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Drought Policy

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It was interesting to have the Agforce President identify their drought policy model as based upon business cycle behaviour (QCL, 25th, July). Policy based upon business cycle behaviour sounds impressive; but, it is not delivering in the real world of protracted drought. Business cycle or alternatively trade cycle behaviour has puzzled economists in industrialised economies since 1790. Nevertheless, it is comforting to know that peak rural industry bodies believe they have found answers to questionable economic behavioural theory that has troubled trained minds for centuries.

In essence, the business cycle describes loosely fluctuations in production and employment in an industrialised economy. The term cycle is used to describe the shape of the production curve traced out over a time by fluctuations in employment and output across the whole economy. By the 1950's, it was assumed that business cycle theory described a pathological condition in industrialized economies that could be cured if certain structural reforms to the economic system were implemented. The structural reform thesis ran into heavy weather when confronted with protracted recession and depressions. For rural policy, protracted drought would seem to be as inexplicable to business cycle theory as recession and depression are in the wider economy.

Since the 1980's, the New Classical School has revived business cycle theory. The New Classical School believe that fluctuations in economic activity such as employment and production can be explained by applying microeconomic model assumptions to failed macroeconomic classical business cycle theory. The relevant microeconomic assumption is that all markets clear in the short run. This of course is a modern restatement of the 1803 supply and demand theory, Say's Law of Markets, more commonly known as supply creates demand. This simple modification of traditional business cycle theory by the new classical school is known as the Theory of Real Business Cycles.

One important parameter that can generate fluctuations in employment and production in New Classical Real Business Cycle theory are technological shocks which can be extended to include bad weather. The bad weather extension allows the real business cycle model to be applied to drought policy. By inference, modern drought policy and more generally rural policy can be now identified with the new classical school and real business cycles theory.

John Maynard Keynes had this to say about the old classical school.

“ Our criticisms of the accepted classical theory of economics has consisted not so much in finding logical flaws in its analysis as in pointing out that its tacit assumptions are seldom or never satisfied, with the result that it cannot solve the economic problems of the actual world”

Keynes, General Theory Money, Interest and Employment p. 378

Assumptions of modern real business cycle theory

- 1 A single commodity economy
- 2 Flexible prices and wages
- 3 Money supply and price level do not influence real variables such as output and employment

4 Fluctuations in employment are purely voluntary

5 Population and labour force fixed

6 All economic agents are rational decision makers

When applied to real business cycle theory of the modern New Classical School, Keynes criticisms of the underlying assumptions of the old classical theory would appear as valid today as they were back in 1936. The underlying assumptions of the real business cycle model do not reflect the real world. Sadly, other economic philosophies that can address economic dislocations are being ignored in deference to this structurally deficient real business cycle model.

Post graduate fiscal studies identifies an important function of fiscal policy as smoothing cyclical fluctuations in economic activity. Fiscal policy therefore is directed to stabilising production, employment, investment, income distribution, and living standards over the business cycle. Consequently, fiscal policy should now focus upon *stabilisation of protracted drought affected regions*. It is time rural industry leaders faced the inadequacy of business cycle theory to address real world problems and needs of agriculture- particularly protracted drought.