

## Economic Reform — Renovating the Agenda: With an Example from the Market for Information

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We hear a lot about lack of leadership in politics these days. Certainly the movements with which most of the essays in this collection are concerned originated outside government and party politics. They arose in the community at large and the pressures they produced had important impacts on governance. By contrast, economic reform was, and remains, an agenda driven by an elite within government and those closely associated with it — journalists and others (for instance those in ‘think-tanks’) deliberately seeking to comment on and/or influence political culture and political outcomes. It was also an area in which, advised by governmental ‘insiders’, politicians have shown considerable leadership, that is, political courage in support of some ideal. Many if not most pillars of economic reform were highly unpopular when initiated, and remain so to this day (Evans and Kelly 2001).

Notwithstanding its continued unpopularity, economics has made an important contribution to Australians’ lives — to the skill and success with which we have faced the practical challenges of a world changing at breakneck speed. Conceptually and even philosophically economics is a very simple, indeed crude, discipline — unlike sociology or psychoanalysis for instance. It is built around a few very simple ideas that make very simple assumptions about human behaviour. Of course this very crudity means that those who don’t — or don’t want to — understand its limitations can abuse it. And it adds to the ease with which it can be lambasted as ‘simplistic’ in public debate. But it was the very simplicity and

universality of the principles to which he appealed that so excited Adam Smith about the potential of economic thought to improve human lives. That was why he wrote *The Wealth of Nations* according to the ‘Newtonian Method’ — building a large edifice upon a bare minimum of postulates. Like Bill Clinton’s injunction to himself to ‘keep it simple stupid’ as he barnstormed America in 1992, like Adam Smith in penning his great work, it is well to remind ourselves that Ockham’s Razor has a role in society as well as in science. Where people of different backgrounds, temperaments and abilities must cooperate — as must happen at all levels in a society — simplicity is surely at a premium.

The following section sets out the central features of economic reform. Subsequent sections offer analytical and narrative sketches of two ‘wings’ or phases of economic reform. The central theme of the first under the Whitlam government was redistribution from traditional lobby groups — industry and farmers — to improving the quality of life for ordinary Australians within a prosperous mixed economy. The central theme of the second period which stretches from 1983 to the present was tackling economic adversity with a systematic search for more ‘market oriented’ solutions to economic problems.

Our central arguments in this paper are that in its triumph over policy-making, this second phase of economic reform is now facing diminishing returns and that the third phase will be marked by a return to ‘mixed economy’ themes. However, the reader is invited to consider this

third stage as a development of the first two stages rather than some swinging of the pendulum back towards government intervention in any crude sense. Indeed the very preoccupation with the ideological positioning of various economic strategies has tended to impoverish the economic and political debate and keep us from the most important task of the economic reformer — fashioning constructive policy responses to our current circumstances from such resources as economic thought provides us. The third phase of economic reform can transcend somewhat the polarities of ‘free markets’ and ‘government intervention’ that have so dominated economic and political discussion. It can do so because we can return to the overarching theme of 1970s reform — that of reforming the mixed economy to improve the quality of life — but without much of the naivete about government intervention current then.

What is being discussed should be distinguished somewhat from the ‘third way’, which presents itself as a new departure in tackling some of the most intractable problems of our society — particularly social inequality and welfare dependence. The third phase of economic reform set out in the project foreshadowed in this article seeks instead to focus on areas in which there remains ‘low hanging fruit’ — relatively easy economic and social gains from a constructive application of the ideas and principles embodied in the tradition of economic thought from Adam Smith to the present. For it is worth noting that, alongside the milestones of deregulation, some of the most unambiguous successes of Australia’s economists and policy-makers have involved the application of very simple problem-solving with an eye to economic principles rather than the application of any sophisticated economic theory. Thus Australian economists helped design innovations such as the Pharmaceutical Benefits Scheme, the Higher Education Charge and the Child Support Agency within the Tax Office. They helped develop one of the world’s most efficient and affordable welfare systems. These Australian innovations have been studied and imitated around the world.

The ambition of the claims made thus far clearly requires far more than a single article in their defence. Nevertheless, they are made in

this article, with examples from one area, as part of a much larger project to be expanded in subsequent work (see Table 1). I argue that light handed and inexpensive resetting of some of the ‘rules of the game’ in traditional markets for labour, goods and services could generate large improvements in the quality and quantity of information circulating in markets. So doing would not only improve the efficiency with which inputs were turned to outputs. It could provide social and human benefits that transcend the purely economic. In so doing it could even improve the social standing of economic reform.

### Characterising Economic Reform

Generally speaking economic reform is governed by the concept of market failure. From the time of Adam Smith economic reformers have argued for the freeing up of markets except where market failure might make government involvement the lesser of two evils. More recently we often add the rider that the prospect of government failure must also be considered before government intervention is sanctioned. If this often involves rationalising government involvement — in the sense of paring it back — it also often involves rationalising government involvement in the sense of sorting out priorities and reconciling the ultimate ends of policy with the means chosen to pursue them. As Adam Smith put it engagingly in 1776:

The bounty to the white herring fishery is a tonnage bounty; and is proportioned to the burden of the ship, not to her diligence or success in the fishery; and it has, I am afraid, been too common for vessels to fit out for the sole purpose of catching, not the fish, but the bounty (Smith 1937:483).

Thus economic reformers have also focused on rationalising the roles of different institutions — arguing for separations between service delivery and the funding and regulation of market activity. Corporatisation too involves ‘rationalising’ in this second sense.<sup>1</sup>

Of course a presumption in favour of free markets subject to caveats about market failure does not determine any policy. Given the ubiquity of both market and government failure it all depends where one draws the line between the presumption in favour of market liberality

and intervening to correct market failure. The next section characterises what are somewhat artificially identified as two traditions in economic reform. It is possible to outline them analytically or ideologically. They can also be outlined as stages in economic reform corresponding to different historical periods. The picture is painted in both ways, though, as with any historical generalisation, the distinctions between periods or between traditions can never be drawn precisely.<sup>2</sup> The ultimate purpose of the exercise is not historical but normative or rhetorical. For a broader understanding of the resources and traditions on which economic reform has drawn in the recent past will surely help in any attempts to broaden the horizons of economic reform as it is practised in the future. Better understanding the first two stages of reform will help us more constructively to fashion the third.

The slings and arrows of electoral politics will continue to deliver the occasional set back to economic reform. Governments will announce, and breathless columnists will report on changes in direction — as they did when a new prime minister announced a fiscal stimulus amounting to half a percent of GDP in February 1992. And amid the new challenges of more populist politics, public antipathy to economic reform will continue to be tapped by politicians in both the centre and the extremes of the political spectrum. But by and large, any consequential changes will be at the margin. The legacy of economic reform — more open markets and a less accommodating attitude to macroeconomic imbalances — looks safe for the foreseeable future.

### **The Story of Economic Reform: From Timidity to Triumph**

In 1968 Max Corden wrote that ‘the use of widespread tariff protection to foster industrial development is not a political issue in Australia for there is no significant opposition to protection as such’ (1968:23). In fact at the time he wrote, the significance of the opposition to trade protectionism was growing (see Table 1). Reform had begun a year or so before as Alf Rattigan turned to economic expertise to help him reconcile the otherwise contradictory demands of his job as the Chairman of the Tariff Board (Rattigan 1986).

This took place in the context of the old Australian debate between ‘free trade’ and ‘protection’. Rattigan’s quest to transform the Tariff Board into an expert commission to advise on all industry assistance from an economy-wide perspective melded well with Whitlam’s agenda to renovate government institutions with expert and independent advice from advisory commissions outside the traditional public service. Corporatisation was also a feature of this early period as the postal delivery agency within the Post Master General’s Department was hived off and some movements were made towards user-pays principles.

If free trade seemed impossible in 1968, then a decade later it was all the rage in political rhetoric, if not in action. And another decade later, two statements in 1988 and 1991 respectively drove the last nails into the coffin of trade protectionism as a serious force in the mainstream policy debate in Australia.<sup>3</sup> After a backlash against reductions in industry and rural assistance, economic reform re-emerged as a major theme of government action from the early 1980s. Important early milestones in the 1980s included financial and exchange rate deregulation and a suite of government plans gradually liberalising trade for Australia’s troubled steel, car, textiles and clothing manufacturing industries.

Economic reform steadily broadened over the 1980s to include welfare targeting, tax reform, corporatisation and privatisation. Investment liberalisation, labour market liberalisation, competition policy reform and the contracting out of services previously delivered by government and even the correction of macroeconomic imbalances like inflation and chronic budget deficits all seemed to grow organically as part of the economic reform agenda.

There are very substantial differences between the two reform episodes. The intellectual milieu out of which mid-1970s economic reform grew was of a piece with Whitlam’s appeal to the educated (small ‘l’) liberal intelligentsia — which was generally, though of course not uniformly, to the left of centre. The transformation of the politics of industry assistance had parallels with the transformation of the politics of conservation and consumer issues, with academics, other independent professional experts and reformist

zealots — both visiting international celebrities<sup>4</sup> and grassroots activists — gradually increasing their influence.<sup>5</sup> Whitlam's reform was resented as the work of 'long hairs' and 'intellectuals' (Freudenberg 1977:281) and avowedly redistributive. The tariff cut and rationalisation of a wide range of subsidies foreshadowed in the Coombs task force on government expenditure were presented as a re-ordering of government priorities<sup>6</sup> — for instance towards social security, education, health, suburban renewal and the arts. It was part of an expansion rather than a retreat in the role of government.

In the mid-1970s reform was pursued where it could plausibly contribute to economic objectives from time to time, and less as the end in itself that it later became. The 25 percent tariff cut was prosecuted because it offered a very felicitous conjunction of short- and longer-term economic management — fighting inflation and a current account surplus in the short term while improving long-term resource allocation.<sup>7</sup> In some ways the establishment of the IAC during the first period of reform looks forward to the second. It sought to make the process of assistance reform more systematic and strategically coherent — and an end in itself. The IAC was committed to 'industry-wide' advice on industry assistance. But this agenda was continually frustrated. It was frustrated by the politics of assistance reform. But it was also frustrated by the narrowness of many of its terms of reference — razor blade manufacture for instance. And although the tariff review sought a much broader perspective it also faltered at the same hurdle. However widely one drew the net, any focus on one industry meant invidious comparisons with industries that were not under scrutiny. Rattigan was uneasy with the opportunism — the lack of system — behind the 25 percent tariff cut though he ultimately supported it.

Much of the reform earlier in the second period was also opportunistic in this sense. Thus the Accord was continually moulded to the macroeconomic circumstances prevailing and the floating of the dollar emerged from the mounting difficulties of managing the currency. As reform deepened, however, the institutions supporting it tended to be antipathetic to this kind of approach. For instance, later tariff reduction was pursued by precommitment to

gradual tariff reductions over relatively long timeframes. Whatever the strengths of such an approach, it clearly prevented tariff reduction being managed in harmony with shorter-term economic management considerations. However this was at a time when the volatility of the exchange rate created just such opportunities.<sup>8</sup>

One of the most critical differences between the earlier and later stages of economic reform was the prevailing economic circumstances and social mood. The economic circumstances of the earlier period were prosperous — until the recession of 1975 put paid to the political acceptability of reform for the best part of a decade. Mid-1970s reform was the last gasp of the Lucky Country with economic growth seemingly assured — it having continued with only minor interruptions for the previous 30 years. Not only did the mid-1970s macroeconomic policies embrace some of the worst excesses of 'vulgar Keynesianism', but values embodied in government rhetoric were more authentically in the spirit of Keynes himself.

It was optimistic, unappreciative of the economic virtues of the pre-Keynesian world like thrift, naïve about the economic and social dysfunction which could arise from expanding economic entitlements with inadequate reward for initiative, focused more upon the division of wealth rather than its generation and disdainful of the moral authority of business practice and leadership. Keynes had prophesied in 1928 that in two generations 'a point may soon be reached, much sooner perhaps than all of us are aware of, when absolute needs<sup>9</sup> can be satisfied in the sense that we prefer to devote our further energies to non-economic purposes' (Keynes 1931:326). Just one generation later Whitlam had argued that politics should be 'more concerned with the creation of opportunities than the imposition of restraints. Within our own nation we do not have to ration scarcity but plan abundance' (Whitlam 1985:184). That included pursuit of economic equity, enhanced opportunity and quality of life for those who were not wealthy, improving human relationships and celebrating the arts.

During the mid-1980s stagflation had undermined confidence in vulgar Keynesian solutions and two global recessions and our own poor economic management had seen a range of intractable economic imbalances emerge in our economy. These included persistent infla-

tion, budget deficits, unemployment, poor profitability and investment. Further the Fraser government had notoriously failed to practise what it preached about both micro- and macro-economic policy. Its performance restraining government expenditure and reducing government deficits and in improving microeconomic efficiency had been quite poor. It bequeathed to its successor government a world-weary Treasury hungry for reform and able to articulate a coherent and wide-ranging reform agenda.

Not only was the Australian economy performing poorly. Our performance was mocked by the performance of countries in our region, which seemed to embrace the more 'dismal' virtues of the dismal science — thrift, hard work, low taxes, with social and economic resources directed towards wealth generation and export development rather than social support. With the exception of Hong Kong, all intervened in industrial development — but this was in vigorous pursuit of new export industries, rather than a political sop to preserve those which served the domestic market.

Our poor performance, these invidious comparisons and the forces of globalisation (intensifying competition in goods and capital markets from developing countries) all supported the development of a rhetoric which focused on making the necessary sacrifices to restore our international competitiveness.<sup>10</sup> One response to this situation was the prices and incomes Accord with its rhetoric of sacrifice socially chosen and fairly shared throughout the community. The corporatism of the Accord was also the foundation of the massive expansion of compulsory occupational superannuation.

Beyond this, and as the second reform period wore on, the corporatism of the Accord atrophied, leaving deregulation and freeing up market forces as a pervasive and dominant leitmotif of government policy. This transition was supported by a rhetoric which Margaret Thatcher made famous. There was no alternative to freer markets — we must embrace the international market or be overrun by others who were already doing so. Paul Keating boasted of 'wearing the hair shirt' (a less 'Keynesian' image it is hard to imagine). The action of market forces, both domestic and global, would discipline the indulgence to which the Lucky Country had become used and in so doing gradually turn round our economic fortunes.

In this context economic reform took on the shape of a comprehensive program which left virtually no economic structure untouched. Virtually all government activity was subjected to the same kind of protocol:

1. If government activity is not necessary privatise or deregulate.
2. If it is necessary can we pursue the following options?
  - User pays and/or the introduction of more transparent means of accounting for community service activity of government agencies.
  - The separation of regulation from service delivery.
  - The separation of purchasing and provision of services.

Even where there was little withdrawal of government — as in the case of policy advice by government departments, and the delivery of education and health services — a variety of administrative innovations were introduced to improve the flexibility with which publicly funded institutions operated. The language of the market often came to displace more time honoured terminology. From the 1990s onwards, students at university were also customers, the minutes of advice government departments supplied their ministers became 'outputs'.

Particularly at times of heightened crisis such as 1986 government expenditure was pared back with unprecedented vigour. Closing some of the less defensible tax loopholes for the wealthy with fringe benefits and capital gains taxation, greater means testing of pensions as well as increased funding to family payments later in the 1980s helped to address growing disparities of income and wealth by now emerging in the market.<sup>11</sup>

Ironically, economic reformers have not been able to carry the populace with them on their triumphant journey. The public was suspicious of economic reform when it began, and remain actively hostile to this day. It is interesting to speculate why economic reform has quite such a poor public image. Since the 1960s, Australian economic reformers have seen themselves as seeking to capture the small benefits which liberalising markets can bring to the many, at the expense of the concentrated benefits which protection was bringing the few. The actual mechanism by which free trade and

many other deregulatory strategies bring their benefits can only be demonstrated to someone prepared to engage in a small degree of abstract thought. Even at the best of times, that makes reform a hard political sell. Indeed the human brain seems hard-wired against this kind of abstract economic thought. No matter how hard its apologists insist that the ‘level playing field’ they seek is a *domestic* level playing field in which the most successful enterprises prosper, there seems to be no way to extinguish the notion that Australia embraced unilateral trade liberalisation out of a Quixotic altruism — out of a preparedness to lay our markets bare to foreigners while they refused to reciprocate such generosity.

This natural hostility to free markets within what David Henderson has called the “‘do-it-yourself’ economics’ of everyman is a template onto which is poured a range of additional anxieties. In addition to simple xenophobic reflexes, the practitioner of ‘do-it-yourself’ economics despairs how we could ever compete against countries as poor as Indonesia or as rich as America.

Economic reform has also been a good scapegoat. Strong productivity growth has been stripping labour out of manufacturing for generations, our appetite for manufactures is growing more slowly than our appetite for services and manufacturing is also highly traded, making it a theatre for the forces of globalisation to play out. This means that job growth in Australian manufacturing is naturally much lower than it is in services. This is particularly the case in areas where protection has been particularly high such as clothing manufacture. Both episodes of tariff reduction have also preceded severe recessions. In addition the 25 percent tariff cut of 1973 coincided with equal pay for women and preceded a massive wage explosion. Tariff cuts were an easy, but mostly unfair, target in these circumstances.

This is not to deny that both major recessions were also the product, to a substantial extent at least, of bad management, and often bad management by the same advisers and departments who were prosecuting the campaign for freer markets. Economic reformers like the politicians who buy their message are also policy combatants — playing the game as hard as any in their respective trades. It is natural

and reasonable in such an environment that their errors and sometimes their hubris are looked upon unkindly by the community. If all this — as it should be — sobering to economic reformers, the silver lining in the cloud is that it shows just how much economic reformers have overcome. The triumph of economic reform, despite its unpopularity in the community, demonstrates the remarkable power and influence an elite can acquire for itself if it possesses a simple and compelling vision of what is wrong and how to put it right.

### The Problems of Success for Economic Reform

Today the problems of economic reform are the problems of success. This is so in at least three respects. First, economic reform is encountering diminishing marginal economic returns. Of course numerous indefensible and inefficient impediments to free markets continue to exist. Some of them may continue to have important productive consequences. But a great deal of the reform which we might today judge appropriate for the economy that Max Corden was commenting on in 1968 has either been implemented or we are in the process of trying to implement it.

We have moved from ‘stroke of the pen’ deregulation as in the case of the freeing of trade, financial controls and shopping hours, into areas where the trade-offs are always difficult. Competition policy is perhaps the best example as we grapple with the competing demands of efficient pricing, incentives for investment and productive and allocative efficiency in providing and accessing natural monopoly facilities. There are no easy answers, and the best results are as likely to come from the quality of execution of policies as they are from further refinement of policy.

Second, the triumph of economic reform takes place within the larger context of diminishing returns to economic wealth — a point that was better appreciated in the first stage of economic reform than the second. Despite the controversy which the issue has generated in economic methodology, the diminishing marginal returns to wealth seem as robust a psychological and behavioural reality as any of the other assumptions on which economic theory is based.<sup>12</sup> And they are a source of

considerable contemporary comment (Ekersley 2000). As we've been getting richer, how come we don't seem to get happier — or if the suicide rate is anything to go by, maybe we're getting unhappier?

Third, there is the cultural matter of the moral authority of economic reform. At its best the spirit of reform which goes back at least to Adam Smith has prospered as a force which has been subversive of established privilege. As argued above, economic reform grew through the 1960s as a critique of the privileges enjoyed by special interests — particularly industrialists and farmers — on behalf of those less privileged.

The later deregulationist reform is often perceived by the community as being done on behalf of the rich and powerful and as being unsympathetic to economic 'losers' in contemporary society. As we suggest below, this is not entirely fair. Social welfare expenditure has become much better targeted to those most in need. Nevertheless at a time when economic rewards have been growing powerfully more unequal, and corporate leaders have been exploiting their 'insider' status within large firms to extract large rents, it is hardly surprising that many will be suspicious of more fully embracing the market. Although economic reform is popularly blamed for growing inequalities of market incomes, much of the increasing disparity of market incomes in Australia has been due to changes which would have occurred within markets with or without market liberalisation. Obvious candidates have been the increasing importance of technology which increases returns to those who develop and run it and diminishes returns to those whose jobs it displaces. Within this context rewards to intellectual property have soared including rewards to 'stars' of entertainment, sport and business management.

Other things being equal, the reduction of the top marginal income tax rate and trade liberalisation would have increased disparities of income in Australia.<sup>13</sup> On the other hand the latter reform would have done so at the same time as improving returns to those in countries with much lower per capita incomes than Australia. And both policies must be balanced against a range of policies by which economic reform has promoted equity including bringing capital gains and fringe benefits within the tax

net, reducing 'middle class welfare' and increasing family payments targeted to low income households (Johnson, Manning and Hellwig 1995).

Be that as it may, there seems little reason to believe that market inequities will lessen — indeed they may well continue to increase. And globalisation and the increasing commercialisation of life will continue to generate the social anxieties expressed in the anti-globalisation movements of today. In these circumstances, the time is surely ripe to explore ways in which, armed with some simple economic ideas, we might be able to improve economic outcomes with light-handed interventions. This is particularly so where such policies help redistribute privilege from those that have more of it to those who have less.

### Markets for Information in Theory

At least in theory, there are strong reasons why profit-driven markets for knowledge fall short of an imaginable optimum. Theoretically the main sources for failure in the market for information arise from the non-rival nature of a lot of knowledge. Information is not destroyed in its consumption. It can be passed onto others *ad infinitum* at zero or near-zero cost. It is also often difficult to exclude others from the fruits of one's discovery. The discoverer can't charge anyone else for the information.

In theory we would like to see knowledge and information circulating through the community at the marginal cost of its consumption — which is frequently too low to fund its creation. As a naïve exercise in theory, the optimum policy then involves governments taxing the community to generate knowledge which is then distributed at the marginal cost of its dissemination. But this will usually be too crude an analysis to be useful.

Governments may have a major role to play in subsidising and directly funding research and the production of new knowledge. And once funded it makes sense for such knowledge to circulate freely.<sup>14</sup> But the generation and dissemination of new knowledge is an exceptionally difficult economic problem. It involves formidable challenges in the management of risk, linkages between multiple producers and consumers and a panoply of principal agent problems. This looks like a job for a complex

commercial ecology of different specialised actors capable of improvising, experimenting, failing and succeeding. On the other hand profit seeking will generally give those who have generated or who are custodians of knowledge — those selling goods and services — incentives to mislead consumers at the very least by omissions of various kinds if not more actively.

If we take a commonsensical look at information in markets, we can see quite a few of the kinds of failures that these theoretical considerations suggest and perhaps some others besides. It should lead us to thinking whether there are light-handed interventions that can help markets generate and disseminate more and better information.

### Markets for Information in Practice

Certainly there is a great deal of information about products and services in markets. Advertising and other kinds of direct marketing and sponsorship generate around \$20 billion in revenue or around 3 percent of GDP.<sup>15</sup> But whatever its merits, with the possible exception of classified advertising, most people would not regard most of this as high-quality product information or as a cost-effective way of circulating it.

If one wanted to know which of the cars on the road was safest and in which ways, there is plenty of ‘spin’ in glossy magazines and TV ads, but it is not such an easy job to obtain the best unbiased information. If one wanted to know which had the least consumer complaints and faults, which generated the highest customer satisfaction, it would be harder still to find out. This is despite the expenditure of tens of millions of dollars on advertising by each of the major automotive brands.

Now what about some other things which are probably more important in our lives? Let’s say I am considering a job in a workplace. The various firms to which I intend to apply all say that ‘their people are their greatest asset’. But I want to know which firms mean it. I want to know which have the best morale, best reputation for developing their people’s skills and the best occupational health and safety record.

I am visiting the hospitals and specialists of the land trying to find which would provide the best treatment for some difficult health problem. Apart from some fragmentary advice I might

get by word of mouth about the reputation of certain institutions, and my impressions upon visiting them, I have virtually nothing to go on. How many people have they killed by accident and other medical misadventure? And how would I assess the answer even if I knew?

It seems unlikely that ‘government intervention’ in any traditional or heavy-handed sense is likely to achieve much in this regard. But collective institutions and policies, which represent interests beyond those of the providers of goods and services, could surely play a useful role in fostering the generation and dissemination of information within markets.

### Some Ideas for Improvement

Let us take the example I have used of a person wanting information about the quality of a workplace. Some important information is already available, but not widely disseminated as part of a conscious strategy. Most workers’ compensation schemes keep very useful information about the occupational health and safety performance of firms.

The workers’ compensation insurance premium compared with that of other firms in the same industry would function as a worthwhile proxy for a firm’s occupational health and safety performance for current and prospective employees. It would improve the efficiency of the labour market to widely publicise it in a way that was readily comprehensible.

Of course by ‘efficiency of the labour market’ much more is meant than its capacity to generate jobs. I mean the capacity to provide what people are looking for from employment — one aspect of which is safety. And of course, this is not a static thing. One would hope and expect that this would help intensify the pressures on managers to improve their firms’ occupational health and safety performance.

There is a range of other problems in workplaces that we struggle to deal with effectively. Contemporary issues include basic issues of respect for employees, helping to develop their skills, and also recognition for other aspects of their lives. There is considerable community anxiety about the disparity of work effort, with what appears to be increasing over-work by elite employees, and an increasingly underemployed



group of less-skilled workers.

Directly regulating solutions to these problems may have its place, but I must confess to the sceptical prejudices of my discipline for the efficacy of some proposed solutions such as the French approach to reducing excessive working hours, complete with working hours inspectors. On the other hand, shining the light of information on the area may do quite a lot of good while risking very little harm.

If I were considering working for a firm, I would be particularly interested in a properly conducted survey of other employees' experiences with and opinion of this firm in this regard, together with some information which would allow useful comparisons between different firms. It seems likely that the efficiency of the labour market, in the broadest sense in which I am considering it, would be improved substantially if such measures were generally available.

These principles of generation and dissemination of information can be applied widely. It would be quite easy to require all stockbrokers to maintain either real or 'virtual' portfolios of investments in the areas they claim expertise. The only rule would be of course that any decisions they made would have to be made in 'real time'. The portfolio might then be monitored for performance with respect to short- and longer-term returns, volatility and any other indicators of interest. Most if not all of the software already exists to enable this to be done on the Internet at close to zero marginal cost.

Over time a publicly available indicator of performance would build up. Of course it would not be a perfect indicator of performance, but it would likely be much better than the informal measures of reputation and word of mouth that are all most investors can go on today. Even if it were not better than the informal measures, it would be a very valuable complement.

In fact with some trouble — and possible expense — these measures can generally be obtained for the performance of unit trusts. But they are not straightforward to get — and are quoted highly selectively in the advertising and marketing of the funds themselves. Reporting on past performance is now required in prospectuses and the like, but objective comparative reporting and attention to ensuring better dissemination would improve things.

## Prognostic Information

All the measures mentioned above are backward looking. They report either on how things have been in the recent past, or are perceived to be at present. It is also possible to use the kinds of systems proposed in the previous section as a platform for generating predictive information.

Imagine visiting several healthcare institutions seeking treatment for some serious ailment. What one requires is an unbiased estimate of the likely prognosis of proceeding with that institution. Here is a quite simple system which will approximate such an outcome. Each healthcare institution approached is required to provide some kind of probabilistic prognosis. For instance, in the case of cancer, some set of chances of the patient being alive in one year and five years, or, in the case of a particular disease or infection, the speed at which various recovery milestones can be expected to be reached.

If the patient is relying on the relative optimism of different institutions' prognoses there is an obvious problem. The institutions 'bidding' for the particular case have the same incentive real estate agents have in quoting to sell a house. They can provide over-optimistic quotes with a more sober appraisal being provided after the business is secured.

To control for this bias one needs a measure of the extent to which the particular institution in question was systematically optimistic or pessimistic. Such a measure could be constructed from the optimism or pessimism of past predictions — measured against actual outcomes in the past. If such information were built into the medical system, medical institutions could compete on as close as possible to a 'level playing field'. One could then seek out the medical provider with the highest expected success rate — taking into account their prognosis in one's own case corrected for any previous optimistic or pessimistic bias.

One could raise various objections to the example I have proposed, and I'm not sure that we should be trying to head too rapidly towards a 'pure' form of the system proposed. But the example provided should surely be suggestive of possibilities for substantial improvements in information about the output of markets. And of course improved information about which

healthcare providers are providing superior outcomes could dramatically improve what matters most — the health outcomes of those systems. The better institutions would get more patients, and the worse ones would face strong pressure — from both the market and the broader community — to improve.

Certainly it should be possible to ‘benchmark’ and publicise the success or otherwise of medical institutions’ treatment of similar cases which are already for the most part arranged neatly into diagnostically related groups for management and funding purposes. And it should be possible to do so in a way that does not pervert incentives within those systems. Generally this will require the involvement of independent agencies either in the collection or selective auditing of data. These principles can be extended elsewhere. Company directors and company management regularly make forecasts. Those forecasts can be monitored in an ongoing way, with individual managers, directors and boards rated according to the extent to which their forecasts were accurate, and/or systematically optimistic or pessimistic. The incentives generated would clearly encourage more thoroughgoing efforts at truthful prediction.

### A Sketch of the Necessary Institutions

Having outlined some examples one can generalise a little about them. We need to decide what information we need to improve the functioning of markets and then how best to generate, present and disseminate it.

A first pass at the principles involved is as follows:

- There should be some group of people involving the ultimate consumers of the information — including some consumers of the information with some expertise in the service being measured. Producers of the product or service should also be involved — but should not dominate — these processes. This group or committee would operate at the ‘industry’ level.
- The committee should specify what things should be measured. This should not start out with a ‘wish list’ but focus on a few parameters judged paramount. As experience develops information will also develop about where to draw the line between what

additional information would improve the efficiency of the market, and what would impose costs incommensurate with benefits.

- Providing it does not compromise its integrity, information should be produced in the least-cost way. In particular it will often be possible to get those entities measured by the system to self-assess subject to audit and penalties for abuse.
- The information should be presented in ways that promote its effective and accurate use. Often this will involve the reducing of performance to certain simple representative indices.<sup>16</sup> It will often be appropriate to mandate that this information be made available to people when they are in the process of making a decision to use a particular service or product.

### Potential Problems

One of the economists’ stock in trade in analysing the shortcomings of apparently attractive proposals is the ‘second round’ effect. We need to ask how the ideas proposed here might affect behaviour in the long run. If they affect behaviour adversely, can we devise effective countermeasures against the problems, or are the problems sufficiently serious that we should ditch the ideas? Some of the proposals set out above do create risks of adverse ‘second-order’ effects or at the very least feedback effects which could dilute the benefits claimed for them. Thus for instance, if as envisaged, firms compete on the basis of customer and/or employee satisfaction ratings, this gives them an incentive not just to improve their own performance but to undermine the measured performance of others. Thus a firm could initiate bogus complaints against its competitors to reduce their customer satisfaction rating.

One might seek to guard against this in a range of ways. One could impose civil sanctions against such conduct when detected, and one could subject complaints as well as positive customer satisfaction claims to some random auditing. Alternatively one could ensure that the process of sampling was independent — either by being managed or scrutinised independently of the agency whose performance was being measured. In addition one could ensure that information we already have which has been through some independent process of

verification — such as an ombudsman or independent dispute resolution process or workers' compensation risk-rated premiums — is disseminated more widely and in a simple, understandable form.

If we take the example of medical services used above, it could be argued that providers will try to realise their predictions, which could work out badly where they have provided a poor prognosis. However, they will retain an incentive to outperform their own prognoses so that they acquire a reputation not only for high rates of success, but for conservatism in their prognoses, making their prognoses — which become in effect 'bids' for work — all the more impressive when corrected for their past conservatism.

There are, however, a constellation of other possibilities. It is conceivable, but one would have thought unlikely, that providers of services will turn some consumers away if they perceive that they will generate poor customer satisfaction and so downgrade their reputation. This could be a serious problem for medical services — especially emergency services. However, it is well handled here by generating information against providers' prognoses before services are provided. In such circumstances, there is never an incentive to turn anyone away, only an incentive to downgrade the prognosis on admission.

Another kind of reaction one could imagine would be for hospitals forced to publish statistics about accident or success rates, to influence the way in which different events were categorised as accidents or successes. Again it should be possible to ensure that independent auditing processes are put in place to deal with this problem.<sup>17</sup>

Where workplaces are surveyed there are richer possibilities because of the conjoint interests of the firm and its employees. Employees may be reluctant to broadcast their poor satisfaction in working for their firm when they realise that it could harm its recruiting prospects or its profitability and so their own wages and/or job security. To the extent that this occurs, however, it is most likely to dilute the potential benefits. It is hard (though as with most such things not impossible) to see how the costs of such effects could outweigh the likely benefits of such systems.

Finally it needs to be kept in mind that many if not all measurements should be regarded as proxies for what we really want to measure. One of the things which makes medicine and

investment performance a good source of examples is their inherent measurability and the correspondence of the thing being measured with the outcome we wish to know about. Providing the measurements themselves have integrity, infection and survival rates are very relevant measures of the quality of clinical healthcare.

On the other hand a healthcare institution can influence the period a patient spends in hospital recuperating from a particular illness or operation by simply changing its discharge policies rather than effecting changes in the rate of recovery. Clearly it is imperative that those seeking to implement the agenda outlined here be sensitive to this point. The issue is of considerable significance in other areas. For instance the current enthusiasm for quantitative assessment of academic output according to publications and citation records has brought its share of dysfunction to the difficult task of assessing the quality of academic output.

A related objection is that the very act of measuring some things does not only raise the scope for perverse incentives to be generated, but is a critical ethical or practical consideration itself. It might not be appropriate to provide a clinically accurate prognosis to a terminal cancer patient, but this would be relatively easily handled by allowing prognoses to be recorded without being divulged to patients in appropriate circumstances. The current enthusiasm for measuring educational outputs right down to Year 3 has undoubted benefits. But it also has costs of pedagogical and other kinds. We may accept the worth of exams as one reaches senior levels in school without accepting that nationally children in third grade should be subjected to a demanding exam and the invidiousness of ranking against others.

### **Excellence-driven Reform?**

One of the huge hidden costs of regulation is the way in which it directs effort almost exclusively towards raising the lowest standards of performance rather than improving performance across the board. To some extent this is both understandable and appropriate. It seems reasonable to assume that at least one of the most effective ways of improving occupational health and safety is to improve — or close down — the least-safe workplaces.

Yet in principle, if we want to improve occupational health and safety, we want more effort put into it *wherever* it yields the desired benefits, not just in the least safe workplaces. In the area of pollution and resource management tradable permits can address this issue admirably. Thus it is generally much more efficient to specify how much pollution is emitted, or irrigation water is consumed, or fish are caught in a region at a global level, and then let markets develop to sort out how best to meet the constraint. But it is much harder to see how this might be done in the area of safety in the workplace or the health system. Here some of the transparency mechanisms set out would provide evidence of which market participants were excelling. In such cases it might well be appropriate to exempt them, or to impose less stringent compliance standards for regulation which is devoted to ensuring that minimum standards are met. This would not only lower total costs. If the regulatory regime which would otherwise be imposed were costly for the regulated entities, it would be an incentive for the regulated entity to excel, rather than simply meet the minimum standards required.

### **Towards a ‘Post-rationalism’ for Economic Reform**

The strange and shifting age in which we find ourselves seems marked by its ‘post-ness’. In the absence of the positive enthusiasms of earlier times, like socialism or feminism, we inhabit a more ideologically modest world dominated by post-‘isms’. Ours is an age of post-modernism, post-feminism, post-colonialism and so on.

One might generalise that a post-ism is a state of affairs in which some new movement has won a substantial victory some large part of which is now generally accepted (either as desirable, or irreversible). On the other hand it is also recognised that the existing state of the new movement must be transcended if it is to remain a constructive and creative force for social progress. This is the stage we have reached in economic reform.

This article has argued that we might move to a new ‘post-rationalist’ stage of economic reform by continuing to use the resources provided us by the discipline of economics. But we can grow the agenda beyond that of the last two decades. At a time when ‘left’ and ‘right’

labels are losing their power and their meaning, we might be able to move towards a broader conception of economic reform. We can do so by embracing again the original spirit of economic reform — going back to Adam Smith. Economic reform could re-energise itself (once again) and re-emerge as a powerful force for social progress, using commonsensical ideas that emerge from an engagement between the discipline of economics and the social and economic problems of our time.

A range of other ideas are foreshadowed in Table 1 and elaboration will have to wait till another time. Nevertheless we might hazard some generalisations about the nature of the economic reforms of this third period based on the character of the reforms suggested in the second half of this article. The reforms of the third period of reform will:

- complement and take further rather than displace much of the economic reform to date;
- focus intervention not on prohibiting undesired activity but on managing markets to encourage and facilitate outstanding performance not least by ensuring that the market is well informed about the quality of performance of different actors in the market;<sup>18</sup>
- recognise that the quality of life is increasingly important;
- recognise that economic outputs are complex — that the output of a firm is not just the quality and quantity of the products it sells but the well-being and sense of human fulfilment of its employees and contractors;<sup>19</sup>
- embrace our own heritage as a country which has pursued economic reform as successfully as any — for all the imperfections and compromises involved in the process. In recognition of this we will be unafraid of pioneering policy innovations as we were for instance when we established the IAC and when we introduced income-contingent repayment of student loans.

How likely is this to happen? That is hard to predict. But whether or not the discipline of economics is the dismal science, there is nothing dismal about the extent to which economists and other professional policy-makers have helped to transform our economy — for the better. When reform started in 1973 Australia

Table 1

Dates	Institutions, Policies and Key Events	Changing Role of Government/Rhetoric
1966– 1974	25% tariff cut (1973) Establishment of Industry Assistance Commission (IAC) — and other commissions — including those to spend the money being saved elsewhere Coombs task force on government programs Removal of superphosphate bounty The oil shock and the end of the postwar boom Macroeconomic mismanagement and emergence of major imbalances	Vulgar Keynesian macroeconomic policies and Keynesian values Reordering Governmental Priorities Redistributive • from privileged to less privileged • from industry and farmers to social and cultural priorities Optimistic Subversive of privilege and wealth Opportunistic A chosen course
1983– 2001	Maintaining and extending existing reform gains: Floating the dollar Financial deregulation Period 2 Liberalising trade in troubled industries Later systematic tariff reform Corporatisation/Privatisation Contracting out	Corporatist attack on macroeconomic imbalances in wages and savings — corporatism atrophies by mid-1990s Restoring our damaged ‘competitiveness’ Embracing an inevitable future ‘There is no alternative to embracing globalisation’. Systematic rationalisation of respective role of governments and markets. The systematic freeing up and often commercialisation of previously more autonomous institutions — for instance the public service
2002– 2020	Maintaining and extending existing reform gains: Information and responsiveness of markets Responsiveness of governments and regulation Quality of inputs — particularly training and education Quality of outputs Broadening our conception of outputs — job and life satisfaction from jobs. Development of a philosophy of public (as well as private) enterprise. Development of a coherent philosophy of corporate social responsibility. Using economic principles to reform intellectual property law. International economic coordination. Strengthening integrity and effectiveness institutions — Auditor-General at the micro-level, RBA-type institution for fiscal policy. Taking utility seriously • Quality of life • Philanthropy • Medical and information technology • Social, economic, physical and intellectual disadvantage • Industry policy in search of utility spillovers — promoting knowledge and industry which alleviates distress	Enhancing the social and economic performance of our economic institutions Focus on actions — both regulatory and deregulatory — to improve micro- and macroeconomic and social outcomes. Australia has one of the most successful societies, economies and governmental structures in the world We can build on this foundation to do even better because: • we want the rewards, and • striving to be even better is profoundly satisfying — ask an Australian sportsman.

had suffered from a long steady decline in relative economic performance for the best part of a century. Today high levels of economic growth have become the norm, even when our trading partners are in trouble. There is nothing dismal about the number of jobs these changes have enabled us to generate or the way in which Australia's economic reformers have been able to show that 'ideas matter' in the battle for public policy. The continuing public hostility to worthwhile economic reforms — like tariff reform — shows that politics and public administration in Australia is not all about the battle of private interests or the pandering to populist prejudices — though they too play their inevitable and by no means entirely unhealthy role.

Now, as in the past, a clear conception of what the problems are, together with some compelling solutions, is a fine platform on which to be optimistic. A group of people thinking constructively and practically about our social and economic problems — using the simple, commonsensical tools of a long and useful tradition — might be able once again to shape the debate.

## Notes

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1. Many of these examples illustrate the way in which rationalising in the first sense of the word used above — sorting out roles and responsibilities — can lead to rationalising in the second sense — to paring back. More attentive specification of both the rationale for and nature of a government intervention can often be the prelude to some withdrawal of government activity. Once regulation and service delivery had been separated for telecommunications it became easier to privatise telecommunications service delivery. And the separation of purchasing and provision of services within government can facilitate greater competition and/or privatisation in service delivery at a later time.
  2. Thus for instance, in many ways Peter Walsh's reformism looked back to the earlier 'left of centre' reform of the mid-1970s in one respect. He was strongly supportive of income redistribution,

- opposing reductions in the top marginal rate of tax. On the other hand this was combined with an astringent opposition to government spending on 'trendy' causes and fiscal laxity more generally both of which had marked the first reform period.
3. Some might quibble with this arguing that protectionism is always a threat. But I would contend firstly that once industry assistance is funded through the budget — which virtually all new industry assistance since the 1980s has been — the scale of any potential misallocation of funds is massively reduced. Industry assistance costs around 1 percent of the Commonwealth budget — not enough to lead to any serious resource misallocation. Contrast this with the misallocation involved in even moderate tariff levels. Further tariffs are very unlikely to be increased in Australia in the foreseeable future.
  4. Like Ralph Nader and Paul Erlich.
  5. Some of the personnel even overlap. Thus for instance, early economic reformers like Alan Lloyd were involved in the conservationist struggle to save the Little Desert in Victoria (Libby 1998).
  6. The Coombs task force was established pursuant to a cabinet decision that 'action be set in train to apply a close scrutiny to continuing policies of the previous Government so that room may be found for our own higher priority programmes' (Freudenberg 1977:280).
  7. 'It was one of the few times when you had over-full employment, a current account surplus and foreign reserves which had risen dramatically ... I just happened to be in a position where I could whisper in the prince's ear that we should cut protection ... [S]ome people thought it was better to appreciate to bear down on inflation ... whereas it seemed to me there was an opportunity to do things that favoured both macro and micro objectives' (Fred Gruen on the 1973 25 per cent tariff cut in McTaggart *et al.* 1992:457–78).
  8. See, for example, Gruen (1990:38–39) proposing some joint consideration of short- and longer-term perspectives.
  9. 'Absolute' as opposed to our 'relative' needs — which were later christened by Fred Hirsh as 'positional goods'. Clearly as community wealth rises the value of 'positional goods' such as the most exclusive real estate rises with increased competition and limited supply. This provides benefits to the individual who goes on generating wealth beyond the point where his or her absolute needs are met, but it is a zero-sum game. One person's purchase of good real estate prevents others purchasing it.
  10. The notion of the international competitiveness of a country is intuitively appealing within the 'do-it-yourself economics' of everyman but is essentially incoherent within an orthodox economic frame-

work. But it usefully captures the essence of the economic response which was sought — some reduction in domestic incomes relative to domestic productivity to be achieved by some combination of future incomes and productivity.

11. Other changes would have exacerbated inequalities — see the following section.
12. The evidence is not just the introspection which is taboo for some economists. It is objectively demonstrated every time a person or firm takes out insurance or adopts some other non-costless strategy to reduce risk.
13. Labour market deregulation is also likely to have facilitated increased disparities of wage and salary income though it would also have brought others into the workforce, reducing poverty and welfare dependence.
14. Classic examples would seem to be meteorological information and government statistics. (This latter observation is not intended as a comment on recent policies for ‘cost recovery’ from the Australian Bureau of Statistics. There are clearly some benefits from such a policy in generating demand signals, but there are also substantial costs — particularly given the poor funding of academics who add huge value to the information.)
15. Productivity Commission (2000:129). The ratio of advertising/direct promotion to GDP is probably an overestimate, as the numerator is a turnover figure while the denominator is a value-added figure.
16. For instance:
  - Fund management: Total return and volatility of actual or sample ‘real time’ portfolios.
  - Educational institutions: Scholastic performance corrected for expected scholastic performance given the socioeconomic background of students and ‘catchment’ area.
  - Hospitals: Accident rates, success rates as measured by a variety of accepted benchmarks by diagnostic related groups.
  - Cars: Statistical measures of primary and secondary safety (ie likelihood of being in an accident and degree of injury if involved in an accident), fuel economy, security against theft. The Industry Commission recommended such a rating scheme .
  - Some standardised measures of performance relating to consumers and employees. For the former one would seek simple customer satisfaction data; for the latter accident rates, employee satisfaction and ‘family friendliness’.
17. Given the current enthusiasm for comparative data collection and ‘benchmarking’, this is a very serious issue already. In the time I spent involved in the Report on Government Services while at the Productivity Commission I was dismayed on occasion to see that what seemed to me to be

inadequate attention was being paid to two critical issues. The first was the integrity of data — and the degree to which it was subject to independent audit. The second was the scope for the measurement of performance indicators to generate perverse incentives. This is discussed at the end of the current section.

18. This is not to suggest that the state withdraws from all prohibitions on conduct, but rather that it strengthen markets’ ‘natural defences’ against shoddy conduct with better information and education. Given this, a range of overly prescriptive regulation could be wound back at least for those who were continuing to demonstrate superior performance (see previous section).
19. Quite obviously there are plenty of other determinants of well-being and fulfilment — most importantly the efforts of employees themselves. No suggestion is being made that workplaces must regard it as their primary function to provide their employees with fulfilment, only that the more we can get them to compete to do so, the more likely we are to further the cause of human fulfilment.

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