Figures that just don't add up

Our economists must go for the facts instead of relying on theory, writes **Martin Feil.**

SPOONER'S VIEW

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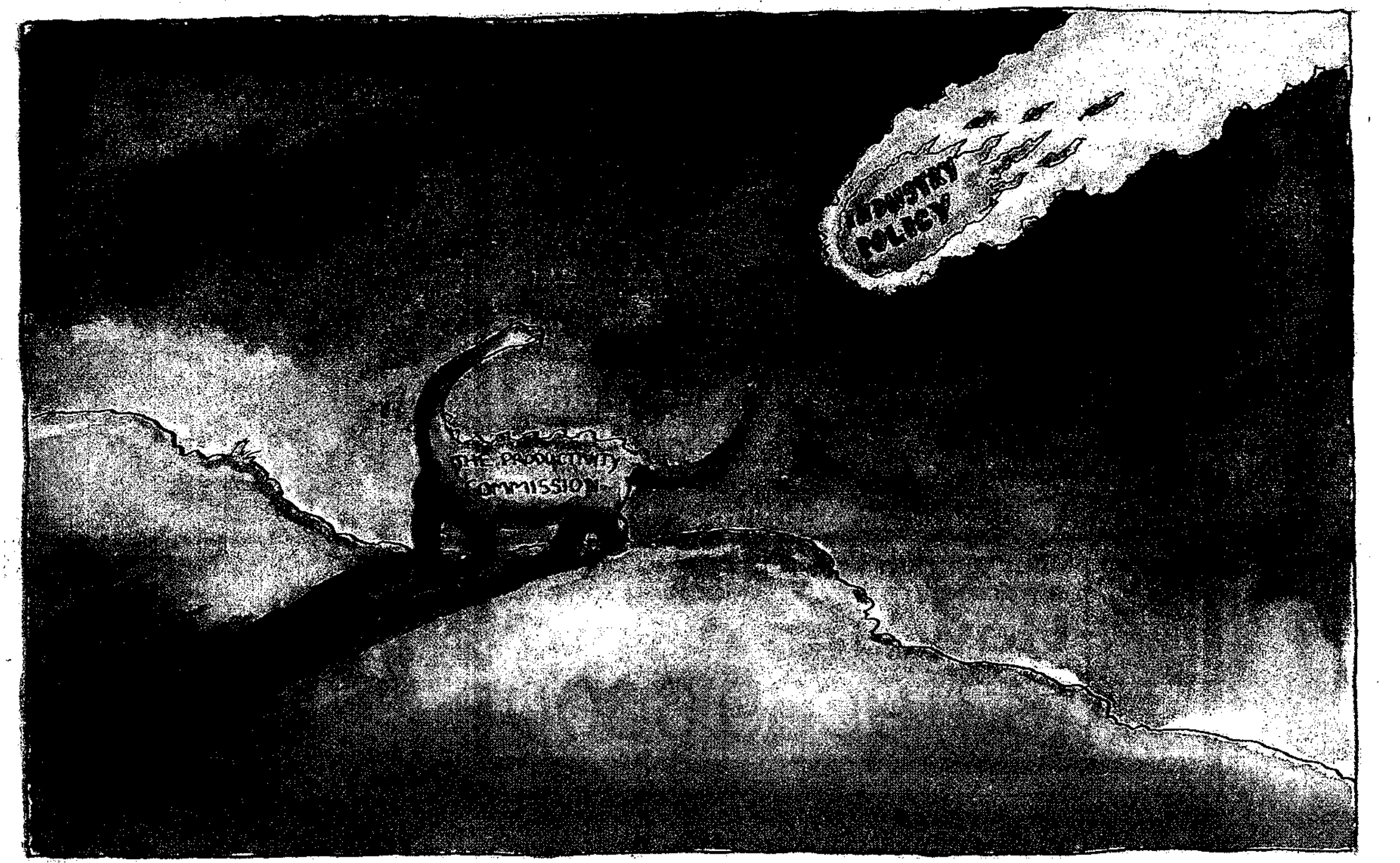

WHY did the Productivity Commission issue its report on *The Cost of Industry Assistance* now? The commission published its 2006-07 annual report in November 2007. It has been publishing this report about the same time of the year for decades.

The feature of the annual report was an analysis of the labour market. Contrary to the upbeat spin on full employment, the commission found that 9.8% of the labour force were either unemployed or looking for more work. Those who had given up and had not sought a job for the past four weeks were excluded from the analysis.

Last week the commission published another annual report (as part of its trade and review annual report series) that failed to report on its inquiry activities at all. Its purpose was to publicise what it regarded as the cost of assistance measures to the economy generally and the motor vehicle industry in particular. The headline number used in the chairman's public statements was $15 billion a year.

That is not the commission's tariff cost number. That is the number for all government budgetary assistance measures.

The commission's analysis and numbers, as always, are prolix and confusing. The big number includes research and development, drought relief and the entire gamut of programs conducted by AusIndustry.

Net industry assistance through the tariff is calculated at $1.3 billion in 2002-03 and $1.4 billion in 2006-07. This is a long way from the headline number of $15 billion. The difference is that about $6 billion was spent on industry programs and the tariff costs of material and component inputs are netted off against final product outputs.

No calculation is made regarding the level of assistance to the services sector on the grounds that it is too hard to measure. The commission's general view is that the sector receives negative assistance.

It should do something to demonstrate that assertion. Apart from fancy imported cars (that don't compete with local manufacturers) and computers (that are duty free) there is little tariff cost for the services sector that I can think of apart from clothing.

Most of the assistance received by the services sector comes in quasi-quotas and other restrictive measures that are absolute anathema to the commission. Overseas and interstate entry into the professions is limited. Our banking policy is limited, the regulation of the financial sector is complex and costly for government.

Given the cost to the economy imposed by the services sector over the past six months, a lot of people would be happy if there had been some publicly measured government intervention in that sector.

It would be quite simple to establish a statistical primary source for the measurement of the cost of the tariff. The amount of duty received by Customs is divided by the total value of imports and the result is calculated as a percentage. Instead, the commission uses a one-or-two-steps-removed number derived from value-added numbers published by the Australian Bureau of Statistics.

The numbers are wobbly. Food, beverages and tobacco attract the highest gross tariff amount. This is, of course, because imported items such as rum, whisky, brandy and beer attract a duty rate that is equivalent to the excise rate on locally produced spirits and beer. That rate delivers a revenue tax that is intended to be punitive. Tariffs are supposed to assist Australian industry.

There is also no satisfactory treatment of duty exemptions through the tariff concession system. The last time I looked, tariff concessions applied to about 70% of the value of imports. They were free of duty. It is difficult to believe that the weighted average nominal tariff rate is still 5%.

The commission's major purpose in the Trade and Assistance Review is to attack the concept that any particular sector of the economy (or industry) should be assisted by the government. The only mechanism that it supports is research and development expenditure. Even there, its endorsement is grudging. I suppose the fact that Australia is trailing pathetically on the rankings of the Organisation for Economic Co-operation and Development in its percentage of gross domestic product spent on research and development may explain the report.

The overall tone of the report is prescriptive. Expressions such as "problematic prescriptions for assistance" and "minimising adverse behaviour" suggest that individual industry solutions and measures have to be avoided at all costs.

The outcome of this is that there will be no individual industry assistance policy measure that meets the philosophical righteousness of the Productivity Commission.

This outcome ignores what every other country is doing. They all provide specific industry assistance policies. The difference between their policy approach and ours may be the size of our current account deficit.

An important message arises in this review. The message is well articulated by a quotation from Treasury secretary Ken Henry, who says ". . . effective policy advice . . . must employ the highest standards of intellectual-based rigour . . . Analytical rigour demands soundness of empirical methods, analytical tools, models and frameworks. Analytical rigour should be the foundation upon which all advice is based, the ultimate assurance of its quality and credibility."

The Prime Minister's action mantra is basing policy on evidence.

It is not appropriate to take just part of the Ken Henry quotation as the lodestar for the Productivity Commission. Henry's rigour begins with soundness of empirical methods. I believe that, as the commission's industry inquiry workload has declined, its isolation from empirical evidence has increased. Departmental data bases, modelling with an assumptions straitjacket and ABS statistics, are not enough.

We need some applied knowledge in this country. There is an elitist attitude prevailing that is separating theory from empirical evidence. It is not good enough to postulate an economic policy. Sooner or later it has to be proven empirically.

Too often in the recent past we have been deceived by claims of economic and financial rectitude that were simply sectoral spins.

Many are asking how our economy has got into so much trouble so quickly. The answer is that it has been on the road to that end for a long time. It is about time that we got back to the facts and forgot about the theoretical dialectic.

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