The Dangers of Crony Capitalism

5 May 2014

The Commission of Audit's report is little more than a political framing device, which will be used to justify spending cuts. That's a pity - because real fiscal reform is needed, writes Ian McAuley.

Three influences have shaped the work of the Commission of Audit. One is its political brief, another is the economic interest of the top end of town, and the third its own limited capacity.

The political brief is essentially an updated version of the Howard Government's 1996 exercise, also called a Commission of Audit. The task is to use a supposedly "independent" reviewer to reinforce the idea that the previous government has overspent, leaving a gaping hole in public finances.

Using accounting that would earn a fail grade in a first year university paper, the commission has done its job, painting a picture of runaway government spending. Yes, Tony Shepherd, real government spending per head has indeed grown over 40 years. So too have incomes. Are you saying that we should have directed all our income growth to the corporate sector, leaving us with 1973 standards of schools, roads and hospitals?

The commission's report serves the Abbott Government well in setting an extreme frame so as to make the government look fiscally reasonable. Behavioural economists refer to the practice of "anchoring", for example when the waiter suggests a $70 bottle of wine in order to make the $40 bottle look like a good deal. Similarly, a suggested $15 GP co-payment helps sell a $5 co-payment. Hockey was careful to say that the report was "not a report by the government but a report to the government".

The second influence on the commission is the idea that government is an economic burden, crowding out the productive private sector. It's an idea that meshes seamlessly with the interests of those in big business, including those represented by the Business Council of Australia. Hence the assumption that Commonwealth taxes — and by implication spending — should be capped at 24 per cent of GDP, even though, in comparison with other prosperous countries, our taxes and public spending are among the lowest, and well below the average by a considerable margin (about seven percentage points of GDP).

This kind of thinking helps inspire the idea that states should engage in tax competition. As one NM contributor said, this would lead to "the first state setting up a Cayman Islands-like haven [to] suck all the dosh there and send the other states into the poor house".

It also explains the recommendation that the Commonwealth should "not take equity positions where the activity can be undertaken by the private sector", because governments are satisfied with a lower rate of fiscal return than the private sector. That is, if only the private sector could get their hands on those enterprises, they could make high profits. Hence the idea that the minimum wage and Newstart Allowance should be cut. Hence the idea that those with high incomes should be forced to take private health insurance. And hence the idea that processes such as visa applications should be contracted to the private sector. (Only the easy visas — the difficult ones, costly to process, should be left to government.)

I am in no position to know the commissioners' motivations in making these recommendations. Are they simply trying to please the new government? Have they been conditioned by 35 years of neoliberal thought? Or is this simply a manifestation of crony capitalism?

Whatever the motivation, these are dangerous ideas. As understood by people as diverse as Karl Marx and Henry Ford, capitalism as an economic system requires a well-paid and productive workforce to provide markets for its products. It requires a well-educated and healthy workforce, and that's not going to be helped by reducing education funding and transforming publicly funded health care into an impoverished charity system, similar to America's Medicaid for the "indigent". Also, high minimum wages make sure that labour is employed productively.

More basically, as pointed out by Thomas Picketty in his work Capital in the Twenty-First Century, countries like Australia, where economic inequalities are already on the rise, are on a path towards plutocracy, where inheritance rather than enterprise, effort or education are the path to personal prosperity. Marxists may gleefully await a revolutionary uprising, but in a democracy like Australia the reaction to widening inequality and a growing sense of unfairness is likely to be a strong public push for anti-market, anti-growth policies.

What Shepherd and his fellow commissioners fail to grasp is that in a democracy, capitalism will survive as an economic system only so long as it retains political legitimacy — only so long as it can spread its benefits widely, and only while it can sustain a link between contribution and reward.

The third factor leading to poor recommendations relates to the limited resources available to the commission, both in terms of time frame and competence. Many recommendations are backed by no more than a few paragraphs of assertion, let alone any cost-benefit analysis. It has issued no analytic discussion papers and has held no public hearings to check out its ideas.

By comparison the Productivity Commission, in looking at just one policy issue, typically goes through a long process of research and consultation. These consultations reveal the complexities of public policy, they help people understand and accept the reasons for change, and they show up possible unintended consequences of what superficially looks like good public policy.

There is no denying that economic reform, including fiscal reform, is necessary, but it's not going to be achieved by a set of provocative recommendations cobbled together over a couple of months by a committee headed by a business lobbyist.

The commission is right, for example, to raise awareness of fiscal problems, such as the complex mess of federal-state relations, and issues of healthcare funding. But to have gone from the point of raising awareness to specific suggestions about abolishing fiscal equalisation and health co-payments, is to raise resistance to reform. Had they held back on specific recommendations they could have saved themselves many late nights and have opened the way for some much-needed public discussion on important issues.

Also, it seems as if the commissioners just don't understand the economics of the public sector. Although the commission's terms of reference accepted that there are many areas where the private sector "cannot do efficiently" what government can do, this conventional principle of market failure is absent in its statement of "Principles of Good Government". Rather, it seems to have been guided by the idea that if the private sector can take over a function, then it should do so, even if that involves higher costs than if the function were to stay in government hands.

Had Shepherd understood the economic principles guiding the public/private division, his report would have criticised government funding for elite sports and their infrastructure, such as stadia — cases where public funding rests on populism rather than any market failure.

Without a backing in economic principles the report is no more than a haphazard collection of targets, recommending cuts where they should not be made and missing cases where cuts should be made.

Some may say that the commission's work was a waste of public money. In fact, its contribution may well be negative. They have reinforced the idea that the only path to fiscal reform is through cutting expenditure rather than increasing taxes and cutting tax concessions. Their provocative and ill-considered recommendations will harden resistance to reform. Worst of all they have given the opposition ammunition to goad the government into ruling out areas for fiscal reform, relieving Labor of the task of presenting a coherent set of policies to rescue the country from the economic incompetence of the Abbott Government.