Return of the Rent-Seeking Society?*

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> *The political effects of this system favour neither the rich nor the poor, but the established and the organised. …Without transparency, it becomes impossible to monitor …and the system breeds cynicism in those it favours as much as in those it discriminates against. (Jan Tumlir, 1984)*
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> *There is no such thing in this life as a free feed – someone always pays (Bert Kelly, 1976)*

Stan Kelly achieved a great deal in his life. Arguably his greatest achievement, though not his alone, was his son Bert, who endowed this lecture in his memory. This struck me forcibly when re-reading the author's dedication to his compilation of 'modest member' essays, *Economics Made Easy* (1986):

> This book is dedicated to the memory of my father, W.S. Kelly, O.B.E., *who pushed me sternly along the road of economic rectitude.*

I believe that this passage tells us something about the qualities of both father and son, as well as of their relationship. Above all it evokes a sense of *duty*: of doing not only what is good, but what is *right.* For as we are reminded in Hal Colebatch's recent biography of Bert Kelly, and in the moving Eulogy by Ray Evans that it contains, there was a strong moral dimension to the Kellys' opposition to 'The Tariff', in addition to their concern about the

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economic damage it wrought. The passage further suggests that the Kellys saw this as a *quest*; a journey; not a single course of action, or even a destination where one could finally afford to rest.

At the same time, in Bert's choice of the words 'sternly' and 'rectitude', there is a hint of not taking oneself too seriously – of the humourist. My guess is that he exhibited this quality in greater measure than his father, and no doubt it helped explain his success.

Bert Kelly was undoubtedly also a *patient* man, as anyone advocating (real) reform clearly needs to be. And I am in no doubt that in this respect too he resembled Stan Kelly, who with his remarkable friend, the politician Charles Hawker, set young Bert on a course that they must have known would prove both arduous and long. Whether they believed he would ultimately prevail is not recorded, but knowing him as they did, we can assume that this was so.

Bert's times

When Bert was doing battle against The Tariff in the 1960s, he, like his father before him, was the odd man out. This was true even within farming circles, let alone in Parliament or public administration. While perhaps no longer the 'detested sect' of Stan's heyday in the 1930s, as depicted in Keith Hancock's *Australia*, public advocates of free (even of freer) trade, faced much hostility and derision. As a result, they were few and far between. Bert recounts in another book *One More Nail*: "I used to be able to empty the House quicker than any other Member," adding slyly, "and believe me, the competition was not negligible".

One of the ironies of that era's prevailing orthodoxy of 'protection all round' – apart from it being predicated on a logical impossibility – was that some of its biggest costs were borne by its strongest supporters. These included not only 'Black Jack' McEwan's followers in the Bush, but also those manufacturing interests in the City most dependent on imported inputs.

But this was not widely understood or accepted at the time, despite the eloquence of Adam Smith two centuries before, or the contemporary wisdom of the Vernon Report (where a young academic called Max Corden cut his policy teeth). The taxation of imports was still seen, above all, as favouring Australian workers, with its burdens falling predominately on the export trade of foreigners, not the exports and incomes of Australians.

At that time, it was not a shameful thing for a conga line of industrialists to be seen wending its way to Canberra. Nor did manufacturing interests feel the slightest embarrassment in seeking ever high rates of tariff protection before the Tariff Board, whose conception of 'economic' assistance, helpfully for those seeking protection, was 'just enough to compete and no more.'

Thus by the late 1960s, the average nominal tariff for the manufacturing sector had reached 22 per cent. For some industries, tariffs were double that, with effective rates of assistance (that new measure associated with Prof. Corden) topping 100 per cent.

Of course, it did not stop there. If farmers protested that they were doing it tough, as many no doubt were (in part because of production costs being elevated by tariffs) then they, too, could expect government to ease the pressure – through tariffs if those were needed, or through marketing boards and other schemes to prop up domestic prices above competitive levels, as well as through drought assistance and other subsidies, and an unduly strict quarantine regime.

Within the largely domestic services sector, not to be outdone for anti-competitive preferment, public utilities and other government infrastructure services with statutory monopoly protections dominated the economic landscape, their high-cost price structures tilted to get a share of the rent from the protection of manufactures. Many other goods and services could only be sold in their state of origin – including milk and beer (I still recall my first venture into alien Reschs territory) and the services of licenced professions and trades.

In workplaces across the country, trade unions ruled the roost in a highly and centrally regulated labour market, where schedules of wages were 'awarded' and conditions prescribed for every conceivable job at every conceivable level of skill or experience, regardless of the circumstances of individual enterprises subject to them. If what the industrial judges regarded as a fair thing, having heard both sides within the 'Club', turned out to be potentially ruinous for some firms, a trip to Canberra by the relevant industry association would soon fix that through another round of 'made to measure' protection.

Indeed, a special trip in many cases was unnecessary, as most industries had representatives permanently ensconced in our nation's capital – all the better to become acquainted with those good people within government who effectively made the decisions. Larger companies requiring more tailored support, like ICI or BHP, had their own Canberra operations – which at the time may well have been among their most important profit centres.

In short, the Australia of Bert Kelly's time could be described as rent-seeker heaven. While the expression 'rent-seeking' had not been invented at the time Bert began his lonely fight in Parliament, it would have resonated strongly with him from the outset. It was first coined by Anne Krueger in her 1973 article 'The Political Economy of the Rent-Seeking Society' to describe the competitive pursuit of import licencing privileges. It has come to be characterised more loosely as the pursuit of 'government preferment' – actions of particular groups directed at obtaining benefits through the State that involve restrictions on markets, to the (net) cost of the community as a whole.

The concept itself had long been recognised. What Krueger (and Gordon Tullock) formally demonstrated, however, was that the costs entailed in rent seeking could be considerably larger than the deadweight losses in the static Harberger 'triangles' of conventional partial equilibrium analysis, potentially encompassing as well the transfer 'rectangles'. The key insight is that resources devoted by a firm (or organisation) to obtaining benefits from the state (or defending those it already has) will be expended up to the point where the expected return is no greater than that obtainable from productive activity, potentially dissipating the entire rent.

It follows that the costs of a 'rent-seeking *society*' – one in which many groups are simultaneously attempting to secure such artificial advantage – can be very large indeed. Yet this was precisely the kind of Australia that existed in Bert Kelly's time, and against which he laboured so valiantly.

The difficulty Bert faced in convincing people about the costs of protection resulted in part from the fact that, at that time, Australia was doing tolerably well economically, aided by favourable world prices for our primary commodities (notably wool and wheat). Growth was steady, unemployment and inflation low, and the incomes of Australians still compared favourably on average with those in other advanced economies. But to the extent that we had been able to continue 'riding on the sheep's back', as the cliché went, we were riding for a fall.

The leading indicator of our demise was chronically low productivity growth relative to the OECD, the inevitable consequence of a system that rewarded lobbying, entrenched restrictive practices and compensated firms for excess costs.

Productivity growth in aggregate comes from two principal sources: a) cost-reducing and value-enhancing changes within *firms* ('innovation'); and (b) the displacement of poor performing firms or industries within *sectors* ('creative destruction'). Both market mechanisms were severely compromised under the 'protection all round' regime.

As a result, Australia's economy became increasingly fragmented, small scale and high cost, with outmoded technologies and low rates of skill development. It was an economy overweighted in (high cost) manufacturing and underweighted in primary and tertiary (and efficient secondary) sector activities.

As our terms of trade diminished, the poor underlying productivity performance translated into what looked like becoming an inexorable decline in the comparative living standards of Australians. Whereas Australia was ranked 4th in the world in terms of per capita incomes in 1950, we had fallen to 8th by 1973 and 14th by the mid 1980s. This trajectory, if maintained, would have seen us languishing, as Treasurer Keating colourfully highlighted, with the resource rich but poorly performing economies of Latin America.

The Kelly message heeded

Obviously this was not to be our fate. Almost against the odds, Australia reversed its immiserising spiral of rent-seeking to emerge as a productivity leader by the late 1990s – indeed within Bert Kelly's own lifetime. But this took considerable effort and skilful political leadership, and it didn't happen overnight.

Two early blows

The initial blows against the preferment system were, ironically, not dealt by Bert's own LCP, but by 'the other side'. And the first of these actually *did* happen overnight. Australians awoke on the morning of 19 July 1973 to learn that the Whitlam Government had slashed tariffs by 25 per cent 'across the board'. This policy initiative, devised in secret, was designed to kill two birds with one stone – to deflate an overheated economy and achieve a more efficient allocation of resources – within the constraints of a fixed exchange rate regime.

The former goal may have been over achieved, given the turn in global economic conditions. But in relation to the latter, the tariff cut's contribution was in the end arguably more symbolic than substantive. Though extensive in reach and an important and unexpected shot across the rent seekers' bows, the more powerful industry lobbies soon rallied. Within a short space of time, the government had capitulated and re-introduced quotas for TCF and auto imports, with further reversals for some steel products and whitegoods. These served to exacerbate (net) assistance disparities, with some TCF activities enjoying effective rates above 200 per cent. Structural distortions accordingly increased, notwithstanding the lower average rate of protection.

The more profound and enduring action against producer rent-seeking was Whitlam's transformation of the Tariff Board into the Industries Assistance Commission, based on a report by Sir John Crawford. The key formal changes it brought, to an institution that already benefitted from formal independence and procedural transparency, were explicit public interest provisions in its new statute: requiring it to assess what was in the best interests of the economy as a whole, not just industries under competitive pressure. Whitlam expressed the rationale for his new Commission in the Second Reading Speech as follows:

The first and most important reason for establishing the Commission is to allow public scrutiny of the process whereby governments decide how much assistance to give to different industries … Such a process must be independent and impartial and seen to be independent and impartial.

Far from receiving the support of Bert Kelly's side of policies, this principled initiative was vehemently opposed by the Country Party. Hal Colebatch in his book *The Modest Member* quotes the following passage from Doug Anthony's speech in Parliament:

What this legislation means, of course, is the end of the long-established and successful practice under which industry policy has been devised, the system of discussions, consultation and negotiation between industry and government. … What will be the point of industry talking to the Government?

A change to long-established practice was of course precisely what was intended. Colebatch notes Kelly's observation that this "meant greater transparency and a reduction of the deals which had led manufacturing interests to so generously build John McEwan House for the Country Party in Canberra."

The IAC became a strong ally for Bert, furnishing him with facts, figures and analytical insights. In shining light on the economy-wide costs of protection, it also alerted those sections of the community who were in effect paying the bill, and in time they (initially the NFF, then AMIC) added their voices to his call for reduced protection.

The next substantive blows against protection were not to be made for another decade, after the intervening reign of Malcolm Fraser – an avowed free trader on the world stage, but regrettably a protectionist at home.

Advent of the 'Reform Era'

The Hawke-Keating Government did not at the outset look any more promising from a reform perspective than that of Fraser. Hawke, after all, had only just stepped down as head of the ACTU. As such, he had been a skilful advocate for protection and member of the Industrial Relations Club. Keating had little training or experience relevant to his new responsibilities as Treasurer. The Labor Party's platform was similarly unpromising, containing no hint of the reforms to come.

How the metamorphosis occurred, and the strategies adopted to transform Australia's economy, is a story that needs to be more widely understood, for reasons that I will come to.

The upshot was that, by the time of Bert Kelly's death in 1996, the principal monuments to Australia's rent-seeking past had been seriously weakened, if not struck down. Tariffs were finally heading towards zero, with even those for the two 'high maintenance' industries – TCF and Autos – being significantly reduced; most public utilities and other service monopolies had been corporatised or privatised and exposed to competition; anti-dumping arrangements were made less 'accommodating'; industry subsidies were being redirected to promote adjustment or address market failures; anti-competitive regulations were being systematically scrutinised and enterprise bargaining was transforming workplaces across the country.

Were Bert with us today, he would no doubt be pleased that reform did not cease under the successor Liberal/National Government of Howard and

Costello. The National Competition Policy rolled on – dismantling many anti-competitive institutions, including the agricultural marketing boards – fiscal repair was vigorously and successfully pursued; and further reforms made to industrial relations regulations to enhance necessary workplace flexibility and innovation.

Most of all, I think, he would have rejoiced at the economic benefits that flowed from this extensive program of micro-economic reform, the prospect of which had been vigorously disputed by those resisting reform. In particular, he would have felt vindicated by the rising employment, falling unemployment and historic gains in labour force participation during this period, and the fact that real wages rose by one third. And he would have been heartened by the fact that, contrary to conventional wisdom, an open, flexible economy proved much more resilient in the face of external shocks.

I also suspect that he would have had little sympathy for the manufacturing lobbies lamenting that their share of output and employment had fallen, seeing this as part and parcel of realising the much larger, economy-wide gains in jobs and incomes.

But if I can continue to second-guess our sage in this vein, there are some features of Australia's contemporary policy scene that he is likely to have found less to his liking, perhaps even concluding that our past ways were not so far behind us after all.

Rent-seeking redux?

The reality of course, is that while tariffs are now historically low, they have not been eradicated. A report by the Productivity Commission in 2000 recommending the complete phase-out of 'general tariffs' was rejected out of hand by the Howard/Costello Government, ostensibly for fiscal reasons (notwithstanding the emerging fillip to revenue from mining).

As long as the Tariff regime remains intact, it not only continues to impose costs on society, costs which are often underestimated, it signals the legitimacy of protection and the pursuit of it. Thus, we have seen intermittent calls for increased protection in recent years and a populist new political party, again based in the Bush, advocating higher tariffs to offset the competitive pressure from a stronger exchange rate. We have also seen protectionist regression in Australia's anti-dumping regime. At the same time, the ability of firms to get relief from paying import duties, where these apply to machinery or raw material inputs that cannot be sourced locally, has recently been constrained.

Meanwhile, the principal delivery platforms for government preferment have shifted from border protection to other forms of assistance. Grants and other budgetary assistance tracked by the Productivity Commission amounted to $9.4 billion in 2011-12, up from $6.8 billion five years before. This compares with (net) tariff assistance equivalent to $1 billion.

The increase in budgetary assistance was aided initially by the mining taxation bonanza. As Kelly would have appreciated more than most, such transparent assistance from the taxpayer has necessitated public interest rationales removed from crude protectionism. These have been furnished by the economics profession – or perhaps more accurately public officials who have learnt their economics 'on the job' – under the headings of 'market failure' in general and 'externalities' in particular.

'Innovation is good'

Innovation has become the sacred cow of industry policy, as though it should be sufficient to invoke it in order to justify any form or amount of government support. Thus, nearly all assistance packages being devised by governments these days have 'innovation' in the title, whether or not they are likely to increase it, let alone do so in such a way as to yield a net benefit to the economy.

This is illustrated by the 'Industry and Innovation Statement' released in February. The statement comprises a package of measures explicitly directed at supporting jobs in manufacturing. However, the declared centre piece of the Statement is not directed at innovation as such, but at import substitution – through measures encouraging mining firms to 'buy local' and facilitating manufacturing firms' access to anti-dumping remedies for 'injurious' imports.

Those elements that are concerned with innovation revive two ideas that someone from the 1980s would have already been familiar with: 'Innovation Precincts' (reminiscent of 'clusters' and the Multi-function Polis) and subsidies for early stage venture capital (long utilised but short on impact).

A sense that not much had really changed would have been reinforced by the announced appointment of a new 'Automotive Supplier Advocate' in order to "boost sales of Australian-made cars to government and business fleets."

The Automotive sector receives, through tariffs and various subsidies quantified by the Productivity Commission, over a billion dollars in assistance from the community annually. But with over one-half of all cars sold going to fleets, substantial additional assistance is likely to be derived from government purchasing preferences and FBT concessions. The Australian Government has indicated that in 2011-12 around 70 per cent of its car purchases, and those of the two car manufacturing states, Victoria and South Australia, were made locally and it recently signalled an intention to buy even more. This compares to an overall market share for local production of around 10 per cent. That FBT concessions have played their own part is apparent from the outcry following the recent tightening of these and the subsequent offer of an extra $200 million in assistance, partly to compensate.

A champion among rent-seekers?

I'd suggest that Kelly would not have been too surprised that the automotive industry was the only industry to have been singled out for special treatment in the Statement. Along with the Pharmacy Guild, it has to be given its due as the most successful rent-seeker in Australia's industrial history. (And, as Bert might have repeated in this context, "the competition has not been negligible.")

The Australian auto industry has arguably managed the rent-seeking side of its business better than the production side. It has been able to argue successfully for much higher rates of assistance than for most other industries over many years. And when the tariff game was finally up, it was able to negotiate substantial new financial assistance for purposes of 'adjustment' and innovation. Arguably, the main adjustment that took place, however, was a shift in the sales mix in favour of (rebadged) foreign vehicles. As Bert's fictional friend Fred might have said "you've gotta hand it to 'em!"

Two developments, however, might have led the 'modest member' to sharpen his pen again. One was the bypassing of the Productivity Commission, descendant of Bert's beloved IAC, for the most recent major review of assistance to the industry (though the Commission's modelling study as an adjunct to that review made an important contribution in its own right). The other is the lack of transparency around recent top-ups in assistance provided to specific firms – some of which were brought to light only as a result of a refused Freedom of Information request. Seeking to dignify surreptitious subsidies to selected firms as 'co-investment' by taxpayers would be regarded as a bit of a stretch, to say the least, particularly given that any real dividends they managed to produce would have gone offshore.

Having been tutored by Eccles, Bert Kelly would have relished in countering the industry's claims that it is actually under-assisted by international standards, or that the taxpayer gets a twenty-fold return for each dollar 'co-invested'. He might point to the Productivity Commission's estimate of a few years ago that every job 'saved' in the auto industry by assistance through the government costs Australian taxpayers around $300,000. At the same time, the mining industry was deprived of skills they desperately needed, obliging firms to recruit overseas on a temporary basis using the 457 Visa route. Thus, when Mitsubishi finally closed its operations in South Australia, around 80 per cent of the workforce soon found alternative employment.

What is rarely acknowledged is that most of those employed in the 'automotive sector' do not depend for their jobs on local assembly operations. And many of the jobs claimed to be in the balance when more taxpayer money is being sought, are related to the distribution and servicing of cars that are largely imported. In any case, long experience tells us that assistance to this industry, as for others, can do little to support job numbers. Rather, it is likely to have mainly underpinned higher remuneration for remaining auto employees and higher profits (or smaller losses) for the owners in the United States and Japan. But until there is a proper independent review we won't know for sure.

Coalitions of interest

As in the past, unions have continued to join forces with automotive and other interests in areas where both stand to gain from government preferment. Recent illustrations of this outside the automotive sector are to be found in coastal shipping, road transport and defence procurement. In each case, a public interest rationale has cloaked the private interests being pursued.

For example, the new Road Safety Remuneration Tribunal's powers to fix haulage rates can be expected to favour large incumbent freight companies and their unionised workforces against the contractors and owner drivers who compete with them.

And the commissioning of another batch of home-made submarines to replace the costly and unreliable Collins Class, following petitions by the Defence SA Advisory Board – "a lobbying machine without compare" according to one public commentator -- will be a boon to the Adelaide-based industry and unionised workforce alike. The former army general astutely chosen to head this lobby, has spoken of the need to "fire up the national imagination" through such an action. (No doubt our modest columnist would have had much fun discussing this with Fred or Eccles. One of them might have suggested that the need for our Aussie subs to take so long to build and for them to then spend so much time in dry dock may actually be regarded, not as a problem, but a job-creating virtue.)

The environmental angle

Rent-seeking under the innovation banner has proven effective enough. But when the prospect of innovation externalities is combined with the reduction of *environmental* externalities, the mixture is a potent one indeed.

The largest beneficiary of this superficially compelling juxtaposition of public interest rationales is the Carbon Abatement Industry. On the last count, there were over 200 different programs to support this 'industry' Australia wide. At the Commonwealth level alone, budgetary expenditure on such programs amounted to around $1.7 billion in 2011-12. Support has been provided both through regulations and subsidies that favour the production or consumption of alternative energies, and by simply taxing carbon emissions. All told, the transfers now dominate most other categories of industry assistance.

As for innovation support, the policy 'cover' is the potential for net social gain through changing the level of externalities associated with industry activity. But this potential is hard to realise even with carefully designed schemes, let alone the ones introduced.

For example, I wonder what Bert Kelly would have made of the giant, futuristic wind turbines that increasingly populate the rural landscape? "Are these financially viable?" he might ask. The answer is that they would clearly *not* be without the benefit of a regulatory regime that obliges energy distributors to obtain 20 per cent of their power from 'renewable' sources.

Bert might then see whether the Productivity Commission had had anything to say about this. He would find that the Commission had found the Renewable Energy Target to be a relatively high cost means of achieving emissions abatement (though not so costly per tonne as the solar panels that now adorn many suburban roof tops). He would further discover that the Commission had recommended that measures, such as the RET, that could not be shown to yield benefits additional to those to be derived from pricing carbon emissions, should be abolished. Instead, 'Big Wind' has been favoured by additional support through the Clean Energy Finance Corporation, which has a government-guaranteed $10 billion budget and little else, other than solar, that it can really spend it on.

Workplace regulation resurgent

How Bert Kelly would have viewed the Industrial Relations scene today is less clear, given the state it was in for much of his life. However he may well have been disappointed that the trajectory under the Keating Government's reforms – towards the negotiation of wages and conditions at the enterprise level, subject to a limited number of regulatory standards – appeared to have lost momentum. Being told that conventional opinion was that deregulation had gone too far under a legislative package called 'Work Choices', he may have struggled to understand how that was so, or why the regulatory pendulum appeared to have swung so far back, in some areas to pre-Keating days. He might express particular surprise at the extent to which the unions had enhanced their influence and powers, despite having a fraction of the membership of his day, perhaps noting that industrial disputes and associated working days lost seemed to be trending up again.

Some of the features that might be found most anachronistic are the legislative freedoms for unions to install their officers in workplaces for recruiting purposes ('On the Waterfront' anyone?); the entrenching of penalty rates for weekend work in what has become a 24/7 economy and society; the right to 'strike first, talk later' (and on issues extraneous to wages and conditions); and limitations on an enterprise's ability to employ external contractors or to engage in greenfield investments without union approval.

While the industrial court has had a name change, would it appear all that different to the old Conciliation and Arbitration Commission? Equally, while the award system has been 'modernised', would it be seen as fundamentally new? 'Modern awards' are fewer in number, but there is still a lot of them, containing a lot of prescriptive provisions. Further, a myriad of prescribed minimum wage rates still exists for different tasks at different levels, when most advanced countries consider a single minimum rate sufficient for safety-net purposes. (The fact that ours is the highest in the OECD and is likely to be a disincentive to employing many people, including new migrants, is another matter.)

The heavy regulatory emphasis on union representation in workplaces might also look out of kilter with the changing nature of work and working relationships in the post-industrial age, reflected in declining union membership itself. Few employers these days would regard their employees as mere factory fodder, if they ever did. And few employees these days would see unions as more deserving of allegiance than their employers (at least outside the construction and stevedoring industries).

Nowadays, people have more generally applicable human capital and more employment choices, and thus greater individual bargaining power. Moreover, low-skill, low-income workers and their households are far less dependent on earned income than previously. Apart from the 'NewStart' unemployment safety net, there is an array of payments and concessions on offer, depending on one's personal and family circumstances. Indeed, 60 per cent of households in Australia today receive more in benefits from government than they pay in taxes.

These payments have their own large constituencies, who naturally seek to entrench and extend what they have come to regard as entitlements. While this might appear to someone from an earlier era as simply another form of rent-seeking, changing social mores and notions of fairness complicate the picture. However, regardless of the merits of the various categories of social transfer, there comes a point, as with the conventional concept of rent-seeking, where transfer-related activities begin to reduce economic welfare for society as a whole. In the case of this form of government assistance, the costs derive mainly from consequent reductions in labour force participation and from the (large) deadweight losses associated with tax 'churn'.

Back to the Future?

On occasion, Paul Keating was heard to repeat the aphorism of his early mentor, Jack Lang that , “In the race of life, you can always back self-interest – at least you know it’s trying”. An appreciation of the constancy and power of self interest is a good thing, particularly in a Treasurer. Properly harnessed and directed, self interest underpins economic progress, as every student of Adam Smith knows. When stifled or mis-directed, however, it can undermine economic performance and indeed society itself.

Rent-seeking is self-interest mis-directed. It weakens economic performance by diverting entrepreneurial energy from productive ends, as well as by attaching itself to policy instruments that distort the allocation of resources. Rent seeking’s preoccupation with wealth distribution over wealth creation ultimately erodes an economy’s capacity for both.

Rent-seeking is also *socially* detrimental. A rent-seeking society is one that favours ‘insiders’, the organised and the politically powerful, at the cost of the rest of the community. This often occurs in opaque, if not surreptitious, ways. Moreover, it is a system, as the Kellys’ felt so keenly in relation to The Tariff, that dispenses preferment unrelated to merit, and is fundamentally at odds with the ‘fair go’. It accordingly breeds suspicion and erodes trust in government, including in its ability to make policies that are generally beneficial and therefore sustainable. In this way it heightens risk and uncertainty, and can erode the accumulation of both social and economic capital.

A further consequence of the prevalence of rent-seeking is that it weakens the capacity of society, through income growth and accompanying tax revenue, to fund programs for the disadvantaged, including those harmed by the preferment of others.

For all these reasons, manifestations of a return to the ‘bad old days’ should be viewed with great concern. With the highs of the mining boom now behind us, the imperative, as at the end of the wool boom, is for governments to pay more attention to the creation of wealth than its further redistribution, and to facilitate productivity rather than preferment. That will mean undertaking reforms in a number of policy areas. But above all, it will mean having a hard look at those aspects of the policy-making environment that have contributed to our relapse -- and urgently addressing them.

The drivers of rent-seeking

As noted, the extent and pattern of rent-seeking is influenced by the expectations of different players about the returns from such activity relative to feasible alternatives. An organisation or industry is more likely to petition a government for special favours: the less well it is doing on its own; the higher the perceived probability of it being successful in obtaining assistance, and the larger the potential benefits at stake.

A number of factors influence what might be called the demand and supply sides of this particular 'market'. Some of these may be temporary, or self-correcting, but others are potentially more durable.

The mining boom will have influenced both sides of the preferment market in more recent years, by putting some industries under increased pressure and providing government with additional revenue to potentially address their needs ('spread the benefits'). Ironically this made the opportunity cost of assistance seem lower, when from a resource allocation perspective it was higher.

Typically, organisations that are already doing well do not go to the trouble of petitioning government for support. As the saying goes 'governments don't pick winners, losers pick governments'. The high dollar significantly reduced the competitiveness of firms in some trade-exposed sectors, particularly segments of manufacturing and tourism, and these were soon seen to be ramping up their lobbying efforts.

Some of the pressure on those sectors, and thus on government, should have abated with the dollar dropping back again in recent months. But markets are tough places. They contain multiple sources of pressure. Some firms, if not industries, will always be struggling and the incentive for them to seek support will generally remain.

How different parties think government is likely to respond to any overtures they make, will obviously be the key to how they choose to proceed: in other words, the nature of the 'supply side' will largely determine the extent of *actual*, as opposed to latent, demand for assistance. A government that, to use an old expression, appears to be 'open for business', will soon find itself getting plenty.

In this respect, the Global Financial Crisis has had, in my view, a significant effect of its own on recent rent-seeking trends. Not only did it exacerbate the pressures on firms and other organisations, including many outside the trade-exposed sectors, it radically heightened the inclination of governments to spend rather than save. Suddenly politics and economics were in harmony -- spending was generally seen to be good, almost regardless of its productive potential (and much of it was not very productive).

This in turn had an impact on community perceptions, with the initial shock many Australians may have felt on receiving a cheque from the government soon passing and a previously suppressed belief in the free lunch reasserting itself. Indeed, these days people seem to have become inured to multi-billion dollar policy announcements. (Everett Dirkson's line 'a billion dollars here and a billion there and pretty soon you're talking real money' hardly even raises a smile any more.)

Another casualty of the GFC can be found in the processes for policy formulation itself. In a crisis, some of the normal procedural requirements within government – such as public consultation, cost benefit analysis, regulation impact statements, Cabinet discussion and whole-of-government processes to inform it, and adequate time for Parliamentary debate of Bills -- come under considerable pressure. Some short cuts are inevitable in such circumstances and perhaps even desirable. However where they persist, they facilitate the rent-seekers' task and increase their expectations of success, by reducing the scope for scrutiny of their claims and any measures designed to address them. That a legacy has persisted in this area is illustrated by the range of programs and policy initiatives in recent years that have occurred with little consultation or warning, a number of which, inevitably, have given rise to unintended consequences.

Loss of due process is particularly problematic in areas where the interests of rent-seekers align with the ideology or inclinations of the government of the day. In Bert's times, the difficulty of countering manufacturing industry's claims for preferment was made harder by it having political champions at the top of the Liberal and (ironically) Country Party Government. On the other side, unions have obviously long had close ties to the Labor Party they founded. As the former Prime Minister observed at the AWU's convention this year, "I come to this union's gathering as a Labor leader. … I'm the leader of the party called the Labor Party deliberately because that is what we come from. That is what we believe in…".

The expressed views of politicians can play a key role in conditioning expectations about the potential gains from rent-seeking activity. From this angle, manufacturing interests would have found comfort on both sides of politics in recent times. A Prime Minister who publicly declares that he does not want be the leader of a nation that 'does not make things' emits a signal that manufacturing interests would fully comprehend. An Opposition Leader who declares that his party "says 'no' to the carbon tax because we say 'yes' to manufacturing" conveys a similar message, one likely to be reinforced by the promise of stricter anti-dumping rules.

Of course actions speak louder than words (what economists call 'revealed preference'). Those interests considering whether to seek preferment from government will be most influenced by whether it has been offered previously to them or to others. And, as indicated earlier, many will find much to encourage them. Thus it is understandable that carbon tax compensation quickly established itself as a favoured route for industry assistance extending beyond those with the more solid claims, as the Grattan Institute warned. It is also unsurprising that we are seeing advocacy of 'reserve pricing' for domestic gas production to artificially lower input costs for (other) local industry. And, as budgets bite, we are starting to see greater competition for available financial assistance -- with the food industries recently protesting at the priority given automobiles -- and greater emphasis on regulated or administered forms of assistance, particularly in the trade area. Meanwhile, emboldened by the many recent regulatory changes in their favour, unions have been actively seeking further extensions to and entrenchment of their legislative powers.

Gaining the support, or at least acquiescence, of the public for measures contrary to the public's best interest has always been central to the success of rent seeking. In Bert's era, newspapers were the main media conduit for this and some journalists, such as motoring writers or IR specialists, proved willing collaborators. However, many were not, and some became strong advocates of reform. The arrival of around-the-clock electronic media has greatly favoured special interest groups, by providing them with a ready and more receptive transmission mechanism, one posing little risk of a detailed questioning of their claims.

It has also meant that interest groups today have much more scope to sell their story to the public directly, using social media and advertising. This is typically executed in ways that encourage the public to see its interests aligned with those of the pressure group and its needs, whether it be pharmacists' anti-competitive privileges or auto manufacturers' subsidies. White coats, blue overalls and happy families tell a convincing tale (a boon, no doubt, to the local acting profession). To the extent that governments follow rather than lead 'public opinion', such advertising can exert a powerful political influence. This was perhaps demonstrated most starkly by the ACTU's media campaign against WorkChoices and by the Australian Mining Industry Council's campaign against the 'super profits tax'.

The changing nature and political influence of the media has also affected the supply side of the preferment market, through its impact on political representatives and the composition of their offices. There is increasing pressure on Ministers to have an immediate (desirably interventionist) solution to the problem or issue of the moment. Failing to do so, straying 'off message' or getting a detail wrong (a 'gaffe') can bring a hapless Minister or even a government unstuck. As a consequence, issues managers – media and public relations people and political tacticians – are to be found in increasing numbers in Ministerial offices.

The ascendancy of the 'Office' over the 'Department', together with the displacement of policy advisers by political advisers, has created conditions conducive to policymaking 'on the run', including for the benefit of special interest. Getting the ear of a ministerial adviser has arguably never been more important to a 'result' than it is today.

All policy decisions are ultimately political, but the scope to inform them with a balanced assessment of the costs and benefits is considerably diminished in this setting. This has been exacerbated more recently by the disproportionate policy leverage that minority government has given to 'independents' and minority parties, who have particular interests of their own. The twists, turns and reversals of carbon 'policy' provide a disturbing illustration of the forces at work.

What can be done?

In my view, the re-emergence of a 'rent-seeking society' poses a bigger threat to the future living standards of Australians than the ageing of our population or the vicissitudes of world markets. The good news, however, is that we know how to change things for the better, because we've done it before.

Moreover, the challenges we faced at that time were considerably greater than they are today.

The transformation of the sclerotic economy of Bert's early years to the productive and competitive one emerging by the end of his life, and the associated changes in societal attitudes and behaviours, were the result of a deliberate government strategy. Its purpose was to detect impediments to performance and devise reforms to remedy them and, importantly, to promote public understanding about why these were needed. Central to its success was the strengthening of processes to ensure the effective scrutiny of policy proposals -- within the bureaucracy, Ministers' offices and the Cabinet -- supported by the commissioning of independent public reviews in policy areas where extensive public consultation was desirable.

All this has been well documented and should be understood. (The OECD upholds it as the 'Australian Model of reform'.) The only question is whether the processes and institutional arrangements that served us so well in the past would still be as effective today. Some have argued that they would not, given among other things the media's seeming intolerance of deliberation and delay. I find that hard to accept. The fundamental principles of good policy process should be timeless, even if the manner of their execution must adapt to the times.

Nevertheless, recent history tells us that good process and the discipline it provides -- on rent-seeking and on policy-making generally -- cannot be taken for granted. Like the classical tale of Ulysses and the Sirens, it would be nice to think that means could be found to hold the line against any temptations that arise. And I believe there is indeed scope to do more in this area. However, in the end, the crucial factor in sustaining good policy practice is good political leadership. This remains as true today as it was in the time of Stan and Bert Kelly.