INSTITUTE OF DIRECTORS (TASMANIA) AND CHAMBER OF COMMERCE

LUNCHEON, WESTSIDE HOTEL, HOBART

TUESDAY 7 JULY 1981

THE LAW, BUSINESS AND MILTON FRIEDMAN

The Hon. Mr. Justice M.D. Kirby
Chairman of the Australian Law Reform Commission

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LAWYERS AND LAW REFORM

This is a week for lawyers in Hobart. The city is invaded by a legion of judges, barristers, solicitors and law teachers. An occasional articled clerk dares to show his face. With the encouragement of the President of the Law Council of Australia (Mr. Peter Cranswick), my good friend the indomitable Bruce Piggott and numerous other Hobart lawyers, we have gathered together in this city 1100 participants all determined to have their say. By the end of the week, the accumulated hot air of so many lawyers concentrated in the one place is sure to melt the snow on Mount Wellington. Bruce Piggott has reminded us that one of finest Australian poets, Banjo Patterson, was a lawyer. He wrote of the 'vagabond law of change'. Whether vagabond or evangelist, change is the chief theme of the law and its profession today. It is the theme that permeates most of the papers that have been prepared for the Australian Legal Convention. There is far less looking backwards to the glory of the past. There is much less smug self-satisfaction and self-congratulation than in any other legal convention I have attended in Australia. Gone is the self-contented talk of eight centuries of continuous legal history. Ours is a time when all institutions are under the microscope. The cold wind of change, which is the constant companion of most businessmen in Australia, is now being felt in the law.

Law reform commissions exist to assist lawmakers, Federal and State, to cope with the pressures of change. Tomorrow, the law commissioners of Australia, Federal and State, will be joined by their colleagues from overseas in a two-day conference designed to explore the operations of law reform commissions and how they may be improved. The host for that conference is the Law Reform Commission of Tasmania and the Chairman of the conference will be Mr. Bruce Piggott. The opening paper by Sir Michael Kerr (Chairman of the English Law Commission) will deal with the 'politics of law reform'. Of course, advisory bodies, including in their number judges, must avoid party politics like

the plague. Yet there is inevitably a fine line between legal decisions, which impact the social and economic order, and political decisions. When Mr. Justice Ellicott left politics and joined the Federal Court, he said at his welcoming ceremony that 'the reform and development of the law and access to justice' raise 'fundamental political as well a legal issues'. He suggested that the work of the law reform commissions of Australia demonstrated that 'lawyers are immersed in the sea of politics whether we like it or not'.

I want to speak to you today about the implications for the law and business and the views of a famous American economist, Professor Milton Friedman. Friedman is a Nobel laureate. He is professor of economics at the University of Chicago. His views on economic issues have become one of the chief points of the modern political debate. Following an important television series on the BBC in 1980, he published an influential and best-selling book 'Free to Choose'. Every businessman in a position of responsibility and every serious student of politics today should get the book and read it. Part of Friedman's impact upon the mind of politicians and economists in all Western countries can be explained by his powerful prose and sharp wit. Now lawyers, it seems, must turn to his writings.

I was in New Zealand in May when Friedman breezed in after a short visit to Australia. At the airport he was asked what was wrong with the New Zealand economy. He told the somewhat startled group of journalists that he had only been in the country for three minutes. He said he needed another five minutes before he could give the answer. I think he was speaking in jest.

The policies being pursued by the Thatcher administration in Britain and the Reagan administration in the United States reflect something of the impact of Friedman's economic theses. The announcement during the past quarter of significant cuts in the Federal public sector in Australia and the proposed transfer of some Federal functions to the States or to private enterprise represent an Australian response to Friedman's views.

THE LAW REFORM COMMISSION AND BUSINESS

The Australian Law Reform Commission is engaged in a number of tasks which concern, directly or indirectly, business operations in Australia. We are a small body comprising ten commissioners, three only of them full-time. We work only on the tasks assigned to us by the Federal Attorney-General. We have a research staff of eight. At any given time we have eight major projects of law reform.

I suppose that of our current projects, four stand out as being specially relevant to business and commerce in this country:

- Debt Recovery. The first is a project designed to modernise the law of debt recovery. Every businessman knows of the inconvenience of bad debts and the inefficiencies of some of the legal procedures for the recovery of debts. In a sense, these inefficiencies are inevitable. The credit society, the proliferation of credit cards and Bankcard, the introduction of mass consumer credit and, now, the advent of electronic fund transfers, all make it unlikely that the laws and procedures of the past could cope with the new social situation. The Law Reform Commission has put forward tentative proposals on this subject, designed to strike a fair balance between the rights of creditors and the needs of debtors to come to grips with their basic problem, which is often plain incompetence in the handling of credit.

- Privacy. A second project upon which we hope to report this year is in some ways related. I refer to our inquiry into privacy protection. One of the issues being dealt with is the proliferation of direct marketing so-called 'junk mail' procedures, including telephone marketing and other intrusions which some people regard as invasions of their privacy. The collection of computerised personal information, including blacklists and credit records, may necessitate legal regulation to ensure that these are accurate, fair and up to date, given the profound effect which an adverse computerised record could have upon an individual or business.

- Class Actions. A third project is our inquiry into class actions. Rarely has a mere legal procedure caused so much agitation and concern in business circles. The class action is an invention of the greatest mass-production economy of them all : the United States. If you mass-produce a product with a defect giving rise to a legal action, American jurists regard it as unreasonable to insist that the law should continue to deliver justice on an individual case-by-case basis. The problem was mass-produced. So, it was said, the delivery of justice should be mass-produced, not confined to expensive craftsmanlike procedures of earlier times. The difficulty with aggregate litigation, however, is that it could be used to 'blackmail' business and to 'rope in' people who would never ordinarily have brought a legal claim. Nevertheless, American proponents of class actions declare that they represent the 'free enterprise alternative to government legal assistance'. I am not sure of Milton Friedman's view on class actions. Certainly, they amount to a form of 'litigious self-help' which we have not so far seen in Australia. The Law Reform Commission has been asked by the Attorney-General to say whether this procedure should now be introduced into Federal courts in Australia.

. Insurance Contracts. Finally, the Commission has been asked to look at insurance contracts law reform. Just as the credit economy has expanded, so too has consumer insurance. Laws created in an earlier time of insurance between more equal bargaining parties, may not be appropriate to an age in which insurance is sold to ordinary citizens by radio, newspaper and television. The rules that have grown up over 200 years must be rescrutinised to see whether they are suitable for today's insuring society. If they are not, the question remains, what, if anything, should be done?

REGULATION OF INSURANCE BROKERS

In 1980 the Australian Law Reform Commission delivered a report addressed to the problem of the relationship between the ordinary member of the public seeking insurance and insurance intermediaries (whether agents or brokers). One special problem which came to light was the fact that between 1970 and 1979, 27 insurance brokers in Australia collapsed. Their known losses amounted to some $7.25 million. Their actual losses probably exceeded $10 million. The sum of known losses has doubled to $15 million in the 18 months since the Law Reform Commission's report was delivered. A large proportion of these losses was ultimately borne by the insuring public.

Clearly, in facing up to this information, the Law Reform Commission had to make a choice. What was the correct response? Should the collapses be shrugged off in the hope that market forces would ultimately 'sort out' the reliable brokers from the unreliable : the honest from the dishonest? Was the fact that the total proportion of losses was a small percentage only of premiums handled by brokers determinative of the appropriate legislative response?

The Commission examined various alternatives by which the law, and law reform, could cope with this problem:

. It could do nothing.
. It could provide criminal penalties to require proper accounting and punish speculative investments by brokers with client funds.
. It could introduce a detailed scheme of licensing.
. It could provide a system of registration with a scheme for compulsory professional indemnity insurance.

In the end, the Law Reform Commission rejected a licensing solution for reasons that would have appealed to Milton Friedman. The increase in bureaucracy needed to police and regulate licences would not have been warranted by the benefits to the insuring public thereby secured. But there remained the problem of innocent members of the public dealing with insurance brokers, the good name of honourable brokers, the losses suffered by those who unexpectedly found themselves uninsured and unprotected by the law and who possibly had to pay a second premium. Finally, there was the reputation of the insurance industry as a whole. In the end, the Commission opted for a modest form of regulation by way of registration of insurance brokers complying with trust account rules. Anti-competetive limitations were avoided. The administrative costs involved were to be borne by brokers themselves. It was estimated that two government employees only would be required to run the new system.

On 10 June 1981 the Federal Treasurer (Mr. Howard) indicated the Federal Government's response to the report. He announced that the government did not favour legislative regulation. Rather, it preferred the 'development of sound and appropriate self-regulatory practices'. This, he said, would assure consumers 'freedom of choice to deal with intermediaries'. The 'ultimate judgment' would 'rest with the consumer'.

Explaining the government's position, the Treasurer advanced a general proposition:

> As should now be well known, the government's general view of intervention in commercial relationships is that a clear need must be demonstrated before Commonwealth regulatory legislation is considered. The government does not believe that such a need has been established either by the Law Reform Commission or by others making submissions. Indeed, the recent decision of the Review of Commonwealth Functions requires by the government critical examination of existing supervision of the insurance industry.

BACK TO MILTON FRIEDMAN

Arising out of this debate, the point I want to make is that law reformers, the courts and lawmakers must become more familiar with the economics of what they are doing and much more aware of the economic impact of the law. Clearly, it will be an ineffective use of public resources for law reform commissions, royal commissions and others proposing laws, to do so in complete ignorance of and indifference to the costs of what they are doing. If they adopt this course, they are almost bound to conflict with those forces in society that are determined to rope in public expenditure and diminish

what Milton Friedman has called the 'tyranny of controls'. According to Friedman, many government controls have 'unduly impeded individual initiatives', often at great cost and frequently at costs disproportionate to the gain in public protection that is secured.

I would suggest that some of the things Milton Friedman has been teaching are likely to attract the approbation of most businessmen in Australia. He says, for example, in 'Free to Choose':

> Freedom cannot be absolute. We live in an interdependent society. Some restrictions on our freedom are necessary to avoid other, still worse, restrictions.

His basic proposition for the design of new laws involving government intervention is a relatively simple one:

> We should develop the practice of examining both the benefits and costs of proposed government interventions and require a very clear balance of benefits over costs before adopting them.

Certainly, in the approach taken by the Law Reform Commission to the regulation of insurance brokers, we adopted the similar approach. Of course, in a matter such as economic regulation, it is much easier to see the costs and to add them up, than to assess the benefits. The benefits of consumer confidence, of helping to rid the broking profession of dishonest or undesirable elements and of upholding the good name of the insurance industry, are hard to put into dollars and cents. The point I want to make is that the Law Reform Commission is very conscious of the need to do its sums and to consider an appropriate cost/benefit analysis before making its recommendations to government. In the end, in a democracy, it is for government, which is answerable to the people, to determine these matters. Economic and political judgments cannot be avoided. Whether self-regulation will work amongst insurance brokers in the future any better than it has in the past, will remain to be seen.

HOW FAR CAN WE TAKE MILTON FRIEDMAN?

I want to close by asking how far we, in Australia, will accept all the views of Milton Friedman. In his earlier book 'Capitalism and Freedom' he also advanced a thesis which sounds strange to the ears of most Australia lawyers and businessmen:

> Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their shareholders as possible. This is a fundamentally subversive doctrine.

The last few decades in Australia have seen the exact antithesis of this philosophy, with the recognition that corporations are citizens too, in the broad sense, and that they owe certain responsibilities, not only to their shareholders and to their managements, but also to employees and, increasingly, to society as a whole. Evidence of this view in Australia may be found in voluntary business support for charities, education, the arts, efforts to deal with poverty, urban problems and other objectives which command consensus approval. This contribution to good corporate citizenship can be seen not only in grants of funds and sensitivity to consumer, environmental and other social concerns but increasingly by arrangements such as the 'ten per cent rule' adopted by I.B.M. Under this scheme any employee engaged in social service may request 10% of normal working time to carry out the commitment and I understand this is readily given. Another American Nobel Laureate for Economics, Professor Kenneth Arrow, concluded that single-minded maximisation of profits was not really efficient for society as a whole in at least two cases:

> The case in which costs are not paid for, as in pollution; and the case in which the seller has considerably more knowledge about his product than the buyer, particularly with regard to safety. In these situations, it is clearly desirable to have some element of social responsibility — an obligation, whether ethical, moral or legal. We cannot expect such an obligation to be created out of thin air. To be meaningful, any obligation of this kind has to be embodied in some definite social institution. ... Exhortation to do good must be made specific in a legal code or in some other external form, a steady reminder and perhaps enforcer of desirable values.
>
> Kenneth J. Arrow, 'Social Responisibility and Economic Efficiency', in Public Policy, 21(3) 303-17, 1973, p.81.

Commenting on Friedman's view of the world, Professor Leon Keyserling put the other point of view:

> If a great fire catches us with an inadequate fire department, the remedy [proposed by Friedman] is to do away with fire engines, instead of preventing people from throwing lighted matches around in a paper factory.

CONCLUSIONS

No-one I know says we should not have laws against murder, nor any police or criminal justice machinery, prisons and the other expensive paraphernalia of the state simply because statistics show that only 0.01% of the population will be murdered. Plainly such an approach dictated only by dollars and cents would be unacceptable. It is not, I hasten to say, a view put forward in terms by Milton Friedman. But deciding when social misconduct (which is usually going to be exceptional) warrants social retaliation and legal intervention, always requires judgment and choice. Enough has been said to show that in the future, in reaching that judgment and making the choice, people in the business of lawmaking will increasingly have to pay regard to the costs of what they are doing. Those costs will have to be weighed against the potential benefits of effective legal regulation. Furthermore, in choosing between differing forms of legal regulation, lawmakers and those who advise them will have to consider the comparative costs of different ways of approaching the solution or avoidance of the problem.

In reminding us of the need to do these sums, Milton Friedman is plainly right and he does lawyers a service. Lawyers tend to talk as if 'justice' was beyond price. It is not so. We must all recognise that there are some legal complaints which will probably not be solved because to solve them would cost too much. We must balance the mischief and the costs of attacking the mischief. But by the same token, some of Milton Friedman's other views do not seem to fit comfortably into the culture, values and economy of Australia. One thing is sure. In the years ahead, we are all going to hear more about Milton Friedman and his economics. These things have a tendency to come in waves. The wave of the Friedmanites is now upon us and we should all be studying its implications for our daily activities.