Public Investment in R&D and Extension and Productivity in Australian Broadacre Agriculture

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[Abstract]

This paper uses time-series data to examine the relationship between public research and development (R&D) and extension investment and productivity growth in Australian broadacre agriculture. The results show that public R&D investment has significantly promoted productivity growth in Australia’s broadacre sector over the past five decades (1953 to 2007). Moreover, the relative contributions of domestic and foreign R&D have been roughly equal, accounting for 0.6 per cent and 0.63 per cent annual TFP growth in the broadacre sector, respectively. The estimated elasticity of total factor productivity (TFP) to knowledge stocks of research (both domestic and foreign) and extension were around 0.20–0.24 and 0.07–0.15 respectively, the ranges reflecting alternative distributions of benefits flowing from knowledge stocks. These elasticities translated into internal rates of return (IRR) of around 15.4–38.2 per cent and 32.6–57.1 per cent respectively. While such rates are less than the average IRR reported in the international literature of 100 per cent, they are consistent with previous estimates for Australian agriculture of around 15–40 per cent. This growth

[Key Words]

R&D, Total Factor Productivity, Agriculture

[JEL Code]

D24, N57, O32

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Introduction

Increasing productivity in the agriculture sector continues to be a core policy objective of rural industries and Australian governments. Investment in research, development and extension (RD&E) is an important means of developing new technologies and management methods. Facilitating their adoption by industry drives long-term agricultural productivity growth. In recent decades there has also been a focus on developing technologies that are both profitable for farmers and deliver better environmental and human health outcomes.

There is an ongoing debate in Australia about the role that governments should play in funding agricultural RD&E and the returns to such public expenditure. These issues are especially relevant insofar as agricultural productivity growth has slowed over the past decade or so, most notably in the cropping sector (Nossal and Sheng 2010; Nossal et al. 2009). Extended poor seasonal conditions explain some of this slowdown, but a long-term decline in the growth of public RD&E since the 1970s has also been shown to be a factor (Sheng et al. 2010).

The returns to public agricultural R&D as reported in the literature appear significant, with no evidence that the rate of return to public RD&E investments is declining over time. Alston et al. (1995) surveyed a large number of studies and found that the median return to public investment in agricultural research was 48 per cent (with an average of 100 per cent) across many different countries. Similar results have also been found in Australian studies that have focused on the broadacre sector. Representative of these is Mullen and Cox (1995), who estimated the internal rate of return (IRR) to publicly-funded research in Australian broadacre agriculture (essentially, non-irrigated crops, beef cattle and sheep industries) to be around 15–40 per cent between 1953 and 1988. Mullen (2007) estimated similar rates of return for the period 1953–2003, suggesting high rates of return to public research have persisted in Australia also.

However, the extent to which technology and knowledge ‘spill-ins’ from research conducted in other countries influences agricultural productivity growth in Australia is not well understood. Research conducted interstate or overseas can be a source of spillover productivity gains, whether as ideas borrowed from the research of others or through foreign technology adapted to suit local conditions. The small number of studies that have considered foreign spillovers have found that foreign R&D is as important—if not more so—as domestic R&D (Alston 2002). Moreover, foreign R&D is likely to be especially important for small, open economies such as Australia.

The objective of this paper is to re-examine the relationship between public agricultural RD&E investment in Australia and broadacre total factor productivity (TFP). The rate of return to public R&D is estimated following a research strategy similar to that used by Alston et al. (2010), using a range of econometric techniques and an extended dataset covering the period from 1953 to 2007. An important advance is to account for broadacre productivity gains arising from technology ‘spill-ins’ from other countries and to distinguish between the relative contributions of foreign and domestic R&D and domestic...
extension activities to broadacre TFP growth. The results of several model specifications are presented. Thus, the results reflect a range of assumed benefit distributions of public RD&E over time and, in turn, a range of internal rates of return.

Public RD&E Investment and Agricultural Productivity in Australia

In Australia the share of agricultural RD&E funded by the public sector has been much larger than that of the private sector; generally greater than 90 per cent of total agricultural R&D, although by 2007 this had decreased to 80 per cent (Mullen 2010). This contrasts strongly with other OECD countries where, on average, more than half of the total investment in agricultural research in 2000 came from the private sector. Not surprisingly, the extent of public investment in agricultural RD&E and its impact on agricultural productivity have consistently been an important policy issue in Australia.

Australian public investment in agricultural research has, in real terms, increased over the past fifty years, from A$140 million in 1953 (2008 dollars) to around A$829 million in 2007 (figure 1). However, while growth in public R&D expenditure was strong up to the late-1970s, it has since slowed. Research intensity (defined as the ratio of public RD&E expenditure to agricultural GDP) peaked at five percent in 1978 before declining to three per cent in 2007. Specifically, the annual growth rate of public R&D expenditure for agriculture has declined from around 7.0 per cent a year between 1953 and 1978 to around 0.6 per cent a year from 1978 to 2007.

Figure 1 Real public RD&E Investment in Australian Broadacre and US Agriculture: 1953-2007

Source: Estimated with data from Mullen (2010) and ERS-USDA.
Notes: In 2008 dollars. Australian public investment in R&D includes expenditure by State and Commonwealth research institutions and universities, including funds from the Research and Development Corporations and other external funders for agriculture, excluding research in fisheries and forestry.

A key objective of agricultural RD&E is to improve farm performance, particularly in relation to farm productivity. In this regard, total factor productivity (TFP) in broadacre
agriculture in Australia generally grew for many decades; from an index value of 100 in 1953 to 218 in 2007, peaking at 288 in 2000 (figure 2). However, of concern is the slowdown in growth since the mid-1990s, particularly in the cropping industry (figure 3). Broadacre TFP growth averaged around 2.2 per cent a year before 1994 (a turning point year determined by Sheng et al. 2010), but declined to 0.4 per cent a year thereafter.

Figure 2: Broadacre TFP and terms of trade in Australia, 1953–2007

Note: The terms of trade is the ratio of an index of prices received by farmers to an index of prices paid by farmers (ABARE 2009). TFP is the ratio of a quantity index of aggregate output to a quantity index of aggregate input (see Gray et al. 2010).

There is now evidence that stagnating public investment in RD&E since the late-1970s may have contributed to the slowdown in agricultural productivity growth (Sheng et al. 2010). Of course, there is a range of factors that could have contributed to the slowdown in broadacre TFP growth. Chief among these is drought, which has been a feature of agriculture for the past decade, but particularly in 2003 and 2007. However, that RD&E should be singled out as a contributing factor is not surprising given the underlying intent of such investment.
Methodology and Estimation Strategy

For a variety of reasons, estimating a relationship between RD&E activities and agricultural TFP is complex. First, agricultural TFP in a given year does not depend on the current level of RD&E expenditures, but rather on the stock of usable knowledge derived from past RD&E expenditures (Alston and Pardey 2001). Second, there are usually long lags before investments can be converted into useful knowledge and technologies that are available for farmers to use (Alston et al. 2010). Thus, because it is unlikely that expenditure on R&D and, to a lesser extent, extension will be directly correlated with broadacre TFP in the same period, the unobserved knowledge stocks drawn on by farmers can be proxied by weighted aggregates of past expenditures on R&D and extension. In these matters, economic theory does not suggest an obvious estimation strategy although past empirical studies do provide some guidance.

In the first instance, an unconstrained base model can be used to represent the relationship between RD&E knowledge stocks and TFP:

\[
TFP_t = f(KS_{DS}^t, KS_{PS}^t, KS_{EXT}^t, KS_{FS}^t, Z_t) + \epsilon_t
\]  

where \( TFP_t \) is the TFP index at time \( t \) and \( KS_{DS}^t \), \( KS_{PS}^t \), \( KS_{EXT}^t \) and \( KS_{FS}^t \) are knowledge stocks pertaining to expenditures on domestic public R&D, domestic private R&D, domestic extension and foreign public and private R&D, respectively. \( Z_t \) is a vector of other control variables cited in previous studies (namely, seasonal conditions, the terms of trade and farmers’ highest level of education attainment). A specific functional form is denoted by \( f(.) \) and \( \epsilon_t \) is an error term.
However, a number of data limitations and various econometric issues mean that it is not possible to directly estimate equation (1) without encountering a range of statistical limitations. The balance of this section outlines a less direct, but more robust four-step estimation strategy involving:

- construction of the R&D and extension knowledge stocks
- choice of model specification
- choice of estimation strategy
- estimation of impacts and internal rates of return.

**Construction of knowledge stocks**

The choice of the models for constructing the knowledge stock variables was based on the findings of previous international and domestic studies (Alston et al. 2010; Alston et al. 2000; Mullen and Cox 1995) and econometric experimentation with similar models by the authors. A small group of models was selected that had sound statistical properties and economic implications, based on a series of econometric tests including the Ramsey RESET test and the Root Mean Square Error (RMSE) test. Knowledge stock variables were derived as the weighted average of past expenditure, using weights based on a suite of specific distributions (determined by an assumed duration and distribution shape of the impact of research over time):

\[
KS_i^t = g_i(R_i^t, R_{i-1}^t, ..., R_{i-t_{L_i}}^t)
\]

where \(KS_i^t\) denotes the knowledge stocks corresponding to various RD&E activities \(i = \{DS, PS, EXT, FS\}\) as in equation (1). The particular level of investment at time \(t\) is denoted by \(R_i^t\) and \(L_i\) is the maximum time lag for each knowledge stock variable is \(L_i\). The distribution functions for alternative time-lag profiles of R&D and extension are denoted by \(g_i(.)\).

The time profile (that is, the duration and distribution of the lag profile) used to construct knowledge stock variables was based on the likely features of the relationship between the flow of research investments and the stock of usable knowledge. There are usually long but uncertain lags between research investments and their eventual contributions to the stock of useful knowledge. To reflect this, R&D lags of 16 and 35 years were considered in constructing the R&D knowledge stock variables (following Mullen and Cox 1995). To describe the shape of the lag profile, three distribution functions were considered: gamma, trapezoid and geometric distributions. The geometric distribution was included because it reflects the perpetual inventory method (PIM) approach, which is commonly used to construct knowledge stocks for the manufacturing sector (for example, Shank and Zheng 2006). However, results obtained with the geometric distribution are not discussed as the PIM approach is inconsistent with the expectation that agricultural R&D investment will have little impact in its early years due to long lags in adoption (Alston et al. 2010).
In total, knowledge stocks were constructed using 10 different distribution functions: three gamma distributions (one with the peak impact occurring after seven years and two gamma distributions that mimic the trapezoid (gamma_T) and geometric (gamma_P) distributions) as well as the trapezoid and geometric distributions for both 16 and 35 year lags.

In contrast to the relatively long R&D lag profiles, extension activities were expected to have a much quicker, but still lagged, effect on productivity. The domestic extension knowledge stock was assumed to follow a geometric distribution with a maximum lag length of four years (Huffman and Evenson 2006).

Choice of model specifications

To identify the relationship between the different types of knowledge stocks and TFP growth, past approaches have usually found it necessary to impose two constraints over the way in which the model is specified. This is because of issues arising through multicollinearity (due to the high correlation between the knowledge stocks) and endogeneity (arising from excluding private R&D).

First, following Mullen and Cox (1995), private R&D knowledge stocks were excluded from equation (1). Time series data on private R&D expenditure in Australian agriculture are not generally available. Not including private R&D (domestic and foreign) may result in biased estimates of the coefficients of public knowledge stock variables if private and public knowledge stocks are correlated. For example, were private R&D positively correlated with public R&D, its omission would bias the estimates of the coefficient on public R&D upwards (Alston and Pardey 2001).

Omitting private R&D knowledge stocks is, potentially, a significant limitation of this analysis. But there are reasons to believe that any such bias may be less than would otherwise be expected. To the extent that farmers pay for the outputs of private sector research and services, the benefits of private R&D will be captured as an input in the TFP index. Conceptually, this would be the case if the private sector is able to appropriate some of the value of improved inputs (including consultancies to farmers). In other words, the productivity effect of an increase in output would be at least partially offset by the measured increase in higher quality inputs.

Furthermore, in the case of Australia, the private share of agricultural R&D has been small relative to public investment, exceeding 10 per cent only in recent years. Given the longs lags between research investments and their eventual contributions to the stock of knowledge, it is likely that domestic private R&D has had a relatively limited impact on broadacre TFP to date. However, excluding foreign private R&D remains a potentially significant source of bias and an area for future research.

Second, rather than estimate the individual effects of domestic and foreign public knowledge stocks (equation 1), it was necessary to form a total public research
knowledge stock variable \((TS_{ij}^k)\) to deal with the high correlation between foreign and domestic public R&D knowledge stocks. Foreign (public and private) R&D is expected to contribute directly to TFP growth in Australia through cross-country technology spillovers. Not controlling for the impact of foreign public knowledge stocks may also result in omitted variable bias, leading to over- or under-estimation of the contribution of domestic public R&D and extension knowledge stocks to productivity.

Two assumptions guided construction of the total public R&D knowledge stock variable: first, domestic and foreign public R&D were assumed to have the same lag profiles. Second, the foreign public R&D knowledge stock was assumed to have a smaller impact on broadacre TFP than the domestic public R&D knowledge stock. This was to take into account possible differences in agricultural production techniques, the focus of public R&D investment and possible trade and non-trade barriers to agricultural knowledge transfers across countries. It is likely that spillover productivity gains from external R&D are greater when the technology or knowledge is sourced from regions (or countries) that have similar agro-ecological conditions, as less investment in adaptive research is required (Sunding and Zilberman 2001). Similarly, openness to trade and investment increases the transfer of knowledge and technology between countries and, in effect, facilitates access to the outputs of foreign R&D. In contrast, the jurisdictional pattern of intellectual property rights may act as a non-trade barrier to international technology flows (Alston and Pardey 2001).

The total public research knowledge stock variable \((TS_{ij}^k)\) was constructed as a weighted sum of domestic and foreign public R&D knowledge stocks. The value of the weight for foreign public R&D knowledge stocks \((\pi)\) was informed by an approach used by Alston et al. (2010) that was based on the degree of similarity in production patterns in the US and Australia and by Australia’s openness to trade (Shank and Zheng 2006). The choice of the value of foreign ‘spill-ins’ was also heavily influenced by the performance of the weighting factor in the Ramsey RESET and CUSUM specifications tests when \(\pi\) was set to 0.1. This yielded the total public research knowledge stock variable, \(TS_{ij}^k\), such that

\[
\ln TS_{ij}^k = \ln KS_{ij}^{DS} + 0.1 \ln KS_{ij}^{FS}.
\]

Regression method and estimation strategy

Given the methodology, the base model for examining the relationship between public research and extension knowledge stocks and broadacre TFP became:

\[
\ln(TFP) = \alpha + \beta_1 \ln(TS_{ij}^k) + \beta_2 \ln(EXT_i) + \gamma_1 \ln(WEA_i) + \gamma_2 \ln(EDUC_i) + \gamma_3 \ln(TOT_i) + \epsilon_i \quad (3)
\]

where the superscripts \(k\) and \(j\) denote the lag duration (length) and distribution (shape) of the research benefit profiles.

Following Mullen and Cox (1995), equation (3) also included three control variables: a measure of seasonal conditions \((WEA_i)\), farmers’ level of education attainment as a proxy
for the unobserved human capital of broadacre farmers (EDUC) and the farmers’ terms of trade for Australian agriculture at time t (TOT). These variables are included because they could have an effect on productivity, but are not reflected in the TFP index.

- Water availability can substantially depress TFP estimates in drought years because the broadacre industries (grain, beef and sheep production) are predominately dryland (rainfed) enterprises.

- Human capital formation is a driver of agricultural productivity growth, which may be proxied by the education level of farmers. If labour can be differentiated in the TFP index according to education and weighted by prices that are indicative of labour quality, then improvements in human capital are effectively embodied in the labour input and will not be reflected in TFP estimates. However, ABARE–BRS only differentiates labour according to whether it is hired labour, services provided by shearers, or owner-operator and family members. Therefore, the effect of human capital formation on agricultural productivity will not be captured by the TFP index, but will be reflected in TFP estimates.

- Changes in the terms of trade may, in the short run, induce farmers in profit-maximising to choose combinations of inputs and outputs that reduce their overall productivity (O'Donnell 2010; Productivity Commission 2008). For example, farmers may expand cropping into relatively marginal land in response to increases in expected output prices.

There are other factors that could influence agricultural productivity that are not included in equation (3). For example, the agriculture sector has experienced spillover productivity gains from government investment in transportation and communication infrastructure. And changes in the structure of the farm sector are likely to be sources of productivity growth. However, it can be difficult to identify suitable proxies for these variables and, to the extent that these variables are not correlated with the independent variables in equation (3), excluding them from the analysis should not introduce bias in the time-series regression model.

A time-series regression technique—the autoregressive integrated moving average (ARIMA) model—was used to estimate equation (3) which assumes the residuals (εt) follow a random normal distribution. Although model can be estimated using ordinary least squares (OLS), the estimates may be biased and inefficient because OLS fails to take into account the time series properties of the data. For example, if ln(TFPt) and ln(TSt/2) are positively correlated with time (that is, they have time-trend unit roots), then OLS may estimate a spurious relationship between ln(TFPt) and ln(TSt/2) (Greene 2007).

Data Sources and Variable Definitions
The measure of productivity used in the regression analyses is the ABARE–BRS broadacre TFP index, which is defined as the ratio of a Fisher quantity index of total output to a Fisher quantity index of total input. An exposition of the concepts, theories and empirical methods underlying the ABARE–BRS TFP estimates for the broadacre (and dairy) industries can be found in Gray et al. (2010). All related data were collected through the ABARE–BRS broadacre farm surveys, which cover the period from 1953 to 2007, and were aggregated to the national level.

Domestic public R&D investment is defined by total public R&D expenditure on plants and animals and excludes fish and forestry R&D. Data were obtained from two sources:

- Raw data for 1995–2007 were sourced from the Australian Bureau of Statistics (ABS) biannual Australian Research and Innovation Survey (ABS 2008).
- Data prior to 1994 were drawn from Mullen et al. (1996), who sourced data from the Commonwealth Department of Science and the published financial statements of the state departments of agriculture and counterparts.

For the period prior to 1953, investment in extension was estimated as one third of the state departments’ investment in research. This proportion was derived based on staff surveys about time spent on research, extension and regulation. The share of extension in total research expenditure for the period from 1953 to 1994 ranged from 27.4 per cent (in 1965) to 39 per cent (in 1958), with no apparent trend.

R&D investment in broadacre agriculture alone was derived by applying broadacre agriculture’s share of the total value of production in agriculture to total public investment in agricultural R&D. The GDP deflator was used to derive real public R&D and extension expenditure.

Foreign public R&D expenditure was proxied by US public R&D expenditure on agricultural production-related research. The United States has had a pivotal role in global agricultural R&D, not only in terms of its investment compared with the rest of the world, but also in terms of ‘know-how’ and new technology spillovers arising from research conducted in the United States. The raw data for the period from 1970 to 2007 were obtained from the Economic Research Service of the US Department of Agriculture. Prior to 1970, the data are aggregated state-level data from Huffman and Evenson (2006).

Seasonal conditions ($WEA_t$) are approximated by an index of moisture availability for broadacre agriculture. Moisture availability—more precisely, the annual wheat water stress index (Potgieter et al. 2002)—is a measure of the relative water stress of the crop accumulated throughout the growing season. The index was simulated using daily rainfall and average weekly radiation data, maximum and minimum temperatures, location specific soil data and crop-specific water requirements. The index reflects the cumulative stress endured by the crop throughout the season relative to its initial value of 100 at the start of the season.
Broadacre farmers’ level of education attainment \((EDUC_i)\) was proxied by the proportion of school-age students in the total population enrolled in schools using ABS data (see Mullen and Cox 1995). Enrolment is defined as ‘school attendance’ or ‘the number of school students at the national level’. The education index is a crude proxy for the real variable of interest, the human capital stock of broadacre farmers, because farmers’ education attainment is likely to differ from that of the total population. The farmers’ terms of trade \((TOT_i)\) is the ratio of the average price received by farmers for their output to the average price paid for farm inputs. It covers all agriculture (not just broadacre) and was derived from data in ABARE–BRS’s Australian Commodity Statistics (ABARE 2009).

**Estimation Results: Effects of R&D on Productivity**

A range of model specifications for equation (3) were investigated to identify a preferred model and to establish the robustness of the main results. These investigations produced a large set of results that cannot be usefully summarised here. However, the statistical tests suggested that:

- a 35 year lag period for capturing the effects of past R&D expenditure was preferable to a 16 year period (the models with 16 year lags did not pass the RMSE specification test and are not discussed further)
- the log-linear function form for equation (3) was preferable to linear and quadratic functional forms
- Aggregating domestic and foreign R&D to construct a total public research knowledge stock variable was preferred to the past practice of omitting foreign R&D (as in Mullen and Cox 1995).

In addition, a standard gamma distribution with peak impact occurring after seven years was preferred over alternative distributions (gamma_T, gamma_P, trapezoid and PIM).

**Effects of R&D and extension knowledge stocks on agricultural TFP**

The estimated elasticity of TFP with respect to public R&D knowledge stocks was positive and significant for all distribution profiles (table 2). In the preferred gamma specification, the coefficient on public R&D knowledge stocks was 0.23, implying that a one per cent increase in the public R&D knowledge stock led to a 0.23 per cent increase in broadacre productivity.

**Table 2 Elasticities of TFP to public RD&E knowledge stocks and other explanatory factors**

<table>
<thead>
<tr>
<th>Dependent variable: ln(TFP)</th>
<th>Gamma</th>
<th>Gamma_T</th>
<th>Trapezoid</th>
<th>Gamma_P</th>
<th>PIM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public R&amp;D knowledge stock (log)</td>
<td>0.23***</td>
<td>0.23***</td>
<td>0.20***</td>
<td>0.24***</td>
<td>0.20***</td>
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<tr>
<td></td>
<td>(0.05)</td>
<td>(0.05)</td>
<td>(0.05)</td>
<td>(0.06)</td>
<td>(0.05)</td>
</tr>
<tr>
<td>Extension knowledge stock (log)</td>
<td>0.10***</td>
<td>0.10***</td>
<td>0.14***</td>
<td>0.07**</td>
<td>0.15***</td>
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<tr>
<td></td>
<td>(0.04)</td>
<td>(0.03)</td>
<td>(0.03)</td>
<td>(0.04)</td>
<td>(0.03)</td>
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<tr>
<td></td>
<td>Gamma</td>
<td>Gamma_T</td>
<td>Trapezoid</td>
<td>Gamma_P</td>
<td>PIM</td>
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<tr>
<td>Water stress indicator (log)</td>
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<td>0.27***</td>
<td>0.28***</td>
<td>0.26***</td>
<td>0.28***</td>
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<tr>
<td></td>
<td>(0.05)</td>
<td>(0.06)</td>
<td>(0.06)</td>
<td>(0.06)</td>
<td>(0.06)</td>
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<tr>
<td>Education (log)</td>
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<td>0.66*</td>
<td>0.02</td>
<td>0.85**</td>
<td>0.29</td>
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<tr>
<td></td>
<td>(0.37)</td>
<td>(0.38)</td>
<td>(0.40)</td>
<td>(0.39)</td>
<td>(0.39)</td>
</tr>
<tr>
<td>Terms of Trade (log)</td>
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<td>−0.24**</td>
<td>−0.26***</td>
<td>−0.26***</td>
<td>−0.26***</td>
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<td></td>
<td>(0.08)</td>
<td>(0.10)</td>
<td>(0.08)</td>
<td>(0.10)</td>
<td>(0.09)</td>
</tr>
<tr>
<td>Constant</td>
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<td>−0.85</td>
<td>1.84</td>
<td>−1.37</td>
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<td></td>
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<td>(1.82)</td>
<td>(1.57)</td>
<td>(1.91)</td>
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<tr>
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<td>55</td>
<td>55</td>
<td>55</td>
<td>55</td>
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</tr>
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</table>

Notes: ***, ** and * represent statistical significance at 1 per cent, 5 per cent and 10 per cent levels, respectively. ARIMA Model with 35 year lag. The values in parentheses are standard errors. ‘Gamma’ refers to the preferred model specification in which a standard gamma distribution was used to construct knowledge stocks, with a peak impact occurring seven years after investment.

Similarly, increases in public extension knowledge stocks have a significant and positive impact on productivity, with an elasticity of around 0.1 per cent. The marginal impact of the extension knowledge stock on TFP was, on average, around half that of the public R&D knowledge stock, where R&D and extension knowledge stocks both increased at the same rate.

The relative contributions of public R&D and extension knowledge stocks to annual TFP growth between 1953 and 2007 can also be calculated by multiplying the elasticities (from table 2) by the annual growth rates of the corresponding knowledge stocks. The elasticity of TFP to the foreign public R&D knowledge stock is the coefficient on total public R&D knowledge stocks deflated by \( \pi \), the weight on foreign public R&D knowledge stocks used to construct the total public R&D knowledge stock variable.

Growth in public R&D and extension knowledge stocks has accounted for more than half of annual TFP growth in the broadacre sector between 1953 and 2007. Broadacre TFP growth averaged around 1.96 per cent a year between 1953 and 2007. Over this period public R&D knowledge stocks increased by an average 5.8 per cent a year, accounting for approximately half of annual broadacre TFP growth a year, around 0.96 per cent. This comprised 0.33 per cent a year from the accumulation of domestic public R&D knowledge stocks and 0.63 per cent a year from the accumulation of foreign public R&D knowledge stocks. Growth in public extension knowledge stocks, which increased by an average 3.2 per cent a year, contributed around 0.27 per cent TFP growth a year. This suggested that, between 1953 and 2007, the relative contribution to broadacre TFP growth of domestic and foreign research activities and domestic extension activities is in the ratio of 1:2:1.

Of the three control variables, seasonal conditions and the farmers’ terms of trade had significant effects on broadacre TFP. The estimated elasticities of TFP with respect to seasonal conditions ranged from 0.26 to 0.28 for all distributions, indicating that a one per cent increase in moisture availability over the growing season would increase productivity in that year by 0.28 per cent, all other things constant.
In contrast, the farmers’ terms of trade had a negative effect on broadacre TFP. The elasticity of TFP with respect to the terms of trade was $-0.27$ in the preferred gamma distribution (ranging from $-0.24$ to $-0.27$), indicating that a one per cent improvement in the farmers’ terms of trade would, on average, lead to a 0.27 per cent fall in productivity, all other things being constant. As indicated earlier, a possible explanation is that improvements in the terms of trade may induce farmers in profit-maximising to choose combinations of inputs and outputs that, in the short term, reduce their overall productivity.

The elasticity of TFP with respect to the level of education attainment was positive but insignificant. This is, to some extent, unexpected, since human capital can facilitate technology adoption and improve farmers’ ability to organise and maintain complex production processes. As intimated earlier, the national education attainment index used in the analysis may not be a good proxy for the human capital stock of broadacre farmers.

**Return to Public Investment in RD&E: A Benefit-Cost Analysis**

The above analysis provides evidence of the positive impact of R&D and extension knowledge stocks on TFP in the Australian broadacre sector. However, of further interest from a policy perspective is the return from public R&D and extension. The IRRs to public investment were calculated using the elasticities of TFP to the R&D and extension knowledge stocks. Estimates of the IRR to public investment provide a measure of the benefits from a one-time increase in public expenditure on agricultural R&D and extension, which can be used *ex post* as a measure of the returns achieved and *ex ante* to assist in resource allocation.

Over the period from 1953 to 2007, the IRR to public investment in agricultural R&D was 28.4 per cent in the preferred model, ranging from 15.4 to 38.2 per cent in the other specifications (table 3). The differences in IRRs across the distributions arose from the different weights assigned to the lagged years, since the estimated elasticities are quite similar in magnitude. Generally, distributions that assign greater weights to more recent years generated higher IRRs.

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<tr>
<th></th>
<th>Gamma</th>
<th>Gamma T</th>
<th>Trapezoid</th>
<th>Gamma_P</th>
<th>PIM</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Public R&amp;D</strong></td>
<td>28.4</td>
<td>14.0</td>
<td>15.4</td>
<td>38.2</td>
<td>51.9</td>
</tr>
<tr>
<td><strong>Extension</strong></td>
<td>47.5</td>
<td>35.0</td>
<td>32.6</td>
<td>57.1</td>
<td>79.5</td>
</tr>
</tbody>
</table>

Public extension generated significantly higher IRRs than those for public R&D. Over the period from 1953 to 2007, the IRR estimated from the preferred gamma specification for public extension was 47.5 per cent, but ranged from 32.6 per cent to 57.1 per cent. The higher rates of return to extension than R&D may be due to the relatively quicker (although still lagged) effect on productivity of extension activities (Huffman and Evenson 2006). In addition, public extension may facilitate adoption of spill-in technology from foreign public R&D investment. However, the IRRs should be viewed with caution, given the source and approach taken in constructing the extension dataset (as outlined previously). Despite these qualifications, the estimated IRRs for R&D and
extension were consistent with the median rates of return in the international literature reported in Alston et al. (2000).

To determine if the IRR to public R&D has changed over time, the estimation procedure was repeated for the period 1978–2007. Growth in public R&D expenditure has slowed since the late-1970s, with research intensity peaking at five percent in 1978 before declining to three per cent in 2007.

The estimated IRR from public agricultural R&D over the period from 1978 to 2007 was 45 per cent in the preferred model (table 4). This is significantly higher than the IRR estimated for the period from 1953 to 2007. Since the model specification used to estimate IRRs for the period from 1978 to 2007 is the same as previously reported, the larger IRRs in the more recent period were due to an increase in the elasticity of TFP to public R&D knowledge stocks (from 0.20–0.23 to 0.31–0.45). Compared with the IRR estimated for the period from 1953 to 2007, these results suggest that the returns to public agricultural R&D may be increasing, possibly because growth in public R&D has been falling since the 1970s.

<table>
<thead>
<tr>
<th>Elasticity</th>
<th>Gamma</th>
<th>Gamma_T</th>
<th>Trapezoid</th>
<th>Gamma_P</th>
<th>PIM</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978–2007</td>
<td>0.45</td>
<td>0.35</td>
<td>0.41</td>
<td>0.31</td>
<td>0.34</td>
</tr>
<tr>
<td>1953–2007</td>
<td>0.23</td>
<td>0.23</td>
<td>0.20</td>
<td>0.24</td>
<td>0.20</td>
</tr>
<tr>
<td>IRR (%)</td>
<td>45.3</td>
<td>21.0</td>
<td>24.1</td>
<td>69.2</td>
<td>81.0</td>
</tr>
<tr>
<td>1953–2007</td>
<td>28.4</td>
<td>14.0</td>
<td>15.4</td>
<td>38.2</td>
<td>51.9</td>
</tr>
</tbody>
</table>

In contrast, the estimated elasticities of TFP to the public extension knowledge stocks were not significant (even at the 10 per cent level) for all distribution scenarios over the period from 1978 to 2007, possibly due to the limited time series. Consequently, an IRR could not be estimated for public investment in extension over the period from 1978 to 2007.

Conclusions

Public and private sector investment in agricultural RD&E has been an important source of agricultural innovations, enabling productivity growth in the Australian broadacre sector. In this paper, the relationship between public agricultural RD&E investment in Australia and broadacre total factor productivity (TFP) over the period 1953 to 2007 was re-examined taking into account technology spill-ins from research conducted overseas.

Public investment in broadacre R&D and extension has generated rates of return that could be as high as 28 per cent and 47 per cent, respectively. While little is known about the opportunity cost of public investment in RD&E, this rate of return is comparable to rates of return estimated for other developed countries (Alston et al. 2010). Further, the growth in domestic public R&D and extension knowledge stocks arising from this
investment has accounted for 0.33 per cent and 0.27 per cent TFP growth annually in the broadacre sector, respectively (an aggregate of 0.6 per cent).

An important contribution of this analysis was to identify the influence of foreign R&D relative to domestic public RD&E for broadacre productivity growth. Growth in foreign public R&D knowledge stocks has accounted for 0.63 per cent TFP growth annually in the broadacre sector. This suggests that the relative contributions of foreign and domestic research activities (including domestic extension) to broadacre TFP growth has been roughly equal.

Statistical diagnostic tests indicated that a log-linear regression function with a lag profile for past R&D investment characterised by the gamma distribution (with peak impact at seven years) and maximum lag length of 35 years was the preferred model specification in an Australian context. Using this model, the long lags between public investment in R&D and appreciable impacts on productivity can be taken into account.

However, data constraints in this analysis suggested that opportunities remain for further research into the relationship between agricultural productivity growth and investment in RD&E. This includes further consideration of the contribution of domestic and foreign private research knowledge stocks and the magnitude of social returns to public investment in broadacre RD&E. These constraints mean that the estimated elasticities and IRRs to public investment in R&D and extension are subject to several qualifications.

First, not including private R&D (domestic and foreign) may result in biased estimates of the coefficients of public knowledge stock variables if private and public knowledge stocks are correlated. For example, were private R&D positively correlated with public R&D, its omission would bias the estimates of the coefficient on public R&D upwards (Alston and Pardey 2001). In turn, this would suggest that the marginal impact of public R&D knowledge stocks on broadacre TFP and the internal rate of return to public investment to be less than reported in tables 2 and 3.

Second, the analysis necessarily focused on quantifying the private returns to public investment in RD&E activities. However, a range of social benefits from publicly-funded research may arise through the application of rural R&D outputs beyond the broadacre sector and/or incidental effects on environmental quality or human health and safety. In recent decades, agricultural research has increasingly focussed on developing technologies that are not only profitable but that also deliver better environmental and human health outcomes. These benefits have largely not been captured in the broadacre TFP index. To the extent that public investment in agricultural RD&E activities benefit society more broadly (that is, beyond broadacre farmers), accounting for such social benefits would translate into higher internal rates of return to public investments in agricultural RD&E than those estimated in this paper.
References


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