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QUEANBEYAN NSW 2620

The Secretary  
Senate Select Committee on Agricultural and Related Industries  
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### **Submission to the Inquiry into Food Production**

I wish to express my views on the above inquiry for consideration by the committee.

#### Overview

As we all know, Australia has been experiencing one of its worst droughts. This has resulted in many farmers becoming desperate because of their lack of income and the lack of real financial support from government. Drought highlights the fact that farmers, in seeking to earn a livelihood, are exposed to far more risks than the average Australian wage-earner or business. On top of the risks of the natural environment in a continent where the climate swings between extremes of drought and flood, farmers also face other major risks and constraints. It is these non-climatic risks that I will deal with below.

#### Price Risk

The chief non-climatic risk that farmers face is the fact that they are price-takers on the following three fronts:

- (i) Farmers buy their farm inputs (farm equipment, fertilizer, seeds etc) from multinational firms which have extensive market power because of the oligopolistic market in which they operate;
- (ii) Farmers sell their farm outputs into a domestic market dominated by a small number of processors and two supermarkets which have excessive market power because of the lack of up to date and effective trade practices laws, along with being exposed to cheap subsidised imports that do not meet the high quality standards of Australian farmers; and
- (iii) Farmers sell their farm outputs into corrupt international markets dominated by tariff barriers and subsidies.

Given the three factors listed above which force farmers into being price-takers, the result is that farmers are not receiving a sufficient return on investment (profit) in the good years to carry them through the bad years of drought or flood. The result is that farmers are among the lowest income group in Australia. This directly leads to and causes the loss of farms as economic enterprises, thereby undermining rural and regional Australia, and also reducing Australia's food production capacity and food security. It is a wonder that farmers survive at all, despite the strategic value of food self-reliance and the vast economic benefits farmers provide to the Australian economy (in export dollars and import replacement).

## Operating Mechanisms that Prevent Governments from Mitigating the Effects on Farmers of being Price-Takers

### 1. Free Trade Idealism

The reason for the dire situation farmers find themselves in are narrowly idealistic economic policies pursued by Governments that fail to take into account the fact that farmers are price-takers and not price-setters. While it is true that in a perfect world free-trade is the best mechanism to ensure the efficient allocation of resources, Government economic advice and policy does not seem to grasp the fact that when it comes to agriculture, the international and domestic markets are so distorted that unilateral or idealistic free-trade policies are suicidal for Australian farmers, and ultimately therefore, for Australian agriculture. Economic policy must always remain grounded in reality, not theory, if it is to effectively contribute to national wealth. Economic advice must always be tested to ensure real-world factors have been taken into account in any modelling or advice that is offered in order to determine what the real net outcome will be.

### 2. Competition Policy

Free-trade idealism is based on the belief that any form of market organisation, regulation or public policy that diverges from a pure free-market model is *prima facie* uncompetitive. It is this 'dumbed down' assumption that is the basis of current National Competition Policy. The effect of this narrow focus in economic policy development has been threefold:

- i) The focus has shifted from policies concerned with outcomes to policies concerned with processes;
- ii) The only interest recognised is that of consumers – groups representing producers and employees are excluded as far as possible from the policy process; and
- iii) The economic role of competition has been misinterpreted.

I will explore the above three points in more detail.

*Process v Outcomes:* In relation to the first point, it must be understood that competition is a means to an end, and not an end in itself. The economic ends that Governments are responsible for are economic efficiency, equity and employment. All economic advice to Government should consider these ends specifically and empirically, it is not good enough to assume or be advised that unregulated competition will in theory deliver the desired ends on a macro-scale in some indefinite time-period. The real world effects must be factored into advice. Allowing departments to assume outcomes based on an idealistic attachment to theory is, at best, pure laziness, and, at worst, deceitful.

*Stakeholders:* In relation to the second point, the benefits of any economic policy that is not sustainable are illusory. It is incredible that key stakeholders in any market such as producers and employees are sidelined from the policy development process. In the long run, if producers go out of business and employees remain unemployed, not only will consumers still lose as supply decreases and prices go up, but the larger economy will be less productive as well.

*The Economic Meaning of Competition:* In relation to the third point, the standard economic approach to competition is to intervene in imperfectly competitive markets, in order to force market participants to behave as if they were competitive firms. However, under current National Competition Policy the approach, such is the commitment to idealistic non-intervention, is that markets supplied by a few firms, or even by just two, are regarded as 'workably competitive' if the firms do not collude in setting prices. Such markets would be regarded as oligopolies or duopolies in a standard economic analysis.

Note: The belief that firms actually need to ‘collude’ in such non-competitive markets is also ‘old-hat’. With computers and information asymmetry, there is no longer any need for firms to ‘collude’ in order to achieve the same effect of higher average prices at consumer and producer expense. This is just one reason why the Trade Practices Act is woefully inadequate and behind the times.

In economic analysis a struggle for market share between two or more large firms does not equate to competition. That is, in analysing strategic interactions between small numbers of firms, there is no presumption that competition for market share will yield long term benefits to consumers. Such ‘competition’ is likely to involve a waste of resources, and the adoption of pricing policies that are not closely related to costs.

In competition policy what is required is a middle course between excessive reliance on regulation (which did characterise agricultural policy for much of the post war period) and the naïve faith in competition that characterises the National Competition Policy. This means that although it is important to recognise the possibility of a market solution, it should not be assumed *a priori* that market solutions will always be optimal. The current approach, based on the dominance of a single process objective, the promotion of competition, must be rejected.

### *3. Efficiency Improvements and Transfers*

It is vitally important in formulating policy that Governments and advice to Governments distinguish between efficiency improvements and transfers. An efficiency improvement arises if, in principle, the aggregate gains from a policy initiative are large enough to permit compensation to be paid to everyone made worse off by the initiative and still leave a net surplus. By contrast, a policy may generate gains to one group, such as consumers or taxpayers, by transferring costs to other groups, such as producers or employees, with a net loss overall. Unfortunately, the need to take such transfers into account is often neglected in assessments of the impact of competition policy. This is another example and outcome of how an idealistic commitment to ‘free-market competition’ disregards the real and bigger world.

### *4. Other Flawed Policies*

In addition to a flawed understanding of competition in the real world it appears that much of the economic advice from Government departments, particularly the Productivity Commission and Department of Trade, is flawed in other ways that exacerbate the precarious viability of farming in Australia. I will list some examples of common misconceptions and flawed policies, but the list is not exhaustive:

- i) The destination of approximately 70% of Australian farm production is domestic, not international. However, for two decades Government policies have been based on the false assumption that Australia exports 80% of its agricultural product. This has led to an idealistic dreaming that the future for Australian agriculture is in pursuing free-trade through the World Trade Organisation (WTO). This utopian vision is patent nonsense (refer to point (ii) below) and disguises the harm done to farmers by food imports. For instance, because the domestic market is so important, if farmers lose 10% of the domestic market they would have to boost exports by 30% to compensate, which is well nigh impossible.
- ii) The European Union, United States, Japan and other Asian countries view domestic food production as a strategically important industry, akin to Defence, and they will continue to pursue subsidies, tariffs and other policies to protect their agricultural industries from overseas competition. This is reality. Australia should properly protect its farmers from these foreign

policies. One remedy among many is the vigorous and effective application of anti-dumping laws.

iii) Quarantine is not a trade issue. This is understood world-wide, including by the WTO. Any suggestion that quarantine is a trade issue is simply a self-serving negotiating ploy. Why do Australian trade negotiators persist in giving any credence to this argument? Government should make it crystal clear that quarantine is not a trade issue by ensuring quarantine is managed by a Government agency that is effectively insulated and divorced organisationally from trade agencies. And in negotiations, simply, consistently and firmly say quarantine is not up for discussion as it is not a trade issue. It is a biosecurity issue that is not negotiable.

iv) Managed Investment Schemes (MIS) distort food and fibre production because they are primarily tax-minimising schemes rather than real market-driven investment schemes. It is the tax deduction that makes them attractive, not any potential profit (which most never make anyway). The result is that MIS investments are not based on market signals, on laws of supply and demand, or on issues of efficient allocation of land. They ignore market signals that are supposed to ensure resources are allocated to the most valuable use so that the community gets the greatest return from its scarce resources. The result is that they frequently lead to overproduction and the collapse of rural commodity prices, turning some high-value farm products into low-value products. The net effect is that MIS investments harm farmers and the regional economies they support, as well as the Australian economy in general. Tax concessions for MIS investments should be eliminated.

v) Tree plantations are low value agriculture and soak up a lot of water which in turn affects downstream farmers. Do not subsidise or provide tax-concessions for them as this simply distorts the efficient economic allocation of resources in the same manner that MIS investments do.

vi) Cheap imported food is not subject to the same quality and health standards as domestic food production. It is patently ridiculous to allow into Australia food that does not meet national quality and health standards. There should be adequate and rigorous testing, funded by importers, to ensure that imported food meets quality and health standards.

Note: Contrary to the claims of the Industry Commission that self-regulation of product quality would not lead to any decline in quality, economic analysis predicts that it will. This is because self-regulating firms do not take into account adverse consequences of regulatory failures for the industry as a whole, and therefore they take fewer precautions against such failures than an external regulator dealing with the industry as a whole.

vii) There should be a safety net of mandatory final-offer arbitration on the price for sugar cane because farmers have zero or minimal bargaining power with sugar mills. It is ironic that under Industrial Relations law employees get a minimum wage safety net but farmers in monopsony markets do not. A monopsony is a buyer's monopoly, which means there is only one buyer (a mill) for an undifferentiated product produced by many sellers (farmers). The effect of deregulation of the sugar-cane industry has been that farmers are only being paid the corrupt world price of raw sugar, which is half the average world cost of production, due to heavy subsidies. In addition, proprietary mills have refused to include in the price of cane any significant return for profitable by-products like cogeneration of electricity from bagasse, molasses, ethanol etc. The net result of farmers not receiving a fair return on their investment is that farmers are leaving the industry and production is falling. High-value cane farms are being turned over to low-value grazing and tree plantations.

viii) The Federal Murray-Darling Basin Water Plan has serious economic flaws because it ignores the fact that water is both a public and private good (it is a mixed good), which means that value judgements must be made about sectoral allocation that cannot be left to the

market. The instigation of water trading in permanent water rights will also lead to water-barons banking water and profiting at the expense of farmers and regional economies. Forcing up the price of water while policies are in place that prevent farmers from passing on their increased costs will simply lead to more farmers going out of business. This will obliterate irrigation farming in Australia.

ix) With the release of the report into grocery pricing and the proposal to overturn the 'Birdsville Amendment' to section 46 of the Trade Practice Act, it appears that the Australian Competition and Consumer Commission (ACCC) under Graeme Samuel is now firmly captured by the companies it is meant to regulate (i.e., the ACCC has come to identify the public interest with that of the companies). The High Court case of *Boral Besser Masonry Limited v ACCC* in 2003 has made it clear that unravelling the Birdsville Amendment will reinstitute the green light for predatory pricing.

x) Single-selling desks are critical for farmers selling undifferentiated product in monopsony markets. Single-selling desks equalise what would otherwise be an unequal bargaining situation. Eliminating single-selling desks will reduce average farm income because competition amongst sellers drives prices down, not up. Single-selling desks are justifiable in monopsony markets and corrupted world markets.

Note: In many agricultural industries, a large number of farmers deal with a small number of firms engaged in processing and marketing. This potential imbalance of market power is exacerbated where storage and transport costs are high, as in the case of milk, sugar and wine grapes, implying that processing must be undertaken close to the point of production. In many cases, this implies that farmers face a single buyer for their products.

Farmers have long been concerned that the inequality of bargaining power inherent in such situations will lead to low farm-gate prices and excessive margins and profits for processors and marketers. This concern was dismissed under National Competition Policy as a result of largely *a priori* arguments rather than empirical analysis, and the institutional bias in favour of free market policies. In particular, the view that duopolies and oligopolies are effectively the same as competitive markets was adhered to.

It should go without saying, but apparently does need to be said, that marketing arrangements that correct bargaining power between farmers and processors are perfectly acceptable if they deliver prices similar to those that would prevail in a properly competitive market, that is, a market where neither buyers nor sellers possess significant market power. If this is so, such marketing arrangements would lead to higher farm-gate prices and lower processing and marketing margins, with final consumers facing the same or lower prices than in the absence of marketing arrangements.

### Conclusion

The above sample of issues demonstrates that farmers are suffering death by a thousand cuts. The final straw for many is the current drought and lack of real financial support by Government. It is truly appalling that during a drought when farmers are desperate, many are being forced to sell at below the true value of their land because they have run out of savings, and bank or Government support. There are plenty of people who like to prey on the weak and vulnerable. It would be unconscionable if the Government colluded in the asset stripping of farmers through the continued application of failed and misguided policies, some of which I have mentioned above.

Markets must not only be free, they must also be fair. Remember always the Australian sense of a 'fair go', that hard work will be rewarded with a fair share of economic growth, and not

have it taken away by the big players in markets who manage to distort the system in their favour, or by the unfair subsidising by foreign governments of their own farmers.

For all the above reasons I urge the Committee to give our farmers a 'fair go' with actual real support rather than empty words and empty-headed policies. This is the only way to ensure that Australia maintains a viable agricultural industry that ensures food security for Australia.

#### References

"The Hilmer reforms and NSW agriculture" by John Quiggin, Department of Economics, James Cook University, 24 June 1997.

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Yours sincerely,

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