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THE BALDERSTONE REPORT: AN OVERVIEW

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Introduction

In September 1981, the then Minister for Primary Industry set up a Working Group under the Chairmanship of Sir James Balderstone to prepare, within one year, a policy discussion paper on agriculture. The terms of reference were wide-ranging and included the need to identify the major policy issues and options relating to the agricultural sector. The relevant time horizon was taken to be the 1980s. The terms of reference were:

(a) intersectoral relationships affecting agriculture, including resource development, wages policy and assistance to other sectors;
(b) trade policy, in particular the impact of the Common Agriculture Policy of the EEC;
(c) factors affecting technical and economic efficiency in agriculture;
(d) current government assistance to agriculture, including the financial aspects of rural credit and taxation;
(e) the marketing of farm products, including the role of statutory bodies;
(f) agricultural resource management, including soil and water conservation; and
(g) 'animal husbandry measures' which the Group interpreted as covering some of the problems of the intensive livestock industries and live sheep exports which have attracted the concern of some animal liberation and welfare movements.

It would be impossible to discuss all of the terms of reference in detail in this overview. What I propose to do is to raise some of the conceptual and philosophical issues which might be reflected in the Report and then to discuss some of the specific policy recommendations which might provide a basis for more detailed discussion. It is important to emphasise that the Group's instructions were to provide a discussion paper and not to come up with a White Paper (in the old terminology) which might have been construed as actual government policy with respect to the rural sector.

The Nature of Policy Recommendations

Agricultural policy is a multi-dimensional concept, a number of which are canvassed in Standen (1983). I believe there are four facets of rural policy in Australia, whether at the state or Federal level, which help in understanding the policy stances taken by the Group. First, there is a loosely stated set of objectives which are often implicit rather than explicit. Second, there is legislation which enables the policy to be enacted. Third, there is a set of institutions which follow on from the enabling legislation. These institutions can be quasi-governmental or part of the formal government structure. In either event, contained within them is a bureaucracy which constitutes the human dimension of the institution and who are responsible for interpretation and implementation of the enabling legislation. In many cases, the legislation is often written in different forms in different states (for example, the Bulk Handling Authorities for grain in each state) or is drafted in general terms so that interpretation is necessary. In such circumstances the value systems which the bureaucrats themselves possess will be important in the interpretation and implementation of the policy measures. Finally, there is a set of measures or instruments which are the means by which the legislation is translated into action at the farm level.

Debate in economics is often about the cost-effectiveness of various instruments to the neglect of the other dimensions of policy. In my view, policy changes consist of variations in one or more of these dimensions. Moreover, agricultural policy is conducted in an on-going environment where, at any point in time, we have inherited a set of legislative Acts, institutions and instruments which will condition future policy changes. Seldom, if ever, do we start with a clean slate without the existence of some of the detritus from previous policy actions. Rural policy views may often reflect ideological positions relating to held values. In fact, one might well argue that, in the real world of policy, such value systems underlie many attitudes towards policy changes by both economists, bureaucrats and politicians.

One stereotype would have rural policy display a large element of intervention, regulation and control. The polar extreme, and again a stereotype, would be those who would have rural policy reflect complete freedom for individuals and firms to do what they conceive to be in their own best interests with minimal, if any, government intervention in the market place. The current debate in Australia and in the U.K. about the wets versus the drys is, I suggest, largely a reflection of held values rather than about economic rationality. In any event it is difficult to find someone who is completely wet or completely dry: most of them fall in between the two stereotypes and exhibit degrees of wetness or degrees of dryness.

In practice, then, policy discussion is likely to be an amalgam of a number of different desiderata and certainly the Group's thinking reflected this. We did not have, nor did we seek to find, a Philosopher's Stone which would provide a universal principle which might provide a reference point for all policy stances.

Macro-Economic Policy Objectives and Rural Policy

At the macro level, policy objectives in the Australian context usually revolve around:

(a) full employment, although what this constitutes has become less well defined in the last few years;
(b) balance of payments equilibrium;
(c) a stable general price level (i.e. the lack of inflation);
(d) growth in real standards of living; and
(e) equity in the distribution of output among various groups in the community.

In terms of macro policy, the emphasis on each of these objectives will vary over time. There is obviously a trade-off among objectives. For instance, one may achieve more rapid economic growth but it may be at the expense of inequitable or regressive income distributions. Currently the major emphasis has moved away from reducing inflation at all costs to the question of the trade-off between the rate of inflation and the rate of unemployment.

I believe that this is a substantive point in that the existence of the trade-offs among policy objectives makes policy recommendations and advice more difficult than if one single objective is to be pursued to the total neglect of all others. Agricultural policy objectives are often nested in these macro objectives and changes in emphasis on these objectives will impact on agricultural policy.

When we move to policy advice at the less aggregative level, the traditional neo-classical framework emphasises the twin aspects of efficiency in resource allocation and equity in the distribution of income. One might add a third, namely, that of economic security, thereby giving some dynamic dimension to the more static orientation of the equity-efficiency criteria of neo-classical economics. As was the case with macro policy, these three objectives are often in conflict with one another. We can trade-off some economic security but it may be at the expense of efficiency and, by the same token, we can have an improvement in the efficiency of resource allocation but it may well result in a redistribution of income away from one group toward another. There is, therefore, a trade-off among these three objectives. Standen (1983) has emphasised the nature of these trade-offs in providing policy advice.

I have formed the view that, particularly amongst the academic agricultural economists, the concentration on the efficiency aspects of policy, while it is the first point of departure in the analysis of rural policy, is at the same time an inadequate basis for policy advice. The efficiency dimension highlights the fact that many economic models are just that and do not map directly into real world situations where one starts with disequilibria, resource distortions and institutions already in place. These are messy problems for the direct application of the models. This focus on efficiency as the be-all and end-all can lead to extreme positions which have been admirably characterised by Sieper (1982).

In the best IAC tradition, three sources of increases in the national output can be identified:

(a) increases in the quantities of input available to the economy;
(b) innovation and dissemination of new products and processes; and
(c) improvement in the efficiency with which inputs are allocated among alternative activities and consumption expenditure is allocated among alternative commodities.

It is relatively easy to translate these three sources of improvement in the national output into their counterparts with respect to the rural economy. In its Report the Group arrived at a judgmental consensus. I make no apology for the proposition that policy in the real world always involves some element of judgment based on a discussion of the issues and options and using a mix of criteria among which there are trade-offs.

These criteria involved questions relating to:

(a) resource efficiency in the context of short-run allocation problems;
(b) equity in the distribution of income among farmers in different

agricultural industries and between farmers and the manufacturing sector; and

(c) growth in the rural sector, in particular, those relating to how the productivity of farm resources could be increased.

Within the context of these three criteria the Group attempted to articulate a set of propositions or principles about agricultural policy for the 1980s (Balderstone et al. 1982, para. 1.14).

Agricultural policy should:

- be responsive to national and international economic developments;
- create conditions under which the agricultural sector can handle change and at the same time realise its full potential in contributing to national economic growth;
- aim to encourage the efficient use and conservation of the nation's resources;
- promote the adoption of new technology and increased productivity in the farm sector; and
- be consistent with other national policies and goals; there should also be consistency of policy at the Commonwealth, state and local levels of government.

In applying these principles to the specific policy issues and options contained in the body of the Report, the Group found itself somewhere between the two polar stereotypes that I have mentioned, but philosophically closer to the drys than to the wets.

That is (para. 4.4):

> in the Group's view, the objectives are most likely to be met by the operation of the market, with minimum intervention. However, the Group recognizes that there are situations where governments will intervene at both the State and Commonwealth level and influence the operation of the market. It is therefore particularly important that policy measures, while seeking minimum government intervention, are generally consistent with each other and seek equity of treatment between industries and sectors.

Some Equity-Efficiency Trade-Offs

The discussion by agricultural economists of agricultural policy in Australia has tended to emphasise the efficiency aspects of the three criteria I have mentioned, to the relative neglect of both distributional questions and questions of economic security. I believe that it is an arguable proposition that the failure to make judgments about distributional questions in particular, and economic security questions, perhaps to a lesser extent, has in many cases resulted in sweeping some of these questions under the proverbial carpet. I find it very difficult to imagine any policy change, ostensibly made on efficiency grounds, which does not redistribute income in one way or another.

As Thurow (1980, p. 17) has so forcefully indicated, 'the difficulties of specifying economic equity neither obviate the need for equity decisions nor stop such decisions from being made'. In the same context, many policy decisions act to destabilise the wealth and income situation of particular groups in the community and the resulting drive for economic security can act to rigidify the economy. At least in the past 10 years the substitution of underwriting schemes, which in a sense provide a safety net for disastrously low prices, has replaced stabilisation schemes so that the distortions which may have been inherent in the latter have been reduced or eliminated, but with the loss of some degree of economic security.

In the context of protection policy, what information do we have on the costs of resource inefficiencies and the size of income transfers? The evidence we have is far from complete and to a substantial extent has been derived from various applications of the Orani model in the Impact Project. The currently accepted position in the profession would seem to be that agricultural output and farm income are lower than they would be if the extent of tariff assistance were to be reduced. Mauldon (1982) has presented some IAC estimates of the redistributional consequences of assistance. 'The IAC has estimated that protection against imports involved redistributions of the order of $6.5 thousand million in 1977-78 and the assistance to agriculture redistributed a further $300 million'. More recently, Crowley and Martin (1982, p. 292) have indicated that 'average cost of manufacturing industry assistance per producer for the export oriented industries (sheep, beef and wheat) was estimated to be $3238 in 1981-82, or $62 a week'. It is important to realise that these redistributions are away from (owner-operator) farm families who are perhaps distinguishable from the rather amorphous shareholders in the mostly corporate manufacturing sector.

The redistribution of output and income consequential on assistance to industry has important regional dimensions as well. A study by Liew (1982) indicates that a uniform 25 per cent tariff increase would benefit the import-competing industries while the main losers would be the export industries. Such a tariff increase would reduce agricultural output in every state of the Commonwealth. Moreover, the output of the food manufacturing sector based on animal production would also fall in every state. By contrast, output for every state in the motor vehicles, textiles, clothing and footwear sectors would rise materially. It is also worthy of mention that such a tariff increase would reduce mining output and the output of base metals in every state.

Such a change in tariffs would have general macro and regional results on a number of key variables. Gross State Product as a result of such a tariff increase would fall in every state except Victoria and the fall would be greatest in states such as W.A. and Queensland which have the highest proportion of output going to export. As well, regional employment would fall in every state except Victoria, but to a neglible extent in S.A. while prices would rise in every state. Clearly the redistributive consequences of tariff assistance will place strains on the Federation as the extent of the redistributions are absorbed by the various states.

Some Specific Policy Issues and Options

The Group's preferred position on the protection issue was that there be a planned and gradual reduction of the levels of protection accorded to the most highly protected industries in both manufacturing and agriculture. In the event that the Government is not prepared to follow such an option, the Group has recommended a number of forms of assistance which should be either continued or implemented with respect to the rural sector. Two of these have produced a degree of comment.

Both measures relate to forms of assistance which are directed at inputs. Currently, both phosphatic and nitrogenous fertilisers are subsidised. Since fertiliser is used by most farmers, the Group felt that assistance by a fertiliser subsidy would be of advantage to a broad range of agricultural commodities. There is little doubt that, in the eyes of the farming community, the fertiliser subsidy, particularly that on superphosphate, is perceived as a very important form of assistance even though the real value of the subsidy declines under rising prices.

The importance attached to the superphosphate subsidy is evidenced by the reaction of the farming community to its removal by the Whitlam Government at the end of 1974. Inside twelve months, the IAC recommended that the subsidy be reinstated on the efficiency criterion that superphosphate was used in lightly assisted industries, even if it was not to be increased. The Group was also aware of the argument advanced by Parish and McLaren (1982, p. 7), even though it is not universally accepted, that 'from the government's point of view, they (input subsidies) may be a more cost-effective way of encouraging output; and if they are, they may also (but need not) be more cost-effective from the point of view of society as a whole'. In the view of these two authors, fertiliser subsidises may well meet such cost-effective criteria.

A second form of assistance recommended by the Group was that interest rates for primary producers were to be deductible at a rate above the current 100 per cent. The deductibility would be in the form of a rebate available to all tax-paying primary producers. The logic behind choosing credit as a form of assistance is essentially that credit it almost a proxy for all inputs and, moreover, is consistent with the Group's view that farm productivity needs to increase if the farm sector is to withstand the pressures of the 1980s. Whether the improved productivity arises from increased farm size, from the further substitution of capital for labour, or from the adoption of new technologies, credit will be required. Even in the case of a costless (for farmers) innovation such as myxomatosis, the need to increase stocking levels to take advantage of the increased feed availability required access to credit.

While it is true that, at least before the 1980-82 drought, the debt position of the rural sector was relatively favourable with BAE estimates suggesting that approximately 50 per cent of farm businesses had debts of less than $10 000, the Group was of the view that agriculture in the next ten years is going to become increasingly capital intensive, that farm sizes will increase and that farmers may not be able to continue to fund the bulk of their farm development programs and increasing farm sizes from internal sources. The comment has been made that this proposal is likely to lead to distortions. Presumably, the basis of this comment is that if we alter the prices of any input then, on efficiency criteria, farmers will move away from a least-cost input combination. This short-term view of efficiency, I suggest, may have to be qualified by the dynamic considerations of increased farm sizes and greater productivity where we may very well have longer-term gains even though we do suffer from short-term inefficiency in resource allocation. I would argue also that it is implicit in this comment that we are currently confronted with a set of market prices which is in some sense 'right'.

This I believe to be a doubtful proposition. The existence of information gaps, particularly on best-practice techniques, means that many farmers may not even be on the frontier and that questions of overcoming problems of X-inefficiencies may be of greater magnitude than reallocations on the frontier. It is arguable that providing this deductibility with respect to interest payments may not be the most cost-effective way of overcoming such X-inefficiency and that the greater use of the extension services might be preferred. If we accept the proposition that there are already significant distortions in existing market prices, then it is not altogether clear that the proposed deductibility with respect to credit will, on balance, worsen the distortions or reduce them.

This leads us into the quick sands of the second-best. In terms of policy recommendations I've always taken comfort from Mishan (1962, p. 216):

> If second-best theory has a positive contribution to make it is that of serving notice that, in the presence of constraints, slap-dash optimising, wherever one can, may not improve matters; one has, in that case, to proceed cautiously, which is rather different to not proceeding at all.

I believe that the Group, in using the criteria that it has set out, is not, in Mishan's (1962, p. 214) words, 'standing by and sadly sucking our thumbs under the sign of the second best'. Rather, it has advanced, admittedly with a dash of pragmatism, a series of policy issues and options which, it is hoped, may not only stimulate discussion but also lead to implementation in the next few years.

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