Economic Rationalism: Social Philosophy Masquerading as Economic Science

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6.1 Introduction

Future economic historians will note three major themes in economic policy in Australia in the last quarter of the 20th century. They are deregulation of the financial system, privatisation and microeconomic reform. The last includes a range of measures including tariff reductions, taxation reform and changes to Australia’s traditional and unique labour market institutions. In all three cases great changes were made in the 1980s and the 1990s. The financial system was transformed. The exchange rate was floated and exchange controls abolished. There were mergers among Australia’s large banks, building societies transformed themselves into banks, foreign banks entered the Australian retail banking market. There were also important technical changes which altered the way monetary policy was conducted and put great weight on interest rate changes as the major instrument of monetary policy. Both federal and state governments engaged in what seemed like an orgy of privatisation. Government enterprises, that were sold to the private sector including overseas buyers, included institutions that had previously been icons of pride in public assets such as Qantas and the Commonwealth Bank. They also included state banks originally set up to help rural Australia. In the name of microeconomic reform tariffs were drastically reduced. There was almost continual discussion of taxation reform, with the introduction of major changes, such as dividend imputation, fringe benefits tax and capital gains tax. The award system was shifted from centre stage in the wage fixing process and enterprise bargaining encouraged.

The election of the Howard Government made change even more wide ranging. The Accord, the major exception to the policy trend, was immediately abandoned and enterprise bargaining given a boost. The first stage of

the privatisation of Telstra passed through the Senate and one of the first acts of the Howard Government was to set up yet another inquiry into the financial system.

All these changes were the visible result of the ascendancy among both politicians and bureaucrats of the ideology known as economic rationalism in Australia and market liberalism in other English speaking countries. The term economic rationalism has become a catch-all term of abuse in some circles, but since it is so influential it is important to realise what its tenets actually are. Economic rationalism is not a very tightly knit school of thought but it has an essential core which is outlined in section 2 of this chapter.

The success of economic rationalism has been remarkable, with many previously held verities turned on their heads. This is not the result of advances or of new discoveries in economic theory. All around the world there was a deliberate political campaign to change the prevailing political ideology to that held by economic rationalists. This is spelt out in section 3 below.

One of the tricks of many economic rationalists is to present their policy recommendations as no more than the logical consequences of orthodox economics. This is very far from the case. Section 4 in this paper shows that the policy prescriptions of economic rationalism depend more on the values held by economic rationalists than on the theorems of economics. In any case orthodox economics is very clear that policy recommendations must rest on both economic analysis and a set of values.

The changes resulting from the implementation of economic rationalist policies were very widespread. However, the most important was the loss of full employment as a goal of public policy. The unemployment rate rose from an average of 2.0 per cent over the five years ending in 1974 to an average of 9.4 per cent over the five years to 1994. Economic rationalism was not the only cause of this increase in unemployment but it certainly contributed to it in ways which are discussed in section 5. The most important, is the abandonment of a commitment by government to maintain or restore full employment. The Howard Government has an explicit quantitative target for low inflation. It has no quantitative goal for reducing unemployment. Economic rationalism has reversed the priorities of the ideology it replaced.

### 6.2 The Definition of an Economic Rationalist

Non-economists tend to define economic rationalism in far too sweeping a fashion. For example, Battin, a political scientist, maintains that the key tenet of economic rationalism is “the belief that the market is the only legitimate allocator of goods and services in society at large not just in the economy” (1991, p.296, emphasis in the original). I know of no economist who believes this or even believes that the unfettered market is the only