Senate Rural and Regional Affairs and Transport References Committee

Questions on Notice – Friday, 9 May 2012
CANBERRA

Inquiry into the Examination of the Foreign Investment Review Board National Interest Test

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SENATE RURAL AND REGIONAL AFFAIRS AND TRANSPORT REFERENCES COMMITTEE

Inquiry into the Examination of the Foreign Investment Review Board National Interest Test

Public Hearing Wednesday, 9 May 2012

Questions Taken on Notice – Australian Taxation Office

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1. HANSARD, PG 13

Mr Hamilton: There is a variety of mechanisms, without resorting to transfer pricing, that foreign-owned entities can utilise to lower their taxation in Australia.

Senator NASH: Could you take that on notice and just provide to the committee what they are?

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2. HANSARD, PG 13

CHAIR: Could I just go back to the example I used earlier? We have come across a company—and some of these are quite colourful, shall I say, in their entities—where a provincial government, shall I say, has lent a facility to a person, who may or may not have been a government official. Part of the financing arrangement is a 30-year interest-free loan, and the end result is that in 30 years time the asset reverts to the provincial government—there are all sorts of commercial arrangements like that. When the asset reverts to the government, how would you treat that for capital gains tax purposes? Would you like to take that on notice?

Mr Hamilton: I would prefer to take these kinds of specific questions on notice so I can provide a meaningful answer.

CHAIR: Do that. We absolutely want to get this right.

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3. HANSARD, PG 15

Senator NASH: How many agricultural entities have a turnover of more than $250 million?

Mr Hamilton: Not many.

Senator NASH: Could you take it on notice to come back with a figure that is close as you can get to how many?

4. HANSARD, PG 16

Senator NASH: Finally, are there any distinctive tax breaks or incentives in place to encourage foreign investment in Australia specifically?

Mr Hamilton: I would have to take that on notice. There are a range of concessions given, but most of them are given to domestics as well, in relation to primary production.

Senator NASH: If you could give us some detail around that as well, that would be useful.

5. HANSARD, PG 16

CHAIR: Finally, there is an argument, which I have described in colourful language, about what the threshold ought to be for reporting. My view is that if it hits the threshold, there are no pointers to where the threshold is and nothing happens. You have the ABN status. You could possibly pick up, through the tax office, every business transaction of an ABN registered company, and I presume that would flow on to sales and for capital gains tax purposes et cetera. When a corporation or a sovereign entity comes into Australia and it is the exact entity of a sovereign entity like the government of Kuwait or something, do they establish themselves here with an ABN? Does the government get an ABN?

Mr Hamilton: I would have to take that on notice.

Rural and Regional Affairs and Transport Reference Committee

ANSWERS TO QUESTIONS ON NOTICE

Australian Taxation Office

Foreign Investment Review Board National Interest Test

9 May 2012

Topic: **Mechanisms for lowering Australian taxation for foreign entities.**

Hansard Page: **13**

Question: **1**

Mr Hamilton: There is a variety of mechanisms, without resorting to transfer pricing that foreign-owned entities can utilise to lower their taxation in Australia.

Senator NASH: Could you take that on notice and just provide to the committee what they are?

Answer:

It would be impractical to attempt to list all such tax planning mechanisms at a detailed level – there are many nuances. At a high level, tax planning mechanisms seek to arbitrage between differences in tax that may be available in relation to:

- **who** is taxed (eg an individual, company, trust etc),
- **where** something is taxed (in Australia or in a lower taxing jurisdiction),
- **what** is taxed (eg revenue /capital, dividend / interest, royalty / fee etc),
- **when** something is taxed (bring forward losses, defer income), or
- **how** something is taxed (eg rollover calculations, uplifts, valuations etc).

With their easier access to low tax jurisdictions, foreign owned entities are more able to take advantage of **who**, **where**, **what**, **when** and **how** something is taxed by structuring transactions or the location of their functions, assets and risks so as to 'earn' more in lower taxed jurisdictions.

One frequently used mechanism to lower taxation in Australia is via the substitution or creation of debt to extract additional income out of Australia and into a lower taxed jurisdiction. For example, a foreign company may be globally geared with $1 of debt to $1 of equity. However they have the freedom to structure their operations through a lower taxed jurisdiction into Australia at up to $3 of debt to $1 of equity (the thin capitalisation safe harbour threshold). For non financial institutions each dollar of additional interest paid overseas has a withholding tax of 10% levied while generating a 30% tax deduction..

An alternative approach is via the use of 'conduit' arrangements whereby an overseas asset (say a company) is purchased through Australia by a foreign owned entity using an Australian subsidiary that they control. The return to the Australian subsidiary is tax exempt while the additional debt load reduces the Australian subsidiaries' tax from Australian sources. Similar outcomes can be achieved via the use of instruments such as redeemable preference shares that create asymmetric tax treatment – debt with interest in Australia, equity and an exempt dividend in the foreign country.

A further mechanism is via the use of the capital gains exemptions for foreign residents. By structuring the return as a capital gain rather than revenue, a foreign resident can lower their taxation in Australia. If the underlying asset is real property the foreign entity would be subject to Australian tax if the real properties value comprised more than 50 per cent of the Australian entities assets. If the Australian entity does not have more than 50 per cent of its' value in real property, the capital gains are exempt.

It is also possible to place functions, assets or risks into lower tax jurisdictions to generate an income stream that is taxed in that jurisdiction at a lower rate than in Australia.

Rural and Regional Affairs and Transport Reference Committee

ANSWERS TO QUESTIONS ON NOTICE

Australian Taxation Office

Foreign Investment Review Board National Interest Test

9 May 2012

Topic: **Capital gains tax treatment where an asset reverts to a provincial government**

Hansard Page: **13**

Question: **2**

CHAIR: Could I just go back to the example I used earlier? We have come across a company—and some of these are quite colourful, shall I say, in their entities—where a provincial government, shall I say, has lent a facility to a person, who may or may not have been a government official. Part of the financing arrangement is a 30-year interest-free loan, and the end result is that in 30 years time the asset reverts to the provincial government—there are all sorts of commercial arrangements like that. When the asset reverts to the government, how would you treat that for capital gains tax purposes? Would you like to take that on notice?

Mr Hamilton: I would prefer to take these kinds of specific questions on notice so I can provide a meaningful answer.

CHAIR: Do that. We absolutely want to get this right.

Answer:

The focus of the scenario is where the asset reverts from the “person” to the provincial government. This is a capital gains tax event as the asset’s ownership or at least the ability to use and enjoy that asset has passed from the “person” to the provincial government.

There are 3 possible outcomes:

1) if the “person” (a real person or a company) is a resident of Australia, the capital gain would be taxable;

2) if the “person” is a non-resident of Australia, they would be taxed on any capital gains where the asset is Australian real property; or

3) if the “person” was acting as agent for the foreign Government then the person would not have use and enjoyment in their own right so any gain would not be taxable

Rural and Regional Affairs and Transport Reference Committee

ANSWERS TO QUESTIONS ON NOTICE

Australian Taxation Office

Foreign Investment Review Board National Interest Test

9 May 2012

Topic:	**Agricultural entities with annual turnover greater than $250 million**
Hansard Page:	**15**
Question:	**3**

Senator NASH: How many agricultural entities have a turnover of more than $250 million?

Mr Hamilton: Not many.

Senator NASH: Could you take it on notice to come back with a figure that is close as you can get to how many?

Answer:

Australian Taxation Office data shows that there were 10 entities (all of which were companies) in 2009-10 (the latest year for which *Taxation Statistics* have been released) with a turnover of more than $250 million and with "agriculture” as their main industry. Of these 10 companies, none were described as 'non resident' for tax purposes.

Rural and Regional Affairs and Transport Reference Committee

ANSWERS TO QUESTIONS ON NOTICE

Australian Taxation Office

Foreign Investment Review Board National Interest Test

9 May 2012

Topic:	**Tax incentives to encourage foreign investment in Australia**
Hansard Page:	**16**
Question:	**4**

Senator NASH: Finally, are there any distinctive tax breaks or incentives in place to encourage foreign investment in Australia specifically?

Mr Hamilton: I would have to take that on notice. There are a range of concessions given, but most of them are given to domestics as well, in relation to primary production.

Senator NASH: If you could give us some detail around that as well, that would be useful.

Answer:

The tax laws contain a number of measures that are specifically designed to encourage foreign investment in Australia. In particular the law provides that:

1. a foreign resident can disregard a capital gain or loss unless the relevant capital gains tax asset is a direct or indirect interest in Australian real property, or relates to a business carried on by the foreign resident through a permanent establishment in Australia. The definition of real property includes a lease of Australian land and mining, quarrying or prospecting rights where the materials are situated in Australia.
2. the income from the offshore banking activities of an Offshore Banking Unit (approved by the Treasurer) carried on in Australia is taxed at a concessional effective rate of 10 per cent. Most of the activity which attracts the concessions can be classified as financial intermediation between non-residents (including foreign branches of Australian residents) or the provision of financial services to non-residents in respect of transactions/business occurring outside Australia. The concessions were designed to facilitate the growth of Australia as a viable offshore banking centre.
3. foreign investors in Managed Investment Trusts of jurisdictions with which Australia has effective exchange of information on tax matters are subject to a 7.5 per cent final withholding tax. It should be noted that the Government announced as part of the 2012-13 Federal Budget that the rate will increase to 15 per cent with effect from 1 July 2012.
4. concessions are available for certain foreign venture capital investments which are designed to encourage foreign investment into the Australian venture capital market and to promote the development of the Australian venture capital industry. The measures involve the taxation of certain venture capital institutions as "flow-through" vehicles and a capital gains tax exemption for certain gains made by foreign residents on venture capital investments (as well as a corresponding exemption for gains or profits that are on revenue account) in certain cases.
5. there is tax relief for distributions by Australian corporate tax entities to foreign residents if the distributions relate to conduit foreign income. Broadly, conduit foreign income is foreign income and gains that are earned by or through an Australian corporate tax entity and not taxed in Australia at the entity level.
6. there is a deduction for certain expenditure incurred to establish a regional headquarters in Australia which is designed to encourage multinational corporations to locate their regional headquarters in Australia.

7. there are a number of withholding tax exemptions, including for certain publicly offered debentures, foreign superannuation funds and Offshore Banking Units.

Also, while the broad object of Australia's double tax agreements is to avoid double taxation and prevent fiscal evasion, certain articles in the agreements are either designed to attract, or may have the effect of attracting, foreign investment.

Rural and Regional Affairs and Transport Reference Committee

ANSWERS TO QUESTIONS ON NOTICE

Australian Taxation Office

Foreign Investment Review Board National Interest Test

9 May 2012

Topic: **Does a corporation or foreign government register for an ABN where they are in business in Australia?**

Hansard Page: **16**

Question: **5**

CHAIR: Finally, there is an argument, which I have described in colourful language, about what the threshold ought to be for reporting. My view is that if it hits the threshold, there are no pointers to where the threshold is and nothing happens. You have the ABN status. You could possibly pick up, through the tax office, every business transaction of an ABN registered company, and I presume that would flow on to sales and for capital gains tax purposes et cetera. When a corporation or a sovereign entity comes into Australia and it is the exact entity of a sovereign entity like the government of Kuwait or something, do they establish themselves here with an ABN? Does the government get an ABN?

Mr Hamilton: I would have to take that on notice.

Answer:

An entity is entitled to be registered for an Australian business number (ABN) where it is conducting an enterprise in Australia. Foreign governments, per se, are not eligible for an ABN as they do not meet the requisite eligibility test. A foreign government operating within Australia will likely conduct any enterprise via a specific entity, such as a corporation. Accordingly, the entity carrying on the enterprise will receive the ABN rather than the government itself.

SENATE RURAL AND REGIONAL AFFAIRS AND TRANSPORT REFERENCES COMMITTEE

Inquiry into the Examination of the Foreign Investment Review Board National Interest Test

Public Hearing Wednesday 9 May 2012

Questions Taken on Notice – Department of Foreign Affairs and Trade

1. HANSARD, PG 19-20

Senator NASH: ... In your opening statement you talked about the benefits of foreign investment. I think they were: new jobs, trade—and there were another three. I think one may have been housing income. Would you mind reiterating those for me?

Mr Langman: It was really just saying that increasing productivity—

Senator NASH: No, you said there were five specific things.

Mr Langman: I mentioned that foreign investment can support new jobs, increase trade, boost incomes—household incomes was the way we put it—encourage innovation and introduce new technologies.

Senator NASH: That all sounds good, but what I would like is some practical examples of exactly where that has happened, because to me those are words on a page and anyone can say that. What I would like is the drilled down examples of where it does provide those things. Obviously I do not expect you to do that now; we have not got very much time. But if you could provide that in detail for the committee that would be very useful—and specific examples that you can point to, not general. I know you will give me a general overview, but I want very specific examples of where that has occurred...

2. HANSARD, PG 20

Senator NASH: Late last year Austrade and your department had organised Austrade representatives, Australian corporate advisers and industry people to meet with a Chinese delegation from China's Ministry of Commerce in Sydney. I think this was an article earlier this year, referring to last year.

Mr Langman: I am not certain it was organised with Austrade; it may have been. I believe there was a meeting in the latter part of last year.

Senator NASH: Who was at that meeting?

CHAIR: You can take that on notice.

Mr Langman: We could take that on notice, if you like.

3. HANSARD, PG 21

CHAIR: Can I just assist the committee. Was this invitation issued following the visit of Minister Craig Emerson to China?

Mr Langman: I believe that is the case.

Senator NASH: Was that the meeting at which the minister said we were actually at productive capacity when it came to agriculture? I could be wrong, but was that the one? I know there was some concern in the industry about that.

Mr Langman: I have no knowledge of that, Senator.

Senator NASH: If you would not mind taking that on notice and checking it, that would be useful. Thank you...

4. HANSARD, PG 21

Senator NASH: ... So how much did it cost to actually host these talks?

Mr Langman: I do not have that information.

Senator NASH: Could you provide that for the committee? That would be very useful...

5. HANSARD, PG 21

Senator NASH: All right. Could you take on notice for me, then, the joint study—you have given me the general outline of what the joint study is going into. Could you provide for the committee some detail around each of those issues, exactly what you are trying to determine in looking at those issues, what the collaboration will actually be. This all seems to be collaborating to, in effect, streamline the investment from China into Australia. Perhaps with the answers to the questions on notice you could also provide what benefits are going to be gained from this collaboration and what the intended outcome is in terms of benefit for Australia as a result of the collaboration.

Mr Langman: Of course we can do that...

Senate Rural and Regional Affairs and Transport References Committee
Inquiry into the FIRB National Interest Test - Public Hearing 9 May 2012
Responses to Questions Taken on Notice

QUESTIONS

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Mr Langman: Of course we can do that...

ANSWERS

Question 1

Increased innovation and competitiveness

Swiss food MNC Nestlé has been a major investor in the Australian food industry for over 100 years. Today Nestlé has 15 food processing factories and over 5,000 employees in Australia, New Zealand and the Pacific Islands (most are in Australia). Nestlé is a global leader in food categories like dairy, confectionery, beverages (eg coffee, mineral water), convenience meals (eg Maggi noodles), petfood (Purina), and so on. Nestlé is a world leader in innovation in the food industry, and continues to invest in maintaining the global competitiveness of its Australian operations. For example, in 2011, Nestlé invested A$18.5 million to expand its Smithtown factory on the NSW Mid North Coast, which involved new equipment and an additional 30 fulltime jobs on top of the existing 131 employees.

Better trade linkages and market access

Foreign investment in Australia's beef industry by companies from Japan (eg Mitsubishi, Mitsui, Sumitomo) and the US (eg Cargill and ConAgra) from the 1970s and 1980s on, was crucial for modernising and boosting the global competitiveness of Australia's beef feedlotting and processing sector. It also helped drive our strong growth in beef exports to those two key markets as well as to world markets generally.

A major player in the development and expansion of Australia's wine exports to the world has been the French company Pernod Ricard which invested in Australia in the late 1980s with its purchase of Orlando Wyndham. Pernod Ricard substantially expanded Orlando Wyndham's operations and exports, and made Jacob's Creek Australia's leading export wine to Europe and other markets.

Question 2.

On 8 December 2011, DFAT and Austrade co-hosted a business luncheon in Sydney. The event was attended by the Chinese Consulate-General in Sydney and officials from China's Ministries of Agriculture and Commerce, the China Development Bank, provincial commerce bureaus, and executives from eleven Chinese companies.

On the Australian side, in addition to DFAT and Austrade, the lunch was attended by representatives from agricultural industry associations, experts and consultants from institutions such as Sydney University, CSIRO and a range of major consultancy firms, as well as a small number of Australian companies with agricultural interests.

Question 3.

The Minister for Trade and Competitiveness, Dr Craig Emerson, did not attend the luncheon.

Question 4.

The lunch itself cost $2,277. A professional interpreter was hired for speeches made during the lunch. Additional interpreting assistance was provided through the use of Austrade and DFAT staff with Chinese language skills. The fees for the professional interpreter were included in the costs of undertaking other work. While difficult to determine exact interpreting costs for the lunch alone, a reasonable apportionment would estimate these services at $1,630 (including airfares, taxi fares and per diem).

Question 5.

The joint study considers how strengthening bilateral cooperation on investment and technology in agriculture and agribusiness can contribute to addressing global food security concerns. The objective is to establish a best-practice approach to: investing in new agricultural productive capacity, particularly in Australia's northern regions, for sale on world markets; and commercialising agricultural technology and services to raise productivity in both countries and the world.

It recognises that foreign investment generates benefits for Australians by providing access to capital, creating and supporting new jobs, increasing trade, boosting household incomes, encouraging innovation, and introducing new technologies.

Both sides recognise the valuable role of commercialisation to ensure the uptake of food security technology and services innovation and the protection and management of intellectual property. The development of long-term cooperation on agrifood is also an important step in diversifying the bilateral economic relationship. It could also help reinvigorate rural communities.

SENATE RURAL AND REGIONAL AFFAIRS AND TRANSPORT REFERENCES COMMITTEE

Inquiry into the Examination of the Foreign Investment Review Board National Interest Test

Written Questions on Notice – Mr Julian Cribb

1.

You were quoted in The Australian last year (4th July 2011) suggesting China was buying up resources including food and that this 'might imperil our food security'. Are you able to expand on your concerns in some more detail?

2.

In your presentation at the Sustainable Food Summit, in April last year you argued that 1% of the world's land is being 'lost' each year. Can you explain the factors contributing to the loss of productive land?

3.

Given the pressures that are expected to be placed on food production across the world what are other Governments doing to ensure food security?

4.

Are you aware of our Australian regulations regarding foreign ownership of land comparing with other nation's regulations?

5.

In your opinion how should the Australian government be viewing overseas interests in agricultural land?

6.

In your presentation at the Sustainable Food Summit one of the solutions you propose for dealing with food security issues is to insure fairer incomes for farmers. I guess you are suggesting that if farm incomes were better then there would be a reluctance to sell the farm business?

SENATE RURAL AND REGIONAL AFFAIRS AND TRANSPORT REFERENCES COMMITTEE

Inquiry into the Examination of the Foreign Investment Review Board National Interest Test

Written Questions on Notice – Mr Julian Cribb

1.

You were quoted in The Australian last year (4th July 2011) suggesting China was buying up resources including food and that this 'might imperil our food security'. Are you able to expand on your concerns in some more detail?

A: If a sovereign nation acquires land within the borders of another sovereign nation history has shown it creates potential for international disputes and possible conflict. As many Chinese companies are government-owned, this possibility arises here, and I feel Australia ought to have a means of scrutinising and policing such deals. Genuine foreign corporate purchases are acceptable if they comply with FIRB and other regulations. Purchases and even leases by foreign governments are risky and in my view, should not be allowed.

The possibility always exists that a large foreign owner might choose to export surplus food from Australia in a time of national and global scarcity, thus causing shortages and higher prices within Australia. However I presume the Commonwealth already has the legal instruments to prevent food exports deemed to be not in the national interest, and can either resume the land or regulate the exports.

2.

In your presentation at the Sustainable Food Summit, in April last year you argued that 1% of the world's land is being 'lost' each year. Can you explain the factors contributing to the loss of productive land?

A: My primary source is the global satellite survey undertaken by Bai et al for FAO, which showed an average loss of 1 per cent a year over recent years. See Bai ZG, Dent DL, Olsson L and Schaepman ME, 2008. Global assessment of land degradation and improvement 1: identification by remote sensing. Report 2008/01, FAO/ISRIC – Rome/Wageningen

Other useful sources include Marler & Wallin, Nutrition Security Institute, USA, 2006, who calculate that at present rates of loss the world has 48 years of topsoil left and who also point out that today's food is >80% depleted in essential micronutrients compared with the diet of our grandparents. This is an insidious form of soil degradation, tied to the rise in diet-related disease in society, about which little is being done, but was recently commented on by the Australian Public Health Association (2012).

The main contributors to land loss are (i) erosion, degradation and salination due to overclearing, overcropping and overgrazing (ii) deforestation (iii) urban and recreational sprawl (iv) mining and other industries (v) sea level rise (affecting the world's fertile delta regions especially) (vi) globalisation and the unsustainable sourcing of cheap food from distant lands (vii) increasing world meat and fish consumption leading to greatly increased feedgrain production and hence accelerated soil loss.

3.

Given the pressures that are expected to be placed on food production across the world what are other Governments doing to ensure food security?

A: Mainly talking about it. The Brits are the most vocal, but the general attitude among western governments ranges from ignorance to complacency. The G8 has three times talked big but failed to act. They have not grasped the strategic connection between food system failures elsewhere in the world and their own economic and security interest. See for example this report by Maj. Gen Jeffery's Future Directions Institute: http://www.futuredirections.org.au/publications/workshop-papers/537-international-conflict-triggers-and-potential-conflict-points-resulting-from-food-and-water-insecurity.html

Of all the governments most keenly conscious of the risks of global (and national) food insecurity, in my view the PR China has the clearest grasp. This is why they are investing in food production around the world.

4.

Are you aware of our Australian regulations regarding foreign ownership of land comparing with other nation's regulations?

A: No. I profess no expertise in this area of national and international law.

5.

In your opinion how should the Australian government be viewing overseas interests in agricultural land?

A: With due caution, and with a strategic eye to the scarcities of water, land, oil, fertilisers and technology that will begin to bite heavily into global food security from the 2020s And 2030s on. It is both in our own interests to retain control of our own agricultural assets (on the basis that we understand them and can farm them more sustainably than inexperienced outsiders) and even to extend our agricultural activities into other countries, as the New Zealanders and Americans are now doing, in order to use our expertise to help stabilise global food security (both by sharing knowledge, as we did in the Green Revolution, and by direct investment in efficient and sustainable farming systems based on our skills in producing food in challenging climates).

I urge the Australian Government to take a leaf from the recent Obama initiative and establish an agricultural knowledge and investment export cluster, to focus efforts in this regard.

6.

In your presentation at the Sustainable Food Summit one of the solutions you propose for dealing with food security issues is to insure fairer incomes for farmers. I guess you are suggesting that if farm incomes were better then there would be a reluctance to sell the farm business?

A: Not really. I am saying that the current economic signals of ever-shrinking profit margins for the vast majority of producers will end up destroying local farming industries, communities and the land, water and biodiversity of the landscape, as well as undermining food quality and public health.

Those economic signals will have to change, worldwide and in Australia, if food production is to be sustained and there is to be renewed investment in agriculture itself, in education and skilling its people, its science and technology etc. There are numerous ways to achieve this. I attach, for the Senators' interest, a discussion paper entitled 'Why farmers need a pay rise' which explains this.

Why farmers need a pay rise...[i]

An essay by Julian Cribb FTSE

The world's farmers need a pay rise – or, come the mid-century, the other 8 billion of us may well find we do not have enough to eat.

True, this assertion flies in the face of half a century of agricultural economics orthodoxy – but please bear with me as I explain.

Globally and in the western world, food has become too cheap. This is having a wide range of unfortunate - and potentially dangerous - effects which include:

- Negative economic signals to farmers everywhere, telling them not to grow more food
- Increasing degradation of the world's agricultural resource base
- A downturn in the global rate of agricultural productivity gains
- An 'investment gap' which is militating against the adoption by farmers of modern sustainable farming and other new technologies
- A deterrent to external investment because agriculture is less profitable than alternatives.
- The decline and extinction of many local food-producing industries worldwide
- Disincentives for young people (and young scientists) to work in agriculture.
- Loss of agricultural skills, rural community dislocation and increased rural poverty affecting tens of millions
- Reduced national and international investment in agricultural research and extension
- The waste of up to half of the food which is currently produced
- A pandemic of food-related disease that sickens and kills up to half of consumers of the 'modern diet', resulting in
- The largest budget blowout in most countries: soaring healthcare costs
- The failure of many developing countries to lay the essential foundation for economic development – a secure food and agriculture base – imposing direct and indirect costs on the rest of the world through poverty, war, government failure and refugeeism.

From this list it can be seen that low farm incomes have far wider consequences for humanity in general than is commonly supposed.

Indeed, in a context in which all of the basic resources for food production are likely to become much scarcer, it may be argued that, indirectly, they imperil every one of us.

A market failure

This aspect of the future global food security issue is primarily about a market failure.

At its 'How to Feed the World' meeting in October 2009 the UN Food and Agriculture Organisation stated that investment of the order of $83 billion a year was needed in the developing world alone, to meet the requirement for a 70 per cent increase in food production by 2050.[ii] However, almost in the same breath, it noted "Farmers and prospective farmers will invest in agriculture only if their investments are profitable."

The logic is unassailable. Today most of the world's farmers have little incentive to invest in agriculture because their profitability is so poor. This applies as much to farmers in developed countries, as it does to struggling smallholders in Asia or Africa.

Reasons for the low returns are not hard to find: farmers are weak sellers, trapped between muscular globalised food firms who drive down the price of their produce, and muscular industrial firms who drive up the cost of their inputs. This pincer movement not only discourages 'developed' agriculture but also prevents undeveloped agriculture from developing.

Nothing new here, you may say. So what has changed? The growing imbalance in market power between farmers and the very small number of companies which dominate the food supply and input chains is what has changed.

Two decades ago most farm produce was largely bought from local farmers by local buyers for local markets and consumers. In the 21st century there has been a dramatic increase in the concentration of market power in the hands of a very small number of food corporations and supermarkets sourcing food worldwide. These are – quite naturally – doing all they can to reduce *their* input costs (farm prices) as they compete with one another. This is not a rant about globalisation: it's a simple observation about the facts of global economic life.

The power of the farmer to resist downward price pressure has not increased. Indeed it has weakened as the average producer now competes against some struggling farmer in a far away country, rich or poor, who is also simply trying to survive by selling at the lowest price.

The power of the global input suppliers – of fuel, machinery, fertilizer, chemicals, seeds and other farm requirements, has also grown as they concentrate and globalise. This makes it easier for them to raise the cost of their products than it is for farmers to obtain more for their wheat, rice, livestock or vegetables or to withstand input price hikes. Even when farm commodity prices are high, farm profitability remains low because input suppliers raise their prices and so absorb much of the potential on-farm profit.

As a consequence of this double market failure, the economic signal now reaching most of the world's farmers from the market is "don't grow more food".

Its effect is apparent in the fact that world food output is now increasing at only about half the rate necessary to meet rising demand, overall farm productivity gains are sliding and yield gains for major crops have stagnated.

Its effect is also apparent in the fact that the world farming and grazing area has contracted in 9 out of the past 10 years, despite relatively high commodity prices in recent years. This defies the classical economic assumption that high prices will cause farmers to expand production.

While some will argue all this market pressure makes for greater economic 'efficiency', the logical outcome of unrestrained global market power will, over coming decades, eventually displace around 1.5 billion smallholders, with devastating consequences for the landscapes they manage and the cities they flee to.

Putting one in five of the Earth's citizens out of work and destroying the food base is not a strategy any intelligent policy or government would advocate, one hopes. But it is one of those 'externalities' which classical economics sometimes omits to factor in – and is happening, nevertheless.

<u>Global degradation</u>

In a recent satellite survey, researchers working for FAO reported 24 per cent of the Earth's land surface was seriously degraded. The FAO team noted that degradation was spreading at a rate of around 1 per cent a year. [iii]

Every agronomist and agricultural economist knows that, when farmers are under the hammer, a good many of them will overstock and overcrop in a desperate effort to escape the poverty trap – and this leads to the kind of resource degradation exemplified by the Oklahoma dust bowl or the Sahel in more recent times. In marginal country, cost/price pressures can devour landscapes – and this is undoubtedly a major factor (though not the only one) in the degradation of land and water worldwide, especially in the world's rangelands.

If we continue to sacrifice one per cent of the world's productive land every year, there is going to be precious little left on which to double food production by 2060: yields on the remaining land would have to increase by 300 per cent or so, which is clearly a tall order, and illustrates the wicked nature of the problem.

Much the same applies to irrigation: "In order to double food production we need to double the water volume we use in agriculture, and there are serious doubts about whether there is enough water available to do this," is how Dr Colin Chartres, director general of the International Water Management Institute summed it up recently.[iv] While in theory it is possible to double the water use efficiency of irrigation farmers, even this will not be much help if megacities and big resources companies swallow half the farmers' water, as presently seems likely.

Solutions to land and water degradation are reasonably well known, and have been shown to work in many environments – but are not being adopted at anything like the rates necessary to double world food production or even to conserve the existing resource base. One reason is that farmers, in the main, cannot afford to implement them, even though many would like to do so.

As a result, world agriculture is today primarily a mining activity. We all know what happens to mines when the ore runs out.

Productivity decline

Today there is growing evidence that world agriculture is no longer making the yield advances and total productivity gains achieved in the previous generation.

In a recent paper Alston and Pardey[v] also documented this decline in the US and globally attributing it significantly to falling investment worldwide in agricultural science and technology and extension of new knowledge to farmers.

Poor returns are discouraging farmers, in both developed and developing countries, from adopting more productive and sustainable farming systems. While a handful of highly efficient and profitable producers continue to make advances, the bulk of the world's farmers are being left behind. Since small farmers feed more than half the world, this is a matter of some concern.

Farm research and extension has been cut in most developed countries and even in places such as China, where the level of ag R&D support is falling as a proportion of the total science investment. Indeed it is likely that the quantum of world agriculture scientific research is presently no greater than it was when the world held 3.5 billion people, instead of 7 billion.

The fact that agriculture appears perennially unprofitable and suffers from continuing social malaise probably contributes, subliminally, to a view that society ought not to be wasting its money investing in it: there are a thousand other more attractive and exciting fields for scientific investment. This negative (and false) image of agriculture is an unspoken driver behind the reduced global R&D effort.

Is food too cheap?

For affluent societies at least, food is now the cheapest in real terms it has ever been in human history.

In the early 20th century, the average western wage earner devoted about a third of their weekly income to food. Rent was relatively cheap, people didn't have cars, iPhone bills, plasma TVs, facelifts or overseas vacations – and food was essential. By the 1970s the amount of household disposable income spent on food was down to 20 per cent. Today it is around 11-12 per cent in most western nations. As incomes rise in China and India, the proportion is falling there too.

It seems almost redundant to observe that, when something is too cheap, people do not value it as they should. This produces a lack of respect for the product itself, for the people and industries involved in its production - farmers and scientists - and for the place it is produced, the bush. It is responsible for the negative image held by governments, businesses and societies towards agriculture and its investment needs.

In an age where 3.5 billion humans have only the dimmest notion where their food comes from, lack of respect for the main thing that keeps them alive is coming to be a predominant 'value' in the human race.

A culture of waste

Food is now so cheap that developed societies such as the US, Britain and Australia throw away one third, while developing countries lose a similar proportion postharvest. [vi]

A society that pays its farmers such a low return, has found it can afford to send a third of their efforts to landfill. Or burn in a vehicle enough grain in one week to feed a poor person for a year.

Where our ancestors stored, conserved and recycled nutrients, we now waste 80% -90% of all the nutrients used to produce food. On farm, up to half the applied fertiliser does not feed crop or pasture but escapes into the environment. Of the harvested nutrients, some are lost post-harvest, in transport, processing and cooking – but more than 30 per cent are simply discarded, in the shops and in the home. Then we dump most of our sewage nutrients in the ocean.

In short, the modern food system has established a culture of total waste, sustained only by the mining of energy and nutrients (from rock or soil), which will eventually become scarce and unaffordable to most farmers. Doubling the world food supply implies doubling the use of fertilisers – but this does not seem feasible at present prices and based on present finite resources.

This situation cannot persist more than a few decades. We need to recycle and invest in new nutrient systems – but for that to occur, farm incomes and the incentive to invest in food production must rise.

An unhealthy situation

Cheap food is also linked for a pandemic of disease and death among affluent consumers larger than any other single cause of human mortality. Cheap, abundant processed food is a driver for obesity, which now affects one in five humans, and plays a role in the society-wide rise in cancers, heart disease, diabetes and stroke. These food related diseases now claim around half of the lives of people living in affluent conditions, in both developed and developing countries.

Cheap food, in other words, is an economic invitation to consumers – including millions of children – to kill themselves prematurely through overindulgence and unsound diets.

Cheap food is thus the chief economic driver of the greatest budget blow-out in most countries: healthcare.

Solving the food challenge

The purpose of this essay is to call attention to the effect a never-ending reduction in farmers' incomes will have on world food security at a time of rising physical constraints to production, including scarcities of land, water, energy, nutrients, technology, fish and stable climates.

At the very time when most experts agree we should be seeking ways to double food output sustainably over the coming half-century, the ruling economic signal is: “don’t do it”.

At the very time when we should be seeking ways to improve the health and longevity of ourselves and our children, the ruling economic signal commands society to undermine it.

Of course, we could simply obey the economic signal and allow agricultural output to gradually fall behind – but that will expose billions of consumers to massive unheralded price spikes, of the sort experienced in 2008 and 2010. These have a dire impact on the poor, start wars and topple governments – and do not benefit farmers much.

It is necessary to state this essay does *not* advocate a return to agrarian socialism, protectionism, commodity cartels or an end to free markets. In fact, we probably need to move much faster and further towards totally free trade in agricultural products in order to encourage efficient producers – large and small – around the world.

But it does hold up a warning flag about the universal dangers of underinvestment, negative signals and sentiment, resource destruction and rural dislocation caused by the undervaluing of the one commodity humanity absolutely cannot do without, as we approach the greatest demand for food in all of history.

There are numerous ways this issue might be addressed. Here are a few:

1. Price: through an educated “community consensus” that results in willingness on the part of consumers, supermarkets and food processors to pay more for food so as to protect the resource base and enable farmers to invest in new technologies[vii]
2. Subsidy: by the payment of a social wage to farmers by governments for their stewardship on behalf of society of soil, water, atmosphere and biodiversity, separate from their commercial food production
3. Regulation: by limiting by law those practices or technologies which degrade the food resource base and/or rewarding those which improve it. By passing laws which prohibit the use of prime farm land and water for other purposes.
4. Taxation: by levying a resource tax on all food which reflects its true cost to the environment to produce, and by reinvesting the proceeds in more sustainable farming systems, R&D, rural adjustment and enhanced resource management.
5. Market solutions: establish markets for key farm resources (eg. carbon or water) that result in higher returns for farmers from wise and sustainable use.
6. Public education about how to eat more sustainably; industry education about sustainability standards and techniques.
7. A combination of several of the above measures.

The technical solutions to many of the world's food problems are well-known and well understood – but they are not being implemented as widely as they should, because of a market failure which is blocking of their adoption.

To avoid grave consequences affecting billions of people, that failure must be corrected.

It is not the purpose of this essay to solve the issue of how to deliver fairer incomes to farmers worldwide, but rather to encourage fruitful debate among thoughtful farmers, investors, policymakers, researchers, food companies and consumers about *how* we should go about it.

However it does question whether some of the 'old truths' of the 20th century still apply in the 21st – or whether the age of globalisation and resource scarcity has changed the ground rules.

It also asks whether the unstinted application of overwhelming market force against farmers is the act of a sapient species - or a mob of lemmings?

Over to the sapient ones among you.

- Julian Cribb*

- Julian Cribb is a science and technology writer. He has been an agricultural journalist and newspaper editor since the 1970s. He is the author of "The Coming Famine: the global food crisis and what we can do to avoid it", University of California Press 2010.

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[i] Sources for this essay are those cited in my book The Coming Famine, CSIRO Publishing, 2010. Since they take up 24 pages, I have not reproduced them all here.

[ii] FAO High Level Export Forum, How to feed the World: Investment, Rome, October 2009. http://www.fao.org/fileadmin/templates/wsfs/docs/Issues_papers/HLEF2050_Investment.pdf

[iii] Bai ZG, Dent DL, Olsson L and Schaepman ME 2008. Global assessment of land degradation and improvement 1: identification by remote sensing. Report 2008/01, FAO/ISRIC – Rome/Wageningen

[iv] Chartres C, World Congress of Soil Science, Brisbane, August 2010

[v] J. Alston, J.M.Beddow, P. Pardey, "Mendel versus Malthus: research, productivity and food prices in the long run," University of Minnesota, 2009. http://ageconsearch.umn.edu/bitstream/53400/2/SP-IP-09-01.pdf

[vi] See for example Lundqvist, J., C. de Fraiture and D. Molden. Saving Water: From Field to Fork – Curbing Losses and Wastage in the Food Chain. SIWI Policy Brief. SIWI, 2008.

[vii] In case this should raise a sceptical eyebrow, the recent stakeholder report by Woolworths Australia "Future of Food", 2010, suggests at least some of the major players in the food game have a dawning grasp of the consequences of their actions and are now looking to invest in (mainly non-income) ways to support farmers.