Australian Financial Review
Tuesday 6/3/2012
Page: 63
Section: General News
Region: Australia Circulation: 72,282
Type: National
Size: 267.69 sq.cms.
Frequency: MTWTFS

Pitfalls of government intervention

The Modest Member

Meddling with market forces can have adverse consequences, writes **Scott Ryan.**

When it comes to the economy, it seems the greatest promise held out by governments and experts is the ability to predict the future.

Economic plans are called for to take advantage of economic opportunities or combat troubling trends. "This cannot be left to the market," goes the cry.

This assumption of seer-like abilities underpins the illusion that somehow "correct" government policy will achieve a better outcome than the market.

A little over a decade ago, the sector that underpins our recent prosperity was derided as part of the old economy. The economic zeitgeist was that mining was yesterday's industry, and its prospects were in long-term decline.

"The mining industry's glory days are now but a memory," was how the BNP equities director outlined the mining sector. Academics jumped in too, with the Centre for Strategic Economic Studies outlining: "The challenge for Australia is to develop new or expand existing industries . . . in order to offset the inevitably slower growth of the traditional resources sector."

In the early 2000s, the real economic opportunity was seen to be in the information sector. There seemed to be an assumption that a local information communications technology (ICT) industry was an end in itself, rather than an enabling technology for all sectors.

Around the same time, the Australian dollar hit record lows, dropping to below US50¢. The resources boom was simply not foreseen.

Consequently, there were calls for the government to "do something" as Australia was seen as an old economy dependent on agriculture and resources. These calls inevitably involved demands for subsidies or the development of government plans to support or nurture ICT industries.

This was the new version of the old claim that public funds should be directed to preferred industries. But for government to "do something" there are very real costs, despite the fact that these are often overlooked.

Every time government redirects resources from one sector to another, the country suffers economic loss: first, because the economy-wide deadweight cost of taxation is increased and, second, this capital is inevitably used less efficiently.

As a capital-importing economy and with the extraordinary capital needs of the resources sector, it makes little economic sense to move capital away from those areas in which we have both an advantage and healthy demand (as well as historic high prices).

This would be just another example of the government trying to pick winners or of patronage and preferment. This principle is still debated today. The minerals resource rent tax is partly justified as a way to address the two-speed economy and redirect resources from the rapidly growing mining sector to others.

Hunger for labour is driving people north and west, where they can be most productive.

To attempt to slow down one sector to advantage another merely reduces our overall economic welfare. Today's mining boom is partly due to the structural reforms of the past 30 years that have freed up capital and labour to move to areas of Australia's comparative advantage. The resources sector has been a world leader in efficiency precisely because of its exposure to competitive international markets.

Its hunger for labour is driving people north and west, where they can be most productive and add most to our national wellbeing.

The era of mass unemployment following the 1970s stagflation is over; debate is now about participation and applying labour to our most productive efforts.

To have acted to prevent or slow this, whether motivated by those seeking handouts or simply based on the best predictions at the time, would have resulted in massive opportunity cost, and a real reduction in national wealth today.

When people and companies act with their own money there is no loss to taxpayers or the broader economy.

When it is done by government, there is. Humility is no bad thing for governments. Being conscious of limited knowledge ensures that limited public resources are not wasted or successful industries held back.

■ *Scott Ryan is shadow parliamentary secretary for small business and fair competition and a senator for Victoria.*