THE GETTING OF WISDOM OR GRUMPY OLD POLICY ANALYSTS?

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It is often said that wisdom is accumulated with age. Equally, I am aware that longevity can bring out bouts of grumpiness at the manifest failings, so it seems, of those tasked with making and implementing policy. In this address, I intend to deliver a few sprays, constructively I hope, but sprays nevertheless, along with some observations that probably fall into a 'reflections' box. Whether what I say constitutes wisdom or grumpiness, I'll leave you to judge.

Counter-intuitive economics

Economics has often been described as the dismal science, perhaps because some of its practitioners have been dismal in demeanour or delivery, but more often because pursuit of economic principles is often unpopular. As Adam Smith said, admittedly with reference to members of Parliament:

> "The member who supports every proposal for strengthening (monopolies) is sure to acquire, not only the reputation for understanding trade, but great popularity and influence with an order of men whose numbers and wealth render them of great importance. If he opposes them, and still more if he has authority enough to be able to thwart them, neither the most acknowledged probity, not the highest rank, nor the greatest public services, can protect him from abuse and detraction."

I like to think that much of the appeal of economics is that it is often counter-intuitive, with the accompanying challenge being to explain in clear terms how what seems at first blush to be odd is actually quite logical. During this address I will attempt to illustrate this challenge with examples.

The former Treasury Secretary, John Stone, gave several notable speeches both before and after his retirement. In the course of thinking about what I would say, I have re-read six of them.[1] They combine elegant use of language, insightful commentary and characteristically searing dismissal of perceived lesser beings.[2]

For example, Stone's 1973 demolition of the Club of Rome, which had sponsored *The Limits to Growth,* a study by the Massachusetts Institute of Technology, was a masterpiece of lofty derision. There is an eerie similarity between the Club of Rome rhetoric and some contemporary claims about anthropogenic climate change. Treasury's landmark publication, *Economic Growth: Is it Worth Having?*[3]*,* of which Stone was the principal author and which

[1] Address to the Australasian Council of the Club of Rome, 3 November 1973; "Australia in a Competitive World – Some Options", Australian Institute of Management, 19 November 1979; "Australia in a Competitive World – Some More Options" Stan Kelly Memorial Lecture, 16 November, 1981; "1929 And All That ...", Shann Memorial Lecture, 27 August 1984; "What Kind of Country?, Australian Business Congress, 17 October 1984; and "Meretricious Players – and Others", Mont Pelerin Society, 21 August 1985.

[2] I should emphasise that while I make approving references here to some of Stone's writings, he and Treasury did have, in my view, a number of shortcomings, including opposing the 25% tariff cut in 1973, opposing the floating of the dollar in 1983, and several tussles with the work of the Tariff Board and its successors that were unworthy of what should have been strong support for a fellow institution pursuing an economy-wide agenda.

[3] Treasury Economic Paper Number 2, June 1973.

was generally seen as a direct attack on the Club of Rome and the MIT study, noted the latter's conclusion that there was an urgent need to bring about "a deliberate, controlled end to growth". To this, the Club of Rome added that: "only the conviction that there is no other avenue to survival can liberate the moral, intellectual and creative forces required to initiate this unprecedented human undertaking."[4] Several years later Stone noted that "most of the industrialised world has now had a taste of 'low growth' since the early 1970s and has found it – let alone 'zero growth' – distinctly unpleasant".[5]

The consistent failures of protection

In his 1979 speech[6], Stone developed the axiom that "the more successful we prove to be at exporting, the more successful <u>we are also going to have to be</u> at importing." (emphasis in the original) He stated that either the increased imports could come by substituting for our least efficient producers, or the required current account readjustment would affect all producers, export and import competing, efficient and inefficient alike. This could occur via an exchange rate increase, reducing competitiveness by inflating, or various interventions affecting capital flows. The preferable approach was easy to distil from his observations, and to some extent was followed by the reductions in manufacturing protection during the Button years.

By way of brief digression, my ACIL colleague, Denis Hussey, during his former life as a senior Department of Primary Industry employee, was once asked by a State departmental secretary, apparently in all seriousness, to calculate the value of "an export dollar". When Denis immediately replied that it was "one dollar" his colleague thought that this was a glib and inadequate response. Such thinking remains surprisingly widespread today.

Unfortunately Australian industry policy has always lacked consistency, whether with direct subsidies to Kodak or the German wool processor BWK – both of which were unsuccessful to the point where the plants closed down once the effect of the subsidies wore off – via continuing generous support to the automotive and TCF industries, via a failure to involve the Productivity Commission – for example, the Mortimer review of export policies and programs[7] – or otherwise cramp the Commission's style.

I will return to the wider topic of trade liberalisation shortly but here want to dwell on two points. First, the work of the Productivity Commission and its predecessors has been instrumental in building community-wide acceptance of the need for reduced protection in the face of widespread belief that tariffs save jobs or Australian production is more worthwhile than imports, regardless of cost.

Perhaps the most encouraging example I encountered was the ship building industry in the late 1970s, once seen as a vital industry for defence reasons. Only when the cost of protection – which in this case was delivered in the form of a direct subsidy from consolidated revenue rather than via a tariff – was expressed in terms of its subsidy

[4] *Ibid.,* p2.

[5] John Stone (1981), "Australia in a Competitive World – Some More Options" Stan Kelly Memorial Lecture, 16 November, 1981.

[6] John Stone (1979), "Australia in a Competitive World – Some Options", Australian Institute of Management, 19 November 1979.

[7] David Mortimer and John Edwards (2008), *Winning in World Markets,* September 2008.

equivalent per employee, an enormous figure relative to average earnings, did the electorate demand that the subsidy be scrapped. The irony was that a more competitive export-oriented ship building industry later re emerged with little or no protection.

One wonders what might have happened had automotive and TCF protection also been provided by direct budgetary subvention.

Second, the quality of journalism in analysing the issues involved seems considerably weaker today than was the case twenty and more years ago, when Alan Wood, Max Walsh and others were at their peak. There are exceptions, Alan Mitchell probably being the most notable, but the degree of media scrutiny which followed, for example, the $6.2 billion automotive package earlier this year was disappointingly superficial and lame.

Economic stimulus packages and the role of Treasury

I am not sufficiently equipped to offer a full assessment of the recent economic stimulus packages but I do confess to major misgivings about them.[8] For example, I despair at the quality of administrative support that can allow large cash payments – $45 million I read at one point – to deceased people, or a $250,000 grant to a NSW school that reportedly has one enrolled pupil. If such anecdotes are the tip of an iceberg, there is reason to be worried about the efficiency with which public finances are administered and the potential for waste and duplication.

More substantively, I am surprised by the unstinting support that Treasury has apparently given to spending which Paul Keating would have described as "low quality". Admittedly, one difficulty for a Government wanting to score some quick runs is that the first submissions received are often those, such as local community halls, toilet block refurbishments and the like, that have been languishing in some bottom drawer – for the very good reason that they don't deserve taxpayer support. The question should be asked: were these proposals assessed using criteria other than the speed with which the funds could be spent and the photo opportunities provided for local MPs?

I recently heard the new Minister Assisting the Prime Minister for Government Service Delivery, Senator Arbib, speaking glowingly about the local multiplier effects of these spending projects. His comments made me cringe; they would constitute an ideal essay topic for first year economics students to demolish. If I ever dished up such twaddle in a submission on behalf of a client, I would have been monstered by Treasury, and rightly so. I therefore worry about what behind-the-scenes push-back Treasury is delivering to silly spending decisions.

To again quote John Stone (in his 1981 paper),

> "it cannot be too often stressed that whether such 'monumentalism' (today we would probably describe it as nation building) takes the form of an over-extravagant Opera House or a bridge or dam that cannot be economically justified, a decision to undertake it has consequences

[8] I find myself in fairly violent agreement with Henry Ergas' "Five reasons an economic stimulus may not work," *The Australian,* 9 February 2009. His reasons were: activist fiscal policy may not be effective, the package seems too much too soon, jobs created may merely be diverted from elsewhere, uneconomic public spending makes everyone poorer, and there is no credible strategy for returning to budget balance.

> elsewhere in the system. Those consequences may take the form of leaving more productive investments uninitiated; or of requiring governments to drive up interest rates, or to raise taxes or charges, so that they may be initiated also; or of increasing our dependence upon foreign capital as an alternative."[9]

My second major concern with the stimulus package is its sheer size, both absolutely and relative to GDP, and therefore the herculean task of repaying it when conditions improve. Treasury has been criticised about this and the Secretary has defended the forward estimates contained in the Budget documents, as would be expected. While I don't have any proof or modelling to refute his confidence, I do have scepticism based on many years of observation about the difficulty of removing benefits and lowering expectations once created. In short, I am not convinced that much of the expenditure will be sufficiently one-off that, along with revenue enhancement, it will act as an automatic stabiliser and help bring the budget back into balance as economic conditions normalise.

As Niall Ferguson, author of *The Ascent of Money,* recently observed:

> "The western world is suffering a crisis of excessive indebtedness.... The delusion that a crisis of excess debt can be solved by creating more debt is at the heart of the Great Repression. Yet that is precisely what most governments propose to do."[10]

Or, as PJ O'Rourke recently told a dinner in Sydney: "think about when you were last broke; how did it go spending your way out of it?"[11]

I have recently read an OECD publication that reinforces some of these concerns.[12] The report produced data to show that, of all the OECD countries, Australia's stimulus responses were the sixth highest in absolute terms and the third highest relative to GDP. Surely this is excessive given our far better fiscal starting point and the relatively benign impact of the crisis here relative to most other countries. Australia's responses were also different to those of most other OECD countries, focusing more on expenditure than tax cuts.

The report also contained warnings about some specific responses, noting that:

> "Several countries have introduced policies that are intended to support industries particularly affected by the crisis, such as the car industry. Introducing or increasing government subsidies to producers may undermine the long-term production capacity of the economy. Even if subsidies boost short term demand, they can backfire by postponing needed restructuring and wasting taxpayer funds."[13]

The report contained an interesting description of the responses by Finland and Korea to earlier downturns (the post Soviet era early 1990s downturn, and the Asian financial crisis in the late 1990s, respectively), where both countries focused spending and incentives on R&D

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[9] John Stone (1981), "Australia in a Competitive World – Some More Options" Stan Kelly Memorial Lecture, 16 November, 1981.
[10] Niall Ferguson (2009), "Taxpayers have suffered enough – now it's the turn of the banks and their owners to pay up", *The Australian,* 28 February 2009.
[11] PJ O'Rourke (2009), "Invisible Hand versus Visible Fist – Securing the Future Wealth of Nations", John Bonython Lecture, Centre for Independent Studies, 21 April 2009.
[12] OECD (2009), *Policy Responses to the Economic Crisis: Investing in Innovation for Long-Term Growth,* June 2009.
[13] *Ibid.*

and innovation, in the private and public sectors. The benefits have been substantial – a fact which might have been considered here before the recent closure of Land and Water Australia, for example.

Finally, the OECD report reminds us that the economic crisis can "magnify the competitive advantage of research-intensive firms who seize the opportunity to reinforce market leadership through increased spending", noting that firms like Microsoft, Nokia, Samsung Electronics and Google were born or transformed in the 'creative destruction' of earlier downturns. Echoing the sentiment of "never waste the advantages of a good recession", the report states – perhaps with General Motors in mind – that "as dominant players weaken, they open space for new players and innovators."[14]

My third concern with the debate surrounding economic stimulus packages is that already many people seem to think that there is plenty more money available where the earlier packages came from, as if we were in an era of Magic Puddings. As the immediate spending kicker of the cash payments to individuals wears off, we are hearing new advocacy for repeat doses. This bears out the old adage that if you hang out a sign, a queue will form behind it.

I have dwelt on Treasury here because of my long-standing respect for its analytical rigour and forthright advocacy of good policy. Indeed about six years ago, I was the guest speaker at its senior management dinner, at a time when it was concerned at declining influence with the then Government. My comments were intended as a morale booster to "hang in" with sound arguments and rigorous analysis. I concluded that speech with two John Stone aphorisms: "reality has a habit of breaking in" and "constant Stoning wears away the drips." I would be greatly comforted, now that Treasury is again front and centre of policy relevance, to see more evidence of "Stoning".

For example, it would have been nice to have seen a solid assessment of the extent to which popular measures such as the first home owners grant are capitalised into house prices, thus transferring the benefits from the intended recipients to presumably less intended recipients, namely vendors. In agriculture we long ago learnt that concessional interest rates – a common feature of the 1960s and 1970s rural credit market – are capitalised into land prices and therefore self-defeating. More recently, we know that drought-related transport subsidies are, at least to some extent, factored into freight rates, again transferring the benefits away from their intended targets.

Fuel taxation and biofuels

Several years ago I chaired an inquiry for the Government into fuel taxation.[15] The committee's report was rejected in its entirety, largely because it had the temerity to recommend the reintroduction of indexation of fuel excise – the abolition of which had partly given rise to the inquiry – and a revenue neutral widening of the tax net to embrace tax exempt fuels such as LPG and ethanol.

[14] *Ibid.*
[15] *Fuel Taxation Inquiry Report,* March 2002.

This was a disappointing return for nine months of solid effort, by both the committee and a competent secretariat, much of it in my case during midnight-to-dawn shifts at my dining room table. The report was fully consistent with its heavily constrained terms of reference; if the Government had wanted from the outset to exclude the reintroduction of indexation, the terms of reference should have said so.

However, it was not all downside and the report was well received by analysts and commentators. For example, the *Financial Review* suggested that the Committee had done its job too well, that the Government should have taken the report more seriously, and that "the task of cleaning up fuel taxes and road charges to reflect actual costs remains unfinished business".[16]

There is still unfinished business. Indeed I was somewhat surprised not to see the topic re emerge as part of the recent budget and wonder whether any Treasury attempts to do so may have been overturned for political reasons, although this would be surprising given the supportive comments made at the time the report was released by several then Opposition representatives.

We approached our task, as all inquiries should, from the viewpoint of determining good policy. Having done so, we then gave consideration to the political context of the inquiry — and to the political environment in which our report would be considered. I concluded, wrongly as it turned out, that although there were likely to be difficulties, they would not be insurmountable. In particular, I felt that the obvious political negative of a return to indexation would be offset by the prospect of an immediate 4c per litre reduction in petrol excise, which expressing excise on the energy content of all fuels would deliver.

Notwithstanding its fate, the report made two valuable contributions. First, it clarified the reasons for fuel taxation — in the process debunking some of the claims commonly advanced. Second, it stressed the importance of taking a neutral view towards future technology, rather than trying to second-guess what might lie down the track or, worse, basing policies on technologies of the past.

On the first point, we considered the various externality, cost recovery and industry assistance reasons often argued for fuel taxation. We rejected all of them except greenhouse gas emissions — and it, we felt, did not warrant consideration in advance of a wider national, indeed international, greenhouse response.

Thus fuel tax to correct for Sydney pollution or congestion makes no sense for a car driving north of Broken Hill. Similarly, fuel tax to fund road maintenance, unrelated to the cause of road damage, makes no sense. It follows that the dominant reason for fuel taxation continues to be revenue raising.

Moreover, if revenue raising is the objective, then this is most effectively achieved by maintaining the real value of collections — via indexation. It makes no sense to try to collect revenue efficiently and then dissipate that effort via gradual reduction in the real rate of tax.

[16] *The Age* stated that "the Government's summary dismissal of its much vaunted fuel tax inquiry is lamentable". *The Australian* said that "bad policy comes back to haunt" and that in this case — "a well constructed contribution" — the "lost opportunity is a reform of fuel taxes that would make them fairer and more efficient".

Similarly, it makes no sense to weaken the taxation base by exempting various fuels — especially when there is no compelling logic to do so.

There is one important qualification to all this — as a number of submissions argued. Given that the Government's principal indirect tax revenue raiser now is the GST, why should fuels be taxed additionally for revenue raising purposes? Isn't the purpose of the GST to promote efficiency via a low, broad and largely uniform tax rate? I have considerable sympathy for this argument; however, it was outside my Committee's terms of reference. It is an argument worth considering by the current Henry taxation review.

Ethanol, and biofuels more generally, have been a topic of considerable controversy ever since. I have nothing against ethanol as a fuel if it succeeds on its intrinsic merits. But this is nowhere near the case. Ethanol's environmental benefits are dubious when all the relevant (whole of life cycle) factors are taken into account. One US authority stated that:

> "Ethanol does not provide energy security for the future. It is not a renewable energy source and is costly in terms of production and subsidies…. Increasing the diversion of human food resources to support the costly and inefficient production of ethanol raises major ethical issues."[17]

Recent developments have borne out these concerns, especially in respect of food security. Paul Krugman has been especially caustic:

> "The subsidised conversion of crops into fuel was supposed to promote energy independence and help limit global warming. But this promise was, as *Time* magazine bluntly put it, a 'scam'. This is especially true of corn ethanol: even on optimistic estimates, producing a gallon of ethanol from corn uses most of the energy the gallon contains.... Meanwhile, land used to grow biofuel feedstock is land not available to grow food, so subsidies to biofuels are a factor in the food crisis....Biofuels turn out to have been a terrible mistake."[18]

It is time that we re-examined the explicit and implicit assistance provided to ethanol producers and decided whether its continuation is really in the national interest.

The conduct of trade policy

Multilateral trade liberalisation is unambiguously beneficial to an export oriented agricultural sector and Australian agriculture has been hamstrung over many years by its absence. While to some extent these effects are capitalised (negatively) into land values, and while there is no alternative than to take the world as one finds it, continuing to push for improvements to the global trading system remains crucial.

Economists have helped explain that the trade reciprocity argument – that is, I won't lower my trade barriers unless you do – is flawed. This intuitively appealing argument is widely held by politicians and is also at the heart of the negotiating stance of the Department of Foreign Affairs and Trade. The fact is that unilateral action by Australia to reduce its trade barriers will benefit the country whether or not other countries follow suit.

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[17] David Pimentel (1998), "Ethanol and dollar costs of ethanol production with corn," Hubbert Centre Newsletter 98/2, Colorado School of Mines.

[18] Paul Krugman (2008), "Grains gone wild", *International Herald Tribune,* 8 April 2008.

Last November the G20 leaders made a public commitment to resist protectionism. Sadly, within a few months seventeen of the twenty (including Australia) had "implemented 47 measures whose effect is to restrict trade."[19] By their actions, the G20 leaders seem to believe that their commitment is an opportunity to limit other countries' protectionism rather than their own. Unless that is, you are cynical enough to believe that the original G20 exhortation was purely for immediate political halo polishing. I rather liked the following observation that appeared in the *Financial Times* last February:

> "The appropriate tactic in the war against protectionism is not a high-level international carpet bombing campaign of warm words and empty communiqués. It is hand-to-hand, country-by-country, issue-by-issue combat against the domestic interests pushing for special treatment."[20]

The major responsibility for resisting protectionism must reside in the domestic policy environment of individual countries. While many explanations have been advanced for the failure to deliver a conclusion to the Doha round – the size of WTO membership, the importance of developing countries, the expansion of the agenda to cover agriculture and services – fundamentally, the Doha negotiations have stalled because pressure from protected domestic interests has dominated negotiating strategies. Thus while most market access requests were bold, the preparedness to concede reciprocal access was constrained by those who felt threatened.

Australia is not immune from these pressures and it has regrettably become my considered view that DFAT is now more the problem than the solution when it comes to trade policy effectiveness. For whatever reason – being snowed by the mindless detail of WTO jargon and technicalities, or a masochistic enjoyment of international conferences, extensive travel and crisis driven deadlines – it is my observation that DFAT's perspective is completely wrong. It is highly resistant to open debate on negotiating strategies, let alone subjecting such strategies to independent quantitative analysis by the Productivity Commission, seems to regard almost any agreement as better than none, has shifted focus to bilateral free trade agreements, the economy-wide benefits of which may not always be positive, has thrown numerous road-blocks in the path of the Tasman Transparency Group – a ginger group pushing for greater domestic transparency[21] – and pursues apparent lost causes like appealing against New Zealand's successful WTO action in the apples case.

If it were my decision, I would relocate responsibility for trade policy to Treasury where the economy-wide arguments and interests would receive fuller and more rigorous assessment.

Wheat marketing

About five years ago, I said to colleagues that seeing the end of AWB's export wheat marketing monopoly was the last remaining challenge of my professional career. That has now happened – and in one sense is disappointing: no more challenges! Even if much of the momentum for change stemmed from AWB's misdemeanours in Iraq rather than desirable policy improvements *per se* – in much the same way that Al Capone was picked

[19] Elisa Gamberoni and Richard Newfarmer (2009), "Trade protection: incipient but worrisome trends", *Trade Note* Number 37. Washington DC, World Bank, 2 March, 2009.
[20] "Less than Open," *Financial Times,* 4 February 2009.
[21] See www.tasmantransparencygroup.com

up for tax evasion – the first's year's deregulated market experience has been both relatively seamless and encouraging.

The basis for encouragement has been the number of producers who have taken individual responsibility for their grain by selling outright, rather than pooling and accepting the residual after various costs had been deducted – the principal marketing option for export wheat in the past. In the process they have put to the sword the notion that growers of wheat – unlike any other commodity the same growers produced – needed mollycoddling.

There is still a small coterie of growers who hanker after the return of the single desk, but the vast majority are getting on with their lives and are too busy to waste their time marching on Parliament House.

Before the past regime fades totally from view, it is as well to recall how far we have come. For example, in the 1950s, and 1960s cost of production formulae were integral components of domestic wheat prices in various wheat stabilisation schemes. A colleague has described how farmers who were part of the BAE surveys used to laugh about the gullibility of the BAE officers who came to collect the data. In what were mixed wheat sheep farms, the cost allocation between the two enterprises was amazing, wheat being such an expensive crop to produce, because it bore all the costs!

Of course, cost of production pricing is a dubious concept at the best of times. It may work for a while in domestically focused industries facing limited import competition, but competition of one form or another is never far away. It is irrelevant in export oriented industries such as wheat. The impact of differences in scale, management efficiency, seasonal variability and, more important, the loss of incentive for productivity improvement when cost plus pricing is attempted are all relevant. Even if all these factors were discarded, the different cost structures in competitor countries render use of the concept in Australia nonsensical.

Agricultural marketing debates were passionate affairs. From the viewpoint of a farmer devotee of orderly marketing, these schemes were vital to protect hard working and honest farmers from the slings and arrows of smart money people from the cities, greedy processors, rapacious international traders, or distorted prices resulting from overseas subsidy arrangements.

"Weak selling" associated with free markets was seen as the most heinous of crimes. For example, the number of wheat farmers who, even recently, could vividly recount what life was like during the Great Depression when the price of wheat fell to 1s 3p per bushel perhaps says something about the average age of farmers, but probably more that if you say something often enough and loudly enough it must be true.

A major advance occurred with the Royal Commission into Grain Handling, Transport and Storage conducted by Jim McColl in the late 1980s. My company, ACIL, made a major submission to it, having raised considerable funds by subscription from interested parties. In that submission many examples of the unintended or efficiency-reducing effects of regulation were unearthed and documented, most for the first time. The elephant in the room was contestability for marketing services, but this had been cunningly excluded from the terms of reference.

Revealingly, none of the international grain trading companies agreed to fund the research, mainly because they were already on a good wicket earning generous margins from the then Australian Wheat Board, assisting it with marketing activities in a way that was unknown to farmers. Competition would have competed these margins away, just as it would have been effective in dealing with inefficiencies in the domestic transport, handling and storage system. Farmers would have benefitted from both.

Dairy industry reform

Today's dairy industry is one of the strongest performers in Australian agriculture – a far cry from its antecedent of the 1960s and 1970s when chronic small farm and low income problems constituted major regional welfare challenges. Yesteryear's butter subsidies, home consumption price schemes for milk, limits on the consumption of margarine or rigidly enforced state regulations did nothing to redress those difficulties. Greater reliance on the market and less regulation – along with trade liberalisation and product innovation – have worked wonders.

The only small piece of the dairy jigsaw I was involved in – along with Mike Taylor, then principal economist at the Victorian Department of Agriculture and Rural Affairs, and until recently Secretary of the Department of Infrastructure, Transport, Regional Development and Local Government – was a 1985 inquiry to, of all things, "arbitrate" the price of "market" (or fresh) milk in Victoria. This took place during a State election campaign when disgruntled farmers were pouring milk down Melbourne's gutters and in front of grateful television cameras. It was conducted by Mr Justice James Robinson, a deputy president of the Conciliation and Arbitration Commission.

Despite my initial scepticism, he turned out to be an inspired choice – a quick mind, prepared to "tell it like it is", and with a beautifully clear writing style.[22] During the 6 or 7 weeks of the inquiry we discovered that, every six months, the Victorian Dairy Industry Authority fixed no fewer than 331 prices or margins for all manner of milk products between farmer and consumer. However, Coles, which was gradually acquiring parts of the supply chain, was able to reap substantial efficiencies, cut out several steps along the way for which VDIA-set margins existed and then trouser all the benefits. Here was an unintended, perverse outcome of regulation if ever there was one. The inquiry recommended that all these prices and margins be done away with, except for a farm gate price and a maximum retail price for one and two litre containers of white pasteurised milk. The recommendations were accepted and, soon after, the VDIA was found to be redundant.

Market failure

One of the most important principles in microeconomic policy is that of market failure. Government intervention is usually predicated on the belief that the market, left to its own devices, will not deliver an optimal outcome to society or farmers. The intervention, it is often felt, will fix the problem.

[22] For a comparatively rare example these days of elegant and plain English writing, as well as demonstrating how far dairy marketing policy has evolved over the past 25 years, I commend this report: Mr Justice James Robinson, *Milk Price Arbitration*, 19 April 1985.

There is much shallow thinking in this area. The analysis shows that occurrences of legitimate market failure are greatly exaggerated, that market failure can often be replaced by even more damaging government failure, and that government intervention can often crowd out private sector endeavour.

A good example of crowding out is the impact of subsidised advisory and extension services historically provided by State Agriculture Departments on commercial farm management advice by consultants. As the former have been wound back – often, it should be said, for the wrong reasons of expenditure restraint, rather than that the intervention was inappropriate in the first place – the latter have expanded in both number and diversity of services offered.

Needless to say, a sceptical view towards instances of market failure is not always popular with clients who may be seeking some new handout or preferment. However, one of the more rewarding engagements for a consultant is to convince a client that its case for government intervention has the proverbial snowflake's chance in hell of success and that a different course of action will be more prospective.

Fifteen or so years ago, there was a good understanding of market failure logic throughout policy departments. Now, my sense is that awareness of the principles has slipped badly. Unless we quickly discover a deeper understanding of the role of government, and the damage that can be caused by government failure, our chances of clawing back recent budget deficits will be slim indeed.

Research and development

As far as R&D priority setting and benefit cost analysis are concerned, in my view the R&D corporation performance has been patchy. Priority setting still seems to rely too much on the subjective views of board members, feedback from farmer consultative committees or the continuation of established projects. All these have a place, but my sense is that there is a very poor understanding among those involved that maximising expected returns from the marginal investment dollar should guide allocation decisions. While these issues are relatively complex, not always intuitive and there is obvious uncertainty in projecting future outcomes, the relevant work to establish the analytical framework was done in the 80s and 90s, most notably by David Campbell of ACIL. It is a great shame – and a potential waste of money – that these techniques are not widely employed today.

It is a similar story when it comes to measuring the benefits of research. I have never understood why some R&D corporations have been reluctant to include this analysis routinely in their expenditure portfolios. At the very least, governments are wont periodically to ask the hard question of whether appropriate value for money is being obtained. When they do, it can be awkward if the relevant data are not readily available. Farmers should also ask the same question because they always have alternative investment uses for levy funds. And finally, surely R&D corporations need such information as inputs to their new investment decisions.

I have seen some benefit cost studies that frankly do not pass a sensibility test. Studies producing extremely high benefit cost ratios may seem impressive but the corollaries are rarely pursued. If a benefit cost ratio of, say, 10 is really robust, then probably more – and possibly much more – spending should be allocated to the topic, and quickly. If this were to require an increase in the size of the R&D levy so be it, because there would be few on farm investments that could boast such a high a rate of return. The fact that these discussions rarely occur suggests to me that there is a believability problem with many of the benefit cost studies that have been undertaken.

A related issue is understanding how the benefits of research are distributed up and down the supply chain. For example, if the beneficiaries of a particular piece of textiles research accrue overwhelmingly to wool processors, rather than being reflected in increased demand for greasy wool, it makes little sense for woolgrower levies to be spent there, compared with, say, an on farm project that may result in improved cost efficiency or productivity. Making judgements on these issues requires knowledge of demand elasticities at various points along the supply chain, a fact that I suspect is not uppermost in the minds of many of those involved in making decisions.

Conclusion

My final comment is definitely an example of grumpiness. It is a plea, probably a forlorn one, for clearer use of language in bureaucratic writing. I have been banging this drum in a number of forums in recent years, no doubt to the annoyance of those on the receiving end. I have been shocked to realise how ingrained certain phrases are in bureaucratic writing, like ‘key priorities’, ‘addressing issues’, ‘delivering outcomes’, ‘overarching strategies’ and dozens of other largely meaningless expressions. At its worst, bureaucratic writing is lazy and it fudges the truth. In my opinion, readers and the general public deserve better.