
Bert's legacy: a talk to the 'Society of Modest Members'*



Charles Robert 'Bert' Kelly CMG (1912–1997) was a prominent member of the Australian Parliament and a federal government minister. He was influential in urging Australian political parties to move away from protectionist policies. He was well known for his 'Modest Member' and 'Modest Farmer' articles in national newspapers and magazines. The 'Society of Modest Members' comprised parliamentarians with an attachment to Kelly's anti-protection ideals.

Bert Kelly's Modest Member newspaper columns in the late-1960s and early 1970s had a significant influence on my career choice. My first job as a graduate was with the Tariff Board and after a variety of other jobs, I ended up heading its 'descendent' the Productivity Commission.

The Commission was created by the Coalition Government in 1998 as a vehicle to assist it to advance the reform agenda. However, the Coalition has not always been a supporter of economic reform, nor of its advocates (including the Industries Assistance Commission and the Industry Commission — both established by Labor Governments).

When Bert Kelly began his tariff crusade in the early 1960s, his was a lone voice within his party and indeed the Parliament. In his book *One More Nail* (1978), he recounts:

* Parliament House, Canberra, 23 September 2002.

To say that my message was received with indifference would be an understatement of immense proportions. I used to be able to empty the house quicker than any other Member, and believe me, the competition was not negligible. Lorna, bless her heart, used to be so sorry for me that she used to come over to Canberra if she knew that I had a series of tariff speeches looming. She would then sit doggedly in the Speaker's Gallery (there was never a great demand for seats when I was speaking) and it was some comfort to know that she was there. (p. 77)

However, it appears that Bert received some surreptitious encouragement for his mission. He records:

Ministers would pass me in the corridors and after a quick look around to see that no one was watching, they would urge me to keep going even if it killed me because I was doing more good than I knew. (p. 84)

Part of Bert Kelly's difficulty in selling reform in those early years was that the Australian economy and community were doing pretty well. Growth was steady, unemployment and inflation low, and the incomes of Australians on average still higher than in most other OECD countries. Australia was at that stage still able to 'ride on the sheep's back'. The terms of trade favoured our primary commodities, and we benefited from a world-wide expansion in demand following the war.

Falling off the sheep's back

But we were riding for a fall. Even in the boom years, Australia's productivity performance was lagging other countries. Over the period 1950 to 1973, productivity growth in Australia averaged 2.3 per cent a year, compared to an OECD average of 3.6 per cent.

Productivity growth is the main determinant of income growth in the long term. Our relatively poor productivity performance was therefore translated into an inexorable slide in our comparative living standards, aggravated by declining terms of trade.

The reasons for our poor productivity performance were not hard to find:

- a fragmented, high-cost manufacturing sector, focussed on the domestic market
- indulgent, inflexible work practices, intransigent and powerful unions and lack lustre management
- outmoded technologies and low rates of innovation and skill development
- bloated public utility monopolies controlling key infrastructure services like power, transport and communications.

As a broadacre farmer selling on world markets, Bert Kelly was well placed to appreciate that these features were not inherent to Australia, but a consequence of an industry development strategy that had become increasingly focussed on impeding or suppressing the forces of competition.

For a small economy, the most important source of competition is international: it defines best practice in costs, quality and technology, and ensures that, at least in the traded sector, our resources are directed to those domestic activities that have the highest payoff. Barriers to international competition were therefore the logical starting point for what eventually became known as ‘microeconomic reform’.

This brings me back to Bert Kelly’s difficulty in pursuing tariff reform. Like all micro reform it involves unwinding policy measures that support inefficiency. Reform benefits the wider community. But in doing so it threatens the privileges or perceived entitlements of a (vocal) minority. The political calculus is made worse by the front-loaded timing of the losses relative to the benefits from reform, and by the lack of awareness by the potential beneficiaries of what is at stake. Indeed the general community will often find the arguments of vested interests more appealing than those of the reformers. These political difficulties are compounded by a government bureaucracy that often serves to sponsor the interests of particular sectors or groups, and makes it hard for governments to see the big picture.

Bert Kelly understood all this earlier than most. His energies were therefore directed at making the case for reform as simply and persuasively as he could. He staunchly defended the independent role of the Industries Assistance Commission and its successors, as objective sources of advice and information about the tradeoffs for the community in industry assistance.

Reform had a big payoff

I could at this point embark on a blow-by-blow description of tariff reform and the succession of wider microeconomic reforms, but I would not be telling you much you did not already know (or had not lived through). What is worth noting is that protection reform was a necessary precursor to other microeconomic reforms. By exposing firms to increased competitive pressure in the markets for their outputs it created pressure for reform in the markets for their inputs.

Firms and industry organisations that had long been complacent about unproductive work practices and the cost of public utility services, found that they could no longer contrive to pass those costs on. Thus the reforms to industrial relations and government business enterprises, culminating in the National Competition Policy,

were a logical outcome of the opening of the Australian economy to international competition.

The reform process by any measure has been a sweeping one. It was successfully implemented only because key industry groups as well as governments became convinced that it would have a substantial payoff. However, that conviction has not always been adequately communicated to the wider community. Concerns and confusion about the reforms and their effects have provided fertile ground for misinformation and misrepresentation, especially in regional Australia. Some think we are worse off, or no better off; others admit to some benefits, but consider that we have had enough reform for the time being. So, *has* micro reform been worth it?

The headline answer can be found in the surge in Australia's productivity growth in the 1990s. Multifactor productivity growth averaged 1.8 per cent a year, one percentage point above the previous trend. This performance outstripped nearly all OECD countries, including the United States.

The sustained rise in Australia's productivity growth cannot be explained away — as some have tried to do — by business cycle effects or increased work intensity, or even by measurement errors. Better macroeconomic management has clearly helped — by bringing a more stable and predictable climate for investment and production decisions.

But *microeconomic* reform has been the real driver of Australia's productivity boom. It did this in two ways:

- by heightening competitive pressures and sharpening incentives for firms to be more cost conscious, innovative and productive
- by allowing businesses greater flexibility to make the necessary changes and innovations (particularly through industrial relations reforms).

This clearly contributed to the unprecedented resilience and adaptability of the Australian economy in the face of the financial crisis in key export markets in Asia. The improved productivity performance brought about an acceleration in the average income of Australians from the customary growth rate of 1.4 per cent in the 1970s and 1980s, to 2.5 per cent in the 1990s. One percentage point of extra income growth annually soon adds up. If Australia's productivity had grown in the 1990s at its previous trend rate, households would have been \$7 000 poorer on average by the end of the decade.

The benefits were widely spread

Commission research shows that the income gains have been shared fairly evenly between capital and labour at the aggregate level. In other words, business has not pocketed all the gains from the productivity improvements. (The main decline in labour's income share occurred in the 1980s — during the Accord years.)

Indeed, the competitive pressures engendered by microeconomic reform meant that productivity gains have been largely passed on in the form of lower prices. The Commission's review of infrastructure trends over the last decade shows that there have been lower prices to households for services such as electricity and telecommunications, notwithstanding some recent increases (PC 2002f). Less obvious but real benefits to the community have also come from lower prices to businesses (for example in electricity, rail freight, post). At the same time there has been greater cost recovery and less budget damage, which have fed through to lower final prices and taxes faced by consumers.

Of course, not all prices have fallen. Australia's scarce water resources have long been underpriced. This required urgent attention to promote sustainability. Following the move to consumption-based charges, per capita consumption has decreased by some 17 per cent in major urban and regional areas. Our assessment of service trends shows that price reductions have not come at the expense of service quality. For example, case studies indicate that the frequency and duration of electricity supply interruptions declined by up to half.

Moreover, our preliminary assessment of the distributional consequences of price trends post reform indicates that the direct impact on household expenditure has been more favourable for people on lower incomes (PC 2002f). There is also evidence that price trends have generally been comparable across regional and metropolitan areas.

The regional distribution of gains and losses from reform has been of particular interest in recent years, with many country people attributing the declines in population, services and incomes to National Competition Policy. The Productivity Commission's public inquiry on this matter found that those perceptions were generally misplaced (PC 1999b). The major drivers of the fortunes of rural and regional Australia remain ongoing technology advances and intensifying competition on export markets, which have relentlessly pushed down rural terms of trade and made farming a much less people-intensive activity. Many pro-competitive reforms have helped rural industries cope with these external pressures, by reducing the costs of major inputs such as energy, rail, transport and communications.

The Commission's detailed assessment was that country Australia as a whole would benefit from National Competition Policy, although there was likely to be more variation in the incidence of benefits and costs among regions than among more diversified urban centres (PC 1999b).

The saga of auto industry assistance

One of the industries of particular interest to Bert Kelly was the auto industry, which was conceived out of high protection and has fought vigorously, both as infant and adult, to extend and maintain that protection. The Commission has completed its inquiry into post-2005 automotive assistance (PC 2002e) and I can assure you that the industry's advocacy skills are undiminished. (Some of you may be experiencing them at first hand!)

While the automotive industry has always resisted cuts in protection and consistently predicted its demise if tariffs were reduced — whether from 57.5 per cent or 40 per cent or 25 per cent or indeed the present 10 per cent — the reality is that this industry has, almost despite itself, become an advertisement for the gains from protection reform.

Under the pressure of increased import competition there has not only been significant rationalisation of production (allowing greater scale economies), the industry's innovativeness and productivity have increased, and product quality has improved dramatically. This has meant that, while tariffs have fallen and imports have risen substantially, the industry has fully offset this through export sales, so that production has stabilised and is now projected to expand.

The industry has admitted that tariff reform spurred its performance in ways that it had not envisaged in more cosseted times. But it does not see scope for further gains from reducing tariffs and believes that any further liberalisation should be contingent, among other things, on other countries eliminating their protection.

The Commission has listened carefully to the industry's arguments. We accept that circumstances have changed and that with tariffs at 15 or 10 per cent, the (static) costs of resource misallocation are nowhere near what they were. But the burden on consumers of even a 10 per cent tariff remains significant. When the Automotive Competitive and Investment Scheme (ACIS) subsidies are accounted for, we are looking at over \$1 billion of support annually. Moreover, the Commission has argued that further tariff reductions would yield worthwhile efficiency gains, including by keeping the pressure on firms and their workers to achieve best practice workplaces.

Looked at the other way, a decision by Government to maintain the assistance *status quo* would not be a helpful signal about the need for workplace change. It could also signal to other APEC countries that we are not serious about the Bogor commitment, and undermine the potential for gains to Australia from APEC liberalisation.

That said, the Commission has carefully considered the adjustment implications of different policy choices and come up with options that minimise the potential for disruptive change to the industry. To the extent that economic modelling can shine light on this aspect, it indicates that reducing tariffs further would make only a marginal additional contribution to ongoing employment reductions in the automotive industry and employment in all regions would continue to grow. Indeed the adjustment issues for this industry are less significant now than ever before, with rising skill levels improving the mobility of auto workers, and less regional dependence on the industry for jobs and income.

You should not be misled, therefore, by the orchestrated campaign in Victoria in which local governments and local newspapers are predicting big job losses from further assistance reform. These ‘estimates’ have been drawn from a so-called ‘model’ that has never been made available for external scrutiny — including by the Commission (despite our best efforts). A better litmus test of the regional implications of reform is the City of Geelong’s support for the Commission’s option of reducing tariffs to 5 per cent in 2010 (with some further ACIS support to facilitate it) — a marked contrast to its position during the last inquiry.

Further reform challenges

The auto industry’s transformation can be seen as a reflection of the transformation of the Australian economy itself. In the past two decades our economy has become far more open and competitive, more specialised and productive, more adaptable and innovative; in short, a more dynamic economy, much better placed to meet the exigencies of globalisation.

Microeconomic reform — starting with the Modest Member’s quest for some rationality in tariff policy — has had much to do with this transformation. But it would be idle to believe that the reform process had reached its conclusion, including on industry assistance. For example, I imagine that if Bert Kelly were writing today, he would express satisfaction with the substantial overall reduction in import protection, but he would be drawing attention to the remaining assistance peaks — and his mate Fred would be complaining not only about the level of support for autos, but the even higher rate of support for TCF. Our Modest Member

might also be urging us to go further with general tariff rates, rather than holding them at 5 per cent on questionable budgetary grounds.

Being also a Modest *Farmer* he would no doubt be looking critically at the handouts to the dairy and sugar industries, and wondering out loud about their costs and their efficacy in securing competitive viability.

As a stickler for public transparency in industry assistance matters, he might raise concerns not only about those decisions, but also about the emerging trend to *ad hoc* assistance for particular firms, such as:

- the lack of clarity about the criteria for making a recent \$35 million cash grant to Mitsubishi
- the support for domestic production of ethanol
- the inter-state bidding wars for investment projects, which are at best zero-sum games, but have so little transparency that it is impossible to assess their impacts.

The other key area of micro reform — National Competition Policy — is also still a work in progress. Recent reviews by the Productivity Commission of pro-competitive regulation of infrastructure services have found significant gains, but have also identified a looming danger of regulatory overreach, which could seriously weaken the incentives to invest in long-lived infrastructure projects (PC 2001b, PC 2002d). The Government's recognition of this in its recent response to the Commission's report on the National Access Regime is a very positive development.

When it comes to investigating reforms to improve the performance of Australia's social infrastructure — its schools, hospitals and community services — we have hardly begun to scratch the surface. Social infrastructure is a large and growing part of the economy — some 10 per cent of GDP — and the work the Commission is coordinating for the inter-governmental Review of Service Provision shows wide disparities in performance across and within jurisdictions.

In those areas, as well as in dealing with the important environmental challenges facing this country, the use of market incentives — property rights, prices and choice — can play a crucial role in getting better outcomes.

However the special interests and sense of entitlement that have made microeconomic reform difficult in the industry domain, are no less evident in the social and environmental domains. Moreover, in areas like education and health, access and equity issues loom larger and social sensitivities are greater.

So the need for ongoing reform, and the challenges of achieving it, remain substantial. The Productivity Commission, like its forebears, can help governments identify appropriate reforms, by laying out the costs and benefits of different policy choices. Through our public processes, we can also help promote community awareness about the need for change.

At the end of the day though, it is *your* ability and willingness to take the case for reform to the electorate that will determine its success. In this respect, Bert Kelly's example remains an inspiration for what Members of Parliament — whether modest or not — can achieve.