In 1945 the South Australian Fisherman's Co-operative Limited was formed by 26 cray-fishers with a total share capital of about $70. Its growth was dramatic and by 1981 it had become one of the world's largest fish processing firms with sales of $135 million. That year it ceased to be a cooperative. But already its overseas operations (in Thailand and the Philippines) had attracted strong criticism for their working conditions, which were described as paying three dollars a day for work in an 'oppressively hot, crowded and poorly ventilated' cannery whilst subjecting workers to 'abusive derogatory treatment' and 'compulsory overtime'. What had started out as a venture to help small fishermen and consumers had turned itself into a caricature of exploitative agribusiness.

CEC100 AUSTRALIAN POLITICAL ECONOMY

Lecture 9 : The Economics of the Arts

1. The economics of the arts is an interesting area for a case study since flows of 'artistic goods and services' are produced by a wide mixture of organisations : giant, profit-oriented multinational, multiproduct firms such as CBS and EMI, small private companies and 'non-profit organisations' of various sizes (e.g. Australian Opera or the Tasmanian Theatre Trust) who have funds coming in not merely from ticket sales but also from private sponsorship and government subsidies. The earnings of the artists have also provoked much comment : most earn well below average (especially far below the average for people with a similar investment in training), but a tiny minority fall into the 'superstar bracket'. Quite what we mean by 'the arts' here is somewhat difficult to pin down. Much of what I say below could be applied to football as well as to opera.

2. Let us first focus on the economic problems of the non-profit arts organisation. Such a body - say a museum - characteristically will be seeking no pecuniary return on its invested capital and will be claiming to fulfil some social purpose. Nonetheless, it still has resource allocation questions to consider, similar to those confronting a firm of the usual sort. In the case of a museum there will be questions such as : How should we trade off our educational or research services against our display services to the general public? How far should we be trying consciously to anticipate future public tastes as we build up our collections? How relevant are contemporary tastes when we are deciding on which of our existing stocks to display? How far should we specialise or diversify our collections? Should we rent or buy items for display? Should we sell off excess reserves that we do not have the space to display ourselves? (Often museums and galleries end up overstocked if they are well known, as a result of bequests which, storage and insurance costs aside, it is hard to refuse. Bequests often include stipulations that collections may not be broken up, which constrain museum managers.) Should we buy now or buy later, given that the price of a particular work may skyrocket? These questions are entirely analogous with those of multiproduct firms operating in speculative markets.

3. With many museums and galleries, the overhead costs are enormous compared with the burden imposed by each extra customer : in fact, the marginal cost per customer might be regarded as pretty near to zero unless exhibitions are so popular that problems of crowd management arise for the museum staff and consumers start posing congestion costs on each other. In the latter case, charging an entrance fee obviously makes sense to get rid of the excess of viewers. However, in the zero marginal cost case, a dilemma arises : if an admision fee is charged, the overheads may be funded in whole or part, but some people who would have attended without imposing resource costs will no longer show up to see the exhibitions. In such a situation, conventional welfare economics argues that it may be inefficient to charge for admission unless a policy of price discrimination can be practiced (people who are less willing to pay would be charged less, in the limit nothing) : marginal potential benefits of expanding attendances would exceed marginal costs. Price discrimination schemes may be difficult to devise in ways which generate enough

revenue to cover overheads without turning consumers away by putting them in the wrong category. Appeals for voluntary contributions may raise relatively little (apart from more exhibits from tax-avoiding bequests!), so the question naturally arises as to whether the trustees should be given a government grant to enable them normally to charge nothing for entry.

4. Funding by subsidy may make it difficult to decide on how well the non-profit arts organisation is performing. Rarely are detailed studies done of how willing consumers would be to pay if a perfect price discrimination scheme could be operated. This means that the grant awarding authorities have little idea of how far services should be extended and how far the quality of the services should be increased. For the people running a non-profit arts organisation, the main concern is likely to be in pushing arts of as high a standard as possible to as many people as possible. Such objectives, combined with some prospect of success in winning funds from the government, make it pay for the managers always to be on the verge of financial catastrophe, even if they actually raise a good deal of money from ticket receipts. As soon as some more money becomes available, the managers of the organization can start talking about a new group of projects which it hopes to be able to undertake if it can get funds in the future.

5. Difficulties in assessing benefits of subsidies to the public (see paragraph 9 below) should not distract us from the question of how well the receiving arts organisations are using their resources : failing cost-benefit analysis, at least try cost-effectiveness analysis and at least see whether resources are being squandered in featherbedding arts organisations. But the idea of using cost-effectiveness analysis here has been questioned by Blaug. He argues that it is misleading to think of the decision makers as having well-defined goals for their organisations, with the only question being what is the least cost way of meeting them. In general it may be wiser to see means and ends as intrinsically related : decision makers learn what they want by experimentation and appraising the results of their experiments (e.g. 'What did the public make of our production of ...?'). In the arts it is difficult to condemn a new production as, say, 'too lavish' in advance of seeing how it actually works. For some economists, this philosophy seems to be nihilistic as regards the public accountability of grant/subsidy-receiving organisations : surely we should be able to make <u>some</u> assessment of managerial competence and the extent of overmanning and waste in arts organisations that are crying out for public funding!

6. Baumol and Bowen have predicted that even well-managed arts enterprises will tend to run into problems with deficits as incomes rise in an economy, even if presently they are able to raise a good part of their revenues from ticket sales and the rest from sponsorship (the latter being prone to dry up, in any case, at precisely the time when ticket sales falter due to an economic downturn). The problem is claimed to be that there is little scope for substitution to save labour as wages rise and that the income elasticity of demand for artforms is only around one. So as peoples' incomes rise they do not make arts expenditures a rising proportion of their budgets : in many cases they become prepared to pay more for better tickets instead of

going out to the arts on more occasions (which would involve more travelling from the suburbs, more babysitting costs). However, rising relative prices of the arts will make them substitute in favour of other ways of spending their money. Unfortunately, we would expect arts costs and prices to rise relative to other goods, since technical progress in other sectors will save labour inputs. Thus, since the demand for the arts is not highly income elastic, we should expect to see either increasingly empty theatres and concert halls - if prices are raised - or increasing deficits of orchestras, operas and so on - if relative prices are kept as they are - or, if the demand curve moves to the left of the average cost curve, deficits even if price discrimination is carefully practiced.

7. The Baumol/Bowen thesis is probably somewhat exaggerated. It is not necessarily the case (actors' equity and the musicians' union notwithstanding), that performers and other arts workers' wages will rise as fast as incomes in general. There probably is scope for cutting costs with orchestras in large centres. For example a full-scale symphony orchestra is only required mainly to play later nineteenth century works and a lot of the time 20-40 members of such an orchestra are paid not to play. Much smaller opera orchestras and chamber orchestras can perform most of the pre-1850 and modern repertoire; these units could be merged and augmented with freelance players on occasions when a full complement were required. The smaller units could also perform in more venues with smaller halls. The use of taped music by dance companies is another example of a way of economising on labour costs. We should also note that substitution against live performances may involve alternative earnings being generated for the performers - for example, records of orchestras, session playing by orchestra members on other records, videos. Furthermore, substitution against the performing arts into other leisure areas may be limited to the extent that the alternatives are ones which also have limited scope for cost cutting via alternative technologies (e.g. restaurants).

8. If grants and subsidies are directed at the arts, we should ask whether they might better be used in other areas (if football isn't art, then 'what about football?' is a question we should be considering if football is in financial trouble). In considering this we will want to ask whether the aid leads to higher incomes for arts-related workers or to lower prices for consumers. If excellence-seeking managers of arts organisations are running into financial difficulties partly as a result of bidding against each other for superstar performers whose supply is strictly limited, then we might well question the wisdom of the aid (do we want to inflate further Joan Sutherland's fee per performance of $16000? If we don't, though, she may not sing here at all if other countries carry on subsidizing their operas). In general, the case for subsidizing wages of arts workers only stands up if they are taking great personal financial risks by committing themselves to particular projects, from whose outcomes others would acquire ideas and information that is socially desired. We would also do well to inquire whether the organisations have properly exploited scope for raising money by methods such as lotteries (Sydney Opera House raises about $20m from its lottery, which more than pays for its deficit of around $13m on net revenue, and the NSW government takes the surplus).

9. Finally, we come back to the question of why we should subsidize ticket prices. If there are other claims on the government budget, and opportunity costs when it comes to expanding the budget (something whose magnitude is hotly debated between economists of different persuasions), then even if seats at performances would otherwise be empty (or museums sparsely attended) there are social costs involved in reducing admission charges via subsidies. To the extent that difficulties in arranging price discrimination schemes prompt cries for funds, we are likely to be in situations where we are subsidising the arts for the wealthy who would have attended anyway. Economic arguments for such subsidies have included the following :

(a) The art form may have been identified to be a 'public good', which anyone in the area can consume without posing costs on others and which it is difficult to make people pay for even though they would admit to enjoying it (for example, large public murals, or community radio stations such as 92FM - which no doubt includes many non-subscribers amongst its listeners).

(b) Good arts facilities may attract business and tourism and outstanding academics more effectively than other kinds of incentives (e.g. I'd like to live in Adelaide because of the festival, even though the cost of living is higher).

(c) National prestige - help improve the image of the country overseas, with possible benefits for trade.

(d) Problems of patenting new art forms may lead to underinvestment in innovation in the arts, from which society would lose (it was a risk, but one which someone <u>did</u> take, to stage Oklahoma, a production which pioneered the idea of a show integrating a story, dance and song). However, we should note that the form of the subsidy/grant may affect innovation : if government bodies make cash grants on the basis of past track records then groups who play safe are likely to get the funds and make life tougher for innovators. Tax exemptions would seem a better idea. (A kind of indirect subsidy here consists of the payment of unemployment benefits to would-be performers who are 'resting'. It could be argued that UK innovation in pop music in the past decade owes a lot to this, in contrast to the situation in the USA.)

(e) Profit making arts activities that contribute to taxation revenue may do well because of the existence of sectors that do not seem to pay their way when seen in isolation. The latter may provide a training ground and source of ideas.

(f) If people participate more in the arts society works better : they become more thoughtful people who care about beauty, more able to converse with each other. TV (via the ABC) may help here, but live performances make people mix more socially.

(g) The 'merit good' argument. As Scitovsky puts it, in respect of US consumers, 'the consumer is unskilled and unwilling to exert himself to enjoy and enrich his life [as is shown by] the largely defensive nature of our consumption, its focussing on the avoidance of pain, effort, discomfort, boredom, the unknown and the uncertain. We shall never be affluent enough to afford both pleasure and comfort, because pleasure depends on the assimilation of novelty, the relief of strain, the resolution of conflict, the understanding of complexity; and one cannot have the pleasure without accepting into the bargain the facing up to the initial shock'. Thus Barry Manilow makes a fortune from providing comfort whilst a challenging programme of new 'serious' music needs subsidising. Obviously we see something of Scitovsky's own values here : financial assistance may be necessary to change people's tastes until they are more like his own. However, a more adventurous attitude generally might make society function better and it may often be the case that people steer clear of some artforms because of misconceptions about them, which a subsidised attempt to inform might be able to change.

(h) Future generations might be more intrested in the arts than ourselves and we owe it to them not to let our arts expertise fall into decay : once lost, it may take years to recreate.

CEC100 AUSTRALIAN POLITICAL ECONOMY

Lecture 10 : The Economics of Health Care

1. Health care is an area where strong divisions of opinion are conspicuous as to the appropriate extent of government involvement in place of market processes. In relation to earlier lectures one might also note concern about the monopolistic practices of multinational drugs firms that 'push' drugs on to doctors by extensive advertising, drugs which, in cases like Valium eventually produce precisely the symptoms (depression, difficulty in sleeping, and so on) that they are supposed to stop. These companies are among the most profitable around, a position they seek to justify with reference to the enormous research and development funds they need to investigate new drugs and the high failure rates amongst those that they try. In this lecture my focus is on the organisation of the provision of health care and allocation of resources to this area.

2. To begin : consider a completely free market in health treatment, and the problems that might arise. It is not that far from the truth to liken the health care business to a mixture of car repairs and servicing and the hotel business. General practitioners are basically employing problem-solving 'recipes for success' just like car mechanics as they diagnose and prescribe, though they earn far more in the process. Surgeons performing major operations are rather like car mechanics doing major repair jobs on cars. A hospital has many hotel-like characteristics. Health problems, like car breakdowns, are an abnormal state of affairs for most people (except as far as routine preventative checks are concerned) and can simultaneously reduce a person's income earning power, while increasing demands for funds. A rare disease can cost a fortune to treat, but an exotic car that is severely damaged or suffers a major mechanical failure can also cost the earth to fix. So what's peculiar about the economics of health?

3. In a free market system, people who feared catastrophically expensive illnesses would be expected to take out appropriate insurance, just as the person who buys an exotic used car insures it comprehensively and pays for a breakdown warranty. Here, we can see some problems. Someone who cannot afford to insure against financial ruin via ownership of an exotic vehicle can choose to run something more mundane. But a poor person who cannot afford insurance presents us with a picture we don't seem to worry about in the car example : can it be morally correct for poor people - whose living and working conditions may make them especially prone to poor health - to enjoy less access to good health than someone who has more money? Is the right to health not a natural right of all in a society? If the answer yes, but we still insist on leaving things to the market, then we need to advocate transfer payments on a sufficient scale to ensure the poor can afford adequate health. But what standards of adequacy should we set? (Cosmetic surgery for all?) Also, how do we reconcile freedom of choice with the possibility that the recipients of 'untied' transfer payments may choose to spend the money at least in part on, say, drinking, smoking and high-sugar junk food and not take out as comprehensive a health insurance policy as we might hope?

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4. There are some general problems with insurance which we should note in this context. First, 'moral hazard' : having insured themselves, people are less careful to prevent the insured against events, and premiums charged those who are careful and those who are not may have to be identical because of difficulties in policing sneaky abuses of the spirit of the insurance deal. Second, people who judge themselves to be low risk but cannot get a special discount, may economise on the cover they take out. This raises the average costs of providing cover for the ones who do insure (if those who don't are correct in their assessments) and deters more from insuring in a market that doesn't discriminate well between high and low risk cases. In the limit, this could lead to sky-high premiums that deterred practically everybody. Thirdly, insurance companies are none too keen on completely open-ended policies; they will usually impose some ceiling on payments they are prepared to make. How can the lay public judge what is an appropriate ceiling to insure for, especially given the possibility of surprising new diseases that become common yet expensive to treat? A possible answer here is that insurance broker specialists will advise them, or consumer magazines may step in. Fourthly, if a person is suddenly taken ill, it may be very difficult to establish what kind of insuranace payout she is entitled to.

5. As with the motor trade, the health business is one where the service required is often required suddenly, the consumer not being in a position to shop around, and where the precise need, and the quality of attention given, is very hard to assess. The consumer, or rather, her insurance company, runs a risk of ending up paying for over-servicing, incompetently performed. It is in the practitioner's interest to offer as expensive a service as is possible without losing the customer in the long run. An alert consumer, ill in a familiar location, may be able to draw on her friends' experiences to judge who is a good doctor : word of mouth will drive out the incompetent even if there is no restriction on entry, but there may be some nasty casualties in a free market before equilibrium is achieved! Insurance companies, in such a market, could try to cut down the risk of funding overservicing by owning medical practices themselves : needlessly expensive treatment would reduce the earnings of the corporate whole and rebound upon the doctors, so they'd be somewhat deterred from suggesting it. Also, audits of doctors' practices might be rather easier within the one organisation.

6. Before we move on to look at a state-run health service we should note that, in reality, the private market for health, where used, has never been a simple textbook-style one. Doctors mostly have a long tradition of putting medical ethics before the pursuit of profit. Price discrimination policies (charging the rich more than the poor for identical services) have been widely practiced not as a means of maximising earnings but to ensure the poor came and received treatment. However, that said, we should note that doctors typically do not encourage the substitution of their roles for cheaper nursing staff and so on and have been keen to restrict entry to their 'profession', instead of leaving it to the market to weed out incompetents in the way that it weeds out bad car mechanics.

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7. One obvious reason for having a state-run health care system is the sheer cost of running a system built around health insurance between companies that have to administer policies and use up resources in competing with each other. Even a system where the state foots the bill but subcontracts the provision of services is likely to be consuming much more than a system where doctors work for the state as mere employees. In this last case, a wage per registered patient helps deter over-servicing.

8. It is often said that 'free' health care at point of use encourages over-use by hypochondriacs and bludgers. But we should note that for many, 'free' care actually imposes a significant cost in terms of foregone time to do other things (there's nothing free in economics even if prices are zero), and the anxiety that many people could avoid by not seeing a doctor and discovering what is wrong. If anything, there is a need to encourage more use generally to ensure early discovery of problems, which, if treated later, will be much more troublesome.

9. Some very tricky dilemmas arise for the public service health economist called upon to advise how much treatment, etc. should be provided. 'Cost benefit analysis' is commonly proposed as a tool for capturing quantitatively things the market would fail to register - for example, the costs to society of an individual neglecting her health and spreading disease or distressing friends and family. Many attempts have been made to value human life, but the whole process disturbs a lot of people. It is difficult to avoid moral and ethical concerns. For example, should we not deny the right to treatment for cigarette-smoking lung cancer sufferers and use resources instead to promote anti-smoking messages? How can we decide between alternative recipients of a donor kidney when each is physically suited yet differs greatly in earning power? What price test-tube babies as opposed to contraception that is reliable and free from side-affects? What balance of resources is appropriate between prevention/treatment and mental/physical health? We would be foolish to expect that such answers to these questions as do emerge are not shaped by self-interest of various groups involved in the decision process, whether or not it is pursued consciously.

A question of cost

THE question of charges for service is at the very center of the controversy over 24-hour clinics.

The Federal Minister for Health, Dr Blewett, says he has no objection to 24-hour clinics as such:

"We certainly concede that the vertically integrated 24-hour clinic, where you have services such as pathology, X-rays and so on available in one location, offers high efficiency and patient convenience.

"What concerns us are the financial implications. We feel that any situation in which a doctor has a direct financial interest in the services which he orders for a patient opens up the potential for abuse of the system."

Despite the Commonwealth's well-publicised concern and detailed in-

have been sheeted home to a 24-hour clinic. Dr Edelsten appeared at a Joint Parliamentary Public Accounts Committee hearing last year and aggressively attacked accusations of over-servicing, eventually forcing Health Insurance Commission officials to withdraw some of their computer-based deductions.

The clinics operate on that well-known business principle that small profits equal high returns: by operating all available primary medical services efficiently under one roof they obtain a high put-through rate and so get a good return out of the basic Commonwealth health benefit without, in most cases, charging the patient extra.

There are usually some sophisticated finance arrangements, involving leasing premises rather than buying them and leasing and sub-leasing equipment. But Edelsten says that as

centers have expanded as a result of "ploughing everything back into the organisation and operating efficiently." Pathology services are carried out by the organisation's associated pathology company, but his GPs or specialists all operate independently and have no financial interest in referrals either for services or specialist treatment, he says.

It may well be, the independent observer is tempted to conclude, that a system of Commonwealth health benefits designed for traditional one-off solo medical practice leaves a healthy margin for an efficiently-organised modern operation.

The fairly standard pathology procedures known as bio-chemical scans, which do seven or eight tests on a single blood sample and provide useful information in specific cases, attracts a Commonwealth benefit of around $20. Edelsten says it costs his company "about $1.50 to do".

The 24-hour clinics: a boon or care gone to waste?

IT'S been called "McDonald's medicine," but none of the 10 or 12 families sitting in the sunny, soft-carpeted waiting room seems to mind.

A receptionist offers them coffee and cake from the free buffet in the corner. The children watch *Beatbox* on the giant TV screen on the end wall. They are, in fact, in more comfortable surroundings than the hamburger chain offers.

In a minute or two they will walk down the corridor on the right to appointments in the warren of consulting rooms and labs, where a duty shift of GPs and visiting consultants waits with an armory of expensive technology — CAT scans, X-ray machines, pathology equipment, and resuscitation apparatus.

Some of those patients return to their regular GP next time they are sick on a weekday when his surgery is open. Others stay with the 24-hour clinic: for one thing, it is cheaper.

"You should see us in a couple of hours, when the football injuries start to come in," says Edelsten. "That's when we begin to get really busy. Every weekend, about 8000 people in Sydney go to see a GP. Around 5000 of them come to one of our clinics."

Twenty-four hour clinics have taken over something like 25 per cent of general practice business in the Sydney area since 1984. They provoke fury in some doctors and envy in others.

They also reveal a glimmer of light at the end of a tunnel which has trapped politicians, planners, and medical lobbyists for 20 years — an answer to the problem of controlling the inexorably rising cost of keeping the nation healthy.

The difficulty is that Dr Edelsten is leading the Australian health system on a medical version of the Janissaries' March — the famous ceremonial step in which the Turkish sultans' mercenary soldiers took two steps forward and one step back.

● The pioneer of the 24-hour clinic, Dr Geoffrey Edelsten, opens his first Victorian branch next month at Frankston. In Sydney, where it all began, he has announced plans to buy out his partners in 23 clinics, which will make him — through service companies — the sole owner of the clinics.

We go two steps forwards, in that when you can get through the miasma of political objections to entrepreneurial medicine, and last year's parliamentary allegations of over-charging, which largely vanished when the computers were checked, the 24-hour clinic begins to look like the most efficient way of providing primary medical care to a modern society.

One step back, in the sense that the glitter surrounding the flamboyant Dr Edelsten tends to obscure the real achievement.

Edelsten is not entirely the kind of practitioner most likely to endear new notions to a notably conservative profession. The fast-car-driving chairman of the Sydney Swans football team, conspicuous consumer with a glamorous blonde wife and a helicopter, lead name on a file of press cuttings from the social pages, and noted self-advertiser with a penchant for attending his clinics in a white doctor's outfit with a Porsche label sewn to the chest, is just not the type to win over the average GP in a dark grey pinstripe.

Dr Edelsten, in fact, is about as popular with the rest of the medical profession as Henry Ford was with harness-makers — and, perhaps, for much the

Back in 1969, when the Gorton Government ran into difficulties with a swingeing AMA fee increase, and the problem of soaring health care costs first registered in this country, an analysis in *The Australian* warned that the traditional GP structure could not survive for long the exponential rise in the cost of health services in the modern society.

Australia then spent something less than 4.5 per cent of GNP on health costs. *The Australian's* analysis suggested that on then-current trends this would escalate to an unthinkable 10 per cent in the 1980s — and that the inevitable result would be the replacement of the traditional GP, sitting in his private office referring patients to distant specialists and outside paramedical services such as pathology and physio, by local "medical centres" combining those services under one roof.

Today, Australia spends almost 9.5 per cent of GNP on health. And the medical centres have turned up, right on schedule.

In effect, the market has produced what the planners failed to create, which is no great surprise. There is a kind of inevitability about economics which not even Medicare can negate.

The average patient fee in an Edelsten clinic over the last two weeks, according to Edelsten's computers, was $16.48. This average includes higher charges for after-hours attention: the regular fee for office-hours consultations is $13.50, which is normally bulk-billed to Medicare, leaving the patient nothing to pay.

The conventional GP in Sydney charges well over the scheduled Medicare fee. Some ask for more than $20 for a standard consultation.

If the 100 GPs in Edelsten's 26 clinics can service 25 per cent of the patients in Sydney at the scheduled fee, it must follow that the other 1500 GPs in the NSW capital, dealing with the remaining 75 per cent and charging a good deal more, are operating less effi-

But the questions raised by the 24-hour clinics do not end there. There is also the national problem of "overdoctoring," which has been worrying Governments and medical authorities alike for years, and the economic case for preventative medicine, which is currently stymied by health service regulation.

At the moment Australia has one doctor for every 520 people, on a national basis. By comparison with other advanced countries, this is a considerable oversupply which carries a concomitent economic problem with it — the more doctors a country has, the more it pays for health care. Despite rigorous entry barriers to university medical courses, Federal Government studies say this will get worse, with a ratio of 1:465 forecast for the year 2001.

Those are national figures. The ratio for metropolitan cities, where there are far more doctors per head of population than in the country, are already much lower.

The traditional GP structure encourages over-doctoring. A newly-qualified doctor has to earn his living somewhere. The natural tendency for doctors who do not wish to specialise, or lack the qualifications, is to join an existing GP practice with an aim to hanging up their own shingle in some congenial city suburb.

The result of that is an awful lot of GPs sitting in separate surgeries, all of which cost money in rent and support staff, working long hours for an average $40-$50,000 net a year according to recent surveys. Early death from overwork or alcoholism is a bigger actuarial risk in the medical profession than in almost any other.

By contrast, the GP member of a 24-hour clinic works a set shift and goes home at the end of it. Some weeks, this will be a night shift. But he clears, in the Edelsten group, an average $100,000 a year. Given the advantages of the efficiently-ordered clinic, he is able to see

(extract from Weekend Australian, April 26-27, 1986)

more patients in a shorter working day.

The case for the practice of preventive medicine in the clinics is theoretically compelling. In principle it would make sense in a fully-equipped clinic to check out every new patient who came in not only for the symptoms he was complaining about at the time but for his general medical condition.

From the doctor's point of view this would be elementary good practice, since many conditions a patient complains about turn out to be related to others which he either does not mention or does not realise are connected.

For example, if you have haemorrhoids the odds are you have a chest condition as well: in the long run it may be just as important to treat the intermittent pain in the chest as the more obvious discomfort in the rear.

From the economic point of view the long-term benefits look equally compelling. To put this in the most dramatic terms, it is better for the health insurance system to pay now for a $30 pathology test that turns up a heart condition in its early stages, than pay for a $30,000 heart by-pass operation later on.

According to Edelsten, this is not the way the clinics work at the moment.

"Government health authorities are now so suspicious of any kind of pathology testing," he says, "that doctors are extremely reluctant to order it unless it is absolutely necessary and relevant to the condition the patient is presenting at the time.

"Allegations of over-servicing on pathology services, made against our clinics last year, were shown to be totally false when the computer figures were checked. Nevertheless, young doctors in particular are nervous about requesting 'path' investigations in case they are accused of over-servicing. I tell them, so long as you are sure it is in the patient's interest, go ahead, you won't be found at fault.

"But in that sort of climate you really won't find the clinics practising very advanced preventive medicine.

"This is perhaps a pity. Two types of testing are available in this area of medicine. There is what is called multi-phasic screening, which involves giving a whole battery of tests to a patient on the off-chance you may turn up an unsuspected condition.

"Most authorities seem to be agreed now that the cost-benefits in this procedure are pretty poor. We might have done it occasionally three years ago, in cases where it seemed appropriate.

"But we certainly would be reluctant to request it today, given the authorities' attitude. Personally, in the majority of cases I would not myself think it a particularly useful procedure, either.

"The other kind of test, which I think *is* useful, is prescriptive screening, in which the doctor orders a pathological examination related to the condition the patient presents.

"In the current climate doctors are very conservative in their requests for pathology. We could certainly do more in the area of preventive medicine if the official attitude was different."

Edelsten's first custom-built 24-hour centre was started in the western Sydney suburb of Baulkham Hills two years ago. Similar clinics today cost some $800,000 just to fit out and furnish, without buying the building that houses them.

But Edelsten's stable of 26 clinics has sparked similar developments in Sydney, and a rival in Melbourne where his first Victorian branch opens next month at Frankston.

The Victorian extension of 24-hour clinics has not happened without opposition. Conservative doctors resent Edelsten because he threatens the traditional picture of the doctor-as-God, sitting on the other side of a waiting room as uncomfortable as the Purgatory in which the newly-lost souls wait for their first glimpse of the Almighty.

The doctor-as-God willingly kills himself with overwork but is not otherwise over-responsive to particular patient needs except in the special circumstances of what the profession fondly refers to as the "doctor-patient" relationship.

This has its ultimate expression in the patient's signature on a cheque: 24-hour clinics generally bulk-bill, leaving the patient's hip-pocket untouched, as well as dispensing with the waiting-room purgatory.

Left-wing doctors, represented by the Doctors Reform Society and the realistically-named Campaign Against Entrepreneurial Medicine, are opposed to Edelsten and 24-hour clinics not so much because they resist clinics as such but because they believe the government ought to be running them.

The government has shown no inclination to do so, but to the Left private enterprise in medicine is anathema and presumably it's better to have no improvements in the system at all rather than have an improvement the Labor Party didn't think of, and the taxpayers did not pay for.

But Edelsten, whether people like his public image or not, claims with some force to have proved that the new style of medical centre works. He says: "I think we have shown that the 24-hour clinic, offering a full range of medical service, is the most efficient way of providing primary medical care in today's urban society.

"I'd emphasise the primary: in a sense we are mini-hospitals, and we are certainly equipped to ease the burden on hospital casualty departments, but we don't of course attempt to replace either the hospital or the specialist system.

"The convenience of having the most necessary services all in one place, in a one-stop medical centre, is the main thing as far the patient is concerned. It is of major importance to the patient not to have to face the futile, time-wasting exercise of being referred to some other location to have X-rays taken or path tests done.

"Frankly, we lose money on our night shifts. You couldn't possibly make money at night. You have to pay your staff time-and-a-half penalty rates and double at weekends, there is no way you could make money on that.

"We run a 24-hour centre because our patients like to know we're there, that's all. And in the end, it's worthwhile.

"Some of our patients drive 15 and 20 kilometres to the centre. I was astonished when one of our surveys turned up that fact. They pass innumerable solo GP practices on the way.

"But when people come that far to see a doctor, he knows he must be doing something right."

CEC100 AUSTRALIAN POLITICAL ECONOMY

Lecture 11 : Cumulative Causation versus Equilibrium

1. Back in lecture 2, we considered the question of coordination via relative price changes and saw that informational problems could result in inappropriate mixes of products being produced instead of supply balancing with demand in each market. In this lecture a related problem with supply and demand is considered, namely, the question of whether the price mechanism left to its own devices, works to equalise factor earnings or to enlarge existing differences. Economists on the Right are generally of the former view; those on the Left tend to believe that the Biblical comment that 'unto he that hath shall be given, and from he who hath not shall be taken away' has a ring of truth about it.

2. The Right would argue that a tendency for one country or region to enjoy a rising income relative to other areas will set forces into motion that will improve the lot of the poorer areas. As incomes rise, so too will production costs. Firms will therefore have incentives to locate their operations in low wage areas. As they do so, they will raise the demand for labour and push up wage rates. If firms are somewhat slow to move, workers will bring about similar equalising tendencies by migrating to the high wage areas. They will thereby add to the labour supply in these areas and hold back the growth of wages. In reducing any surplus of labour in the areas they leave, they will set in motion moves towards higher wages. Sooner or later, the system will converge to equilibrium, both areas growing at the same rate and no tendency for workers and capital to move between them in search of higher returns.

3. One can see some sense in this argument : for example, General Motors owns 50% of the Korean car firm Daewoo, which has grown rapidly and produces cars similar to GMH. Daewoo's workers receive $A265 a month for a 68 hour week, not much of a living compared with Australian auto workers but an advance compared with previous standards. With such wage rates, Korean manufacturing industry is in a strong position to start exporting and repeat the example set by Japan. Sure enough, 1986 will see Daewoo's local rival Hyundai exporting to Australia and Daewoo itself no longer using Australian made body panels, producing them instead with its own presses. Australian car and steel workers had better watch out!

4. The moral of the Right's analysis is that, if one is interested in reducing regional and national inequalities, one should remove barriers to capital and labour mobility. Direct government shifts of investment resources are unnecessary, since the market will signal appropriate flows.

5. Against this line of thought we can oppose Myrdal's theory of cumulative causation, an analysis of comparative income and corporate growth rates in terms of virtuous and vicious circles. The idea can be understood in varying degrees of complexity. First, consider the position of a poor farmer, struggling to survive. There is no room for saving, hence no way of increasing output by investing in new farm implements, so the farmer stays on the margin of survival. Secondly, consider the position of a firm which, for one reason or another, manages to get an edge over its rivals. Since it sells more, it gets higher profits from higher capacity utilisation and a greater spreading of fixed costs. With these higher profits, it can afford higher pay increases to its workers, so there are fewer strikes, and its quality of output and delivery rehability increases, raising profits still further. It can also use profits to invest in the development of new products that are even better than the offerings of its rivals. It gets further and further ahead, even though it may be paying more to its workers.

6. In the context of regional growth, cumulative causation processes work like this. Suppose an area happens to be specialised in producing a product whose demand falls. Local investment in making that product is cut back and so is current output. This rebounds upon local suppliers, both of material inputs and of anciliary services, whose viability requires a particular minimum scale of production. The demise of such locally available services raises costs for the firms still in the business of producing the declining product, as they have to get them from further afield or perform them internally using less specialised capital. The revenue of the local authorities suffers as a result of the decline in activity, so spending on local infrastructure, such as road links and educational facilities declines. It is thus less attractive for firms to invest in the area, even though wage rates have started to grow at a slower rate. The best workers tend to migrate elsewhere in search of better prospects. Those who are unemployed tend to lose their capacity to work as effectively as before; the more so, the longer it is before they find work again. The area stagnates while others grow, or, worse still, unemployment rises and local capitalists shift their resources to areas with higher growth and employment, despite more rapidly rising wages. The area has an ageing population, outdated industrial techniques, poor housing and infrastructure.

7. In the example just described we see that income and employment growth depend on a complex of linked factors, not just on relative wages compared with prospering areas. Cumulating effects of these linked factors swamp the relative price effects upon which the orthodox economist would focus. Direct government investment or measures to change the region's net exports could set the cumulating factors in reverse in a beneficial way : before long, the government's investment could pay for itself many times over in terms of higher tax revenues. Not surprisingly, economists influenced by Myrdal look with horror at the attitudes of Rightwing economists to countries or regions in trouble. The International Monetary Fund tends to insist that governments cut back expenditure or development as a prerequisite for short term loans to deal with balance of payments outflows, neglecting the effects this may have on the future strength of the economies in question, including their abilities to purchase goods and services from other economies.

8. Oddly enough, the non-equilibrium view of the cumulative causation school has a pedigree that may be traced back to Adam Smith. A leading theme in Smith's work is that, in general, expansions of output led by increases in demand result in falling prices, because they permit the breaking up of tasks into specialised functions. In other words, the extent of the division of labour is limited by the size of the market. The long run supply curve in each manufacturing market is downward sloping, not at all like the curves you are being trained to draw in other classes. A similar view is found in Marshall's writings and in the thinking of modern management consultancy firms when they speak of 'learning curves'.

9. Increases in demand, however initially generated, will be self-fueling. Rising output increases employment and purchasing power. Already-employed workers enjoy increases in real income as goods fall in price when production rates increase; so their demands for other products increase, leading in turn to rises in their outputs, reductions in their prices and rising real income. The system never attains equilibrium. Growth is demand-constrained, rather than limited by scarcity of factors of production, in the long run.

CEC100 AUSTRALIAN POLITICAL ECONOMY

Lecture 12 : Protection and Free Trade

1. The question of whether Australia should open up its markets to foreign competition or maintain/increase its trade barriers against imports from the rest of the world is perhaps the most significant one of all in Australian Political Economy. Changes in trade policy of a variety of kinds may be conceived of to help reduce Australia's current trade deficit and increase employment. Different strategies will involve different mixes of products being produced. This should be borne in mind as I survey some of the common points of argument.

2. First let us consider the distributional implications of a removal of protection from Australia's manufacturing industry. People would tend to buy more imported goods, causing the balance of payments on current account to worsen. This would lead to a fall in the value of the Australian dollar relative to other currencies, a fall whose extent would depend largely on speculators' expectations and the rapidity of response by Australian firms to more profitable export opportunities. A public service employee would initially feel better off as imports were easier/cheaper to obtain, but might ultimately end up feeling little better off as the fall in the dollar raised import prices. A car worker might feel worse off, as easier imports lead to reduced employment in the Australian car industry. However, the fall in the dollar might open up opportunities for bigger exports of, say, car components to Europe. The sectors which clearly benefit from a free trade strategy are tourism, agriculture and mining. If the world prices of products are unaffected by any expansion of Australian output, it is obvious that the fall in the dollar enhances profit margins on exports by these sectors. Suppose the $A falls to $US0.50 from $A1.00 = $US0.75. Then $US75 worth of exports converts not to $A100 but to $A150. Mining and agricultural shares would go up in value, and one would expect increased investment in these sectors. Extra export from these sectors would strengthen the balance of trade and to some extent limit the fall of the dollar. Not surprisingly, mining interests tend to be 'anti-protection' and industrial unions tend to be 'anti-free trade'.

3. Proponents of free trade often argue that domestic industries tend to become inefficient if their markets are protected. They would point to the poor record of Australian manufacturing industry in respect of quality, to illustrate this point. However, we should not forget that although domestic firms may be partly shielded from overseas competition, they still have an incentive to be efficient insofar as they are competing with each other for domination of domestic markets. Against this, the 'free traders' might well argue that, if competition is only betwen two or three large firms in a market, a kind of truce <u>may</u> develop. Each firm knows that its one or two rivals may watch out for and easily copy any improvements it makes, so there is not much point in making them. With a larger number of firms it may be the case that product improvements are worthwhile, since some of the firms may be slower to react and get driven out of the market, leaving bigger shares for the quick, innovative ones.

4. The free traders' view of efficiency is very much in the nature of a 'stick' view of market incentives. Protectionists point out that a growing level of demand also provides an incentive to invest in production and product innovations, a 'carrot' incentive. High demand generates high profits; growth of demand means that labour saving equipment can be installed to cut costs without it being necessary to reduce employment. However, if a country has not yet got low cost technologies of production, attempts to pump up demand, without the aid of trade control measures, will see much of the demand leaking overseas, making foreign firms, more so than domestic ones, stronger. So the protectionist might well

urge Australian policy makers to look at the very different experiences of the UK and Japan. The former steadily removed trade barriers in the post war period, and found that it was impossible to run a sustained demand boom for long enough to get domestic capacity expanded and costs cut. In the consumer durables industries, particularly, demand gyrated widly as expansions were followed by credit squeezes when the balance of trade turned bad. Firms that did invest in new capacity could find it coming on stream at a time of slack demand, so incentives to invest were not very effective. Failing domestic capacity growth, each demand boom helped foreign products get established and build up reputations and distribution networks. Japan, by contrast, employed a highly protected home market as a means to ensure that investments could be made profitably. Despite rising wages, Japanese workers could outcompete workers whose wages began to fall behind (e.g. those in the UK). Their employers had protected markets and yet efficiency increased remarkably.

5. You may notice that protectionists are prone to give stress to cost positions that could be achieved behind a wall of trade controls. To remove such controls and put pressure on firms to invest according to current relative costs is something they believe could be disastrous. Conventional trade theory, however, is cast very much in terms of current opportunity costs. It would argue that Australia has to choose between improving its balance of trade by increasing exports via the stimulus of a depreciated dollar and downward wage pressure from workers displaced from hitherto-protected sectors, or by producing import subsitutes behind increased trade barriers. It makes no sense to use a given volume of resources to save $X million foreign exchange if a greater sum could be generated by using these resources to produce goods for export.

6. The Japanese experience clearly suggests that future export earnings may depend to a great extent on past import-avoiding strategies. From a short run standpoint it may look crazy to use import controls to create 'artificial' incentives to invest in import substitutes. The 'artificial' incentives lure resources out of presently 'efficient' exporting industries and, overall, the economy obtains less goods from the rest of the world than it might have done. In the long run, however, such sacrifices pay off it efficiency advances are made in the import-substitution sectors, which permit higher exports than would otherwise have been achieved. It should also be noted that, if there is unemployment to start with (as there is), an import substitution policy may be carried through without any sacrifice. Imports could be reduced by putting unemployed resources into the production of substitutes. To ensure that this did not result in unemployment rising elsewhere in the world, and in retaliation, domestic demand could be stepped up, so that the overall balance of trade is exactly as it would have been (i.e. if taxes are cut, people may spend some of their extra incomes on imports despite them now seeming relatively unattractive).

7. A second long run consideration concerns likely changes in world relative prices of exportable goods. If Australia were to take a free-trade approach and expand resource exports there could be long run problems insofar as new products economised on their use as inputs, causing their world prices to fall. There is also the qustion of what to export when the resources have been depleted. Cyclical swings in world demand for resources make an undiversified resource-oriented economy very vulnerable; this is another reason for thinking seriously about the protectionist strategy.

8. Protectionists are not always unanimous over the question of general versus selective protection. The latter is more open to abuse by lobbying from inefficient industries. The former cuts down on such risks and on bureaucracy, but it sounds rather like a devaluation/free trade strategy that fails to encourage exports. 'Generalists' amongst protectionists stress, however, that a uniform tariff combined with exchange controls is much more likely to be an incentive that can be made to stick than can a large devaluation, which speculators may not take seriously.

CEC100 AUSTRALIAN POLITICAL ECONOMY

Lecture 13 : Structural Change in the Steel Industry

1. Events over the past decade in the national and global steel industry have illustrated neatly some of the limitations of free enterprise and free trade views of how economic activity should be conducted. One would have expected, from an analysis of resource availability, that Australia would be one of the world's most significant steel producers and exporters. Abundant iron ore and coal and steel-making knowhow should have ensured the nation had great advantages over countries deficient in one or more of these areas. However, at its peak, Australian raw steel production of a mere 8 million tonnes roughly coincided with Australia's own consumption of steel in that year (1974) with imports (1.7m tonnes) virtually equal to exports (1.6m tonnes). The Japanese, by contrast, and despite having to import their raw materials - from Australia - were dealing with three-figure levels of domestic production and consumption. Instead of employment being generated within Australia in the processing of steel for export, adding value to domestic raw materials, Australia acted largely as the 'world's quarry'. (Likewise, instead of having a much larger, export-oriented, paper, packaging and furniture industry, Tasmania mainly exports raw materials for these industries, in the form of its chopped down forests.)

2. Steel production in Australia has been virtually monopolised by BHP. This firm's operations were highly vertically integrated, both backwards into ore production and forwards into tying up the markets for its outputs. From 1956 onwards, BHP steadily expanded its capacity so that its production was usually slightly ahead of local demand. These factors have made the domestic market highly unattractive to potential entrants - even those who could raise the kind of capital needed to enter on a competitive scale. An entrant would need to be confident of being able to win export markets in the face of competition from the Japanese.

3. Within its monopoly position, BHP appears to have failed to invest in steelmills that generally achieve the minimum unit cost (2.5 m.t. per annum at least is required, and 4 m.t. p.a. in steel rolling). Only its Port Kembla (Wollongong) plant is large enough. This is partly the result of growth by merger rather than by new capacity creation, but is also partly due to government intervention (State Government pressures). It might further be suggested that investment in productivity improvements in steel has been pushed rather to the back of the minds of top management in BHP as they have become more interested in diversification into energy and in taking advantage of booming demands for raw materials each time they arose in world markets.

4. The oil crisis of 1974-5 put a great brake on sales in the world steel industry. Excess capacity in the car industries, for example, and a general downsizing of vehicles were associated with greatly reduced demand for sheet steel. Products that embodied the fruits of integrated circuits and microchip technologies generally used very little steel relative to their total values. Future prospects for steel do not look very promising when one notes advances in the production of substitutes such as carbon fibre and ceramics. This

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plan hardly provide an environment for the taking of confident long term investment decisions.) The steel plan's main elements were as follows (Hawke had promised a plan within 100 days of a Labor victory):

(a) The Government would set aside $71.6m p.a. for 5 years to ensure a 80% share of the local market was retained by BHP's associated companies.

(b) BHP agreed to invest $800m over four years and to stop retrenchments after 1 January 1984 (by which time it had already made its massive cutbacks).

(c) The Unions would agree to dispute settlement procedures and not to seek pay rises outside the arbitration system.

(d) Productivity targets of 250 tonnes p.a. per worker (an increase on 200 tonnes p.a.) were agreed to during negotiations, but were reached even before the plan came into operation; the target for 1994 would be 350 tonnes per worker.

It has been argued that the fund for bounties to ensure 80% of the local market could easily prove insufficient if the world price of steel falls greatly, if countries such as South Korea continue to engage in competitive devaluations, and if the US and EEC persist with secret discounts, extended credit terms that do not attract anti-dumping action and yet enable discounting by importers.

9. The human cost of the turn round in BHP's steel operations has been enormous, leading one to agree with J.B. Priestley's interwar years observation that 'A rationalization of industry that suddenly leaves a whole mass of men sinking into the bog of permanent unemployment cannot be very rational'. BHP's workforce was dominated by immigrants, many of whom would find poor English a barrier to achieving alternative employment. BHP had enabled them to start new lives, but adopted a distant, ruthless attitude towards them. To keep wages at award levels, BHP took contracts from local firms if it caught them poaching workers; black lists of political and industrial activists determined who could be hired. Workers found it hard to face up to the idea that BHP could no longer be relied upon to employ them; their feelings were especially soured on the day that BHP simultaneously fired 641 steel workers and announced that it would be buying Utah International Inc. for US$2.4 billion. Workers took the view that 'BHP had taken millions of dollars of profit out of the area for decades. This was a time to put some of that back into the community'. After all, was it not BHP management that had allowed the company to slip behind and had refused to listen to the Unions' plan in 1978? For many workers the impact of unemployment on their feelings of self-esteem and self-worth - quite apart from on their bank balances - was considerable. Even modest dreams were shattered. Some failed in small business ventures financed from their severance pay. Welfare services found it hard to cope, with huge waiting lists appearing at marriage guidance centres. Local training facilities were hopelessly inadequate. Alcoholism and theft increased. The cost is recounted in Schultz's Steel City Blues; attempts to quanity the cost in a similar case in the UK are made in the paper by Rowthorn and Ward, who do try to include the costs of mental illness and rising crime.

10. Wollongong's future looks bleak. Tourism was suggested as a possibility, but typically was a low wage, low security industry. 'High-tech' 'sunrise' industries hardly matched the skills of the displaced workers. Local infrastructure left much to be desired. Schultz sums up as follows :

> 'The planning that occurred in Wollongong was very different from that which produced Canberra - the paucity of social services and narrow economic base showed that. Wollongong's crisis in the mid 1980's points to the failure of market forces to produce a city that would sustain its residents and communities in the long term. Profits and community benefit were not necessarily synonymous : it was a city that resulted from decisions made elsewhere, by people who didn't live there and didn't have to confront the advantages and disadvantages of the place and the consequences of their decisions.'

CEC100 AUSTRALIAN POLITICAL ECONOMY

Lecture 14 : Development Economics and Assistance to less Developed Countries (LDCs).

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1. As we move on to consider the economics of poor nations we may draw on themes from earlier lectures. Green economics claims that the world's resource base simply could not support a worldwide average rate of consumption anywhere approaching that enjoyed by the typical Australian. Critics of advertising and agribusiness would point to the ability of companies such as Nestle to sell potentially harmful compounds as substitutes for mother's milk to mothers who can ill afford the outlay in the first place; in the Pacific Islands traditional diets based on cassava, taro, leafy green vegetables, coconuts and fresh fish are being replaced by tinned corned beef or tinned fish and rice, cakes, biscuits and snackfoods - sugar consumption increases, bringing with it diseases of affluence. Multinational corporations may indeed invest in LDCs as a means of combatting rising labour costs in their major markets, but if they do set up subsidiaries they may be expected to be very careful not to let the locals have much access to their production secrets.

2. Perhaps the most important notion to consider here, however, is Myrdal's cumulative causation hypothesis. In the absence of injections of resources from overseas investors and governments, a nation can only hope to expand its outputs if it can generate a surplus persistently (some surplus years will be needed merely to permit survival through years when the harvest fails). Generation of a surplus may be impossible if one does not have some kind of surplus in the first place. Sarah Sargent's book on The Foodmakers adds a further dimension to the vicious cycle of poverty, noting the harmful effects that attempts to generate export earnings can have on local groups. The EEC has encouraged soya been schemes in Indonesia, as a cheap route to fattening European pigs and poultry, not for feeding protein deficient Indonesians. Local soya supplies get syphoned away for export - the same thing happens with high quality fish, prawns and lobsters which are frozen and air-freighted to affluent markets. High food prices undermine the purchasing power of rural Asia, discouraging those with surpluses from investing them for local production.

3. Proponents of the cumulative causation analysis are drawn to the conclusion that rich countries must offer assistance if the LDCs are to achieve a take-off into self-sustaining economic growth. To be sure, private capital mobility may play some part, but what multinational firm is going to wish to set up operations in some land-locked country where the people are poorly educated and unfit for work as a result of persistant drought conditions? In any case, the large corporations may be disinclined to develop technologies that are suited to local needs, outside of their developed enclave (Schumacher's Small is Beautiful explores this theme at length). Such investments may rather serve to promote migration to the relatively brighter prospects of the cities, leading to shanty towns and rural/urban political problems.

4. An outspoken critic of Myrdal and his followers has been Professor (now Lord) Bauer, who is not averse to going so far as saying that assistance to LDCs is positively harmful. He is also strongly critical of the idea that comprehensive central planning is a desirable tool for speeding up economic development. (The case for such planning is often argued in relation to the coordination problems of complex systems. In Ghana, for example, the construction of the Volta Dam was promoted not merely as a means of providing irrigation facilities, but also to

generate hydroelectric power, much of which was to be used in a steel plant that recycled steel from ships being broken up at a new coastal development. The set of projects was only viable in prospect if taken together, whereas individuals acting in isolation would have experienced great difficulty in getting the activities undertaken that related to their own investment ideas).

5. Bauer argues that Myrdal et al. emphasize the role of physical capital resources in development and play down the human resources of a country, and the positive or negative part they can play. For example, a country may well have surplus agricultural workers who could be turned to other activities that could earn foreign exchange, or save foreign exchange and thereby make it possible to import capital equipment for further development. If such surplus labour is indeed available, then what will stop the country pulling itself up are (1) lack of entrepreneurial capabilities in organising the labour ; (2) limitations on the extent to which highly intensive use of labour can overcome a lack of machinery (manpower as a substitute for giant earthmoving plant or for precision machinery) ; (3) inelastic world demands for the things that can be produced with surplus labour, so that as countries produce more of those things they end up earning less (for a small producer unable to affect the world price this will not be a problem when it expands its production unless other nations are also expanding in the same area) ; and (4) a failure to prevent the extra output from being used to purchase consumption goods.

6. Attitudes may be decisive in shaping whether labour not essential for subsistance production actually contributes to the generation of a surplus. The following passage from Bauer's Dissent on Development make clear his view :

> 'Beliefs which emphasise the lack of a clear distinction between man and his environment, and the belief in the power of the supernatural over personal destiny, have almost certainly contributed to the more pronounced authoritarian tradition of Asia and Africa compared to the West ... The subjection of individuals to political authority and the authority of traditional values and attitudes usually discourages some of the major attitudes behind material progress, notably self reliance, personal provision for the future, and a spirit of experimentation ... (for example, the) belief in reincarnation which reduces the meaning and significance of effort in the course of the present life; lack of interest in material advance ; resignation;' belief in the efficacy of the supernatural ; high leisure preference ; recognised status of beggary, lack of stigma in acceptance of charity, etc.'

Thus Bauer concludes that, in many countries, 'Economic development requires a modernisation of the mind, notably a revision of the attitudes, modes of conduct and institutions unfavourable to material progress." Without such changes, foreign aid merely serves to reinforce the charity-orientation, and often augments government resources and consolidates power in the hands of those who have vested interests in maintaining growth-inhibiting systems of patronage.

7. To make the point that attitudes rather than physical resources are crucial, Bauer notes the case of a once empty, barren rock, now Hong Kong. In spite of increasingly severe population pressure and a restricted domestic market, the free-enterprise growth of this 'resource-poor' country has been such that trade barriers have been

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9. But even if we cannot lightly dismiss Bauer's arguments, we may find it difficult also to deny the present existence of extreme poverty, malnutrition and starvation that the present rules of the game have produced. These problems are exacerbated by technology allowing the birth and death rates to get out of alignment before education can change attitudes concerning the production of children. Horrendous refugee problems arise from tribal and international wars. But to give aid to charities with projects in the LDCs may merely perpetuate the situation. For example, education projects funded by the Catholic church agencies may help promote some of the attitudes favoured by Bauer, but may go hand in hand with the Pope's wisdom on why contraception should be avoided, so the population pressures may remain. Gifts to agencies that dispense food enable people to live to starve another day, but hardly promotes changes in attitudes that may foster agricultural improvements or tribal cooperation. But to do nothing at all is also a questionable form of behaviour, as the attached piece by Peter Singer indicates.

"They're poor because they have too many kids" is the commonest of all cliches about world poverty. It is a convenient myth for blaming poverty entirely on the poor.

Until recently it was necessary for poor people to have a large family. Take the case of an ordinary Indian peasant-farmer. His life is plagued by malnutrition and ill-health, with the result that he is too old and weak to work by the time he is fifty (indeed the average person in India dies before his fiftieth birthday). Unless he has sons to support him he will simply die young. But only half his children are likely to be sons and only half of them are likely to survive. Therefore, for very survival, he and his wife need to have a large family.

Now, because of improvements in child health care, more and more people are surviving. But it takes time for an understandably-insecure people to adjust to this trend and compensate for it by having fewer children.

Secondly, the need to have a large family would be dramatically reduced if a man and his wife did not have to die in poverty when they are too old or ill to work – if there was adequate social security, the population increase would automatically slow down. For evidence of this we need only look at the slowing down of population growth in rich countries as these countries have become more affluent.

In other words, large families are more a result of poverty than a cause of it, and in the last analysis prosperity is the best contraceptive.

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Education for family planning is still an essential part of the fight against under-development. But to blame the poverty of half the world on the population explosion is a mistake which obscures the need for more important changes and stands in the way of their realisation.

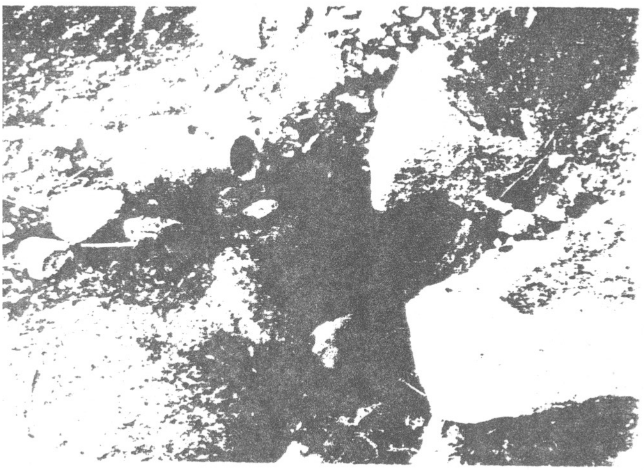
Adapted by the Australian Freedom From Hunger Campaign 'ideas centre' from the *New Internationalist*. Green Series, No 3.

"THEY'RE POOR BECAUSE THEY

FAMINE AND MORALITY

PETER SINGER

Peter Singer, author of *Animal Liberation* and head of the Center for Human Bio-ethics at Monash University examines the global distribution of wealth and presents the case for our moral responsibilities.



This 15 cm puddle provides the sole water supply for over 500 people of the village of Gera, central Tigray Province, Ethiopia.

People are now dying of starvation and malnutrition in Ethiopia. There is nothing unique about this situation. It is just the latest and most acute of a series of major emergencies in various parts of the world, arising both from natural and from human-made causes. There are also many parts of the world in which people die from malnutrition and lack of food independent of any special emergency.

What are the moral implications of a situation like this? In what follows I shall argue that the way people in relatively affluent countries react to a situation like this cannot be justified.

Unnecessary Human Suffering

I begin with the assumption that suffering and death from lack of food, shelter and medical care are bad. I think most people will agree about this.

My second point is this: if it is in our power to prevent something bad from happening, without thereby sacrificing anything of comparable moral importance, we ought, morally, to do it. By "without sacrificing anything of comparable moral importance" I mean without causing anything else comparably bad to happen, or doing something that is wrong in itself, or failing to promote some moral good, comparable in significance to the bad thing that we can prevent. This principle seems almost as uncontroversial as the last one. It requires us only to prevent what is bad, and not to promote what is good, and it requires this only when we can do it without sacrificing anything that is, from the moral point of view, comparably important.

An application of this principle would be as follows: if I am walking past a shallow pond and see a child drowning, I ought to wade in and pull the child out. This will mean getting my clothes muddy, but this is insignificant, while the death of the child would presumably be a very bad thing.

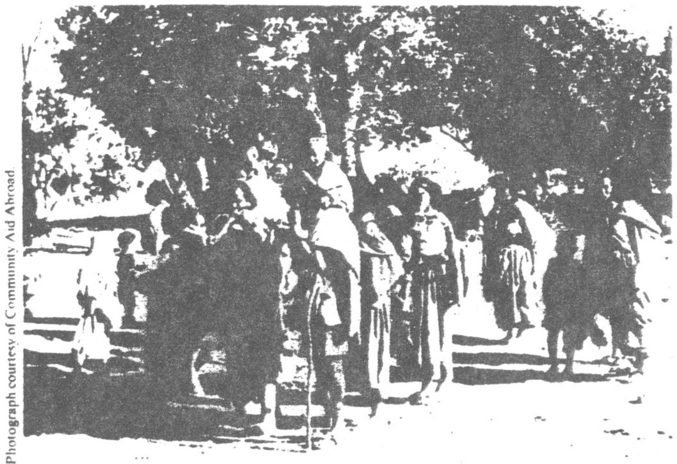
The uncontroversial appearance of the principle just stated is deceptive. **If it were acted upon, even in its qualified form, our lives, our society, and our world would be fundamentally changed.** For the principle takes, firstly, no account of proximity or distance. It makes no moral difference whether the person I can help is a neighbor's child ten metres from me or an Ethiopian whose name I shall never know, twenty thousand kilometers away. Secondly, the principle makes no distinction between cases in which I am the only person who could possibly do anything and cases in which I am just one among millions in the same position.

Distance away is no excuse

I do not think I need to say much in defence of the refusal to take proximity and distance into account. The fact that a person is physically near to us, so that we have personal contact with him, may make it more likely that we shall assist him, but this does not show that we **ought** to help him rather than another who happened to be further away. If we accept any principle of impartiality, universalizability, equality, or whatever, we cannot discriminate against someone merely because he is far away from us (or we are far away from him). Admittedly, it is possible that we are in a better position to judge what needs to be done to help a person near to us than one far away, **and perhaps also to provide the assistance we judge to be necessary. If this were the case, it would be a reason for helping those near to us first.** This may once have been a justification for being more concerned with the poor in one's own town than with famine victims in Africa.

Unfortunately for those who like to keep their moral responsibilities limited, instant communication and swift transportation have changed the situation. From the moral point of view, the development of the world into a 'global village' has made an important, though still unrecognized, difference to our moral situation.

Unfortunately most of the major evils — poverty, overpopulation, pollution — are problems in which everyone is almost equally involved.



Photograph courtesy of Community Aid Abroad

Tigrayians migrating westward to Sudan. REST (Relief Society of Tigray) is organizing the people into village groups (from hundreds up to 3000) to move together.

Expert observers and supervisors, sent out by famine relief organizations or permanently stationed in famine-prone areas, can direct our aid to someone in Ethiopia almost as effectively as we could get it to someone in our own block. There would seem, therefore, to be no possible justification for discriminating on geographical grounds.

Joining others who are doing nothing is irresponsible.

There may be a greater need to defend the second implication of my principle — that the fact that there are millions of other people in the same position, in respect to the Ethiopians, as I am, does not make the situation significantly different from a situation in which I am the only person who can prevent something very bad from occurring. Again, of course, I admit that there is a psychological difference between the cases; one feels less guilty about doing nothing if one can point to others, similarly placed, who have also done nothing. Yet this can make no real difference to our moral obligations. Should I consider that I am less obliged to pull the drowning child out of the pond if on looking around I see other people, no further away than I am, who have also noticed the child but are doing nothing? One has only to ask this question to see the absurdity of the view that numbers lessen obligation. It is a view that is an ideal excuse for inactivity; unfortunately most of the major evils — poverty, overpopulation, pollution — are problems in which everyone is almost equally involved.

The view that numbers do make a difference can be made plausible if stated in this way: if everyone in circumstances like mine gave $20 to the Relief Fund, there would be enough to provide food, shelter, and medical care for the Ethiopians; there is no reason why I should give more than anyone else in the same circumstances as I am; therefore I have no obligation to give more than $20. Each premise in this argument is true, and the argument looks sound. It may convince us, unless we notice that it is based on a hypothetical premise, although the conclusion is not stated hypothetically. The argument would be sound if the conclusion were: if everyone in circumstances like mine were to give $20, I would have no obligation to give more than $20. If the conclusion were so stated, however, it would be obvious that the argument has no bearing on a situation in which it is not the case that everyone else gives $20. This, of course, is the actual situation. It is more or less certain that not everyone in circumstances like mine will give $20. So there will not be enough to provide the needed food, shelter, and medical care. Thereby by giving more than $20 I will prevent more suffering than I would if I gave just $20.

Since the situation appears to be that very few people are likely to give substantial amounts, it follows that I and everyone else in similar circumstances ought to give as much as possible, that is, at least up to the point at which by giving more one would begin to cause serious suffering for oneself and one's dependents — perhaps even beyond this point to the point of marginal utility, at which by giving more one would cause oneself and one's dependants as much suffering as one would prevent in Ethiopia. If everyone does this, however, there will be more than can be used for the benefit of refugees, and some of the sacrifice will have been unnecessary. Thus, if everyone does what they ought to do, the result will not be as good as it would be if everyone did a little less than they ought to do, or if only some do all that they ought to do.

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"THEY'RE POOR BECAUSE THEY

CEC100 AUSTRALIAN POLITICAL ECONOMY

Lecture 15 : Economics as a Coordination Problem (2)

1. This lecture deals with a variation on the coordination problem discussed back in Lecture 2, where we saw how difficult it might be to ensure that, even if one had a good idea of consumer demand in a market, one's profit hopes would not be ruined by too much competitive investment and too little complementary investment. The other coordination problem concerns difficulties of ensuring that the amount 'people' plan to refrain from spending from their income flows equals the amount that other 'people' would like to spend in excess of their income flows, and of getting this equality to hold when income payments are being made to every factor owner who would like to offer her factor services for sale (i.e. there is full employment).

2. Every owner of a factor of production, be it a machine, a piece of land, so many hours of labouring of a particular kind, or the loan of funds, will have some minimum price, relative to goods in general, for which she is prepared to make it available for hire. However, payments for factor hire are made in terms of money, and there is no guarantee that the money price one receives (if one actually receives it) will, when compared with money prices of other goods, offer the real return one has been hoping for. For a worker, the price level may be higher than expected, and she may feel she would have been happier on the dole, given what her wages seem to be able to buy. For the firm, the big question is: given the factor payments we are contracting to make, do we think the output we get from selling the associated output can be sold for a price that yields a net revenue which is high enough, given the prices that other goods turn out to have?

3. Whether or not each firm will feel itself able to answer 'yes' or 'no' to that question will depend on the scale of production it contemplates, and on its expectations about the size of the market and of complementary and competitive investment that may take place. Each firm will find itself able to say 'yes' only up to a point, and the profit maximising scale of production (if it wants to try to maximise profits, and it may actually have other aims, so long as it can get satisfactory profits) may be somewhat short of this point. Taken together, firms' decisions about how far it is safe to extend their production volumes will determine the level of employment and total payments to the factors they hire.

4. There is no obvious reason why the sum of such decisions will necessarily amount to full employment of the factors that are available at the current set of money prices. One might say: surely, if demand for factors is less than supply, factor prices will fall and deter some factor owners from continuing to try to sell their services. Certainly such forces may be at work, but employers may be unwilling to hold back while they operate, so factor markets may fail to clear at the full employment position. As such forces start to work, it is not certain by any means that they will make the employment situation any better - at least, not to Keynesians, as later lectures will explain.

5. But suppose firms happen to have hired all the available factors in the present period. There is no guarantee they will wish to repeat their hiring decisions next time, even if their expectations are realised in the present period. for example, workers may currently be employed on building a new factory, full of computer controlled robots. Next period there may be no demand for such workers from engineering and construction firms, and little in the way of new jobs in the robot factory (which may actually replace a manned assembly factory).

6. But there is no guarantee that firms' expectations will be realised in this period, and their disappointments may rebound upon their expectations about how much it is appropriate to produce next period. Here we come to the savings question. People who have been paid for their contribution to production are not obliged to spend their incomes to the full on output produced during the period in question. They might choose to save, adding to their holdings of financial assets. Others may choose to dissave and offset the gap in demand : these spenders will be running down their previously accumulated holdings of wealth or borrowing from other people. Suppose the amounts saved and dissaved, by wealthholders other than firms, were equal. Then firms, taken as a whole, would find their outpayments equal to their sales revenues. This would mean their sales revenues left no profits over costs. Firms themselves could ensure profit expectations were realised only if they themselves spent their <u>expected</u> profits to the full, initially financing such actions from past reserves or new bank loans. Some firms could be savers, and others dissavers, just as in the non-corporate sector.

7. Another situation in which 'overall' expectations <u>could</u> be realised is if saving by the non-corporate sector were matched by net borrowing from the corporate sector (on top of spending by the latter equal to its expected profits). After all, if people are saving up for things, they will be spending the money and dissaving in the future (or their heirs will be!), so firms will need to invest now to cope with extra orders in the future.

8. Such situations, in which expected proceeds materialised, <u>could</u> happen, but they need not. As far as the relationship between savers and dissavers in the aggregate is concerned, there is no foolproof mechanism to link the two together, so that a desire to save encourages others to borrow to an equal degree. Very simply (details in later lectures), savings may be hoarded rather than lent out, or borrowing capacity hoarded rather than used. A reason for firms being unwilling to borrow (or run down their previously accumulated funds) is that it is not obvious, in most cases, what people are saving up to buy. As Keynes put it :

> "An act of saving means - so to speak - a decision not to have dinner today. But it does <u>not</u> necessitate a decision to have dinner or to buy a pair of boots a week hence or to consume any specified thing at any specified date. Thus it depresses the business of preparing today's dinner without stimulating the business of making ready for some future act of consumption."

9. Another major problem is that, even if total expenditure in the event equals total expected expenditure, its <u>distribution</u> may be very different from what firms had been expecting. Some firms will be unexpectedly faced with accumulations of stocks (or a need for a knock-down sale price), so their net indebtedness will be worse than expected. (They are, if you like, doing 'forced dissaving'). Other firms will find their products surprisingly easy to sell. The former may make plans to contract their operations next time, the latter to expand. But there is no guarantee their opposing movements will be symmetrical.

10. Problems discussed in paragraphs (8) and (9) are compounded once we recognise the international dimensions of this coordination problem. A country with a balance of payments surplus is saving and forcing deficit countries to dissave. But deficit countries may be unwilling or unable to run down their reserves or borrow from surplus countries. Hence, the deficit countries, like firms in difficulties, may cut back their expenditures. If surplus countries want to keep their surpluses, they will have to cut their expenditure on foreign products in retaliation, or improve their exports still further at the expense of the rest of the world's employment. If some countries want surpluses, the whole system has an inbuilt deflationary bias.

CEC100 AUSTRALIAN POLITICAL ECONOMY

Lecture 16 : Financial Markets and the Saving/Spending Problem : A Post Keynesian view

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1. Last time I drew attention to the scope in a market economy for firms not to wish collectively to hire all factors that have been made available, and for income recipients to fail collectively to spend as much as employers have been expecting. All this implies that we may easily end up with a situation where people find themselves involuntarily out of work, even though there are many things they would dearly like to buy if only they had the money to spend on them, and even though firms have the physical capacity to produce things to satisfy such wants. There is a kind of 'Catch-22' problem : firms fail to hire people because they cannot see the demand for their products that would exist if only they produced more and paid out more income. (But it is not quite that simple, for people might have marginal propensities to consume of less than one, so if more were hired, extra factor payments might exceed the extra generated demand.) In this lecture I explore the ways in which the workings of financial markets can impact on this problem.

2. As Keynes saw it, the economists of his day denied that there could, overall, be a deficiency of demand for labour. Any tendency for people to want to save more would not take the economy away from full employment for a long period, since a fall in interest rates would lead to an offsetting rise in borrowing for consumption in excess of income or for investment. On the pre-Keynesian view, interest was something that people received as a reward for waiting, for refraining from present consumption. If people became more willing to wait, they would need a smaller reward than before, to make them do so. Likewise, if firms could not see such good prospects for making a profit, they would be less willing to bid resources away from consumers by bribing them to wait, via interest payments. Keynes argued that a major flaw with this view is that, in reality, interest payments are rewards for parting with immediate access to one's money - for lending it. People can refrain from consumption but this does not mean that funds will become available that will induce others to step up their own spending.

3. A person who decides to increase her rate of saving from her flow of income may simply allow her money to accumulate (e.g. in her keycard savings account) in a bank. Although she is increasing her lending as she does so, she is not increasing the ability of the bank to lend to others. The money she lends the bank as a deposit is money that her employer had previously been lending but has withdrawn to pay her. It is money that someone else would have had as a bank deposit had she spent it. She is holding up expenditure flows without necessarily making it any easier for anyone else to increase expenditure.

4. Just as an increase in the desire to save may not liberate more funds for others to borrow and spend, so we may have a change in the rate of interest without anyone necessarily changing their desire to save and postpone consumption. For example, suppose I have no wage income but considerable wealth, which I have accumulated in the past, a lot of which is held as Commonwealth Government securities. Suppose I now decide I would rather reduce my risks and turn my bonds into bank deposits. I sell them at a price which is somewhat lower than the recent price. This price reduction means that their effective yield has gone up. I have obtained my bank deposit, but someone else now has assets offering a higher rate of return than before. Neither of us need have changed our savings behaviour, for savings are that part of current income which are not spent in the period in question. We may simply have changed the composition of our portfolios.

5. In the case considered, the desire to save may not have altered, but actual savings and investment could well be reduced in consequence, without any offsetting rise in consumption expenditure. For example, the rise in bond yields may have involved someone buying bonds with bank deposits that otherwise would have been used to finance a new investment project : after all, if, after allowing for risk, a firm believes it can earn more by lending money to the government than it can by building a new factory, why should it want to do the latter? The purchase of the bonds cuts demand for current output but involves no increase in government spending : in fact, to the extent that the government is issuing new bonds, it will be finding them harder to sell and there may be pressures for a cut in its deficit. Alternatively, we can note that the bank deposit used to buy the bond might originally have been intended to buy company shares which now fall in price compared with what they would have commanded. This event may then rebound upon expenditure in several ways. First, anyone with shares (and bonds) that have fallen in value unexpectedly may be feeling worse off and cut back on consumption. Secondly, a company which had planned to invest in a new factory may feel inclined to expand its operations by the device of taking over an existing producer whose shares have fallen in value. Thirdly, falling asset prices may lead to a loss of confidence and further falls in their prices, enhancing the first two effects.

6. Keynes was acutely aware of the problems dicussed in paragraph (5), as a result of his experiences (after an unpromising start) as a hugely successful speculator. His message at its most simple is that unemployment is going to emerge whenever people with wealth lose their nerve and try to get hold of existing assets (such as bank deposits) instead of accumulating (or consuming) newly produced goods. If the existing assets cannot be easily produced, as money, gold and land cannot be, then the prices of produced goods will fall due to the lack of demand for them, and firms will cut back production and employment.

7. Let us now return to the case discussed in paragraph (3), where there is an increase in the desire to save that does not necessarily lead to offsetting increases in expenditure by others. Initially extra saving will occur, because incomes are given in the very short term via hiring contracts. Investment will rise initially, but it will be forced investment in stocks, made by firms that are surprised by the lack of orders and insufficiently quick at passing the problem back down the line (e.g. from retailer to distributor to manufacturer to subcontractors and other input suppliers). Sooner or later, ordering, and the hiring of factors of production, will be reduced. The cut back will generally be by more than the initial rise in the excess stocks as a result of firms having been surprised. Secondly, if demand is expected to stay at a lower level, average planned stock levels will be smaller and so too will capacity levels. So there is de-stocking and a reduction in investment.

8. We now have a situation where an increased desire to save actually leads to a fall in absolute savings and in incomes, despite a rise in the proportion of income saved. If investment suffered no planned reduction (despite the accumulation of stocks), then we would have savings the same as initially in total, but people saving a bigger proportion (as they planned) from reduced incomes (which they have not planned). This 'if' scenario is the one being assumed in orthdox textbook models (e.g. 'income-expenditure 45^{o} line' model and IS-LM), where the investment function is assumed to be stable, not affected by shifts in the propensity to save.

9. Although an increased desire to save need not liberate funds for others to spend, it may do so. A person might save by paying off a bank loan or buying a finance company bond. Replacement consumption demand might rapidly be generated before any corporate cutbacks occurred. In such a situation we would have something akin to the pre-Keynesian processes at work, but it is not a situation that is guaranteed to eventuate. An extra bank loan might take the form of an overdraft extension to a company whose stocks had unexpectedly risen, or a reduced rate of overdraft repayment by a worker who is put on short-time due to a decline in orders.

CEC100 AUSTRALIAN POLITICAL ECONOMY

Lecture 17 : Wages and Unemployment : A Post Keynesian View

1. Supply and demand analysis takes one to an unduly simplistic conclusion about how one should tackle the problem of unemployment : if there is an excess supply of labour, this must be the result of wages which are too high relative to the level of demand; therefore, to cut unemployment one must cut wages. If wages are cut in money terms, unemployment will fall, partly as a result of people deciding it is no longer attractive to work and consequently removing their offers to supply labour, and partly as a result of firms hiring more labour as marginal employment schemes are made viable.

2. Keynes was unimpressed by this analysis, for it depicted unemployment as being due to labour market rigidities caused, for example, by trade union monopolies, that kept wages unduly high and encouraged an over-supply of labour. Keynes believed that there could be involuntary unemployment even in the absence of union barriers to wage flexibility. His definitional test for the existence of involuntary unemployment was to see whether, in the event of a rise in the cost of living relative to money wages, the number of workers still wishing to be employed would be greater than the number originally employed, and whether the number of workers that firms wished to hire would also be greater. This definitional test has caused enormous confusion. Keynes is saying that one may have a situation where, from the standpoint of firms, it is excessive real wages that cause them not to hire as many workers as they might hire, yet where a reduction in real wages would not reduce the supply of workers below that in employment at a higher level of real wages. But Keynes' definition makes no connection between money wage changes and employment or labour supply. Rather, he seems to be suggesting that if prices are somehow pulled up (e.g. by an injection of purchasing power into the economy) at a faster rate than wages move upwards, we may be able to say something about the nature of unemployment.

3. A common reaction to Keynes' view of involuntary unemployment was that Keynes must be assuming workers were under some kind of 'money illusion': they would resist cuts in their money wages but would allow their real wages to be eroded by price increases. Therefore, it is argued, Keynes ended up writing as though money wages were given and that the key to reducing unemployment was to increase demand, even though this would be inflationary. Keynes' attempted message, as seen by Post Keynesians, is very different.

4. To take money wages as 'given' was something that made it much easier for Keynes to outline his theory of how unemployment could arise due to a failure of effective demand, but he believed that money wage flexibility was by no means guaranteed to lead to reduced unemployment and could just as likely make matters worse. (In an inflationary environment, we would be talking about reductions in the rate of increase of wages not necessarily helping the unemployment problem.) If there could be a failure of effective demand regardless of the level of money wages, then one would not be missing the point by taking wages as given in an explanation of effective demand issues and then (as Keynes did in chapter 19) seeing what happened if excess supplies of labour led to falls in money wages.

5. In the context of an open economy, it might seem obvious that wage cuts would help reduce unemployment, since exports and import substitutes could be sold on more competitive terms. However, Keynes was acutely aware of the system-wide implications of such policies. One would simply be exporting unemployment to other countries, who could retaliate with wage cuts (or import restricting policies) of their own. This system-wide perspective is evident in his other inquiries into the impact of wage reductions on unemployment.

6. If wage costs are reduced in money terms, firms may hire more workers and plan to offer the extra output flow at a lower price. If, for a given money wage, their

cost curves are upward sloping (which Keynes assumed, in order to depart as little as possible from the conventional wisdom), firms will cut prices by less than wages, so real wages will be reduced for people who already had jobs, but increased for those who are newly hired; real profits are also expected to rise. The question then is : will actual demand be at least equal to effective demand? The answer depends on the weighted average of marginal propensities to consume from real income. On the one hand, the real income losers will cut back their real demand by less than their real income reductions if their marginal propensities to consume are positive fractions; on the other hand, real income gainers will increase their consumption in real terms by less than their increase in real incomes if they have similar MPCs. Output is being expanded, yet there is no obvious reason why expenditure in real terms need expand by exactly the amount firms require it to increase for their expectations not to be disappointed. Unless firms increase their investments, there is likely to be a shortfall of actual demand due to an increase in aggregate planned savings. Only if the overall marginal propensity to consume is equal to unity will the money wage cut seem to succeed. Otherwise, we shall observe that firms find unsold products pile up on their shelves at the lower prices. (These arguments are even easier to see if one takes the case where the firms' average cost curves are horizontal at a given wage and money wages and prices fall by the same amount, with firms hiring more workers in the hope of selling more at lower prices.)

7. What Keynes had realised was that, while money wage cuts may certainly shift the supply curves of firms, they would also affect the positions of firms' demand curves, since reduced money incomes would reduce purchasing power, while those that enjoyed increased money incomes (wages rather than dole) might prefer not to spend all of their gains. Wage changes would have no direct impact on the viability of levels of employment larger than those currently preferred by firms. so Keynes sought to uncover <u>indirect</u> mechanisms that might work.

8. A falling price level might well be expected to have some indirect effects on the rate of interest, which might prove favourable as regards encouraging firms and consumers to increase their spending. People who owe money will be paying it back day by day, so banks can lend anew to other clients. If the price level falls, a given nominal bank loan will buy more units of output than before. Furthermore, the daily requirements for transactions balances will be reduced, so people may consider turning surplus holdings into less liquid, higher yielding assets (e.g. deposit accounts rather than 'call' accounts) which will enable institutions to lend more than before. Faced with this increased real lending capability, banks an other financial intermediaries could lower their rates of interest to attract borrowers. Falling interest rates could also push up the prices of government bonds, making their owners feel more wealthy and increasing their tendencies to spend.

9. Such things <u>could</u> happen, but one can see possible barriers in their way. First, we should note that people who do respond to lower interest rates by requesting loans may not be those whom lenders judge to be creditworthy. Creditworthy people may be afraid to increase their spending in case they are forced to resell things at lower prices (e.g. if they lose their jobs and can't meet repayment obligations) or because they expect falling prices will continue and things will be cheaper to buy in future. There is little point in lending to unsound borrowers and losing the money, or in making unprofitable interest rate cuts to make reluctant, but seemingly-sound, potential borrowers change their behaviour. Institutions may therefore accumulate unused lending power rather than cut their loan interest rates.

10. Falling wages and prices may, secondly, raise the burden of previously contracted debts. For example, if my mortgage payments are fixed but my income is falling, I may be forced to sell my house, only to find that it is worth less than I borrowed and I am bankrupted. Bankruptcies do nothing to make firms confident to hire labour whose money costs are falling.

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Lecture 18 : Inflation and Unemployment : a Post Keynesian Perspective

1. In the previous lecture, we saw how reductions in (or a slow-down in the rate of increase of) money wages may fail to make it viable for firms to hire more workers from the ranks of the unemployed. A Keynesian analysis of inflation in situations of full or less than full employment turns these arguments about money wage cuts upside down. Suppose workers succeed in negotiating higher money wages but firms do not immediately make any retrenchments, hoping instead to be able to pass the wage increase on in higher prices, keeping their percentage profit margins unchanged. If prices change by the same amount as money wages, real wages are unchanged, so real consumption may be unaffected. If firms' expectations about business prospects are unchanged, they will wish to invest exactly the same amount as before, so we shall only run into trouble if there is a shortage of finance.

2. Some individuals and firms will find that the higher prices come as a blow, for funds they have been accumulating to buy things will not purchase as much as expected. However, others will be pleased to find the real value of their previously accumulated debts has gone down. The two groups' reactions could exactly offset each other, but need not do so. In fact it might be reasonable to presume that debtors have a higher marginal propensity to consume out of their wealth than creditors have, so demand might actually tend to increase as these groups adjust. It might be further fuelled by savers deciding to borrow to buy things now, before their prices rise further, instead of carrying on the losing battle of saving up. However, inflation reduces the real lending capacity of financial intermediaries if their supplies of funds are not increased. (As old loans are repaid, new loans of identical nominal amounts won't buy as much as before.) This could mean that actual demand was less than expected ('effective') demand and firms were driven to make retrenchments 'as a result of excessive wage increases'.

3. Post Keynesians argue that, in practice, inflation will not tend necessarily to lead to a reduction in real lending by financial intermediaries. Rises in interest rates can be used to expand the nominal supply of finance. If the inflation is expected to continue, would-be borrowers will be prepared to pay higher nominal rates of interest (and may not be deterred even by an increase in the real rate of interest, in any case). The extra nominal supply of funds can come from a number of directions. Banks may find private sector advances more attractive than lending to the Government and, in consequence, sell public sector securities. Security buyers' bank deposits fall, but banks then create new deposits in the names of those to whom they are lending money. If such a move involves a fall in price for government securities (i.e. a rise in interest rates) the Reserve Bank itself may step in and buy them, in order to prop up their prices. Banks' deposits at the Reserve Bank will thus rise, and so, then, will their lending capacities. More finance may also come into being as a result of people placing their money with institutions such as Finance Companies and building societies, in response to them offering higher nominal interest rates than banks. Such acts will not reduce the ability of banks to lend, since such 'non-bank financial intermediaries' themselves keep reserves in banks. The upshot of all this is that rising money wages may be things that firms can successfully pass on in full as higher prices without changing the overall volume of production, since aggregate nominal demand can move in tandem with nominal factor payments.

4. So far we have considered inflation in a situation of full or less than full employment, where money wage increases are obtained as a result of negotiation processes not yet explained. If changes in the level of unemployment are to affect the rate of inflation via their affects on money wages, they must do so by changing the bargaining stances adopted by unions and management. Tylecote argues that one's toughness at the bargaining table depends on one's assessment of the costs of resisting making a climb-down, and on one's assessment of the costs of climbing down : i.e. on the balance of resistance costs versus concession costs. As far as

workers are concerned, the costs of resisting employers' offers will be increased in a time of depressed demand if they believe there is a greater risk that firms will react to higher wages, not by waiting and seeing whether they can pass them on successfully, but by making retrenchments (either cutting output or looking for ways of reducing input requirements). But if they expect that the rate of inflation is going to slow down, their concession costs will fall (not getting such a big pay increase won't be so much of a blow). Taken together, these forces will make for a softer union bargaining stance. Against them, however, we should note that, in depressed times, take-home pay may have been reduced by tax increases or a lack of overtime opportunities, so the workers resistance costs are lessened.

5. As far as firms are concerned, an unexpected fall in sales may have left them with surplus stocks (just as a rise in sales would deplete their stocks), so they are in a much stronger position : they can resist wage demands, even if there is a strike, by running down their stocks and thereby maintaining their market share. Concession costs may seem to have risen, if there seems a greater risk that some firms in their market will start a desperate price cutting war to overcome a cash crisis, disrupting normal oligopolistic discipline. Such considerations would tend to make firms adopt a tougher bargaining stance when activity is declining, and this, coupled with unions' moves in a softer direction, will reduce the rate of money wage increases. As a slump persists, it is possible that wages will eventually start to increase at a faster rate : shortages of skilled workers will appear, owing to cutbacks in training programmes, and firms will eventually get rid of surplus stocks, leaving themselves once more in a position where strikes could prove disastrous for their customer goodwill. Skilled workers may succeed in obtaining higher pay increases, making firms rethink their training programmes and making other workers examine their differentials : if relative pay matters, and if other groups seem to be doing better, concession costs rise and one will adopt a tougher bargaining position.

6. The message of all this seems to be : that, at <u>any</u> particular level of unemployment, money wage increases need not make it unprofitable for firms to continue their existing hiring policies; and that wage inflation is a <u>result</u> of the recent <u>history</u> of output and employment (plus <u>expectations</u> about inflation and real demand, and any other institutional and political <u>changes</u> that affect bargaining stances) rather than its basic cause. Whatever the current <u>state</u> of activity, the economy may very easily live with high inflation without workers finding they are pricing themselves out of their jobs by bidding for higher pay - especially if everyone believes inflation is not going to slow down and the level of real activity is not going to change. To try to stop inflation by cutting aggregate demand seems grossly inefficient, not merely in terms of lost current output, but also because of the potentially inflationary problems it will create for the future by reducing investment in machinery and worker training and hence causing structural bottlenecks. Failing an effective incomes policy and anti-union legislation, one might hope to exert leverage on firms via a price control policy (schemes involving the issuing of a limited supply of price increase permits or wage increase permits, which would be marketable, offer some hope).

7. The comments above come from recent Post Keynesian thinking. Keynes himself did emphasise the importance of relative wages, rather than absolute levels of real wages, in shaping the supply price of labour. His own analysis assumed upward sloping firm supply curves at any given money wage, so an increase in output and employment necessarily involved at least a <u>one-off</u> price increase and real wage reduction (just as he concluded a fall in demand would depress prices and raise real wages). However, evidence suggests that, with given wages, firms tend to have falling or horizontal supply curves, unless the economy is very overheated, so if wages can be controlled there is no reason why a move towards full employment should <u>necessarily</u> entail such a hike in the price level, and a consequent wage-price spiral. Our biggest worries should concern a fall in the exchange rate as demand for imports goes up (not a problem if countries coordinate their reflations), or rising raw materials prices and skilled labour costs - but the longer a recession is allowed to persist, the worse the raw materials and skill situation may become.

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Lecture 19 : From Keynesianism to Monetarism

1. The message at the end of the previous lecture was very much of the form that, if there is unemployment, it may well be possible to improve matters by increasing spending in the economy, and this will not necessarily worsen inflation. Fear of inflation is a reason for seeking to affect price- and wage-setting behaviour, not for acquiescing in a state of unemployment. To increase demand, one can expand government expenditure or cut taxes, financing the deficit either by borrowing from the private sector or by borrowing from the Reserve Bank ('printing money'). This is a view to which monetarists are completely opposed.

2. Monetarists argue that, among other things :

   (a) Inflation can always be traced back to excessive monetary growth, so attempts to increase employment by increasing net government expenditure and financing the deficit by monetary expansion will, sooner or later, result in higher inflation.

   (b) Attempts to reduce unemployment by increasing net government expenditure and financing the deficit by selling bonds to the private sector will simply see the share of government in total national expenditure increasing at the expense of private sector expenditure. Government spending, in other words, 'crowds out' private spending, either by depriving it of scarce physical resources (e.g. skilled personnel) or by depriving it of finance (higher interest rates on government bonds make people buy them instead of, say, corporate debentures). Attempts to increase employment by fiscal policy whilst avoiding the inflationary consequences of monetary expansion are doomed to failure.

3. These views were ideas with which Keynes felt he was having to battle in the 1930s, and which he seemed, until the late 1960s, largely to have discredited. In respect of the first, we should note that, on p. 304 of his <u>General Theory</u>, Keynes had argued that:

> "The view that <u>any</u> increase in the quantity of money is inflationary is bound up with the underlying assumption of the classical theory that we are <u>always</u> in a condition where a reduction in the real rewards of factors of production will lead to a curtailment of their supply".

If there were involuntary unemployment, a rise in demand could produce an expansion of output accompanied, if one assumed upward-sloping firm supply curves, by a one-off increase in the price level, without all workers resisting this threat to real wages by withdrawing their labour services from the market. With horizontal corporate supply curves, there could be a pure quantity response if the labour market included involuntarily unemployed workers, and no upward shifting of supply curves. It is implied that monetarists must be assuming there is no involuntary unemployment, that workers could 'price themselves into jobs' if only they chose to do so.

4. The 1930s equivalent of modern claims about 'crowding out' was the UK 'Treasury View', which held that there was a fixed pool of savings available to finance expenditure, so any increase in government investment would displace private sector investment, total investment remaining equal to total savings. The pool of savings could only be enlarged if interest rates rose and consumers were attracted to postpone consumption, but higher interest rates would cause private investors to reduce their expenditure. The discussions in lecture 16 should make clear why Keynes rejected this view. If increases in total investment can be financed by expanding the money supply or by borrowing idle money balances, then the rise in income will automatically bring about a rise in savings exactly equal to the increase in investment. If there is a barrier to expanding investment in a state of involuntary unemployment, it is a financial one, not a barrier caused by an unwillingness to reduce consumption.

5. The crowding out argument must presume either that there is 'full employment' in the financial markets (i.e. that there is no way the supply of money for lending can be increased at the existing level of income, unless the government borrows from the Reserve Bank), or it must presume full employment in the labour market or, at least, in particular parts of the labour market (i.e. that government projects employ workers for whom the private sector employers can find no substitutes). As far as the financial markets are concerned, Keynes argued that a good deal of flexibility may exist. At any moment, people will hold some 'speculative balances' on which they earn little (e.g. a deposit account in a bank) or no interest (e.g. cash, or a 'call' deposit). To go after higher returns is risky, since there may be possibilities of capital losses that could swamp any excess interest earnings over one's time horizon. However, small rises in interest rates on more risky assets (such as government bonds or finance company debentures) may be sufficient compensation for people to part with their speculative balances and add to the volume of lending, especially if they are big operators and therefore able to cut down on transaction costs. Governments may also issue low risk short term securities to finance their deficits, and find that firms treat them very much as close subsititutes for bank deposits. So it would appear that, unless holders of speculative balances are exceedingly pessimistic, the government ought to find itself able to finance an increased deficit without pushing up interest rates so far as to make the private sector significantly reduce its own borrowing. (This does not preclude the possibility that monetarist beliefs about crowding out may be a major cause of money market pessimism.)

6. It is only recently that economists have started to recognise how Keynes was concerned that, despite widespread unemployment, some sectors of the labour market could be suffering from shortages, and that these might cause problems for a simple policy of cutting taxes or increasing government expenditure generally. In a series of articles in The Times in 1937, entitled 'How to Avoid a Slump', Keynes argued that reflationary policies would have to be highly selective in nature. In a sense, he was thus worried about crowding out and would not have approved of many 'blanket' reflation policies carried out in his name. What he would surely have preferred would have been increased spending on schemes aimed at relieving bottlenecks, or subsidising depressed sectors.

7. Keynes was also entirely willing to concede that, if there is no involuntary unemployment, attempts to reduce observed unemployment (with frictional/structural origins) by increasing demand would be inflationary. Firms would find actual demand in excess of expected ('effective') demand and waiting lists would appear or prices would be increased. Attempts to increase production by bidding for extra labour would simply bid up wages. Unless real expenditure were somehow reduced, firms would find that, as they passed on higher wage costs in higher prices, they would still suffer from an excess of orders. Keynes analysed how one might handle a situation of full employment, in which the government had to increase expenditure, in his pamphlet How to Pay for the War, and he argued that unless workers could be forced to save more (e.g. via higher taxes which the government would promise to repay at a later date), there will be no necessary convergence towards steady prices. If people insist on buying more than the economy is producing, then prices will be bid up, regardless of what is happening to the money supply in total, provided money can be made to circulate fast enough.

8. Those who were taught by Keynes or by his original proteges were not surprised in the later 1960s when 'stagflation' - rising prices and unemployment happening simultaneously - was observed, and when reflationary policies often ran into trouble. Post Keynesians had anticipated what would happen if wage rates ceased to be sticky in money terms, and if changs in industrial structure became intertwined with deficiencies of effective demand. Orthodox 'Keynesians', however, who comprised the majority, were at a loss to explain what was going on - why the 'Phillips curve' relationship ceased to hold, and why demand increasing policies could not be guaranteed to deal with unemployment. Monetarism came along and captivated the minds of politicians who sought something simpler than Keynes' ideas, something which [illegible] with their free market predispositions.

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Lecture 20 : Unemployment : A Post Keynesian View of the Monetarists' View

1. We saw in the previous lecture how the suggestion that any monetary expansion is inflationary presupposes the non-existence of involuntarily unemployed workers, quite prepared to take jobs even if real wages are cut. In this lecture, the aims are to explain how monetarists attempt to argue that there is no such thing as involuntary unemployment, and to present some objections to their analysis.

2. The monetarists argue that unemployment is either structural (i.e the result of an imperfect skills/requirements matching, or a lack of information about job opportunities) or due to mistaken expectations. The structural side is easy enough to see, and was indeed recognised by Keynes. Suppose preferences move in favour of one kind of product at the expense of another - possibly involving a switching of expenditure interstate. The two products may involve entirely different production technologies and possibly highly specific machinery. In the growth sector, it takes time to train up new workers and get new machines, so prices will rise and wages and profit margins will increase. Workers in the declining sector can only keep their jobs there if they can make it attractive for their employers to cut prices and divert demand back, away from the growth sector. If they refuse to do this - by not accepting wage cuts or a reduction in pay increases - they are voluntarily entering into unemployment until the growth sector can absorb them. (Actually, we should recognise that technological change might be the initial cause of the problem and it could be the case that an old product was demanded by no one, even if it were free, so even a zero wage would not save the workers from structural unemployment. This can happen - indeed did happen in the telecommunications industry - if the new technology has far lower operator costs as well as capital costs, and these capitalise at less than the operating costs alone for the old technology.)

3. Suppose now that instead of an unexpected structural shift, we have an unexpected reduction in the rate of 'monetary growth'. (The quotation marks are used for reasons that will become apparent in Lecture 21.) Decision makers in the economy will find that their income flows in nominal terms are high in relation to their nominal money holdings. To restore their real bank balances to suitable levels, they will, so the monetarists suggest, cut back on their expenditure, thereby reducing corporate incomes. Firms react by retrenching workers. Clearly unemployment has gone up, but is it involuntary unemployment? No, say the monetarists.

4. Workers who have lost their jobs can set about applying for new jobs, and even if unemployment is high or increasing, there will always be some vacancies due to retirements, interstate moves, and so on. If some of these vacancies are in sectors where workers are being retrenched, firms will rapidly see, even if they have made no retrenchments, that there are lots of applicants. Like the retrenching firms, they will be less generous in their offers, and this will apply not merely to new hiring but also, at the next pay round, to existing employees. If workers don't like the terms of the offers, they can look elsewhere. If they do look elsewhere, they presently are voluntarily accepting unemployment instead of the wage that is being offered.

5. Some workers will not have much choice in the wage formation process, since their unions may stand firm demanding a higher wage than that which the firms are prepared to offer to hire the available workers. The firms may concede a higher pay deal and hire fewer workers. The workers thus priced out of jobs by their unions will then start applying for jobs in other sectors, encouraging firms in these sectors to stand more firmly against unions or, if these other sectors have

no unions, simply to offer lower pay on a take it or leave it basis. Overall, then, unions are not depicted as causing unemployment via excessive wage demands, merely as affecting the sectoral composition of pay, with strongly (weakly) unionised sectors having higher (lower) pay increases and lower (higher) employment than would prevail in a 'free market'.

6. In non-union-dominated sectors, it looks rather strange that some workers faced with a 'take it' or 'leave it' offer choose to 'leave it'. It also looks strange that workers keep trying for jobs in union-dominated sectors whilst remaining unemployed instead of getting a job in another sector at a lower wage. The monetarists argue that in both cases people believe that the wages they could get by 'taking it' or 'moving and taking it' seem insufficiently attractive in real terms - for several reasons. First, the workers do not anticipate that the slowdown in nominal demand and wages growth is going to involve a slowdown in inflation. So they underestimate what 'taking it' is worth. Secondly, they believe that by continuing to look around full-time, instead of looking around for jobs whilst employed, they will end up with a better job. Thirdly, unemployment benefits may be so high as to encourage extensive search for a good job, since the foregone income from accepting a stop-gap one isn't so great. Fourthly, the difference between the real wage they anticipate from working and the real wage they anticipate from living on the dole may be so little as to encourage them not to bother to find a job.

7. Workers will gradually revise their target level money wages downwards, for they will see the slowdown in inflation is making real wages higher than expected. Workers who find they overestimated their chances of employment in unfamiliar parts of the labour market (or of re-employment in their original kinds of job-slots), and who are prepared to suffer a reduction in real income to get a job, will move down-market, putting downward pressure on wages in the sectors in which they start applying (and pushing others further down-market). In the end, we will have a situation where employment is as it was before the contraction in the rate of monetary expansion; where wages and prices are increasing at a slower rate than before; and where nominal incomes and nominal money balances are growing in the same ratio as before. If the workers had not held out for high pay increases in the first place, the temporary increase in unemployment could have been avoided. In the interim, expectations of unsatisfactorily low real wages lead to a withdrawal of labour and unexpectedly high real wages for those in employment.

8. Monetarists adhere to this line of argument even when it is pointed out that the number of unemployed is hugely in excess of vacancies. There are so few vacancies, they suggest, because firms can see how high are the levels of money wages that workers are demanding. Post Keynesians object that the situation may really suggest involuntary unemployment, not 'excessive' wage demands, since :

(a) Firms may well realise that even if they succeeded in obtaining lower pay settlements, actual demand might be insufficient to cover costs, since a fall in wage rates across the economy would reduce purchasing power for the majority and those who receive extra income as a result of obtaining jobs are by no means guaranteed to spend it all.

(b) It is pretty easy to search for improved employment whilst employed; indeed, if one is unemployed, firms may not look favourably upon one's application.

(c) If workers tried to take wage cuts by moving down-market, employers might not take them seriously as long term employees who would be worth training.

(d) It may not be rational for firms to resist demands for pay increases, since this could be very bad for productivity.

(e) There might be no non-unionised sector to absorb workers who would be willing to undercut union labour rates.

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Lecture 21 : The Quantity Theory of Money

1. A core idea in monetarist thinking is that, in the long run, money is neutral; it does not affect the volume of real output in the economy. Changes in the supply of money may affect output in the short run, if expectations are slow to take account of them, but in the long run only nominal values will be affected. A slow-down in monetary growth, if unanticipated, will lead to a temporary fall in output, but sooner or later the rate of increase of wages and prices will slow down and output and employment will return to their original pathway. An unanticipated rise in the rate of monetary growth will initially cause a rise in output and employment - workers will be attracted to supply more labour by higher money wages, little realising that prices are going up too, so real wages are not going to increase. But people will discover that inflation increases and build this new inflation rate into their expectations. In the long run, the only way governments can hold employment above the level of which it would naturally gravitate is by increasing the rate of monetary growth more and more, ahead of expectations. But this will eventually lead to hyperinflation.

2. This core idea is itself dependent upon a simple supply and demand analysis of markets. Workers will only supply more labour, than they are presently selling, if the real rewards of doing so are increased. Firms will only hire more labour if demand increases or if the cost of labour decreases. If demand increases, more has to be paid to entice factors to become available to produce it, so prices must be put up - which deters factors from supplying more, so output is restricted by the willingness of factor suppliers, especially workers, to make their services available. Unless you can change this (e.g. by cutting dole payments or by cutting income taxes (and recouping the revenue by indirect taxes?) and government expenditure), you are constrained by the underlying real forces of supply, which depend on what factor owners think they can get as a result of selling their services. Incentives are the key to economic growth.

3. Money is seen by monetarists as being 'just another commodity', like labour or any consumer good. Increase its supply without increasing the demand for it, and you will drive its price down : in other words, if the supply of money is increased, the prices of everything else will rise. This view is encapsulated in the so-called 'Quantity Equation' : $MV = PT$. M is the supply of money. T is the volume of new production being exchanged. P is the weighted average of prices paid in transactions. V is the 'velocity of circulation', that is, how often the average unit of money changes hands in the length of time under consideration. T is fixed unless the incentive structure of the economy is altered. (Temporarily, mistaken expectations may change it.) V is also fixed so long as money's ability to do whatever it is that money does is fixed.

4. Suppose there is an unexpected increase in 'the money supply'. Compared with other assets, increased money balances will seem relatively unattractive to hold (just as a person suddenly given a basket of apples might prefer to exchange some of them for other commodities). Monetarists presume that people will try to substitute out of money and into all other assets (not just liquid securities such as Treasury Notes, but also consumer durables, etc.). Since T is fixed by assumption in the long run, individuals can only get non-money assets by passing money to others. The desire of the economy as a whole to turn excess money into something more desirable can be brought to a halt only if the money leaves the economy in exchange for imports, or if the prices of other goods rise in terms of money. In the latter case the price rise stops when the real value of money holdings is exactly as it was before the unexpected increase in nominal money balances. To stop this inflation, in the absence of any way out via the balance of payments (the world as a whole is a

closed economy), the only possibility seen by the monetarists would be a reduction in velocity - somehow, as the money stock is expanded, the desire to hold money expands too. But the monetarists reject this idea, seeing changes in V as very gradual as payments conventions change. (They do admit that unusual phenomena such as wars may suddenly shift the willingness to hold money.) Therefore they conclude that changes in M will be expected to be followed after a few quarters or so (they are often vague about how long) by changes in P, and they claim that the evidence supports this contention.

5. Post Keynesians argue that while MV ≡ PT is necessarily true as an accounting identity, the monetarists could well be jumping to incorrect conclusions about causality when they write MV = PT and read the equation from left to right. From the standpoint of Keynes' work, one might well want to read it from right to left. For example, suppose there is some involuntary unemployment but firms get more confident and decide to spend more on investments. More workers are hired. T has risen, but if M is unchanged, V can rise to accommodate. One way this can happen is for firms to pay for their investment projects by running down their cash reserves - i.e. their demand for money has fallen. The recovery in the economy may encourage workers to toughen their bargaining stances and find that employers are more willing to concede pay increases and try to pass them on as higher prices. Now P has gone up too. V might rise further or M could increase.

6. A rise in the level of activity reflects a decrease in the demand for money but a rise in the demand for finance, which will tend to pull interest rates up. If the Reserve Bank is unwilling to allow this to happen, it can buy bonds on the open market, and bond sellers' bank deposits - in other words, the 'money supply' - will rise. So M is adjusting to accommodate P; an unstable V is avoided if monetary policy is passive with respect to monetary aggregates. However, even if the authorities allow interest rates to rise, M may accommodate. Funds may flow in from overseas, or banks may find it profitable to borrow funds from the Reserve Bank. What may also happen is that, to the extent M lags behind the demand for funds, a broader definition of money, which includes liabilities of 'non-bank financial intermediaries' will expand to accommodate and V will seem to rise. (An example is that consumers who can't get loans from banks may turn to finance companies which then issue debentures that are purchased by people with bank deposits. Bank deposits are thus transferred from the debenture buyers to the finance company borrowers and hence to the sellers of consumer goods, instead of just staying where they were.)

7. It rather appears that there are as many 'Quantity Equations' as there are definitions of 'the money supply'. If the authorities follow restrictive monetary policies when the demand for finance is booming, they may succeed in controlling their chosen definition, only to find a broader definition has grown unexpectedly fast, as market shares of non-bank lenders have risen. Similarly, a relaxation of controls over one definition may see it suddenly growing without any growth in expenditure or in a broader money supply definition. All of this makes it rather unclear how one might seek to control inflation by controlling 'the money supply'.

8. Post Keynesians, in raising such questions, are challenging a basic monetarist premise, that the quantity of money is controlled by the authorities and increases in it cause increases in expenditure. They are suggesting it is inappropriate to depict consumers, as monetarists do, as if they 'find' themselves with excess money (dropped from the sky by a Reserve Bank helicopter?). People who want finance persuade others (e.g. banks) to create it and they pass it on to others. Any 'excess' is automatically extinguished when recipients of loan-financed expenditure directly or indirectly cause other loans to be repaid. Kaldor states the PK view thus : 'the supply of credit money is infinitely elastic at the given rate of interest, and this alone rules out the possibility that an 'excess' supply of money relative to demand, or *vice versa*, should be the cause of a 'pressure on prices', upwards or downwards. In a credit-money economy, unlike with commodity money, supply can never be in excess of the amount individuals wish to hold'.

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Lectures 22-23 Marxian Views of Economic Crises

1. In many ways Marx's view of the potential for economic breakdown foreshadows Keynes', but for a genuinely Marx-inspired analysis of effective demand problems one should look, as many Post Keynesians do, to the work of Kalecki - written in Polish around the same time as Keynes' work. Marx's own starting point is to distinguish between workers - who have a commodity ('labour power') that they sell for money, with the aim of obtaining other commodities - and capitalists - who have money which they will consider turning into commodities with the aim of turning these back into more money than they started with.

2. Whereas Keynes is greatly concerned to highlight the implications of workers having fractional marginal propensities to consume, Marx sees workers as a whole spending all of their current income flows in the current period. Any failure of overall expected revenue to equal actual revenue (at whatever level of employment has been contracted) is the result of capitalists failing to spend. Kalecki has a phrase which sums it up very neatly: Workers spend what they get, capitalists get what they spend. If firms as a whole spend more from expected profits, actual profits will, overall, be bigger by the same amount.

3. Marx's view that the working class does not save does not mean no workers will be saving; rather, it means that one person's savings will be offset by the dissaving of others. In the context of the modern economy we can see this process at work: some people save with building societies, for house deposits or for retirement; others borrow from building societies to buy houses or run down previously accumulated building society deposits to finance consumption in excess of their incomes. Over their lives, workers will not accumulate money like capitalists, even if their incomes rise. There will be social forces at work that ensure the 'subsistence' level of income rises with income ('everyone' in Australia now days expects to be able to have fridges, televisions, cars and so on). In Marx's day, of course, one might have taken subsistence more as pertaining to survival 'necessities'. Sweezy points out that an expanding population might have a tendency towards 'accumulation' by workers, but he notes that if there are many unemployed surviving only with the aid of charity (e.g. extended family help), net savings could still be negligible. An expanding population might well see unemployment if the demand for labour power grows more slowly than its supply. Sweezy claims that 'it is doubtful if the net savings of the working class as a whole have ever been substantially positive for any considerable period of time. There is hence every reason to believe the assumption on which Marx always works, namely that workers consume their entire incomes, is fully justified on theoretical as well as empirical grounds'.

4. The assumption about the lack of workers' savings means that if the consumption sector as a whole is to be faced with a shortfall in demand, the problem must be due to the investment goods sector having hired too few workers: 'too few' in the sense that investment workers' incomes are less than the difference between expected profits in the consumption sector, and all capitalists' consumption. A failure of actual demand to match up to expected consumption demand thus originates either with reduced investment activity or with the unwillingness of capitalists to be consumption

spenders. Although Marxists often speak of 'underconsumption crises', we should not see these as resulting from, say, a failure of monopoly capitalists to convince workers to buy their products, nor from poor pay at the level of the individual worker who has a job and may have unemployed fellows to support and who cannot buy anything but 'necessities'.

5. Now let us focus on capitalists' behaviour. Certainly, if capitalists seek to make money, we may reasonably expect their consumption to be moderated by their accumulative aims. There will be pressures at work for capitalists to spend as much as they can get hold of in the way of their own and borrowed money: if they fail to invest in cost-cutting techniques, they will be undercut by those who do, and will lose capital. In boom times, higher production costs may simply slow down one's accumulation rate relative to one's rivals, rather than causing decumulation. But in a crisis, the high-cost capitalist is liable to be forced to join the ranks of the workers.

6. Despite the pressure for capitalists, like workers, to spend, we may nevertheless find the economy in a crisis where expected sales are not realised ('realisation crises'). First, there are crises due to 'disproportionality'. Sales in one sector may be dissappointing because spenders are trying to buy other things; in other words, a structural mismatch. Linkages between firms can result in this turning into a problem of apparent general over production: the losing sector cuts back its expenditure causing other sectors to lose, possibly with bankruptcies along the way. Excess demand may thus vanish from what, in structural terms, we would have seen as a gaining sector. Problems may also arise if firms have to accumulate for quite a time before they can finance 'lumpy' projects, and many firms happen to be trying to do this simultaneously.

7. The most familiar crisis concept in Marxian work is perhaps that economic crises may arise because of a falling rate of profit. Capitalists hope to profit by selling their outputs for more than the cost of the capital invested in them. Capital has two components: 'v', which is the wage bill - the advances that firms make to workers before they receive any revenue, which Marx calls 'variable capital'; and 'c', which consists of inputs that embody past labour inputs, namely raw materials and fixed capital (or rather, expected depreciation of fixed capital plus foregone interest on fixed capital not used up in the period in question), which he calls 'constant capital'. The rate of profit is the expected value of net revenue - the surplus s - divided by v + c. Profit is 'surplus value' in the sense that the capitalist earns it by paying others less than it is expected buyers will pay for their output. If, as a result of hiring a worker for a day, the capitalist expects that $40 extra profits will be made and $60 will be paid to the worker, it is as though the worker is spending 0.6 of the day working for herself and 0.4 of the day producing surplus value for the capitalist. In this sense, the worker is being 'exploited'. and Marx defines the rate of exploitation as s/v - the ratio of surplus to wage bill.

8. Marx argues that capitalists will not employ their capital in commodity production if the expected rate of profit is below some 'conventional' level. If consumption-sector capitalists are pessimistic about prospects and cut their investment spending and hiring of workers, they will reduce consumption-sector demand by workers directly and possibly indirectly - they

will reduce the rate of profit in the investment goods sector, possibly making investment goods sell for less than their expected prices, reducing the rate of profit and causing investment sector capitalists to retrench workers. (Note that a realisation crisis can arise due to a fall in the rate of profit, as well as being associated with a fall in the rate of profit after being sparked off by 'disproportionality' or 'under consumption'.)

9. The question then arises as to how a fall in the rate of profit can start a crisis. Suppose output has been expanding. This must have been coming either from an increase in capital inputs (more workers or more machines, plus raw materials), or from an increase in the rate of exploitation (output is increased by making workers work faster or for longer hours without increasing their pay or the volume of machinery). Any forces which have been making current labour power more expensive than labour power embodied in machinery (e.g. rises in wages) will tend to make capitalists increase the organic composition of capital' (written either as c/v or $\frac{c}{c + v}$), in other words, increase the capital/labour ratio. If this rises, but s/v is constant, then it is easy to see that $\frac{s}{c + v}$ must fall. Of course, the use of more capital equipment will raise productivity per worker and tend to increase the rate of exploitation if the wage rate per worker is not increased. Marx seems to forget the impact of productivity improvements on the rate of exploitation and thence concludes that a rise in the organic composition of capital <u>will</u> cause a crisis due to its impact on the profit rate. I think it would be more appropriate to say that it <u>could</u> do so, depending on the extent of the productivity improvements achieved through the greater use of machinery, and on the amount by which money wages increase during the expansionary phase. Of course, once capitalists do stop spending, the amount of s will fall compared with its expected level and this will make capitalists with lower target profits stop spending too.

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Lecture 24 Marxian Views on Unemployment and Inflation

1. In the previous lecture, I said nothing about the level of unemployment that might prevail when an economic crisis breaks. All I did was to try to show how a Marxian sees the origins of a breakdown. But Marxian views on the likelihood of breakdown certainly are not divorced from any consideration of the state of the labour market; it is just that this is only one of a number of issues on which they would focus.

2. We saw last time that a lack of worker purchasing power is not essential to explaining the prosperity or otherwise of capitalism. We could have a situation where there was huge unemployment, yet the consumption goods sector was in a non-crisis state despite being small relative to an expanding investment goods sector. We could have machines being needed to produce machines, bought by machine users, with very little current labour power being expended. Profits in the investment sector could be high despite a rising organic composition of capital if productivity growth were rapid and high expectations of profits kept demand for machines up and prevented any realisation crisis. Workers could be doing terribly, yet capitalists could be quite happy and only disproportionality problems or a slow down in productivity growth might seem able to call the situation into question.

3. As Marxists see it, high levels of employment, rather than being a characteristic of prosperity, are a potential source of capitalist crisis. The unemployed comprise a 'reserve army' who constrain the ability of employed workers to push up wages at the expense of profits or to resist attempts of capitalists to raise the rate of exploitation and ensure that, despite a rising organic composition of capital, the rate of profit does not fall. Once a sustained boom absorbs the reserve army, worker bargaining power is enhanced and the rate of profit is likely to be squeezed to unsatisfactory levels. Attempts by capitalists to substitute against workers by using machinery may not only fail if workers extract the benefits of enhanced productivity and keep the rate of exploitation from rising. Rapid labour-saving technical change may well spark off a crisis of disproportions - as some firms in the investment goods sector fail to keep pace with customer requirements - or a crisis of underconsumption - retrenchments of workers as machines are introduced may not immediately see rehiring, so worker spending falls and consumption goods-sector capitalists are disappointed. A Marxian boom is fragile.

4. Aside from lobbying for freer immigration, one response to the exhaustion of a national reserve army of unemployed workers is for firms to go multinational, setting up operations in low wage, low skill labour markets and thereby seeking to undermine the strength of their original labour supplies Such corporate imperialism may succeed in extending the life of an upswing, but it could cause a breakdown if the setting up of plants overseas involves a closure of some high wage plants. Low wage workers' consumption demands will not be the same as high wage workers' demands. Initially, the total employed worldwide could rise but the fall in the average wage could spark off a crisis of disproportionality. Similarly, subcontractors to the shut-down 'domestic' operations may find themselves driven out of business if multinationals change their sourcing policies in favour of low wage countries, even if final products are made in the same place.

5. If there are fixed exchange rates, a rise in the power of the working class may prove especially troublesome, for firms cannot try to pass on higher labour costs as higher prices and expect that the exchange rate will fall to accommodate. If there are also barriers to capital mobility, the imperialist escape route may be closed. Small wonder, then, that big business favours free markets in foreign exchange. However, the inherent instability of such markets opens up new prospects for crises of disproportionality. Moreover, flexibilty in exchange rates may work to the apparent benefit of the working class: they may become more militant, believing that exchange rate movements will shield them from international competition, and meanwhile they may extract better terms in markets for non-traded goods.

6. Given their emphasis on increases in working class power during the prosperous 1950's and 1960's, it is curious to see how the modern Marxists explain inflation, and stagflation of the 1970's. Frank's analysis in part resembles moneterist views, since he disagrees with the Keynesian claim that the OPEC oil price rises and other 'supply shock' features were inflationary. Monetarists argue that if a supply restriction pushes up the prices of some commodities, people who buy them will be exerting less excess demand in other markets, so prices there will rise by less than they would have done. Instead of emphasising such supply shocks (which he partly attributes to relative capitalist underinvestment in the mining and agriculture), Frank proposes a 'profit push' theory of inflation. Increased industrial concentration is said to enhance the ability of capital to translate higher costs into higher prices. Yet, if this is so, arguments about falling rates of profit must be greatly qualified.

7. Mandel's analysis also mentions monopoly pricing policies, yet sounds curiously monetarist in tone (aside from the attention it gives to anticipatory speculation in real estate, works of art and commodities). For Mandel asserts that:

> "Inflation gradually ceased to have a stimulating effect on capitalist productive activity as a whole and even began to have perverse effects. At the same time, larger and larger doses of inflation were needed to stimulate 'aggregate demand' ... inflation ... was accentuated by colossal military spending, which is rising ceaselessly and to which all bourgeois societies have become accustomed...The prime cause of inflation, however, is undeniably the swelling of credit in the private sector, in other words the swelling of bank debts, and of credit facilities, which was the essential pillar of the long period of expansion that preceded the accelaration of inflation. The western economy sailed into prosperity on a sea of debt, the cumulative incidence of which inevitably accelerated inflation".

Given that Mandel is also claiming the 1970's economic crisis was a classic example of capitalist over-production, it is far from clear why the growth of debt financed expenditure should be the essential cause of inflation.

8. Marxian emphasis on the need for governments to inject greater and greater purchasing power to stimulate demand ties in with their view that the world capitalist economic system is now on the downward path of a 'long wave' of economic activity. Each 'recovery' fails to attain the height of the previous upturn, so the unemployment trend is upwards. Historically, one can certainly see long term cycles in operation: from 1790-1820 activity picked up with the use of steam engines and iron machinery, but turned down until 1848. Then the failure of widespread revolutionary attempts provided the political and economic conditions for a new boom (based on railways, steamships and free trade) which lasted till 1873. Then, until 1893-5, there was relative stagnation, the so-called Great Depression. The next upswing, to 1918, centred on electricity, heavy chemicals, rearmament and the internal combustion engine. From 1919-40 there was sustained depression, including the Wall Street Crash. The next recovery centred on armaments, household durables, cars, aircraft, petrochemicals and cheap oil. Signs of a downswing are said to have appeared in 1967, but were ameliorated by arms expenditure and the use of guest-workers as remaining surplus agricultural labour was absorbed into industry. Given that these cycles had entirely distinct technological aspects, it may be entirely coincidental that they trace out seemingly regular waves. The microprocessor revolution may coincidentally lay the foundations for another upswing since the application of the new technology displaces workers and helps restore the reserve army of the unemployed, destroying working class bargaining power.

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Lecture 25 : Business Cycles and Processes of Policy Formation

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1. For much of the Postwar period, unemployment levels were far lower than even Keynes had thought possible. However, things began to go seriously wrong in the early 1970s and, even in the 1950s and 1960s, it was noticeable that sustained levels of employment were hard to achieve. Suggestions started to appear that government policy actions had a major part to play in generating disturbances, rather than moderating fluctuations to which economic systems would naturally be prone.

2. Back in 1943, the Polish economist Kalecki had written a paper in which he expressed doubts about the prospects for sustained high levels of employment in the absence of major changes to the institutions of capitalism. He had been intrigued by the fact that leaders of the business sector - except in Nazi Germany - had, in the 1930s, opposed loan-financed government expenditure schemes aimed at improving employment. Such opposition seemed curious since it did not threaten corporate profits or involve higher taxes. He sought to explain it in three ways :

   (i) First he noted the belief of the corporate sector in the notion of 'sound finance' : government interference with the problem of unemployment via increased deficits was disliked because it seemed 'unsound'. It was as though corporate leaders, who worried about possible dangers their firms might encounter if they increased their use of debt finance, generalised their views to the level of the economy as a whole. Given such thinking, a government which went ahead with expansionary policies could severely upset the confidence of the corporate sector and harm investment - even though, from a Keynesian standpoint, the corporate sector's worries about deficit financed expenditure made little sense.

   (ii) The corporate sector might also be seen as opposing expenditure increases in general because of the diretions they tended to take. Consumption subsidies (or, one could say, income tax cuts for the masses - who didn't pay such taxes, by and large, at the time Kalecki was writing) seemed to Kalecki to conflict with the fundamentals of capitalist ethics : they suggested it was not always the case that 'You shall earn your bread in sweat". Government expenditure on goods and services must only be on things that do not compete with the private sector's activities - things such as hospitals, schools, roads and so on, which unfortunately are limited in their scope. Government's own 'enterprise' activity may simply displace that which the business sector would have undertaken anyway. (Of course, government enterprises might drive out imported products, but to the extent that they partially impinge on domestic markets, domestic capitalists will be hostile to them.)

   (iii) Most significantly, the corporate sector may be quite willing to weather periods of high unemployment because it is fearful of the social and political changes that might arise were high levels of employment sustained. In particular, questions would arise about the ability of employers to get their way with respect to work practices and wage rates if workers were not afraid of 'getting the sack' if they resisted. A sellers' market for labour would give the working class great self assurance.

3. One might seek to portray Kalecki's view of the corporate sector's attitude in terms of a short run/long run trade off. A slump might depress profits now, but it will also put workers back in their places. When the boom comes, the corporate sector will earn higher profits for longer, as it will take the workers some time to regain their confidence. However, when factory discipline breaks down, and the political status quo is called into question, big business will lobby for a return to an orthodox policy of cutting down the budget deficit. Only after a suitably long slump will they cease calling for restraint by government.

4. Kalecki did not note that prolonged slumps store up problems for a recovery phase. During the downturn, buildings and machinery get scrapped, stocks are run down and investment in exploration for an discovery of new sources of raw materials dries up due to depressed commodity prices. For the majority who have jobs, living standards may be doing quite well during the stagnation period, owing to the state of commodity prices : their fear of doing worse in unemployment makes them moderate their pay demands, but unless their close relatives and friends are unemployed they may not switch in large numbers to vote for a party promising expansionist policies. When expansion comes, the economic system very rapidly runs into trouble due to a lack of slack : raw materials prices skyrocket (which is fine for Australia, but bad news for resource-poor importers of raw materials) and inflation is also fuelled by shortages of skilled workers, whose pay increases spark off relativities claims by other groups. Technologically progressive firms find that they can pay higher wages without pushing up the prices of their outputs; their less efficient rivals, who have not been able to invest in labour-saving production methods during the low profits of the slump, are forced to offer matching wage increases.

5. Although big business may have considerable lobbying power and an ability to exert leverage on governments by threats to hold back on investment spending, they do not, in democratic systems, actually get to vote governments into or out of office. Whether or not high levels of unemployment will ensure that a government is ejected seems to depend very much on what voters are used to : departures from the convetional level may indicate something about the government's general competence in economic management and worry voters even if they do not themselves feel highly at risk. But the conventional level changes : aspirations adjust into line with what seems feasible, and what is taken as feasible is often judged with regard to overseas reference standards. Compared with the 1½-3% rate of the 1960s, Australia's 1986 unemployment rate of about 8% is high, but things look very good compared with, say, the United Kingdom, where recorded unemployment is running at 14% (in reality probably much nearer 20%).

6. When an election is due and unemployment is politically worrying, governments tend to forget other goals and become expansionists in a big way. After the election, whoever wins may have major balance of payments or inflation problems to deal with : these issues (whichever of them is the most politically troublesome) then become the focus of attention, even if this means allowing unemployment to rise once again ... until the next election comes near. Thus we may have an election-based trade cycle, which one can cynically argue it is hard to avoid unless a law is introduced decreeing that elections are held at random intervals.

7. The tendency for only one issue to be at the centre of attention at any one moment conflicts strongly with the neoclassical view of carefully optimizing policy-makers and voters, who are able to trade many economic variables off against one another in deciding what it is possible to achieve and what is the most desired combination. However, evidence in psychology has led some economists to argue that decision makers suffer from 'bounded rationality' due to the complexity of their environments and the time constraints under which they have to make decisions. Instead of carefully performing trade-offs, they set targets for the variables they are interested in, and only act if performance seems to be falling short of the target level. They often ignore spill-over relationships between performances on different targets and may thus seem forever to be 'going round in circles' as they try to fight what they judge to be the most important 'fire' of the day. 'Fires' keep breaking out because they are basically reacting rather than anticipating how their environments could change and sitting down to design more fire-proof structures : it is the 'burning issue of the day' that grabs the attention.

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Lecture 26 : Prospects for the Australian Economy

1. There is no doubt that, despite increases in income per head, Australia has been falling back in relative terms : from first place at the end of last century, to third in 1950 and fifteenth in 1985. Other countries, far less well endowed with natural resources, have managed to achieve much faster rates of growth. A major cause for concern is the dependence of Australia on its mining and argicultural activities. Together, these sectors employ only 7% of the population, but they each contribute 40% of Australia's exports. (Manufacturing employs only 18%, and the rest consists of employment in the service sector, particularly public service.) Somewhat in contrast to the views of the 'Greenies', the prospects for resource based activities do not look good, in the sense of over capacity and depressed prices being very likely. Although part of the problem lies with protectionist policies elsewhere (for example, agriculture in the EEC) and relatively depressed world demand, we should not overlook the impact of technological change. For example, the use of satellites and fibre-optics in telecommunications has dramatically reduced the demand for copper for use in cable manufacture. Increasingly ceramics and plastics will displace steel and reduce demand for Australia's iron ore.

2. Since Australia already has an unusually low ratio of exports to GDP, and is so heavily dependent on primary products with potentially limited prospects, the lacklustre performance of much of Australian manufacturing or dollar-earning services such as tourism (Australia's ratio of foreign visitors each year to total population is almost as bad as Japan's) is a cause for special concern. Views about how it might be improved vary according to diagnosis of how the situation has arisen.

3. Politically most conspicuous are those of a free market persuasion who point to the growth of an over-regulated system as the cause of the trouble. The views of Mancur Olson make it easy to see how 'protection all around' may have come about. Olson sees interest groups as preventing competition and price flexibility, holding up innovation and technical change - in short, as barriers to dynamic efficiency improvements. In a newly settled, 'frontier' economy, these groups will not have had time to become established, so growth can be rapid, especially as the frontier is pushed further and new potential opened up. However, in time interest groups form, noticing that as others seek to enjoy the fruits of growth it impinges on their own positions. For a small group, it pays to push for restrictive policies (for example, protective tariffs) even though it harms the well-being of the economy as a whole. Olson notes that if you are a 1% organisation and work for increased overall prosperity you get only 1% of the benefits, whereas if you impose costs on the system, you only suffer 1% of them, but may be able to engineer substantial personal benfits. So it pays to lobby for a bigger slice of the present pie (even if the pie shrinks a bit as a result) then work for prosperity, unless you can appropriate much of the prosperity gains for yourself.

4. Olson argues that the emergence of a system in which there is no dynamism and everybody is trying to live off everybody else can be thwarted by two things. First, traumatic political upheavals such as boundary changes (German growth accelerated last century when small states were consolidated in a single free trade area, that wrecked the cosy positions of existing state-based restrictive policies), invasions, revolutions and dictatorships.

From this standpoint, the deliberate irony in Donald Horne's view of Australia as The Lucky Country can be readily appreciated. (However, Horne himself was particularly concerned with Australia's luck leading to it never having been traumatized in such a way as to become used to the need to engage in long range planning, the result being that it was not gearing up for the emerging high-skill 'high-tech' world and still relied on the idea that some more natural resources could be dug up and sold to pay for imports.) Secondly, legislation or historical accidents that increase the size of interest groups will make them behave in a more social responsible manner. Australia, in contrast to, say, West Germany, has a system of craft unions rather than industry unions, for example (see the discussion of Tylecote's view of inflation for some overlap with Post Keynesian thinking). This means that demarcation disputes are very common. In the absence of upheavals and forced consolidations of interest groups, Australia has seen the growth of more and more extensive regulation : each new regulatory measure places a burden on someone else and leads to further action. (For example, tariffs on imported agricultural machinery help manufacturing but raise costs in agriculture which then seeks to gain protection via price support schemes.) Regulations also lead to an over-inflated public sector to administer them.

5. In addition to urging the need for the removal of excessive regulations and restrictive practices, the free market school tends to stress the need for a change in taxation, attitudes and conventions if Australia is to become competitive outside of mining and agriculture. Taxation has encouraged the pursuit of capital gains by trading existing assets, rather than the generation of income from new production schemes. There is alleged to be an excessive leisure orientation which hits employers via costs for long-service leave, leave-loadings, four weeks annual holidays, penalty rates for overtime and weekend working and 38 hour working weeks. Workers achieve rewards for seniority, not for productivity, and do not expect career paths that involve major changes of course and ups and downs. Management has fallen into the attitudinal trap of thinking it should produce entire products on a small scale for proteted domestic markets, rather than looking at the possibility of producing a few things on a very large scale for world markets (there are signs that, in the car industry at least, these attitudes are changing, now that export earnings from component sales can be used to gain import credits for fully built up vehicles).

6. Economists on the Left are far from convinced that a free market approach (built especially upon a freely floating Australian dollar to generate investment incentives for export and import substitution) is necessarily going to stop Australia from descending to 'Banana Republic' status. They would suggest that lessons might better be learnt from Sweden : even smaller than Australia in population, with a bigger public sector and a much more developed involvement of government and trade unions with firms in ensuring economic growth, focusing on social concensus, not worker-management confrontation of the kind implied by the New Right.

7. The Left (and technology minister Barry Jones) note that 87 of Australia's top 200 firms are overseas owned - something that came about in large part via the encouragement given by Menzies to British and American capital in the belief that Australians couldn't successfully do anything on their own. Sweden has Volvo and Saab as world-oriented exporters; Australia has Ford Detroit deciding that the 1988 Falcon cannot be exported to the United States because it would compete with Ford's US output.

8. There is a risk that a low dollar will not be enough to produce the needed shift of activity : the volatile floating exchange rate regime makes it very uncertain whether investment is worthwhile in manufacturing - growth in the primary sector could push its value back up just as manufacturing schemes were coming on stream. The deregulated foreign exchange market also makes it easy for large domestic firms to move their funds overseas; freeing-up of local equity regulations may allow overseas funds in, of course, but at the risk of further loss of control to head office thousands of miles away.

9. A radical left solution would involve state-led industrial restructuring behind a managed trade screen (rather like Japan). To ensure that local firms didn't collude in this protected environment (protection being guaranteed to last long enough to make investment attractive), state enterprises would be run as aggressive market leaders in major sectors (these might be formed by nationalisation of overseas owned companies). To the extent that new technologies displaced workers from traditional tasks, these would be absorbed in reskilling for schemes aimed at further expanding 'new' activities, or for improving social infrastructure and services. Needless to say, such ideas fill the Right with horror.