The MARKET Mystique

It’s easy enough to point out the shortcomings of our current economic orthodoxy. It’s a much harder task pointing the way out of the morass. ALR assembled a roundtable discussion to ponder the issues.

Sue McCreadie is economic research officer for the Textile, Clothing and Footwear unions. Ivo Favotto is an economist for the NSW Chamber of Manufactures. Peter Kriesler and Greg Mahony teach in economics at the University of NSW. The discussion was chaired by David Burchell.

Over the last few months there has been a discernible shift in the tide of public debate. Criticism of economic rationalism has become much more fashionable, when for most of the 80s it was ruled out of court as being manifestly silly. You’ve got the Victorian opposition, you’ve even got Malcolm Fraser polemicising against it. So from a whole lot of different sectors, including business and manufacturing, economic rationalism is more under siege than it’s been for years. And obvious evidence of this is the way that Michael Pusey’s book Economic Rationalism in Canberra has been received—much more respectfully than it might have been until quite recently, one would have thought. One starting-off point for this discussion, then, is perhaps to step back from the critique of economic rationalism that Pusey’s popularised, which is not really a new one and has been lurking around the backblocks of Australian politics for most of the last decade, and look at what it is that we mean when we talk about economic rationalism.

Peter: The way I would define it is that markets are the most efficient way of achieving various ends, that reducing government intervention in markets is always going to lead, in the long run, to people being better off.
Sue: I think one of the problems in looking at it at the level of popular discussion is that it's become what monetarism used to be, which is a kind of catch-all term of abuse. Under the heading of economic rationalism one will tend to find the obvious things such as privatisation, financial deregulation, reduced protection, micro-economic reform. You'll find labour market deregulation and user-pays. Fundamentally enough in some definitions you'll find wage restraint under the Accord—which seems a bit odd to me. It may not be something to celebrate, but nor is it economic rationalism, it's incomes policy. The problem with that is, that having defined it as simply a rag-bag of policies, do those policies constitute a coherent whole?

Ivo: One thing related to why it's popular is the name 'rationalism'. If you're not an economic rationalist, what are you, an irrationalist?

Peter: I think it's very important that there is no economic justification whatever for this view of markets. There's no body of theory that tells us that unfettered markets allocate better than the government sector, that unfettered markets are better at doing any particular job than markets with government intervention. The important thing to note is that economic rationalism does not have a body of theory behind it. It's a pure ideology, divorced from theory, and any good economist will tell you, no, we can't justify what we're doing on the grounds of theory.

Greg: You can say at one level of economic debate that that's been true, certainly since the 1870s, and perhaps since Adam Smith. But that still doesn't deter the great bulk of conventional economists from being persuaded to free-market conceptions as a political view.

If you look around the world, the commonsense view that the intelligent person on the street would get, would be, if you look at the experience of the world economy in the last 10 or 20 years, that market economies are more successful than economies which have particularly high levels of government intervention.

Peter: But this belief is based on a misperception. If we have a look at the great success stories, the developing Asian economies, and Japan in particular, they are countries in which there has been very active government intervention.
Greg: I see Japan as a bit of a different story. I see it as being a shining example of how to blend extreme market forces, excessive competition, with high levels of government intervention in the economy. It's a mixture of both, not necessarily an example of one or the other.

Sue: Generally, the critique of economic rationalism would criticise the reduction in protection, which seems to assume that we're not in favour of it. It also tends to add micro-economic reform to the litany of sins that are going on. Is the assumption therefore—and it is for many people on the Left—that those are incorrect policies? I would think that it's a rather complex issue. How far should you be reducing protection? I don't have an article of faith that we should retain it at its current levels, or that the old-style protectionism worked, but some of the critiques of economic rationalism seem to me to simply leave us with what we had in the past, without an understanding of why that past approach didn't work.

Why hasn't the Left been able to put up a coherent alternative understanding of this thing called the market?

So when you have some sort of coherent platform put up, say from the Australian Manufacturing Council, or from the ACTU, that platform tends to say: well, we agree with some of the attempts at removing impediments to the market, such as reducing protection and micro-economic reform. At the same time, as you mentioned before, we don't have an approach called market fetishism, where we think that simply removing those impediments will make things work. But rather, we say: remove some of those impediments and introduce other industry policies, some of which, we would have to admit, are also about making markets work better. A lot of the policy initiatives that have been proposed from the labour movement aren't about setting up alternatives to the market, but recognising market failure.

Greg: I think that's an interesting issue for the Left. Why hasn't the Left, in the current debate as in the past, been able to put up a coherent policy, or a coherent alternative understanding of this thing called the market? There are a whole series of ad hoc proposals and different propositions, with varying degrees of coherence, and it seems to me that this goes back a lot longer than 10 years, this lack of capacity to put forward a coherent perspective.

Sue: But is what we want an alternative blueprint—or, as some would argue, is that approach really not that helpful if you're trying to influence actual policy-making?

Greg: Well, I think some sort of understanding of how the market works in the first instance would have to precede any blueprints.

People often depict economic rationalism as being a kind of reincarnation of Adam Smith. Now obviously in one sense it's not, for the very obvious reason that it's not a matter of simply endorsing some underlying laissez faire structure of the economy, which functions like a free-market economy in the 19th century. Obviously when people talk about a free-market economy these days, they're talking about trying to create something which doesn't exist—something which has to be nurtured, structures created and so on. How different is that from the commonsense notion of market economics that people derive from their understanding of Adam Smith?

Ivo: I think it's more basic than even their understanding of Adam Smith. There's a dichotomy between what I'd call micro- and macro-rationalism. The concept of competition is very logical, very appealing to an average person. If there's competition between two service stations down the road, you know the price of petrol is going to be cheaper. And that sort of grass-roots level of identification with the benefits of competition has grown into what Peter calls market fetishism, the belief that markets work in every single case. And it's a hard case to argue against, because of that simple logic to the average person that competition is a good thing.

I suppose the point I was getting at was, how many competitive markets can one point to in the real world?

Greg: Without wanting to get theoretical, perhaps Ivo's example of the petrol station tends to focus the mind on the assumption that the issues might lie. We speak about competition and efficiency, and the social benefits from those two things, but it's always focusing on the consumption of these final commodities like petrol or supermarket goods. And neither the theoretical answers, nor the popular imagination, goes to the heart of things.

Peter: But even in the sphere of consumption, there isn't any competition. A lot of policy has been aimed at creating so-called level playing-fields, but what level playing-fields do is favour the big players. Financial deregulation is exactly a case in point. The idea of financial deregulation was that it was going to improve everyone's access to financial markets, and what happened? It was the big players, the Alan Bonds and Kerry Packers, who gained, and the small players, individuals and small businesses were denied access to those markets.

Ivo: In the banking industry there's a more fundamental problem of the market in that there are barriers to entry in the corporate banking sector, but at the retail level there was just no competition.

Sue: I wanted to go back to the question of how far orthodox economics is really guiding things. My intelligence...
tells me that Michael Porter’s *The Competitive Advantage of Nations* is the book that’s in every bureaucrat’s in-tray. I would not describe Porter as an economic rationalist, if you define rationalism as market fetishism, and certainly it’s not simply a re-hashing of outmoded ideas. And without eulogising the book, I think that in it there are new ideas about industrial clusters and new forms of industrial collaboration, drawn from overseas experience. So, I’m not convinced that the only thing driving policy in Canberra is some sort of neoclassical textbook model of the economy—although I’m sure there are many people there who are recruited on the basis that that kind of analysis is all they can do.

**Greg:** What’s interesting about Michael Porter’s book is that Porter, even though he doesn’t define competition, is I think using it in the same way as Adam Smith and the classical economists, as part of a story about growth and accumulation. In neoclassical or conventional economics, competition is simply about the price mechanism—it’s quite static, if you like. I think that makes Porter’s a more sympathetic story.

**Sue:** And I think it’s true that to a certain degree that static view of, for example, comparative advantage, based on the textbook view of things, has been to a large extent superseded? The old Industry Commission abstract orthodoxy, it seems to me, has moved a bit into the background. And ideas like Porter’s, which focus more on innovation and knowhow, are now actually driving policy to some extent.

If we’re reasonably clear about what we think economic rationalism is, and what its shortcomings are at the level of a body of ideas, why it has been so powerful and persuasive—and why now, over the last decade or so? Michael Pusey’s book focuses on the bureaucracy, its cadres, if you like, where they’ve come from and how—and obviously there are some people who would find that perspective persuasive. But there are other ways of looking at the question as well. It’s not just a matter of how the bureaucrats were taught, it’s also a matter of why that seemed to them useful in what they thought was the context of the time. And then also, why it spread out, far wider than the bureaucracy, to become ‘commonsense’ in public life as well.

**Ivo:** There’s one simple factor here which I think is underestimated. The ability of the rationalists to ‘produce a number’, to generate sets of figures, via the rise of econometrics, has helped their ability to win the case, and to influence the debate. It has done so because it provides a simple focus on the benefits of a particular political point of view, whereas the opposite point of view may seem a bit abstract.

**Peter:** My objection to that is that every time they produce a prediction they’re wrong. And not only are they wrong, but by a matter of orders of magnitude.

**Ivo:** But that doesn’t get into the mainstream of the policy debate in my opinion, and it doesn’t really matter, because, having a number, even if that number is wrong, is better than having no number at all. From the point of view of someone who’s trying to write an article for a newspaper and explain something very simply, someone who’s not a specialist in economics, numbers matter. Just look at the newspapers. Every number that the Industry Commission puts out gets front-page coverage.

**Sue:** There are other models, too, some of which can generate just as many predictions as the Treasury’s model can. The question is, why are the assumptions in the Treasury’s model taken for granted? It’s been very widely criticised, yet somehow it seems impossible to demolish it as a tool.

**Greg:** I want to come back to the question about economic rationalism arising in a period of turmoil, that period being the 80s. My thinking is that it was not a period of such turmoil; it was a period of growth—and, if we take 1983 as a base, it has until recently been a period of pretty much sustained growth. I don’t have an answer to your question, but it seems to me that only compounds the irony that the sort of economic populism associated with economic rationalism should be arising in this period. Maybe we really need to look back to the late 70s, to the disaffection with traditional policies which emerged then.

Maybe then we also need to sketch in the wider political and economic context of the 70s—the anxieties of Keynesianism, the rise in commonsense of the idea of a crisis of the welfare state, and therefore a certain loss of confidence or direction.
Sue: And then you also need to look at the international economy: the collapse of the old world financial system symbolised by Bretton Woods, and the subsequent internationalisation of the financial area. Surely that's part of the objective context in which those policies grew up.

Peter: And that's vital for a small country like Australia, because it really limits what we can do. Before the collapse of Bretton Woods there was a certain degree to which we could insulate ourselves from world events, but that's very much less the case now. A Cambridge economist called Frank Wilkinson has talked about how bad monetary policy in one country will crowd out good monetary policy in other countries. Why? Because a tight monetary policy will push up interest rates in any economy. If other countries don't change their policy, that will lead to huge capital inflows into the country practising the bad monetary policy. Their balance of payments will start looking good, they'll get a lot of money to revitalise industry and so on, so that other countries have to imitate bad monetary policy as a response. That was what started happening in the 80s. Countries were using their rate of interest as a way of defending their balance of payments, and, because tight monetary policy is associated with tight fiscal policy, that allowed economic rationalism much greater leverage in the debate.

What strikes me whenever there's a Left discussion about the triumph of economic rationalism, is that we tend to talk about it as if we're trying to explain why people collectively start behaving in a quasi-hysterical fashion. It's like some of the liberal explanations of why Germany went Nazi—explanations which claim that the Germans have a peculiar kind of national angst, or that it's all the fault of 19th century romanticism. In other words, we try to explain economic rationalism as if it's, ironically, irrationalism, which people have adopted for reasons that are therefore not rationally explicable. But are there perhaps rational reasons why policy-makers might have adopted the tenets of economic rationalism when they did, and what is it about economic rationalism that seems to make economic problems look more easily explicable to policy-makers?

Peter: To look at why economic rationalism has succeeded, you've got to look at who are the main beneficiaries. And again, it's the large corporations and powerful individuals. They have a very strong vested interest in economic rationalism. And those are the people who, to a very large extent, control the means by which information is disseminated. And that must have some effect.

But the same people seemed to tolerate very different economic views for a considerable period of time—decades, in fact.

Sue: And also there are surely different sections of capital, if you want to call it capital. Many capitalists are doing very badly at the moment, and are beginning to become more critical of economic rationalism.

Peter: And isn't that exactly what we're finding in the press and elsewhere? Doesn't that partly explain why the Pusey book is popular? People are starting to get hurt.

Greg: I'd like to come back to something I queried earlier, which is why there hasn't been more resistance, not just in the battle of ideas, but in a political way. And I'd suggest that one of the successful areas for economic rationalism, as with Thatcherism, was its capacity to break down that political resistance. In Thatcher's case it was a matter of crushing union power early on, but in the Australian context I suspect the key factors were structural change and the secular shrinking of the union movement.

Sue: As I said before, the unions have been seeking a new kind of economic approach, because the old approach didn't work. And in doing that they've adopted some of the policies which are often labelled economic rationalism—policies which are popularly perceived as in that catalogue, but which may nevertheless not involve market fetishism. I don't think that improving the efficiency of the ports is necessarily market fetishism. I don't think reducing some types of protection is market fetishism. Certainly there's a big divide between the union vision of what should be happening, and what the government's actually doing. But the government has done some of what the unions have suggested—which is why I have a problem with the assertion by some that the whole of the last eight years, if not 12 years, has been completely consumed by economic rationalism. There have been some initiatives which have been about setting something up alternative to markets, such as sectoral plans. There are other initiatives such as the states' Industrial Supplies Offices, which are definitely industry policy initiatives and are about making markets work better. So I don't think we can define the whole period of the 1980s as being one which has been totally dominated by market fetishism.

Peter: Sue's made a very important point, and that is that there were various entrenched inefficiencies in the economy prior to the 80s. Some of those may have been things that originally were efficient, and circumstances changed. Protection was seen as pork-barrelling. There were a whole lot of aspects of policy which were seen as being inefficient, of being a drag on the Australian economy. And the rationalists clearly scored some early victories by pointing that out.

Sue: One other reason why economic rationalism has been so powerful is that rationalists could point to failures of intervention. There are obvious ones which we don't even need to catalogue in the Australian context. There's a tendency in the labour movement Left to invoke interventionist industry policy as some kind of saviour. But there are very important debates waiting in the wings about how to intervene, and who should make the decisions. Should it be politicians or bureaucrats, or should it be workers in the workplace who decide whether the company's fit for assistance? Should assistance be directed towards picking winners in the quest for big bang for the buck, or should we be trying rather to improve infrastructure to make the markets work better—like enterprise networking? Those things just aren't being debated. And that's one of the
problems of casting it in such black-and-white terms; it's hard to get into those serious issues.

We've talked a lot about where we are today. But it seems to me that a lot of the critics of rationalism, and particularly Michael Pusey, have very little to say about how to move from where we are to where we would prefer to be. Given that it's not much use walking up and down the street carrying a banner saying 'Death to economic rationalism! We want an alternative now', how do you in the environment we're in mount the arguments for a more interventionist policy?

Sue: Well, there's a view which says the arguments have already been put, and that better arguments aren't going to win the day in the political sphere. There's a strong argument now that in the current situation of high unemployment there could be some changes but they'll be the result more from political pressure. And that if there was going to be a change due to the acceptance of superior intellectual argument, then that would have happened some time back.

Let me couch the question a little differently then, so it isn't so easily dismissed. What I was getting at is not so much the idea that if you argue cleverly enough your opponents will suddenly slap their foreheads and say 'My God! You're right and I was wrong'. But rather, how do you mount a case in specific instances for particular methods and mechanisms of intervention — such as, in Greg's example, sectoral policies?

Ivo: One way of arguing for intervention is to focus on the issue of transition costs. If you want to create structural change, you have to realise that moving from one point to another is not just instantaneous — which often seems to be the assumption. In fact, there are significant human and other costs involved. So then you can argue for sectoral policies as a means of ameliorating those costs. That's what the steel and TCF plans were.

Peter: There's a problem, though, in sectoral policy which means that I doubt whether any government will introduce it. And that is that the sort of policy that would actually do something activist about our economic situation is the sort of policy that would take a long time to show benefits. The payback might not come for a decade.

Ivo: But that's what the rationalists say, too. They say: 'if our policies don't seem to be working, it's because we haven't got there yet. Just keep on deregulating.'

Peter: But you can see something immediately as a result of deregulation; you can see deregulated markets. With the more interventionist approach, the problem is that it takes years and years to build up an industry, but governments are elected every three. Three years isn't long enough to fully implement a sectoral policy, let alone see the benefits.

Ivo: We need to look at the Japanese combined approach we talked about earlier. We have to accept that free market forces do work in some cases, and then find ways to combine that with intervention.

Peter: What it also requires is getting a consensus. If a government comes in tomorrow with a policy that's 'correct', they would still have problems implementing it. But it's more than that. You've got to have a policy consensus which you can build up from the grassroots — so if the government gets dumped and a new government gets in, the new government is still going to find the consensus hard to shift.

The name that comes to mind in this regard is Paul Keating. Whatever one thinks of his policy stance in the 80s, he pursued precisely that political approach. He took a set of ideas about Australia's economic problems which were not commonsense up to that point. He hawked them around the country with simple but nevertheless plausible slogans which could be disseminated widely in the media. He said we wouldn't get the payback for the 'hard decisions' right away. And he was remarkably successful in that, wasn't he?

Peter: But look at what he's saying now. He's attacking those very policies. It's very easy, in other words, to point to a long-term scenario of whatever sort and say the costs are too great.

Greg: On the subject of consensus, and how to argue the case to try to secure that consensus. I'd argue the first thing you have to do is set out what the objective conditions are. There's been a lot of headway made in that direction in the last five or six years. The nature of the external constraint is much more widely understood, both in the electorate at large and in the labour movement, than it was five or six years ago.

It's interesting that the last time such a broad policy consensus was obtained was after World War Two, in a climate of national emergency and with the popular ferment provided by the war.

Greg: And it wouldn't be impossible for such a broadly-based support for a set of policies to arise again, in the next five years. But I suspect that if it does, it will be by virtue of an unholy alliance of the NSW Labor Right and the Victorian Labor Left...