Australian agriculture’s never-ending quest for ideal drought policies

Mick Keogh, Australian Farm Institute

Of all the agricultural issues that have vexed Australian policy-makers and farmers over the past 100 years, the one that has created most controversy and which has persisted as a ‘live’ issue during almost the entire period is drought policy. Yet despite what sometimes appears to be backward steps, there are signs that drought policy reforms are slowly resulting in better outcomes.

Despite their frequency, droughts have long been regarded as abnormal events in Australia which farmers were often ill-prepared for. This probably explains why the droughts of the last century had such a major impact on farm businesses, as the following highlights:

The first two decades of the new century were characterised by a series of droughts, each having a marked impact on livestock numbers. The ‘Great Drought’ from 1895 to 1903 was thought at the time to be the most widespread drought in the history of Australia... Sheep numbers, which had reached more than 100 million in the early 1890s, were reduced by half, and cattle numbers by more than 40%. In the nine years from 1895 the average wheat yield exceeded 8 bushels per acre (0.55 tonne per hectare) in only one year... (Pollard 2000)

The earliest government responses to drought were attempts to physically ‘drought proof’ the nation through the construction of water storages and irrigation systems. By the 1970s the focus had shifted to providing financial support to drought-affected farmers. Perhaps unsurprisingly, given the disastrous impact of droughts during the first half of the century, policy-makers equated droughts with natural disasters. They relied on a set of policies developed for natural disasters like floods and fires as an appropriate response to drought events, with the cost of that response borne by taxpayers.

It didn’t take long for both state politicians and farmers to realise that declaring a region to be in drought triggered funding from the Australian Government, and delivered mutual benefits. State governments effectively... (continued over page)
shifted the cost of drought to the national government, while at the same time securing the gratitude of grateful constituents. Farmers received the undoubted benefit of a range of different financial measures funded by taxpayers.

A review of these arrangements in 1989 identified many problems including the frequency of drought declarations and the related fact that government drought subsidies removed the incentive for farmers to better prepare for drought. This led to the introduction of new drought policy measures in 1992. The three principal objectives of that policy were to:

- encourage primary producers and other sections of rural Australia to adopt self-reliant approaches to managing for climate variability
- facilitate the maintenance and protection of Australia’s agricultural and environmental resources base during periods of climatic stress
- facilitate the early recovery of agricultural and rural industries, consistent with long-term sustainable levels.

Support measures implemented to give effect to these objectives included farm household support payments and interest rate subsidies, both of which were triggered by the declaration of a drought to be an ‘Exceptional Circumstance’ event. This was defined as a one in 20 to 25 year climate event which impacted farm incomes over a period of more than 12 months, and which was not predictable or part of normal structural adjustment processes.

The rationale for interest rate subsidies as a drought support measure was that farmers who were in the early stages of their farming career or who had recently taken on more debt to expand their business were the ones most exposed to the risk of a drought event, and therefore interest rate subsidies ‘self-selected’ those farmers who needed help due to unlucky timing rather than bad management.

While the logic of that approach may have been reasonable at the time, a range of subsequent developments made it less so. Not the least of these was the progressive ‘normalisation’ of debt as a part of farm business operations, and the increasing concentration of debt amongst larger farm operations. For example, the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) reports that average farm debt levels more than doubled in real terms between 2000 and 2009, with the debt predominantly used to fund farm expansion. According to ABARES, around 70% of aggregate broadacre sector debt as at 30 June 2013 was held by just 12% of farms. On average, these were much larger farm businesses that in aggregate produced around 46% of the total value of broadacre farm production in 2012–13 (ABARES 2014).

Another major change that occurred in relation to the demographics of the farm sector was the growth in reliance of owners of small farms on off-farm wages to fund their farming ‘habit’. According to the Australian Bureau of Statistics (ABS), some 50% of farms generate less than $100,000 in annual farm output each year, and ABARES survey data for broadacre farms reveals that the owners of these farms now rely largely on off-farm wages for their annual income. In many respects, the owners of these farm businesses have ‘drought proofed’ themselves (Figure 1).

These changes led to questions by both policy-makers and farmers about the merits of policies such as interest rate subsidies. These questions were also exacerbated by the experiences of the ‘millennium drought’ extending from 2003 to 2010, and the observations that some regions of Australia had been declared to be experiencing an ‘exceptional circumstances drought’ for most of the period from the mid-1990s through until 2008 (Figure 2). It was also the case that many recipients of drought support accessed that support repeatedly, with no strong evidence they were becoming more self-reliant.

Starting in 2008, the Australian Government initiated a series of reviews of drought policy, examining the related financial, social and climatic issues. The conclusion of

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**Figure 1:** Sources of income for owners of broadacre farms with less than $100,000 in annual agricultural output.

Source: ABARES Agsurf database.

**Figure 2:** Frequency of Exceptional Circumstances drought declarations, 1992–2008.

Source: ABARES (2012).
As is invariably the case when new farm debt mediation guidelines are implemented in drought policy reform, which was finalised in April 2013 (effective from 1 July 2014). It resulted in a number of changes to existing drought policy. These included the cessation of drought declarations, a broadening of the availability of farm household welfare support, the removal of farm business support measures, and a focus on training and support to improve farmers’ business management skills and drought preparedness (see Box 1).

In addition, Australian governments continued to fund the Rural Financial Counselling Service, and engaged in efforts to develop standard national farm debt mediation guidelines.

As is invariably the case when new drought policies are implemented in Australia, these changes coincided with events such as the intensification of drought conditions in northern New South Wales and Queensland, and a federal election. Despite the agreement, in the run up to the election the then Australian Government implemented a new drought support measure in the form of a concessional farm finance scheme, with the finance available even in states where drought was not occurring. These measures have subsequently been modified and refined, and a range of different support measures have also been implemented by state governments, including cash grants and transport subsidies.

Many of these measures appear to be contrary to the 2013 intergovernmental agreement, although governments argue that there was insufficient time to transition to the new policy arrangements, and hence the need for interim policy measures. Whether these measures are temporary, or become a permanent feature of the drought policy landscape is yet to be seen.

There are a number of lessons arising from the recent developments in drought policy in Australia.

The first is that enduring drought policy is necessarily a compromise between the economically ideal and the politically acceptable. While economists are able to come up with an economically sound set of policies largely based on the need to send farm businesses the right messages about appropriate risk management and preparation for drought as a normal feature of farm management, there is an innate tendency of politicians to respond to drought by ‘doing something’ – even when they know that the ‘something’ is largely ineffective.

In many respects, some farmers and politicians engage in mutually beneficial behaviour in response to drought – both knowing that if farmers make sufficient noise then politicians will act, and both may benefit as a consequence. Drought policy that ignores this reality is unlikely to succeed.

A second key lesson arising from changes in farm demographics is that unless a great deal of care is taken, industry-wide policy responses now have much less chance of being effective, due to the increasing diversity of farm businesses.

Demographic data highlight that changes over time have rendered the notion of the ‘average farmer’ obsolete. As can be observed in Figure 3 (over page), while livestock and horticulture farm populations are dominated by small-scale farm businesses, sectors such as dairy and cropping have experienced major changes, and the intensive livestock sector is now dominated by very large-scale farms.

This highlights the very obvious difficulty inherent in attempting to develop drought support measures that treat participants in the sector in an equitable manner, let alone considering the need for effective policies that provide the right preparedness incentives.

A third key lesson is perhaps best summarised by the observation that ‘farm businesses are different’.

There has been a tendency in some drought policy reviews to draw parallels between the treatment of farm businesses and other small to medium sized businesses, and to question why...
farm support measures are different to those available to other similar-sized businesses in other sectors.

Part of the answer to this question lies in the fact that the level of revenue volatility or risk experienced by the owners of farm businesses in Australia is much higher than the level of risk experienced by businesses in other sectors of the economy, or indeed the level of risk faced by farm businesses in other nations.

Research results published by both the Productivity Commission and the Australian Farm Institute identified that annual revenue volatility in the farm sector is the highest of any sector, and more than double the ‘average’ for the entire economy. Similar research by the Australian Farm Institute comparing the volatility of returns for the farm sector in Australia with that of farm sectors in other nations revealed that the volatility of returns is much higher than the level of risk experienced by the owners of farm businesses in Australia (Keogh 2012).

Given this, the potential exists that major drought events in Australia will result in severe industry and regional disruptions, which have the potential to impose significant costs on the community and necessitate extended recovery periods. Exposure to this risk also limits the flexibility of farm business managers in making capital investment decisions aimed at improving farm productivity, and is the reason that equity levels of Australian farm businesses are frequently maintained at much higher levels than is the case for other, similar-sized businesses.

Government measures that assist farm business managers to better manage this risk exposure therefore appear to have some justification as part of drought policy, especially in situations where there is a degree of market failure hindering the development of commercial risk management options.

Given these lessons and the many and varied twists and turns that have occurred along the drought policy reform road, how adequate are current drought policies?

First and foremost, one of the most important developments in relation to drought policy over recent years has been the separation of farm household welfare support from farm business support, and changes that have made farm household welfare support more widely available.

Under the previous arrangements, it was not until an area was declared to be in Exceptional Circumstances that farm household welfare support was available – subject to meeting eligibility requirements. Under current arrangements, farm household welfare support has been made universally available to members of farm households (subject to them meeting income and net asset-test requirements), irrespective of whether an area has been declared to be in drought or not. This overcomes the inequity of previous arrangements, where a person on one side of a road may have been eligible for support, while a neighbour on the other side in identical circumstances was not. It also means that farm families experiencing low income due to non-drought related reasons (for example a storm wiping out an orchard, or a disease outbreak) can also access welfare assistance measures, without the need for special declarations or arrangements.

Perhaps the only negative aspect of this policy is the fact that payments made under this program are accounted for in the budget of the Department of Agriculture, rather than the normal social security budget. This creates the impression that this measure is ‘special’, rather than just a normalisation of farmers’ access to the same welfare support that is available to the rest of the community.

It had long been an anomaly that someone owning a multi-million dollar house in Toorak or Point Piper who met the income test did not have to first sell their home (due to the exemption of the family home from the asset test) in order to access welfare, but that farm families were effectively required to dispose of their farm (which is also normally their home) before they could access the same welfare measures.

It is easy to underestimate the significance of this measure, and no doubt there will be some fine-tuning of eligibility requirements and application processes, before it is finally ‘settled’, but the Western Australian Drought Pilot of 2010–11 highlighted its significance in assisting farm families. Recipients spoke of the benefits of having regular cash income available to pay for groceries and things like children’s shoes and school fees, which was not the case when assistance was provided in the form of interest rate subsidies that went straight to the bank.

The decision to cease drought declarations and to stop farm business support in the form of interest rate subsidies has attracted criticism, but it is important to examine this decision in the light of evidence rather than...
rhetoric. This is a measure that only a relatively small proportion of farm businesses have been able to access in the past. Even during the extended millennium drought, 70% of broadacre and dairy farms in drought areas received no assistance at all for the duration of that event (Productivity Commission 2009).

Further, the availability of interest rate subsidies had long been an issue that divided farmers, with many of the view that the measure ‘rewarded’ poor farmers or those carrying too much debt, and actually penalised those who prepared adequately for drought by propping up land prices and slowing structural adjustment. In addition, the measure was generally not available to farmers in the intensive livestock and horticulture sub-sectors, despite the fact that these constitute almost 20% of all farm businesses.

The issue that is still contentious in relation to drought policy is what is referred to as ‘in-drought’ support. This was effectively what was provided by interest rate subsidies, and while many farmers and politicians recognise the shortcomings of that specific support measure, they are reluctant to go ‘cold turkey’ and to completely remove all in-drought support. To some extent this is being addressed at the moment through the availability of low interest drought and drought recovery finance packages, although they are a far-from-ideal measure that is expensive to administer, and which will require long-term management. They also create the possibility that at some time in the future it will be the government, rather than the banks, that will be involved in foreclosure actions in relation to farm businesses.

The dilemma, of course, is that these finance packages and all the forms of in-drought support available in the past invariably sent perverse messages about the need for drought preparedness, and also had a hidden cost in that they discouraged the development of commercial risk management options such as insurance products.

An alternative approach to in-drought support that is now attracting increasing attention is multi-peril insurance policies, with several trials of these products conducted over recent years. There are a number of different forms of these, with some based on defined meteorological events, and others based on realised farm income. These products are commonly available internationally (although almost invariably with premiums heavily subsidised by governments), and allow farmers to select and pay for the level of risk they are prepared to be exposed to. The multi-peril insurance products that have been trialled in Australia have generally been crop-specific, and have also been priced at a level that made them unattractive to many farmers. This is, in part, because the relatively low level of take-up meant that insurers needed to set high premium rates.

While there are many who question whether such products will ever gain wide acceptance in Australia, they certainly offer much more flexible and personalised drought risk management options for farmers, than will ever be achieved by a blanket government payment program, with all the inevitable eligibility criteria and policy changes that go with such arrangements.

There is potential for government to provide greater incentives for farmers to take up these policies through measures such as offering enhanced tax deductibility (for example 150%) for the cost of premiums paid by farmers for suitable insurance products. This would help to reduce the apparent cost of this insurance, while ensuring commercial providers remain competitive and tailor products to meet the different needs of the various sub-sectors of agriculture. It would also likely be close to revenue neutral for governments, as any insurance payouts would be taxable income, in times when recipients would otherwise be unlikely to pay tax.

Governments could also assist the development of a commercial multi-peril insurance market by actions such as increasing the density of high quality weather stations across the landscape, a measure that also has additional benefits for weather forecasting and the management of bushfires and floods. The Western Australian Government did this several years ago, with the added benefit being that it improves the usefulness of computer models used by farmers to assist with management decisions.

The final lesson for government out of the long history of drought policy changes is that drought policy reform will not work unless it is widely communicated to, and understood by farmers and their advisors and financiers. It was very notable that subsequent to the signing of the IGA of 2013, there was virtually no effort made by any government to explain the changes or the rationale for them. It was therefore no surprise that several state governments very quickly pretended they knew nothing about the IGA as soon as drought conditions emerged. Unless the farm sector is fully engaged in future drought policy reforms, this will undoubtedly recur in the future.

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Farm300: reducing emissions and boosting productivity

More than 300 beef and sheep producers across Australia are boosting their bottom line while reducing environmental impact. They are participating in the Farm300 program initiated and managed by Meat & Livestock Australia (MLA) and funded by the Australian Government. The program aims to reduce greenhouse gas (GHG) emissions of cattle and sheep businesses by up to 30% while at the same time boosting profitability and productivity by at least 10%. The program is being delivered in partnership with the Australian Farm Institute (AFI), Australian Wool Innovation, and Dairy Australia.

As part of Farm300, farm advisors have been trained to build their practical knowledge and skills, so they can support producers to adopt new management techniques that will increase productivity and profitability, whilst reducing emissions.

There are 23 Farm300 coaches around the country, each working with one or more producer group(s) to run workshops, discussion forums and one on one coaching sessions. Each coach has used a greenhouse gas calculator with their group to help benchmark baseline emissions, and then to test the impact of different on-farm strategies that look to improve those baseline emissions. AFI’s FarmGAS calculator has been one of the calculators used by coaches, and AFI’s producer case studies were a valuable tool to help illustrate some of the management options to Farm300 producers.

Currently, the main opportunities for livestock producers are to reduce the intensity of livestock emissions; the GHG emissions per kilogram of red meat produced. Therefore, emissions intensity is strongly correlated with increased production efficiency. Implementation of a specific action, such as increasing lambing percentage, may reduce emissions intensity by 30%. If the stock numbers are not increased, this will also result in a 30% reduction in net emissions.

Some of the other ways producers are increasing productivity whilst reducing emissions include improving reproductive efficiency (ie increased lamb or calf marking percentages) or improving pasture utilisation to speed up turn-off times.

Farm300 aims to support producers’ business objectives, encouraging them to make small and robust adjustments to their enterprise now, rather than wait and be forced to make more radical, and often more costly decisions under stress. Farm300 assists producers to implement a three-step process, to monitor, set triggers and strategies, and put their plan into action, making the process more manageable.

While Farm300 is a two-year program due to finish in May 2015, it aims to leave a lasting legacy by equipping producers and advisors with the tools to manage emissions on-farm, understand and respond to challenges from climate variability and potentially benefit from trading carbon credits while minimising their environmental footprint.

Further information

Some of the tools developed by Farm300 which are widely available for agricultural producers include:

- Why Sustainability Matters – a short video which outlines why industry should act now to reduce emissions: www.youtube.com/watch?v=8SiR3nVIEV4
- The ‘Sustainable Grazing’ producer manual explains how grazing management techniques can be used to achieve productivity and emissions benefits: www.mla.com.au/Livestock-production/Environmental-management/Sustainable-grazing-a-producer-resource
- More information on Farm300 is available on the MLA website: www.mla.com.au/Farm300

Figure 1: Farm300 map – locations of coaches.
Factors that define agricultural competitiveness

Ideally, agricultural competitiveness assessments should be useful in identifying factors that provide Australian agriculture with a competitive advantage, and for guiding policy development and decisions about the application of limited resources to continually improve the sector’s competitiveness.

Competitiveness can simply be defined as:

[T]he ability of a firm (or a farm) to face competition and be successful. Competitiveness is the ability to sell products that meet the demand requirements (price, quality and quantity) and, at the same time, ensure profits over time that enable the firm to thrive. Competitiveness is therefore a relative measure.

The Rural Industries Research and Development Corporation (RIRDC) commissioned the Australian Farm Institute (AFI) to conduct a project which defines the requirements for assessing the competitiveness of the Australian agricultural sector in world markets. The project involved a review of available literature on competitiveness. The purpose of the literature review was to define the term competitiveness in the context of Australian agriculture and to identify from available literature the factors that may be appropriate to incorporate in an index or scoring system.

The review found that methods used to assess competitiveness normally involve identifying the range of composite factors (fundamental drivers) that are understood to be significant determinants, and the relevant economic, social and environmental indicators that can best be used as a measure of these. However, while there is a growing body of knowledge and expertise associated with such assessments at the sectoral level – such as agriculture sector competitiveness.

The Organisation for Economic Co-operation and Development (OECD) is perhaps the only organisation to have attempted to develop an assessment of national agriculture sector competitiveness. That research involved a study of agricultural competitiveness in the context of agricultural development objectives such as poverty alleviation, prosperity of small farmers, productivity growth and environmental sustainability. The OECD found that the best competitiveness scoring system was an approach that involves four composite factors including specific agricultural sector sub-factors, plus broader economy-wide governance, capital availability, and market factors.

This approach to assessing agricultural competitiveness was developed by the OECD to help policy-makers focus on the sectoral and economy-wide issues that require some improvement amongst developing nations, and it was acknowledged that the approach taken in the OECD work was ‘rudimentary’, but an important first step.

In the context of efforts to develop a relevant assessment process for the competitiveness of the Australian agriculture sector, there are a number of other insights available from the efforts that have occurred to develop competitiveness assessments of national economies. These involve the identification of critical factors thought likely to influence competitiveness, and then to utilise objective indicators for these in order to obtain valid and robust information about changes in those factors over time. Ideally, the significance of each of the factors or indicators should also be weighted on the basis of an objective and statistically valid approach. Although it is recognised that the limitations of data may make such a weighting approach problematical.

Based on the initial research, it appears likely that the combination of factors and weightings that are significant in assessing the competitiveness of agriculture sectors of developed nation economies will not be the same as those that are relevant to developing nation agriculture sectors. Ultimately, this means there will be a need to either only compare nations that are at a similar stage of development, or to construct the assessment process in a way that allows some variation in weightings allocated to nations at differing stages of development.

Another key lesson from earlier efforts in developing competitiveness assessments is that there is undoubtedly a need to change factors and indicators as learnings emerge. Hence, it is always important to retain some flexibility in the way an agricultural competitiveness assessment process is constructed.
Emissions Reduction Fund to provide financial opportunities for Australian farmers

The Hon Greg Hunt MP
Federal Member for Flinders
Minister for the Environment

Australia’s commitment to taking action on climate change in line with countries around the world presents considerable opportunities domestically for farmers and landholders across Australia. In fact, the Government’s $2.55 billion Emissions Reduction Fund provides one of the most significant financial opportunities ever for Australian farmers.

2015 will be an important year in international climate change policy, with a new global climate change agreement to be discussed in Paris at the end of the year. This new agreement will govern the actions that countries take from 2020 onwards.

All countries are expected to take on emissions reduction commitments under the agreement and a taskforce has been established in the Prime Minister’s department to develop Australia’s commitment. This new commitment will follow on from Australia’s 2020 emissions reduction target of 5% below 2000 levels.

In developing our post-2020 target, we will carefully consider the extent to which other countries, especially major economies and trading partners, are taking real and comparable action.

Through an auction and the Government will contract with successful bidders for the delivery of emissions reductions. The first auction is due in the first quarter of this year.

More than 20 methods are already available. A range of new methods now being developed will provide further opportunities for agriculture. They include soil carbon sequestration (storage), beef cattle herd management, savanna fire management, avoided land clearing and fertiliser use efficiency for irrigated cotton.

This puts farmers in the box seat to make productivity gains on their land while also helping cut Australia’s greenhouse gas emissions.

The Government’s agricultural competitiveness White Paper – also due this year – will drive the long-term agricultural policies of the government and ensure Australia’s agriculture sector remains a significant contributor to the economy and local communities.

Together these initiatives will make 2015 an exciting year for our agriculture industries.

Greg Hunt is the Federal Minister for the Environment and the Federal Member for Flinders.
Global tide of change opens opportunities for Australian businesses

The Hon Mark Butler MP
Federal Member for Port Adelaide
Shadow Minister for Environment, Climate Change and Water

As Australia experiences its longest drought in history, our farmers are having their inherent ability to adjust to the conditions tested.

Unfortunately, climate scientists warn that long-term drought conditions may persist as Australia’s temperatures continue on the warming trend of the past decades. I don’t need to tell Farm Institute Insights readers of the impacts this will have on Australia’s agriculture industry.

Last year saw a huge shift in momentum towards taking strong global action to reduce the effects of climate change. United States (US) President Barack Obama released his Clean Power Plan, United Nations Secretary-General hosted world leaders in a climate summit and most importantly, one of the world’s biggest polluters, China, moved towards a clean energy future by introducing eight emissions trading schemes, signing a historic agreement with the US and attracting $32 billion in investment in renewable energy. It’s clear the biggest economies recognise the urgency to take action on climate change due to the devastating economic impacts of a warming climate.

This global tide of change opens opportunities for Australian businesses to be involved in developing new technologies that improve efficiency, sustainability and ultimately reduce carbon pollution and greenhouse gas emissions.

Many Australian farmers are already leading the way with practical adjustments to their practices as they adapt to the changing climate. I’ve read with great interest some of the activities being undertaken in drought-stricken areas that have seen reductions in pollution, improvements in land viability and increased yield profitability.

Labor’s Carbon Farming initiatives were doing real things for farmers, for example farmers could have avoided clearing land that had been approved for clearing, instead using it for sustainable grazing and earning carbon credits. There are also proven benefits from simple measures such as changing feed types for dairy cows, which has reduced methane emissions and increased milk yields.

Farmers have always been adaptable to the conditions at hand and adjusting to meet the challenges presented by events such as drought and floods.

In its submission to the Federal Government’s Agriculture Competitiveness Green Paper, the National Farmers’ Federation (NFF) said:

A continued challenge for much of the agriculture sector is that many cost-effective emissions reduction technologies are still in the embryonic phase of research and development and further investment is required to unlock the potential for further abatement in agriculture.

The NFF confirmed there’s a willingness within the agriculture sector to contribute to Australia’s emissions reduction efforts.

There are constructive ways for the Abbott Government to work with the agriculture sector to reduce the intensity of agricultural emissions, while ensuring that Australian farmers are not unfairly disadvantaged in the global market place.

The responsibility falls upon the Abbott Government to provide the policy framework to support the development of the technologies and practices to help farmers meet these objectives. Inexplicably, the Abbott Government has not included resource sustainability in the terms of reference for its agricultural White Paper.

As the world explores the possibilities of sustainable farming practices, consumers are seeking clean and sustainable products and there is a growing need within the agricultural sector to adapt to changing conditions, Australian farmers are provided opportunities that can be created by developing new practices. As a country that’s reliant on the agriculture sector, we need to support the industry to embrace these opportunities, invest in best-practice development, assist neighbouring developing countries with improving their practices and create a competitive edge for our agricultural exports.

While last year was a big year for climate policy internationally, 2015 should be even bigger. In December, world leaders will meet in Paris to agree on post-2020 emissions reduction targets. While the targets are important, the means for achieving the targets is what will impact Australian businesses.

Agriculture has a big role to play in our emission reduction activities, with potential to change the way we use our land with the view to improved sustainability and profitability.

The Hon Mark Butler MP was elected to Federal Parliament in 2007 representing the electorate of Port Adelaide. His career in Parliament has so far included: Parliamentary Secretary for Health; Minister for Mental Health and Ageing; Minister for Social Inclusion; Minister Assisting the Prime Minister on Mental Health Reform; Minister for Housing and Homelessness; Minister for Climate Change, Environment, Heritage and Water.

Mark is currently the Shadow Minister for the Environment, Climate Change and Water.
Supermarkets’ ‘low-cost’ squeezes out mid-sized farmers

In January 2015, supermarkets were at it again causing a stir with loss leader promotions on products originating from the farm sector. This time they were spruiking Australia’s cheapest sausages at 29 cents each (equivalent of $3.85/kg). The head of trading meat at one of the major supermarkets was reported¹ as saying:

‘Aussies love a snag especially over the summer so whether it’s on the barbie in the backyard or something quick and easy for dinner we know our customers will love the great price.

Furthermore, the head of trading meat plugged their business’s consumer catchphrase by saying ‘it’s part of our ongoing commitment to give families great quality food at unbeatably low prices.’

The loss leader marketing strategy for sausages has brought back memories of the $1 per litre milk wars which started in January 2011 and the 85c sliced bread promotion which occurred in September last year. The loss leader marketing strategy generally aims at selling goods at the cheapest price to entice more consumers to the seller’s stores. Ultimately, as the number of consumers enticed to their stores increases the potential for these additional consumers to buy other goods that enjoy higher retail margins also increases.

Although the low-cost concept for the supermarket business may appear healthy from a consumer perspective, it is not necessarily healthy from a farm sector perspective. Some observers may think that low-cost consumer products such as milk would lead to increasing consumption of the low-cost product per capita. However, a limited analysis of retail milk prices (in real terms) and market milk consumption in Australia shows that milk consumption only increased slightly (up 2%) after the loss leader promotion for milk which commenced in early 2011 (see Figure 1).

It is also difficult to determine whether lower retail prices for milk have been the major driver behind the slight increase in market milk consumption. Dairy Australia highlighted other factors for the increase in milk consumption such as the relentless expansion of the coffee culture in Australia.

Industry experts have highlighted how low-cost marketing strategies for supermarket products originating from the farm sector can have negative impacts on mid-sized farm businesses. Major supermarkets are increasingly negotiating long-term supply contracts with fixed profit margins to consistently offer low-cost products like milk, bread and sausages to consumers. Industry expert – Dr David McKinna – argues that for farm businesses to meet the market specifications for these type of long-term supply contracts they generally need to have economies of scale (large-sized farms) and a typical corporate business model.² According to McKinna, the major supermarkets long-term supply contracts leave small-sized and mid-sized farm businesses with three options.

Firstly, the small- and mid-sized farmers could increase their scale to improve their chances of meeting the market specifications of the major supermarket consistently. However, scaling-up these types of farm businesses usually requires a lot of capital funding and risk management. Considering that most small- and mid-sized farm businesses are family owned and operated, the opportunity to obtain capital funding efficiently and manage risk affordably is generally low.

Secondly, the small- and mid-sized farm businesses could establish a niche marketing strategy and supply a premium product to consumers. However, this option may not be that suitable for mid-sized farmers, as the premium market category is tiny in comparison to the mainstream categories and is much more suited for small-sized farmers that are agile and generally supported by other off-farm income.

Lastly, the small- and mid-sized farmers could continue with business as usual and operate in fear that they will eventually be squeezed out. The major supermarkets, which are increasingly adopting a low-cost marketing strategy, control up to 80% of the supermarket business in some regions. The market power of the major supermarkets leaves these farmers – particularly the mid-sized ones – with no other option but to continually eat into their own profits to keep their businesses alive.

Figure 1: Retail milk price and milk consumption in Australia.

[Graph showing retail milk price and milk consumption in Australia with data points from 2006/07 to 2013/14]

*Indicative Melbourne based prices for a 2 litre carton. e = estimate

Source: ABARES, dairy manufacturers and Dairy Australia, and AFI analysis.

¹ ‘Woolies’ cheap shot at Aussie meat’, Farm Weekly (16/01/2015).
² ‘The snag in Woolies’ 29c sausage’, Matthew Cawood, Farm Online (23/01/2015).
Australian and international farm policy news

USDA optimistic for 2015 outlook

The 2015 forecast for United States (US) agriculture released at the recent USDA Agricultural Outlook conference presented a reasonably positive outlook for US farmers, despite the build-up in grain stocks and the strengthening of the US dollar. Robert Johansson, USDA Chief Economist, summed up projections for 2015 as follows:

Overall, the forecast for the coming production year is bright. Record production has meant that stock levels are higher and prices are lower, but producers will benefit from record asset levels and from new farm programs intended to cushion declines in farm revenues. New crop insurance products are covering more products than ever before. In addition, falling energy prices will reduce input and transportation costs. Regional disruptions in port and rail services are expected to be resolved. While agricultural trade has become increasingly competitive, the resolution of old trade disputes and prospects for new agreements promise to open new opportunities to US producers. Lastly, the technological advances in our ability to collect, process, and report data offer new ways to optimize field production, improve risk management, and enhance market transparency.

Queensland sugar taskforce

The contentious issue of the future of sugar marketing arrangements in Queensland will be the subject of a review by a taskforce, which will report back to Minister Joyce by May 2015. Queensland Sugar Limited (QSL) has effectively maintained a single-desk marketing arrangement for sugar refined by Queensland sugar processors for many years. The arrangement is gradually being dismantled, with the possibility now available for sugar mills to opt out of the arrangement, and market their own sugar.

Three mill owners, Wilmar, MSF Sugar and COFCO have given notice of their intention to cease participating in QSL from 30 June 2017. Some growers supplying these mills are concerned that they have no choice about which mill they supply, and that the removal of the QSL pooling arrangement will leave them vulnerable to monopoly pricing. The dilemma all involved face is that the processors have high fixed costs, and capital that is only utilised for a short period each year. Any ‘leakage’ of cane to alternative processors (where they are available) can quickly render a processor unviable, so processors are having to carefully manage their relationships with growers, while seeking the option of exiting the QSL arrangement.

Lower rates for drought finance

The Australian Government has announced that interest rates for Farm Finance Concessional loans and Drought Concessional loans will both be lowered 16 basis points due to lower government borrowing costs. From 1 February 2015, interest repayments on these loans will be set at 4.34% and 3.84% respectively, down from 4.50% and 4.00%. These interest rates are reviewed on a six-monthly basis. Under the program, loans are made available to eligible farmers for debt restructuring of existing commercial loans and productivity enhancement where new debt is anticipated to generate positive return. Applications for 2014–15 are now open in all states and territories and will close on 30 April 2015.

Chinese fertiliser export tariffs to change from seasonal to flat

China will impose flat tariffs on urea and phosphate exports in 2015, as the Chinese Government shows signs of continuing to remove some of the trade restrictions that have been such a feature of Chinese trade policy in the past. Previously, the Chinese Government exercised a variable tariff rate on fertiliser exports. In 2014, urea exports were tarifffed at 15% + 40 RMB/t during the peak periods (January to June and November to December) and 40 RMB/t during the low season (July to October). These will be replaced with a year round 0% + 80 RMB/t. Phosphate exports will be subject to 100 RMB/t tariff in place of a high season tariff of 15% + 40 RMB/t and a low season tariff of 50 RMB/t.

A key factor driving the policy change has been rising domestic fertiliser supplies in China. China has annual capacity to produce over 80 million tonnes of urea, but only consumes around 65 million tonnes. Additional capacity to produce a further 30 million tonnes is also expected within the next two years. The move to a flat rate export tax is expected to further integrate Chinese fertiliser producers into world markets and to reduce the volatility of global fertiliser markets associated with episodic Chinese exports during low season tariff periods.

Its (very) dry in Brazil

First it was California experiencing a prolonged and severe drought which significantly reduced agricultural output, especially for commodities like almonds. Now it is Brazil that is also experiencing a prolonged and severe drought, especially in the southeast region. In São Paulo state – one of the worst hit areas – agribusiness represents 15% of GDP. There are reports that some farmers have lost almost a third of their crops due to water shortages. The Agricultural Economy Institute estimates that last year may account for the state’s worst agricultural losses in half a century.

On the state’s coffee plantations, many new crops lost their fruit due to the dry weather, and around 20% of the state’s citrus crops died. The 2013–14 bean crop production was almost 10% lower than the previous year, while corn production fell by 26%. Production of soy, one of the country’s largest export crops, shrank 17% over the same period. This year, sugarcane farmers are expected to see a nearly 12% production decline. In addition, the domestic price of beef increased by 22% last month as a result of the drought. The drought has become so severe that there are real concerns that the municipality of São Paulo, home to more than 20 million people, may run out of water in the near future. To try and prevent this, government officials have begun locking taps used to pump water from streams and rivers to farms. In February, the Governor authorised the police to carry out this task, and to impose fines on those who disobey. Farmers will receive compensation through financial credit from the state in some cases.
In the news

Foreign investment in Australian agriculture has again been a topic of great discussion. The Institute was quoted in David Uren’s article ‘Coalition split on Nationals’ call for tighter rules on foreign investment’ in The Australian newspaper (25/02/2015), and Mick Keogh was interviewed for ABC’s 7:30 Report (19/02/2015) on the topic of ‘Foreign investment laws for farmland – necessary safeguard or deterrent for investors?’

No-one quite knows the extent or the trends in foreign investment in Australia and it’s very difficult to have a sensible debate in the absence of that sort of information.

AFI Executive Director, Mick Keogh, was awarded the Medal of the Order of Australia (OAM) for service to agriculture and regional development in the 2015 Australia Day honours list (26/01/2015). Following this Mick was interviewed extensively, including, ‘Mick Keogh OAM on farming and the future’ (ABC Country Hour); ‘Mick Keogh OAM says agriculture needs long term vision not reactivity’ (ABC Rural); ‘Rural leaders named among Australia Day honours list’ (The Weekly Times); ‘Where is ag’s recognition? – A matter of opinion’ (Farm Online); and ‘Ag nation’s Australia Day honours’ (The Land).

Out and about

Recently the Institute’s Executive Director, Mick Keogh, has spoken at:

- APVMA Advisory Board Futures Forum, Griffith, ACT
- NSW Department of Primary Industries Ag Leaders and Managers Forum, Sydney
- Syngenta Growth Awards (judging panel), Sydney
- University of Southern Queensland/Toowoomba and Surat Basin Enterprise ‘Innovation in Agriculture’ Forum, Toowoomba, Queensland
- North East Catchment Management Authority Board, Lake Hume, Victoria
- Strategis Partners Crop Insurance Seminar, Sydney
- NSW Department of Primary Industries ‘The Social Licence of the Agricultural Industry’ Conference, Sydney

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