

Senate Inquiry into food production – impact of Managed Investment Schemes

Summary

Primary producers have little or nil influence on the final retail pricing of their produce or the final price of a product if their output is transformed via a manufacturing process. Price rises have and are blamed on the effects of the drought limiting production but the producers have generally not seen any resultant rise in the prices they receive for their products. Farmer viability is influenced by many factors and the prime factor is the price for their produce. In many instances these prices received are either near or below the costs of production such that all influences need to align to assure profitable farming. There are exceptions and these tend to be the one quoted or used as reference points for the viability of that sector. Climate change will have a significant impact upon primary production and water will be a key component of what happens to a number of farming sectors over the next 20 years and beyond. MIS schemes have enjoyed a subsidy non MIS producers did not enjoy giving them a significant advantage in bidding for scarce resources. There appears to have been little consideration of the true economic viability of their enterprises.

Food production in Australia and the question of how to produce food that is:

- 1. affordable to consumers;**
- 2. viable production by farmers; and**
- 3. of sustainable impact on the environment.**

1. affordable to consumers;

The cost of food at the retail level is neither influenced directly or indirectly by primary producers, in almost all instances (produce sales) the primary producer is a price taker rather than a price maker. Although there will be negotiations for a proportion of sales or where producers/growers have moved to a vertically integrated business model, overall these remain a small percentage of the overall food market.

Analysis of food prices and primary production will show that the degree of correlation between primary production prices and affordability is closer to zero than towards one. Often in times of short supply, retail prices rise but at a far greater rate than prices to primary producers

While I am not presenting research results to support this statement, a basic analysis of food costs to consumers using raw materials produced by primary producers shows there is a significant disconnect between these two. For example in 2006 when the wheat crop was significantly reduced in size farm gate prices for milling wheat increased substantially, due in part to competing demands for the limited harvest tonnage. The amount of flour in a 650gm loaf of bread equates to some 45% of the finished weight. A typical bread mix contains, *wheat flour, water, yeast, vinegar, gluten, salt, vegetable oil, fish oil, soy flour, emulsifiers, milk protein, gelatine, sugar, vitamins*. Flour as a component of this loaf weighs in at 293gms. To achieve this flour component the weight of wheat milled can vary between 150 - 200% of the flour weight incorporated into the loaf of bread. When prices for unmilled wheat reached \$500/t this equated to \$0.26 of wheat before any processing costs and transportation costs from the flour mill onwards are included into the final cost of the loaf of bread at the retail outlet. We need to bear in mind that any so called waste produced during the milling process in fact has economic value either as a human food substance or is incorporated into animal feed stocks so the true net cost of the flour component for the loaf of bread is less than the 26 cents in this example, it actually is most likely to be nearer to a net 18 cents in this example. Now that milling wheat farmgate prices have fallen the price of a loaf of bread hasn't and have risen further .

Similarly if we look at meat or dairy products a similar relationship between supplied raw primary product, processing activities, generation of subsidiary economic goods translates into a product to the consumer that actually contains a very small percentage of the farmgate price to the primary producer. Another good example of this is that prior to world dairy commodity prices escalating by over 100% in early 2008, the drought was

blamed by retailers of liquid milk for causing substantial price increases in the retail price of bottled milk to the consumer. There was or had been no increase in the price paid to producers beyond the forecast prices for milk supplied by either the Milk Co-ops or the Commercial milk processors buying milk from their suppliers. The retailers claim that the rising price of milk was due to the drought impacting on production while technically correct was in fact not related to any price increase (returns to) for the milk producers . As world prices escalated there was no corresponding increase in consumer prices “due to the need to compete for supply” indicating again that the arguments previously raised by retailers in justifying retail price increases were in fact “furfies”. Or when the 11 cent a litre levy on milk to fund industry deregulation was removed prices to consumers did not correspondingly fall, milk producers saw no change in the prices they received so somewhere, someone collected a windfall and still does.

Vegetable growers are in the same position as grain, milk and meat producers, they in the end either have to take the market price or receive nothing for their produce, meaning that they are even more vulnerable to price manipulation. They cannot take back their stock from the market and return it to the paddock, it can only be held in storage for a limited time before it must be sold or it becomes valueless. But of course any investigation shows up that there is no manipulation of prices.

The cost of foodstuffs based upon in part or whole on primary produce to the consumer is not influenced to any extent by primary producers. Reasons for why this is are varied and range from a lack of true competition in the market place for their produce through to a dominant oligarchy of retail organisations.

Primary producers have never been able to effect food prices to consumers other than in times of extremely low production.

2. viable for production by farmers

Viable production by farmers is influenced by a large range of factors. These can range from the cost of finance and the availability of finance, through to climatic factors, disease outbreaks, chemical resistance of pests and weeds, transportation costs or availability of transport options, international prices for similar products, overall production. Farmers selling into the domestic market sell into a food delivery chain for consumers that has been over the last part of the 20th century reduced in the breadth of competition and pricing diversity.

The most critical factor affecting viability of production is of course the price they receive per unit of their output. Unless a low per unit purchase price is offset by the farmers ability to produce at a matching low per unit cost there is little likelihood of them remaining viable. Intensity of the farming operation is another crucial factor in producers remaining viable if the conditions under which they are operating change such as drought affecting farm inputs. For example as cost of feedstuffs for their stock or water for their

crops or stock rise or fall, sustained high temperatures impacting on plant growth or survival, diseases not previously experienced. This list can go on.

One issue of viability, is that primary producers are in general across a broad range of products getting an insufficient economic return for their investment in their production enterprise, on the labour input and given the increasing input costs they incur in achieving that physical output level. Primary production has been complimented by the industrialisation of some of its processes, some of which are now attracting active negative resistance from the urban community. In this I refer to the campaigns by animal liberationists, animal rights advocates against activities such as caged hens, conditions of broiler chicken production, farrowing cages for sows, dairy farming based upon feed pads and feed barns, even beef feedlots are not outside of concerns for animal welfare.

Why these intensive production systems have been adopted has been partly a response to demand for bigger volumes of output with perceived better consistency and also the need to remain viable. Although now we have free range eggs, and free range pork, free range chickens, organic/biodynamic farming systems and these products do attract premiums that reflect the ethical treatment of the animals concerned through to the perception that less or zero medications or chemicals are used to produce the final product. But unfortunately non free range or very limited lip service organic producers are leaping onto this market opportunity with product that is not really produced in accordance with these systems. They are able to do so because there is no statutory protection for the standards that the genuine producers work to when considering the domestic market as opposed to the export market where standards and certification are crucial if you wish to have the “Organic” status of your products credited and the premium prices captured by the producer.

Currently potential returns for primary producers meeting the true requirements of “Organic” are having their returns diluted and captured by other producers and retailers keen to capitalise on the consumer’s desire for organic produce. This is a very clear case of where formal statutory standards need to be created and applied so that if the primary production process meets the formalised criteria of the standard then they are free to capture any higher margins that may exist and those who are not certified as meeting the standard and flout the rules as is currently happening then they need to be penalised substantially both financially and with the threat of a custodial sentence for repeat offences. It is clear from the current situation that unless the Government sets out the rules of the game, self regulation or quasi regulation has failed and will continue to fail and the consumer in significant numbers are not getting what they believed they were purchasing. Is this in fact theft by deception even though it is played out in the retail shop?

Primary producers can be viable given a fair and open market, where competition drives the prices received for produce. The influence of the trade practices Act on collusive behaviour if it is applied to producers grouping together without the umbrella of a Co-operative to market their produce for a higher price would be deemed to have fallen foul

of the Act and run the risk of substantial penalties, they certainly aren't running a cartel in the strict sense of that term. All too frequently when primary producers sell their product they are selling into a market that is predominantly a purchasing oligarchy and in some instances oligarchy members have entered into the production effort to capture the entire profit stream whether this is a commercially sensible approach by these enterprises remains to be seen.

There has been a continuing mantra of the need to get bigger to survive but this doesn't guarantee viability or survivability. This view has not been restricted to primary producers and similarly we have producers of all scales in all sectors remaining viable because they have access to slightly altered circumstances than their peers. These could be low debt, very low costs of production, niche markets or products. We need to ensure that legislation and standards that are applied to industries that process primary production are not saddled with excessive costs that effectively eliminate the small processor because they need factors of scale to survive. Reducing processors reduces market competition for the input primary produce and hence market opportunities for primary producers. Examples of this are the meat processing industry, aquaculture operations being treated as processing activities instead of production processes.

Harmonisation of the standards applied to processors of primary produce needs to be undertaken to eliminate inconsistencies between states and to ensure that the long term viability of primary producers and their resultant markets. We have started down this path by having a national livestock recording scheme and national standards exist for other industrial sectors so this is not impossible to do and in fact should have been done soon after we moved away from the horse and cart.

Water is currently and likely to be the major issue that primary producers face. Their demand for irrigation water and the need to leave a substantial proportion in the river systems for environmental purposes means that neither side of this argument is going to be happy with the outcomes. But demand for irrigation water to grow food crops in semi desert or arid environments is environmentally wrong and also a profligate use of an extremely valuable resource. If we examined what we were growing and why, we would most likely shift where we were growing it and what we were growing. For example growing cereals, legumes and pulse crops under irrigation is also inefficient and if examined rigorously, uneconomic and it would cease but with a low price on water this will not happen.

Primary producer viability is also hampered and damaged when special interest groups argue that their sector is different and needs different treatment (subsidy), this is the other extreme of the "goes to the most efficient" mantra. All that it causes is distortion and disadvantage to those not part of the group. A good example of this is our wheat exports, if moving away from the single desk was to benefit farmers we should be seeing a significant increase in farmgate prices for wheat. But what we have instead is a range of small (relative to the old wheat desk) exporters, selling relatively small volumes of wheat against massive wheat exporters from competing countries and to top it all off they are now getting support to establish their overseas marketing. Now if the so called benefits

were there and were not being captured by the old single desk these new exporters should by all rights have had the market beating a path to their door. It hasn't, and the farmers haven't benefited significantly (a few have) but it has resulted in a significant investment in on farm grain storage and handling systems all of which is a duplication of what already existed but now has been fragmented and any beneficial gains to producers will be captured and held by the new exporters.

What can be accurately forecast is that the mix of primary goods produced will change compared to the historical mix of 10, 20 and 30 years ago. This change is being driven by low farm gate prices, drought and international markets. It will translate into true food production shortages for certain primary products and any past price increases will seem to have been minor, reversing this potential change that is happening now will not be an easy or simple task as price signals have been sent to farmers for a substantial number of years. Examples of changing primary production are falling dairy cow numbers, the declining sheep flock which is in part impacted through low wool prices this will translate into lower stock numbers overall even though currently this is contradicted by increasing lamb production in the short term. Climate change will impact upon all forms of primary food production through rising temperatures, extended periods of drought, higher rainfalls or larger rain events but not necessarily higher total rainfalls.

Within the dairy industry changes are being exacerbated by hidden implicit subsidies to larger producers through higher prices because of larger volumes supplied ignoring both the fact and reality that these processing plants were supported and paid for by smaller suppliers who are now penalised for being smaller although they may be more efficient. The impact of this is yet to be felt but being big is not a guarantee for financial viability and survival. The impact to a processor of a large supplier exiting is far more noticeable than if a small supplier exits.

Intensive livestock industries based upon feed lotting techniques will find viability is a major issue when input prices rise due to low input (feedstuff) productivity. Currently beef feedlots are running significantly under their design capacities and maybe their economic breakeven points. Unfortunately using grain resources to produce meat for human consumption if we looked at it critically is a profligate (a 6 or 8 feed to meat conversion ratio) use of a scarce resource when compared to grass finished beef. The feed lot industry has recognised that dependence upon grain for finishing beef is a higher risk (economically) activity and they have moved to incorporate the feeding of waste generated by the food processing industries such as potato waste, grape marc, brewers grain, citrus pulp from juice manufactures and the list can go on. Fortunately we didn't go down the even higher risk path of feeding dead animals to live animals as has occurred in other countries. All these activities are undertaken by the lot feeders to remain viable, but actually highlight the vulnerable viability that they chase.

Also the aging of the primary producer base and the lack of recruitment of younger producers, although examples will be quoted to say this is not the case, but if we look at the historical age mix of primary producers it is now currently skewed to a higher aged

mix. What this means for primary production can only be guessed at but all pointers indicate falling productivity as a likely outcome.

3. of sustainable impact on the environment.

Primary producers in the main are responsible partners with the environment. Failure to do so by themselves results in the degradation of their land and their water sources and then upon their production. Unfortunately in a significant number of the negative environmental impacts upon farm lands it has been the result of the wrong signals being given to farmers. They can all be summarized into one general category that of produce more, farm more intensively. The end result being that the land degrades, soils lose their structure, fertility declines, salinity rises, crop diseases become more severe, weed resistance grows, dependence upon chemical inputs grow and so it goes on. Frequently producers end up chasing their tails to satisfy the demands for more, but at a lower price.

Climate change is potentially going to cause significant disruption to primary production and cause a relocation of optimum production areas in response to altered climatic patterns. This is separate to any policy changes that will impact via carbon taxes, carbon permits etc. The benefits to the environment of having effective and environmentally contributing farming practices needs to be recognised in the current debate on carbon sequestration. Instead we have seen agriculture placed in the too hard basket which places primary producers at disadvantage as we have been informed that a carbon emissions tax is most likely to be placed upon livestock. Considerable research has been undertaken into the contribution of livestock to greenhouse gas levels and interestingly no consideration has been given to the amount of carbon sequestered into the human food chain via livestock. Similarly there has been a failure to acknowledge that emission levels vary depending upon the intensity of the farming operation within the same type of farming operation

Unfortunately and while I don't wish to be classed as a climate change sceptic there is considerable research undertaken to indicate that what is being described as climate change due to our now raised CO₂ levels have in fact been occurring for over 3500 years and in this instance I am referring to El Nino. Similarly research has shown that sea temperatures have been up to 1C warmer and colder all within the last two millennium, both temperature extremes occurring within a 400 year period. Recent research in the USA has found that the early part of the 20th century in the western half of the USA was far wetter than the average. This was a period on which they based all the dam construction and irrigated agriculture development. In this respect I have a concern that maybe we are missing significant pieces of information that would inform us as to whether our now re-ordering of water use or over water use is going to lead us into a substantial fall in primary production in what we have thought of as our traditional producing areas. If in fact we were wetter during the 20th century to our long term average then food prices are going to go up and the consumer will have to pay, there can

be no way around this. No similar work as done in the USA has been undertaken and the results published here in Australia so all our arguments and debates can be said to be based upon speculation and guess work with dressed up support from researchers with a lack of hard objective data. Within this changing climatic environment primary producers will continue to practice techniques that ensure their economic and environmental survival and given the resilience of primary producers with the right price signals they will produce. What will stop or break up this responsible behaviour is the imposition of illogical and unrealistic criteria that dictate how farming activities are to be carried out.

Subsidizing any form of agricultural production is a major hinderance to efficient production and delivery of appropriate produce for the market.

Managed Investment Schemes

Managed Investment Schemes that developed in the Food Production system were in effect subsidized by the Australian Taxpayer, while non MIS producers were not subsidized. This subsidy in the form of a taxation benefit that other primary producers were not able to benefit from encouraged them to not only outbid rivals who did not have access to such substantial rivers of cash. It appears that there was little regard for the economic viability of their enterprises and the scale of them ensured that there would be impact in terms of volumes produced and sold into the markets

Claims that they were generating employment with their respective developments while technically correct, were only transferring employment from one region to another. It is also questionable as to whether this employment location transfer was actually generating more employment opportunities than the positions being foreclosed in the loosing regions. The decline in employment opportunities in the old regions is far slower but more pernicious than the advocates of water relocation were prepared to admit to. Overall the potential benefit to the Australian economy was in fact a net loss. This has occurred due to the gradual decline in economic activity within the old regions, and the smaller gains in the new regions and this ties back to the money flows in the respective regions. For example significant numbers of dairy farmers in Northern Victoria sold irrigation water to the MIS operators. These farmers ceased dairying and operated farming ventures that employed fewer people and generated significantly lower economic activity. Industries servicing those farms saw a significant decline in their workload to the extent that a considerable number of them ceased to carry on business. Other businesses saw a substantial decline in their own businesses and consequentially laid off staff. This decline in economic activity took place over months and years before the full impact was clearly visible and it still continues as those previously experience monthly cash injections into the regional economies shrink in size. The Federal Government environmental water purchases will see this decline continue and in fact it may accelerate. A detailed review of ABS data will show how over the life of the MIS

schemes in Northern Victoria has changed the mix of activities making up the region's GDP and in the new regions where the MIS schemes operated.

MIS ventures transferred profit gains out of the regions they operated in, contrary to the previous economic activities and relocated those gains to the major urban areas such as Sydney and Melbourne.

Cynically, MIS scheme managers most likely never intended their physical activities to generate net profits as their whole model was focussed on selling more investment (110% tax deduction) opportunities and the physical activities were there purely to serve as window dressing. This argument is given credence and standing by the business structures that they put into place to run their operations such as complex interlinked multiple business entities and the fact that the managing entities owned none of the assets necessary for these enterprises to succeed. Third parties while related owned those assets that all assumed belonged with and linked to the physical production assets. In this respect I refer to water.

If the ATO ruling had not been changed to reflect what the original intent of the Legislation creating the Forestry MIS industry then great harm would have been done to the overall food producing industries in Australia.

Advocates of this change have said that irrigation water should go to the most efficient uses but in the instances where this has occurred we have moved to growing irrigated crops in desert and semi desert environments. While prices per tonne produced or litres produced appear substantial if they were paying the true cost of that water or the 110% tax deduction had not been available then we would most likely never have seen them established. Current events also indicate that MIS food schemes were more concerned with farming taxation benefits making a mockery to the mantra that water should go to the most efficient (high value) water uses.

With the collapse recently of two of the largest MIS operators the ongoing impact of their presence in their respective industries is rapidly dying and while they maybe resurrected in another form their impact has been lessened by the removal of the taxation incentives. When they were operating they provided a ready market for farmers in straitened circumstances for their irrigation water. Literally up until their collapse from the time they first entered the water market they have under pinned pricing and fortunately since their collapse the Federal Government is underpinning the market with its purchases of water for environmental purposes.

MIS operators had a significant financial advantage over their traditionally tied primary producer allowing them to bid for and take inputs/assets above what primary producers could economically bid to.

The extension that that MIS schemes got again showed how a specific group can argue successfully that their activities are special and need to be supported. Support is always

at the expensive of rational production and is used as a means of gaining financial advantage over other sectors or competitors.