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HOW REGULATION AND RED TAPE MAKES FAMILIES POORER

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About the author

Daniel Wild is a Research Fellow at the Institute of Public Affairs. He specialises in red tape, regulation, economic policy, the philosophy of free enterprise, and criminal justice. Daniel has authored research papers on economic policy, environmental regulation, and criminal justice reform. Daniel frequently appears in the media, and has published a number of opinion pieces in The Australian, The Daily Telegraph, The Sydney Morning Herald, The Courier Mail, and The Spectator. Daniel has also made a number of radio and television appearances, including on 2GB, 3AW, Sky News, and Channel 7 News.

Daniel previously worked at the Commonwealth Department of the Prime Minister and Cabinet where he analysed global and domestic macroeconomic policy. Prior to that he worked at the Commonwealth Department of Finance where he worked on regulatory reform. Daniel holds an honours qualification in economics and a degree in international studies from the University of Adelaide.

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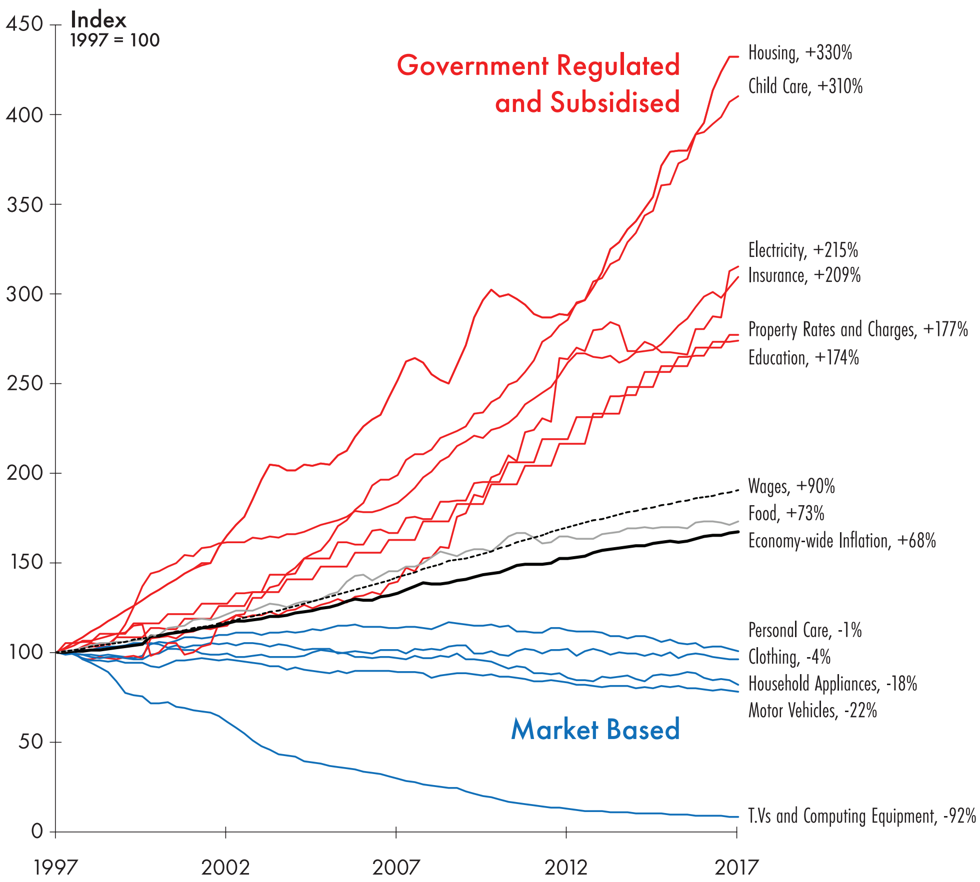
Executive Summary

- Over the past two decades prices have been rising rapidly in some sectors while declining in others, compared with inflation and wages. The purpose of this paper is to analyse what the key factors are that explain these price patterns. In doing so this paper analyses a number of sectors which are key household expenditure items and investigates what factors are driving increases or decreases to prices.
- This paper finds that there are a range of factors pushing prices either up or down, such as the prevalence of international trade, how labour-intensive an industry is, and the changing nature of consumer preferences.
- However, the main finding, shown in Chart 1, is that prices have been rising most rapidly in industries which feature high levels of government intervention through regulation and subsidies. Conversely, prices have been falling in market-based industries which feature limited government intervention and openness to international trade and competition.

Chart 1: Price Changes in Highly Regulated Versus Market Based Sectors[1]



1 All data is in nominal terms for purposes of comparison between price changes in relevant sectors and wages and economy-wide inflation. The reason these items have been selected is that they are a large and growing component of overall household expenditure.

Note: Food is in grey because it is a mix of government regulated and market-based.

- The cost of essential household services, such as education, housing, insurance, child care, and electricity, have grown rapidly over the past two decades. Over the past twenty years, the cost of the following services has increased:
    - » Housing +330 per cent.
    - » Child care +310 per cent.
    - » Electricity +215 per cent.
    - » General insurance +209 per cent.
    - » Education + 174 per cent.
    - » Property rates and charges + 177 per cent.
- Prices in these sectors have increased much faster than the economy wide inflation rate of 68 per cent. Prices have also grown much faster than average wages, which have grown by 90 per cent over the past twenty years.
- This paper finds that the primary cause of rising prices is government intervention through a combination of regulation and subsidies.
- Regulation causes cost-push inflation by increasing business operating costs, reducing market supply, and reducing competition.
- Subsidies cause demand-pull inflation by inflating demand for services above what would prevail in a market-based setting.
- The coincidence of regulation and subsidies leads to a price spiral: supply restrictions push up prices which governments respond to with higher subsidies, which in turn further pushes up prices.
- In some sectors, prices have been rising even as quality has been declining. For example, electricity has become less reliable and more intermittent over the past twenty years, while education results in schools has been declining.
- While prices have been rising rapidly in sectors which are heavily regulated by the government, they have been falling in other sectors. The prices in the following sectors have decreased over the past two decades:
    - » T.V.'s and computing – 92%.
    - » Motor vehicles – 22%.
    - » Household appliances - 18%.
    - » Clothing -4%.
    - » Personal care -1%.
- The price of these services has been decreasing even as their quality has been increasing.
- Prices in these sectors are declining because, a) they are less regulated, b) the government does not provide subsidies, and, c) these sectors are open to international trade.
- In order to alleviate cost pressure governments should deregulate the child care, education, health care, insurance, and electricity markets and remove subsidies.

Introduction[2]

Australian families are working harder than ever before, but many are struggling to meet the financial and time demands of modern life. This year the Commonwealth, state, and local governments will confiscate a record $540 billion in taxes, approximately 30 per cent of GDP, from Australian workers, families, and businesses. At the same time real income growth has been stagnant in the private sector for the past two years. Adding further pressures to household budgets has been a rapid growth in the cost of key household essentials, such as electricity, insurance, education, housing, and child care.

Over the past two decades the price of housing has risen by 330 per cent, child care by 310 per cent, electricity by 215 per cent, general insurance by 209 per cent, and education by 174 per cent. This is compared with an average price rise across the economy of 68 per cent and an average increase to wages of 90 per cent.

There is a substantial body of evidence demonstrating that government intervention is a key cause of rapidly rising prices in a number of sectors. Government intervention causes prices to rise through both what economists describe as cost-push and demand-pull inflation. Cost-push inflation is driven by regulation. Regulation increases costs in two key ways. Firstly, it adds to the cost of providing a given good or service. This extra cost is passed on to consumers, in full or in part, as higher prices or fees. Secondly, regulation makes it more expensive to start a business. This increases the barriers to market entry which reduces competition. Markets which are less competitive are less responsive to the needs and preferences of consumes. Consequently, less competitive markets feature higher prices and lower quality services than more competitive markets.

At the same time, governments provide extensive subsidises to consumers in the markets listed above. This increases demand which causes demand-pull inflation. In a market-based economy, higher demand causes prices to rise. Higher prices increase profits for incumbent businesses which, in turn, creates incentives for new businesses to enter the market. The entry of new businesses then puts downward pressure on prices, so that, over time, prices return to their long-run average. However, fewer new businesses are able to enter markets which are highly regulated. This means that government subsidies increase prices, and the bulk of the higher prices go to incumbent businesses. That is, the government effectively taxes families through constraints on market supply, and distributes this back to business owners in the health, education, child care, and insurance sectors.

There are also associated economy-wide efficiency costs as families are forced to spend more money than what would prevail in a market-based economy on highly regulated services, and less on sectors which are less regulated. This results in an inefficiently large amount of resources going to heavily regulated sectors – causing them to grow in size – and an inefficiently low amount of resources flowing to less regulated, market-based sectors – causing those sectors to shrink in size.

There are a number of other causes of price increases in the aforementioned sectors, and not all of them are to do with government intervention. Nor can all such causes conveniently be defined as 'good' or 'bad'. Nor can all of these causes be resolved by changes to public policy. At least not without incurring other, perhaps less desirable, consequences. Economies are complicated. It

2 This paper takes inspiration from Perry, Mark, "Chart of the day: Price changes 1997 to 2007", American Enterprise Institute, (2018), http://www.aei.org/publication/chart-of-the-day-century-price-changes-1997-to-2017/

is not always easy or possible to understand the total range of root causes of changes to prices. A single decision made by someone living miles away can affect the price of coffee at a local café.

One such example of a relatively innocuous cause of prices increases is rising incomes. As incomes rise people become willing to pay more for a given good or service. This could, perhaps, just induce general inflation, rather than faster inflation of specific goods or services over others (education over computers, for example). However, people can become willing to spend more on one set of services over another at a faster rate than alternative goods or services as their income rises. For example, a family whose income rises rapidly may be prefer to spend a larger share of that rise on their children's education, rather than on more or better food. Other costs are also relatively capped. A mortgage, for example, is fixed for a long time even as income rises and so takes up a smaller share of income over time. Energy costs are similar: there are large fixed costs (i.e., to run the basics such as a fridge or lighting) but, beyond attending to those fixed costs, the marginal cost of, say, adding additional outdoor lighting, is fairly marginal.

The evidence supports hypothesis. Higher income households spend a smaller share of their income on energy and housing costs than lower income people, meaning the cost of these items does not rise linearly with income. According to the Australian Bureau of Statistics (ABS), low income households spend about 4 per cent of their gross weekly income on household energy costs, compared with about 2 per cent for middle income households, and 1 per cent for higher income households.[3] The ABS data could even understate the regressiveness of higher energy prices. For example, the *Finkel Review* into Australia's energy market, referencing the Australian Energy Regulator's 2016 Annual Report, argued that "a typical low income household spends around 4 to 9 per cent of its disposable household income on electricity bills."[4]

However, prices have not uniformly risen over the past two decades. In fact, prices have decreased in many sectors, in some cases significantly. The price of televisions and computing equipment have dropped by 92 per cent over the last two decades. At the same time the quality of these products, such as computing power, and sound and visual features, have increased dramatically. Similarly, the price of motor vehicles has decreased by 22 per cent, household appliances by 18 per cent, and clothing by 4 per cent.

There are three key reasons why prices have fallen in these sectors. Firstly, businesses in these sectors are less regulated by government. This means the costs of starting a business are lower, barriers to market entry are fewer, and competition is fiercer. Secondly, as government's do not control market supply, they also typically do not subsidise demand. This reduces demand-pull inflationary pressures. The third key ingredient is free trade. Free trade is a key mechanism to increase competition as it gives consumers access to products produced overseas, as well as those produced in Australia. This puts downward pressure on prices, as well as expanding choice and improving quality.

There are many reasons why market-based economies are superior to economies which feature substantial government intervention. One of these is the incentive problem. In an economy where governments confiscate a large share of profits or earnings, or interfere in the normal market process to favour self-interests (crony capitalism), the incentive to work hard, earn more income, and develop human capital is muted. The second is the information problem. Information about preferences, value, and commercial decisions is scattered across the community and society. It is

3 Australian Bureau of Statistics, 'Household Energy Consumption Survey, Australia: Summary of Results, 2012', Canberra, Australia, (October 2013)

4 Australian Government, 'Independent Review into the Future Security of the National Electricity Market', Canberra, Australia, (2017), pg. 144

not available at a central location to government officials. Market-based economies respond to, and aggregate, this information through voluntary transactions. The outcome of this aggregation is price formation.

Prices aggregate the information which is dispersed across societies, and fundamentally reflect relative resource scarcity. The price of an item may rise, for example, because of a surge in demand for that item (perhaps because of a new trend). The relative price rise of this item sends a signal to producers and suppliers that the value of that product, relative to other products, has risen. Those producers and suppliers then respond by directing more limited resources to the production of that item, and fewer resources to the production of other items. This allows a market-based economy to better satiate consumer preferences than alternative forms of economic organisation. In that sense, prices are an important signal that coordinate the actions of dispersed economic actors in a direction that is socially beneficial. Government distortions of price signals such as through regulation, distort this allocation process. Rather than prices reflecting underlying consumer demand, government intervention results in scarce economic resources following to political actors, and their favoured interest, rather than to everyday consumers and businesses. [5]

5 See Hayek, F.A, "The Use of Knowledge in Society", *The American Economic Review,* Volume XXXV, Number 4, (September 1945), and Hayek, F.A, "Prices and Production", Augustus M. Kelly Publishers, New York, (August, 1934)

Definitions

This section outlines how “highly regulated” and “market-based” are defined.

A highly regulated market is characterised by substantial government and regulatory oversight, and high barriers to market entry. Such markets are typically characterised by large degrees of market concentration with a small number of larger firms accounting for a substantial portion of total market share. It is difficult to obtain empirical evidence of how competitive markets are. Whilst market share can be a good proxy in some cases, it is incomplete: some markets, such as supermarkets, are highly concentrated yet highly competitive. Similarly, high degrees of market concentration can reflect the fact that those producers with a higher market share have outcompeted their rivals because they offer better products and services at lower prices.

However, one indicator of the extent of regulation in a market is whether governments directly regulate a given market or service, or instead rely on general regulatory provisions and the common law. Governments directly regulate, and in most cases either have a specific department or ministerial function, the services analysed in this paper. Each state government has an education department and education ministers. Governments regulate child care specifically and the Commonwealth government has an assistant minister responsible for Children and Families, while the previous labor government had a minister responsible for Early Childhood and Childcare. The government has specific regulation of general insurance through the Australian Prudential Regulation Authority (APRA). And all state governments, other than Tasmania, have a minister dedicated to housing matters (although this would be covered by the Building and Construction, and Planning and Local Government portfolios).

In a market-based sector, by contrast, businesses provide products and services in response to the demands and preferences of consumers, families, workers, and intermediary businesses. There is little direct regulation of these transactions, and limited government subsidisation of demand. Market-based sectors are characterised by extensive competition (both from domestic and foreign sources via trade), and low barriers to market entry. In lieu of direct regulation, market-based sectors are governed by general rules, such as the common law, contract law, “consumer protection” provisions, and unfair trading practices. There are rarely government departments, or ministers, dedicated to regulating such sectors specifically.

Sectoral Analysis

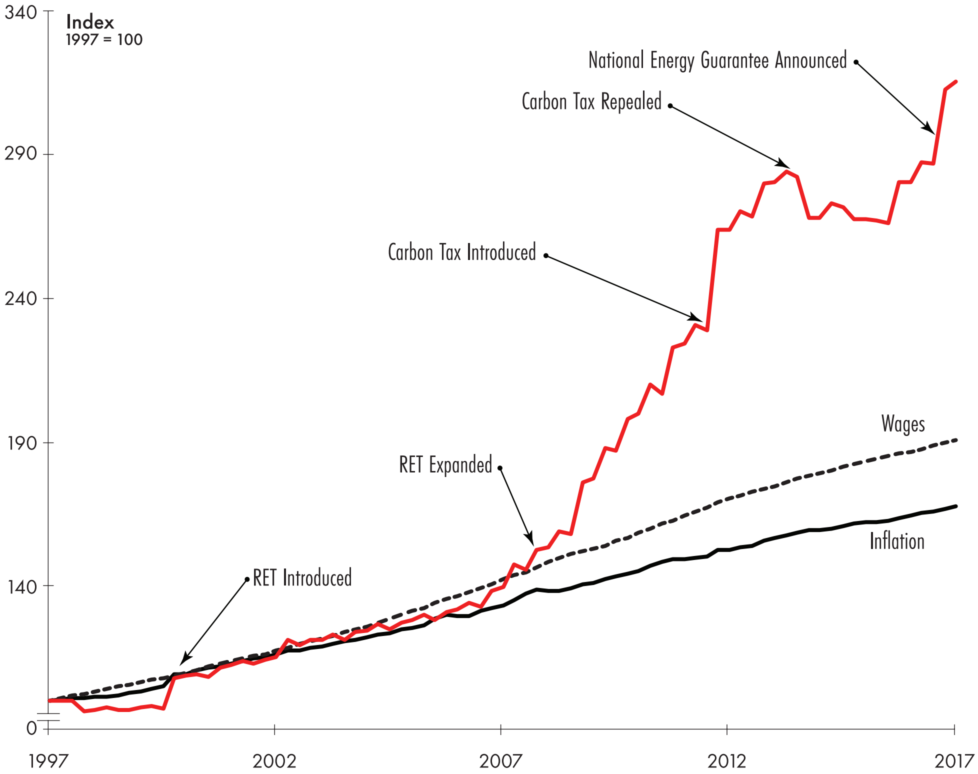
This section analyses the price changes outlined in Chart 1 in more detail by analysing each sector which has experienced price rises - electricity, education, child care, insurance, and housing, along with property rates and charges.[6] In doing so this section analyses the relationship between government intervention and price changes by investigating the key regulatory interventions in each sector. As always, there are a myriad of factors, other than just government intervention which are responsible for the observed price changes. These alternative factors are discussed in each section.

This section focuses on sectors where prices are increasing, rather than decreasing. There are two reasons for this. Firstly, each sector has unique regulation and so ought to be analysed separately, whereas the forces pushing prices down in other sectors are alike (free trade, low government regulation, and absence of subsidies). Secondly, and as discussed in the Introduction, price changes resulting from voluntary, market-based decision making are not a problem in and of itself – they merely reflect the aggregation of preferences across society for scarce resources and the relative value of the products and services which those resources are used for. Price rises emanating from government intervention, by contrast, distort the normal operation of the market process, reflect the superseding of political preferences for the individual preferences of Australians, and typically result in net costs to society, although provide concentrated benefits to certain interest groups.

6 Note: Unless otherwise specified, price data is from the Australian Bureau of Statistics, "Consumer Price Index, Australia, December 2017", Canberra, Australia, (2018), and wage data is from the Australian Bureau of Statistics, "Wage Price Index, Australia, December 2017", Canberra, Australia, (2018)

Electricity

Chart 2: Electricity



The average price of electricity across Australia has increased by 215 per cent over the past 20 years. This is 2.3 times the growth to average wages. Much of this increase has occurred over the past decade where prices have grown by 12.5 per cent per year on average, around six times the rate of wages growth.

There are a number of other factors which have, or may have, contributed, to rapidly rising electricity prices. State governments have been heavily involved in the electricity market through, for example, implementing their own renewable energy targets independent of federal government interference.[7] Network costs, charges, and upgrades – both from private enterprise decision making and via government edict – play a role in price rises. As do independent changes to supply and demand.

However, government intervention at the Commonwealth level is the key cause of rising electricity prices, through subsidisation of renewable energy over coal and gas, regulatory restrictions on coal and gas exploration, development, and production, and prohibitions on uranium use.

One of the main mechanisms governments have used to promote renewable energy is through a Renewable Energy Target (RET). RETs have been implemented at both the Commonwealth and state level, and by Coalition and Labor governments. In 2001 the Howard government

7 All Australian states and territories have a state-based renewable energy target other than Western Australia.

introduced the first Commonwealth level RET, which required 9,500 GWh of new renewable energy generation by 2010 (or around an extra 2% of total energy generation). As can be seen in Chart 2, this had a negligible impact on energy prices as the mandated percentage of renewable energy generation was around what would have prevailed under normal, market-based conditions.

In 2009 the Rudd government increased the RET to require 45,000 GWh extra energy to be generated from renewable sources by 2020 (then forecast to equate to 20 per cent of total energy generation). In 2011 the RET was split into two schemes: the Large-scale Renewable Energy Target (LRET) of 41,000 GWh for large energy generators (i.e., those designed to feed into the energy grid), and a Small-scale Renewable Energy Scheme for small household and commercial-scale generators, which was, and remains, uncapped. In 2015, the Abbott government reduced the LRET to 33,000 GWh, or around 24 per cent of the total energy generation by 2020.[8]

The Renewable Energy Target causes prices to increases through two mechanisms. Firstly, the RET forces energy retailers to acquire a certain percentage of their energy from renewable sources, as opposed to from coal or gas. The added cost of this is passed onto consumers as higher prices. Secondly, the RET forces extra energy supply regardless of demand. In the short-run this lowers wholesale prices. But by depressing revenue many coal-fired stations are forced to shut down or mothball, causing both a reduction to long-run supply and higher prices. ACIL Allen estimated that total energy prices for end-users would be approximately $30 billion higher over 2014-2030 as a result of the RET.[9]

Moreover, government intervention into the energy market has come at a substantial cost to taxpayers. In an address to the *Future of Energy Symposium* in February, 2018, Dr Allan Moran estimated that total greenhouse gas expenditures by state and Commonwealth governments reached $4.8 billion in 2016 alone.[10] Earlier analysis by Adam Creighton and Joe Kelly found the cumulative cost of 'green schemes' would reach $60 billion by 2030.[11]

On top of the direct subsidisation of renewable energy by governments are substantial regulatory impediments to coal exploration, development, and production. The exploration and production of coal is heavily regulated at both the state and federal level. Project proponents must meet a range of regulatory obligations and contend with a vast array of red tape. This has led to an imposing regulatory burden. For example:

- The Tads Corner Project, the first mining pit to ship coal from the Galilee Basin in Queensland, required more than 5,000 approvals, permits, and licenses for the pre-construction phase alone.[12]
- The Adani coal mine in central Queensland spent seven years in the approvals process, endured more than 10 legal challenges, and prepared a 22,000-page Environmental Impact Statement.[13]
- In a 2013 report the Productivity Commission gave the example of a project which was

8 The reason why a smaller amount of GWh equates to a larger percentage of total energy generation is that energy demand was far lower than forecast when the RET was originally expanded in 2009. For a further discussion of the problems with the RET, see, Wild, Daniel, "Five Reasons to Abolish the Renewable Energy Target", Institute of Public Affairs, Melbourne, Australia, (2017)

9 ACIL Allen, RET Review Modelling: Market Modelling of Various RET Policy Options, 2014. Analysis assumes all of the costs of the renewable energy certificates are passed on as higher energy prices.

10 Moran, Allan, "Address to the Future of Energy Symposium", Regulation Economics, Adelaide, (6 February, 2018)

11 Creighton, Adam and Kelly, Joe, "The cost of going green: taxpayers hit with a $60 billion power bill", *The Australian*, (1 September, 2017)

12 Rinehart, Gina, "The Emperor Fiddles While Rome Burns", Speech to the Global Natural Resources Conclave, (April 2017)

13 Department of State Development, "Carmichael Coal Mine and Rail Project Environmental Impact Assessment", Queensland Government, Brisbane, Queensland. Available at http://statedevelopment.qld.gov.au/assessments-and-approvals/ carmichaelcoal-mine-and-railproject.html

required to meet 1,500 government imposed primary conditions and 8,000 sub-conditions.[14]

- Legal challenges brought by green groups under section 487 of the Environment Protection and Biodiversity Conservation (EPBC) Act have resulted in project proponents spending some 20 cumulative years in court.[15]

All of these interventions reduce supply and put upward pressure on prices.

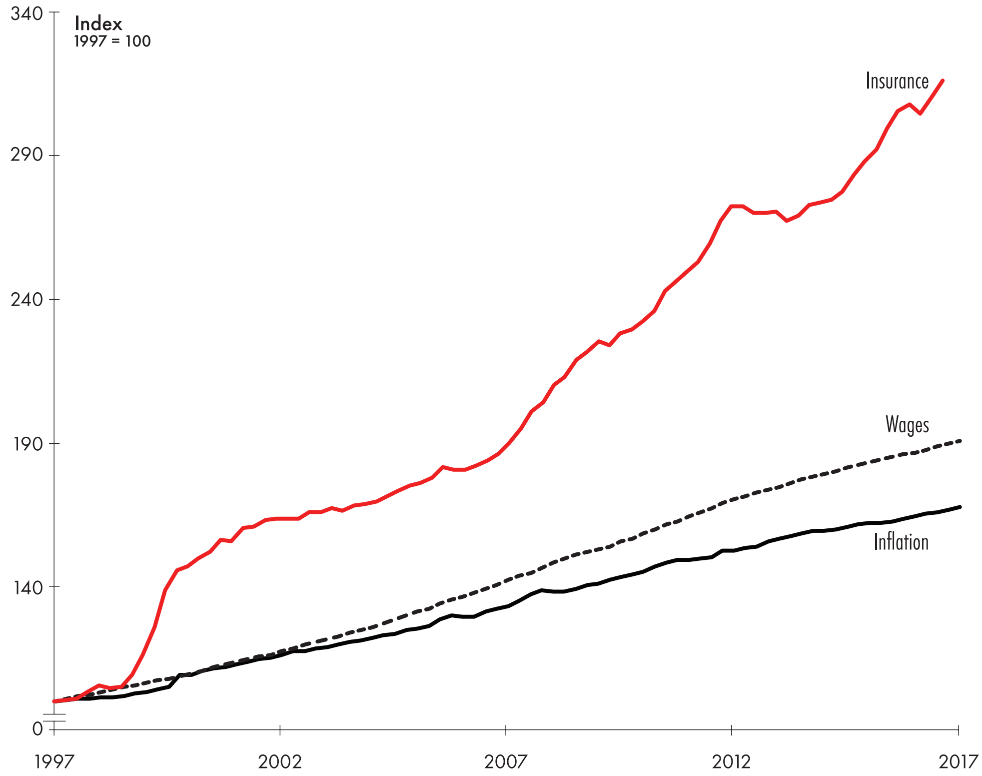
It is worth noting that some of the government interventions outlined in Chart 2 were, and are, explicitly designed to increase prices. The expressed intent of the carbon tax, for example, was to raise the cost of carbon-intensive activities relative to carbon-intensive to incentive substitution from one to the other.

14 Productivity Commission, "Major Project Approvals", Canberra, Australia, (2013)

15 Wild, Daniel, "Section 487: how activists use red tape to stop development and jobs", the Institute of Public Affairs, Melbourne, Australia, (2016)

Insurance

Chart 3: Insurance



The cost of general insurance has increased by 209% over the past two decades, or 10.5% per year on average. This is 2.3 times the growth of the wage rate. General insurance, as distinct from "life" insurance, is defined by the ABS to include comprehensive insurance for home and contents and motor vehicles, and compulsory third party insurance.[16]

Australia's general insurance market is characterised by high barriers to market entry, and is heavily regulated. General insurers are regulated by the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC), and the Australian Consumer and Competition Authority (ACCC). ASIC requires that general insurers obtain a license to operate, meet mandatory product disclosure requirements, and regulates standard terms of contract. APRA sets out capital adequacy laws. And the ACCC administers anti-competitive and consumer protection provisions. These regulatory requirements are in addition to common law provisions and contract law.[17]

These regulatory restrictions have contributed to the general insurance market being dominated by four major players: QBE Insurance Group, Insurance Australia Group, Suncorp, and Allianz

16 Australian Bureau of Statistics, "Consumer Price Index: Concepts, Sources, and Methods", Information Paper, Canberra, Australia, (2006), pg. 82

17 Parliament of Australia, "Australia's General Insurance Industry", Senate Committee, Canberra, Australia, (2017)

Australia. These four players collectively account for around 74% of total market share.[18] Moreover, the number of licenced insurers has fallen in recent years, with a net decline of 25 over the past decade.[19] And even the absolute number of providers is masked by the fact that a number of smaller providers are subsidiaries of the larger firms.

Part of the rise in home insurance is due to an increase in the overall value of houses: assets which increase in value need to be insured at a higher value. For example, IAG argued in its submission to the *2017 Senate Inquiry into Australia's General Insurance Industry* that "the cost of a home insurance premium must be viewed in the economic context that the value of the asset has increased over the past decade." IAG also argued that "a more accurate indication of the movement of insurance premiums in comparison to earnings over time takes into account the sum insured of the asset being covered."[20] This is a reasonable observation. However, there are three off-setting factors.

The first is that premiums are often paid by households out of income rather than wealth. So while households can borrow against the rising value of their property and use this to pay for rising premiums, few in practice do. One reason is because owner-occupier households don't typically view their house of residence as an investment vehicle, but as a home to live in (a consumption good).

Secondly, rising house values are, in part, driven by government intervention. Regulations, such as minimum apartment sizes, and planning and zoning laws, along with low interest rates, high and concentrated immigration, and subsidies such as first home-buyer grants, have made major contributions to rising prices.

Thirdly, none of the aforementioned arguments negate the fact that insurance premiums would be rising slower, or declining, in a market with less regulation and red tape, and more competition.

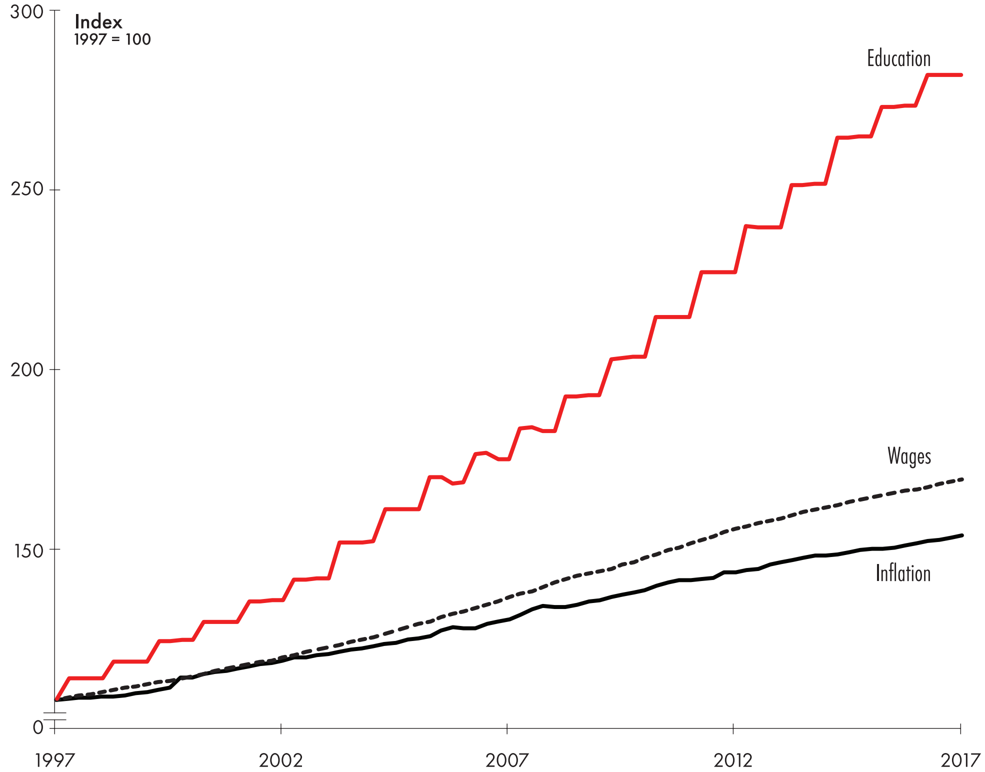
18 Parliament of Australia, "Australia's General Insurance Industry", Senate Committee, Canberra, Australia, (2017)

19 Ibid

20 Parliament of Australia, "Australia's General Insurance Industry", Senate Committee, Canberra, Australia, (2017)

Education

Chart 4: Education



The average cost of private and government primary, secondary, and tertiary education has increased by 174 per cent over the past two decades which is close to double the growth of average wages.

Australia's education sector is a mix of substantial regulation, high barriers to new entrants, and taxpayer subsidisation. At the tertiary level, it has been remarked that Australia has one university with a number of different campuses. This is not far from the truth. According to *Universities Australia* Australia has 37 public universities, two overseas universities, one small specialist university, and just three private universities.[21] The key reason why there are so few private universities is that subsidisation of students who attend public universities crowds out private sector investment. This occurs because private universities are unable to match the post-subsidy fee that students of public institutions receive. The Commonwealth government currently provides $9.6 billion in subsidies to public universities.[22]

21 Universities Australia, "Data Snapshot: 2017", Canberra, Australia, (2017)

22 Commonwealth Government, "Budget: 2017-18", Table 7, Pg. 6-18, Canberra, Australia, (2017)

In addition to the crowding out of private universities, governments also heavily restrict the entry of new universities. All providers of higher education that offer higher education qualifications in or from Australia must be registered by TEQSA. In order to receive accreditation from TEQSA, higher education providers must meet a range of standards, ranging from infrastructure requirements to course approval and accreditation. However, the regulatory requirements on obtaining entry to the higher education market acts as a barrier to entry, which reduces the number of higher education providers and reduces competition. A less competitive education sector results in higher education providers being less responsive to student needs and of lower quality. The costs of restricted competition are largely hidden because of government subsidisation of fees.

Similar regulatory restrictions are also in play at the school level. According the Jennifer Buckingham and Trisha Jha of the Centre for Independent Studies:

> "Though educational provision is becoming more diverse, choice is still limited in several ways for many people, particularly lower-income families due to restrictive enrolment and funding policies."[23]

Competition between schools is limited, in the public sector, by enrolment zones or priority zoning areas, which means choice within the government school sector is largely restricted by residence. Across both public and private school sectors, regulation has increased and competition decreased due to federal government intervention. Again, according to Buckingham and Jha:

> "From the inception of public education until the 1960s, curriculum was developed by state and territory governments without influence of the federal government. This changed when the federal government began funding schools, eventually leading to the establishment of the Curriculum Development Centre in 1975."[24]

Partly as a result of these regulatory interventions, and despite a substantial increase in expenditure on schools by state and federal governments, the quality of education is in decline. According to the Productivity Commission, real government expenditure on schools increased by 24 per cent between 2004-05 and 2013-14.[25] Yet results for Australian students in mathematics have declined by 6%, science by 3%, and reading by 5% over the relevant assessment periods.[26]

23 Buckingham, Jennifer and Jha, Trisha, "One School Does not Fit All", Centre for Independent Studies, Sydney, Australia, (January 2016)

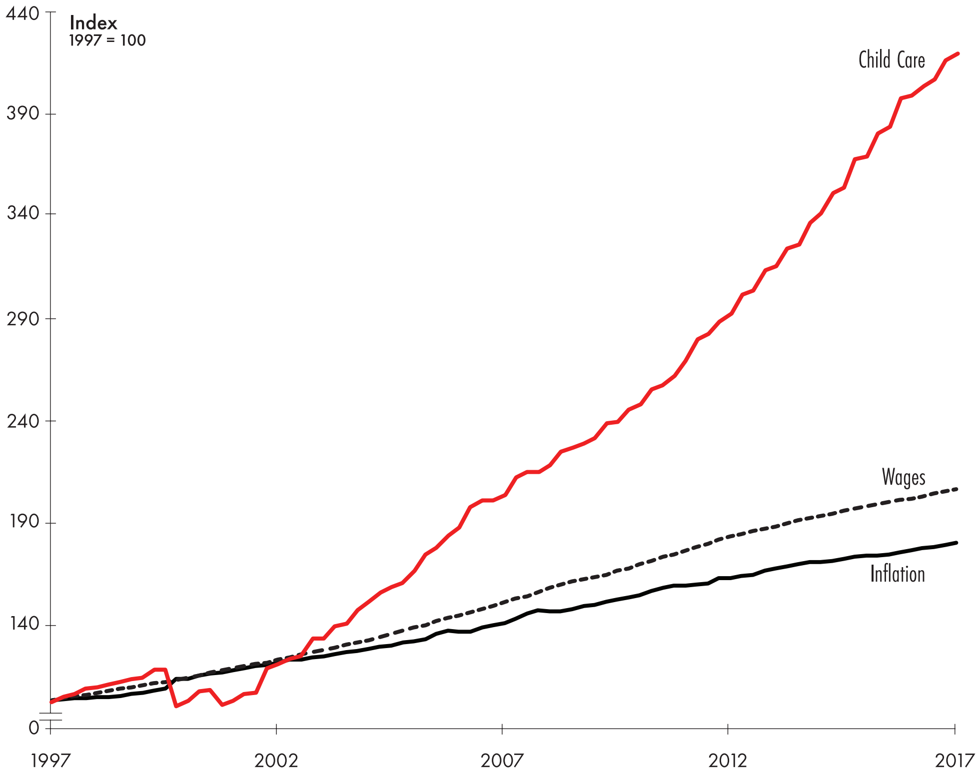
24 Ibid.

25 Productivity Commission, "Education Evidence Base", Canberra, Australia, (2017)

26 Results available from https://www.acer.org/ozpisa/

Child Care

Chart 5: Child Care



Child care is a heavily regulated and heavily subsidised industry. The coincidence of supply constraints induced by regulatory barriers to entry, and expanding demand through subsidies has caused child care fees to rise rapidly, especially over the past five years. The cost of childcare has increased by approximately 310 per cent over the past 20 years, which is around 3.5 times the rate of growth to average wages.[27]

There are a range of factors which have contributed to rising child care prices. Firstly, female workforce participation has been rising over recent decades, which has contributed to rising demand for childcare services. Secondly, child care is highly labour intensive, which adds to labour costs (although it is far more labour intensive due to the introduction of a number of regulations discussed below). And, thirdly, there are low limits to how far child care services can be scaled up, meaning it is difficult for child care centres to achieve the type of economies of scale one could find, say, in supermarkets.

However, government intervention has played a key role in rising prices. The child care sector is heavily regulated, with that regulation having increased over recent years. A key price of regulation in the childcare sector is the *National Quality Framework* which was introduced by the

27 Child care figures have been adjusted to remove the effects of structural breaks in the data in 2007 and 2008, following, Potter, Michael, "Red Tape and Australia's Economic Malaise", CIS Occasional Paper 164, Sydney, Australia, (2018). For further information, see Australian Bureau of Statistics, "Treatment of Child Care Services in the Australian Consumer Price Index", Canberra, Australia, (September 2008)

Gillard government in 2012. The national framework increased the physical space required per child, increased the staff-to-child ratio, required more 'qualified' early childhood teachers, and more general staff. [28] All of these requirement snecessitated child centres spend more money per child, with consequent higher costs for families. These higher costs have been largely driven by higher labour costs driven by credential inflation.

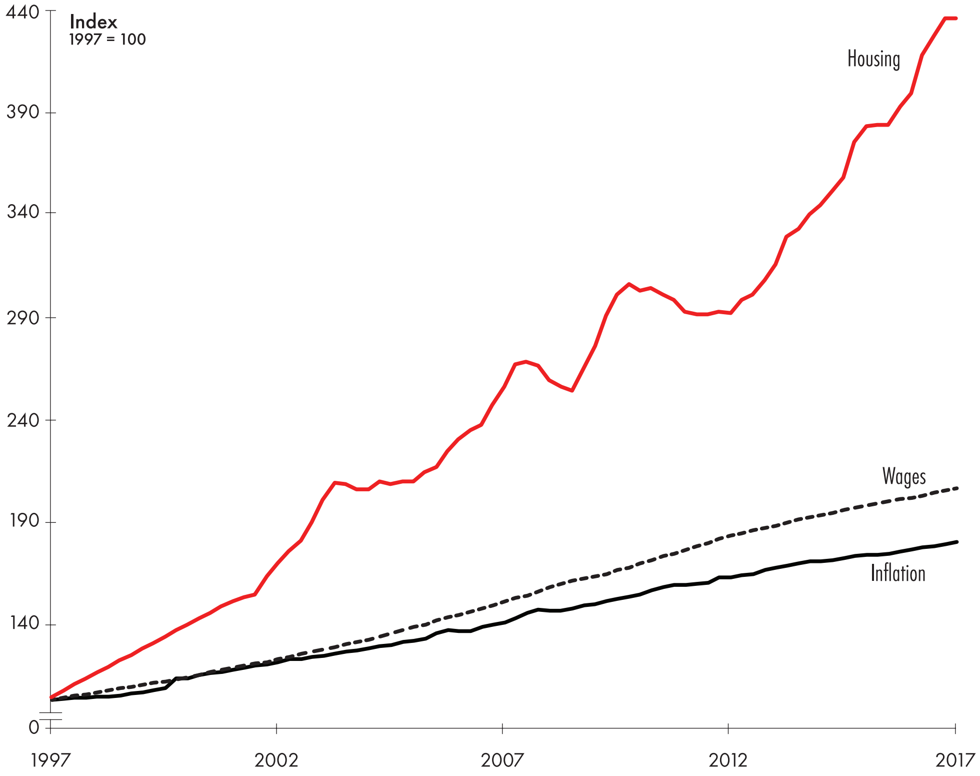
At the same time as regulation has been increasing, so too have the volume of taxpayer subsidies. Total federal government subsidies are projected to reach $10 billion by 2020-21. This flows through mostly as higher costs – so the benefits of subsidies to households are washed away, and instead childcare providers benefit the most through higher revenue.[29]

28 Australian Children's Education and Care Quality Authority, "National Quality Framework", (2018), available at https://www.acecqa.gov.au/nqf/about

29 Commonwealth Government, "Budget: 2017-18", Table 3.1, Pg. 6-12, Canberra, Australia, (2017)

Housing

Chart 6: Housing



The cost of housing has increased by approximately 330% over the past 20 years, which is around 3.6 times the rate of growth to average wages.[30]

There are a range of factors which have contributed to price rises. Firstly, household wealth has risen over the past three decades which has enabled higher borrowings (although part of this wealth increase has been from house price inflation itself). Secondly, there has been a decline in overall household size over the past two decades which also contributes to an increase in demand for housing (although some of this would be offset by the fact that smaller households should be correlated with a demand for smaller housing size, and potentially lower borrowing capacity). Thirdly, first home buyers today may be less willing to compromise on amenity than those in the past, which would increase their willingness to pay for higher quality property, rather than choosing to compromise on lower quality property. Although, this third effect is speculative and difficult to quantify.

However, housing construction is subject to a range of regulatory restrictions which have exacerbated price rises. These include planning and zoning laws which limit the areas that residential premises can be constructed; regulations of housing materials such as in relation to

30 Australian Bureau of Statistics, "Residential Property Price Indexes: Established House Price Index", Canberra, Australia. Data from December 1997 to September 2002 are interpolated due to changes in ABS data methodology.

environmental and energy efficiency requirements; and minimum apartment sizes. On top of this, governments at the federal and state level have provided subsides to encourage house purchases, such as first home buyer grants, which inflates demand and adds to cost pressures.

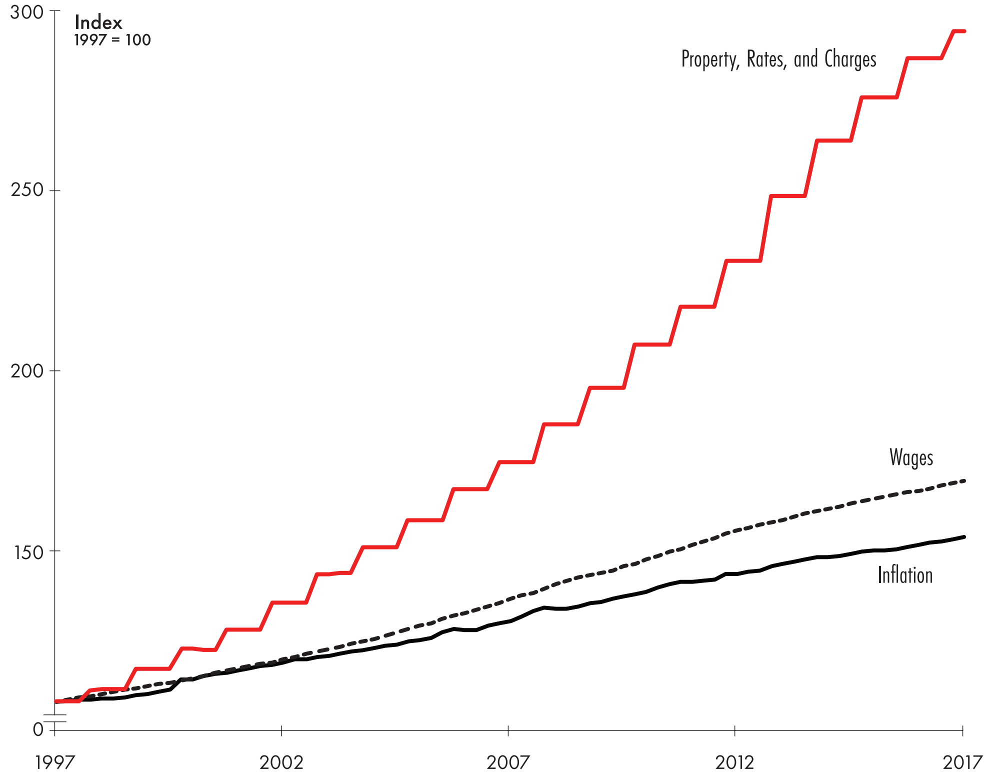
Further, government policies such as high and concentrated immigration have increased demand through population growth, while low interest rates have reduced the cost of borrowing and, similarly, increased demand for housing. According to the Reserve Bank of Australia, population growth has been a key contributing factor to rising housing prices:

> “Combining the range of estimates of average household size, population growth and demand for second homes and replacement dwellings, suggests that annual demand for new housing was relatively stable prior to the mid-2000s, fluctuating between 120 000 and 145 000 new dwellings every year (Graph 4). Since then, annual demand for new housing increased by around 40 per cent (or by around 50 000 new dwellings), largely owing to strong population growth.”[31]

31 Kohler, Marion and van der Merwe, Michelle, “Long-run Trends in Housing Price Growth”, Sydney, Australia, *Bulletin*, (September, 2015)

Property Rates and Charges

Chart 7: Property Rates and Charges



Property, rates, and charges implemented at the local council and state government level have increased by 177% over the past 20 years. This is double the rate of growth to average wages. According to the ABS, property rates and charges include state and local council based rates and charges except water and sewage.[32] Property rates and charges are separate to the categories analysed in this paper in that they are not a service, but a tax. Nonetheless, this category has been included because such rates and charges are a non-trivial, and rising, component of overall household expenses.

Part of this rapid increase is driven by the fact that councils in Australia are larger than what they otherwise might be. This leads to two related problems. The first is a lack of competition between councils. In a setting where there are a large number of small councils, residents are better able to avoid, and move away from, councils with high and rising rates. This puts downward pressure on such rate rises as councils must compete to keep and attract residents. At the same time such competitive pressures also put downward pressure on council costs, including wages, travel expenses, staff numbers, use of consultants, and pursual of non-local political issues.

32 Ibid, pg. 66

Secondly, it is much easier for larger councils to become bloated. A relatively small increase to rates would go relatively unnoticed to most rate payers. However, a small increase across a large number of ratepayers can result in a substantial increase to a Council's overall revenue. Conversely, obtaining the same revenue increase over a smaller number of rate payers would require a larger increase to rates. It is more likely that larger increases would be noticed by ratepayers, and this would put downward pressure on such increases.

Other factors driving price changes

As discussed in the introduction, there are a number of other factors playing a role in the dichotomy of price changes illustrated in Chart 1.

Firstly, the products for which prices have been decreasing are typically tradable, while those for which prices have been increasing are typically non-tradable. It is possible, for example, to import a t-shirt or car from overseas, but it isn't possible to import a haircut. Tradable products and services are typically subject to more competition and, hence, downward pressure on prices. The exception to this is education, where tradability freely takes place via the entrance of foreign students to Australian schools and, more significantly, universities. Technological advances have also made it much easier to access education material produced overseas, rather than having to rely solely on domestic content.

Secondly, most of the products which have been rising in cost are services, while most of those falling are manufactured goods. Services are, by their nature, much more labour-intensive than manufactured goods which are more capital intensive. As labour costs rise relative to capital costs, service industries are unable to substitute toward capital inputs in the same way as manufacturing industries have been able to through automation and use of robots. This means service-based industries are unable to as easily avoid rising labour costs, a fact partly reflected via rising prices.

The question could then arise of why does this report focus on government regulation rather than the above-mentioned factors. There are two reasons. The first is freedom of choice versus coercion. Price rises which are due to voluntary decisions undertaken by individuals, families, and businesses are categorically different to price rises which are the result of coercive government interference. There is nothing nefarious about price rises which reflect underlying supply and demand changes because changes to underlying supply and demand reflect preferences of individuals in society who have sovereignty over their own decisions.

The second reason is to do with influence. Public policy cannot influence the two above-stated alternative causes of price rises, other than through imposing significant offsetting costs. For example, the disparity in price rises between tradable and non-tradable goods could be reduced through imposing prohibitions on free trade, such as through increasing tariffs. Such a move would reduce the price disparity, but it would do so by increasing the price of tradables (by making them less tradable), with the effect of reducing competition, choice, and real incomes. Public policy can, however, reduce the effect that regulation, red tape, and subsidies have on price rises and so it is logical to focus on this area.

Conclusion

High and rising prices in education, child care, housing, insurance, and electricity sectors have been driven by government intervention. Government regulation reduces supply, increases barriers to market entry, reduces competition, and raises business operating costs. These costs are passed on, in part of full, to consumers as higher prices. At the same time, governments typically provide subsidies to households, which increases demand. Higher demand with restricted supply further exacerbates price rises.

To put downward pressure on prices, governments should:

- Deregulate the education, child care, electricity, and insurance markets to increase competition and put downward pressure on costs.
- Reduce subsidies provided to households to put downward pressure on demand-led inflation.
- Reduce barriers to free trade by reducing tariff and non-tariff barriers to international trade.

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