

## **‘The political outlook for agriculture – the big picture’**

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### **Introduction**

Being asked to provide an opening address on the big picture issues for agriculture presents both an opportunity and a risk. The opportunity arises because, as first speaker, you can be sure no-one has already said what you intend to say. The risk, however, is that later speakers will have plenty of opportunity to criticise what you have said. In the case of this Riverina Outlook conference, the risk for me is even greater. I was born in Wagga Wagga and grew up on a farm not far from here, and I am acutely aware of the biblical observation that ‘no prophet is accepted in his own country’!

The situation in which Australian agriculture finds itself in 2007 is one which also involves enormous opportunities and significant risks. The opportunities arise from some fundamental changes that are occurring in global markets, and the risks arise from a range of sources, not the least of which are some current policy issues.

Taking all these into consideration, however, my view is that with good management and a bit of climatic luck, much of Australian agriculture is set to experience a period during which there will be an opportunity for sustained profitability – the like of which has not been seen for many decades. Not only that, but there is also a reasonable chance that this will be a longer-term change, not be just a brief boom followed by a sudden bust.

As an added bonus, this provides a rare opportunity for Australian agriculture to take a much more positive approach to tackling current political issues that pose risks for the sector.

### **The global agricultural outlook**

The drought that has been experienced in Australia over recent years has been, if not the worst since European settlement, then very close to it. It has had an enormous negative impact on the profitability of farm businesses. Fortunately, however, farmers have had many more options available to reduce losses than in past droughts, meaning recovery should be quicker.

The impact of the drought and the related water supply problems it has created has led to much public debate and negative comments about the sustainability of Australian agriculture. However, these

negative sentiments have overshadowed some very positive developments in global agricultural markets, which some are suggesting signal a fundamental increase in agricultural commodity prices that will continue well into the future.

One of the most bullish about the global agricultural commodity price outlook is major United States (US) investment bank Goldman Sachs. In a report recently published, the bank forecast markedly higher prices for virtually all agricultural commodities, and concluded:

*'We believe that the recent rise in agricultural prices is not a transient spike, but rather represents the beginning of a structural increase in prices, much as has occurred in the energy and metals market. A combination of food, feed and fuel demand for crops has created an upward shift in the trend demand growth for agricultural products'.*

These sentiments were echoed in the most recent Agricultural Outlook report, published jointly by the Organisation for Economic Co-operation and Development (OECD) and the Food and Agriculture Organization (FAO) of the United Nations. That report concluded:

*‘Current strong world market prices for many agricultural commodities in international trade are, in large measure, due to factors of a temporary nature, such as drought-related supply shortfalls and low stocks. But, structural changes such as increased feedstock demand for biofuel production, and the reduction of surpluses due to past policy reforms, may keep prices above historical equilibrium levels during the next ten years’.*

The most recent European Union (EU) report on future prospects for farmers in Europe was slightly less upbeat, given the reliance of European farmers on domestic markets, but still concluded that:

*‘the medium term (farm) income projections display a rather favourable outlook as the EU-27 agricultural income would grow by 21% between 2006 and 2014 in real terms and per labour unit’ (European Commission 2007).*

High global agricultural commodity prices do not always translate into high prices for Australian farm commodities, due to the impact of trade barriers and currency exchange rates. Even after taking

these factors into account, however, the most recent forecasts released by ABARE were very positive.

ABARE predicted an average increase in Australian farm commodity export prices of 5% in 2007–08, with stronger price increases for coarse grains, cotton, beef, wool and dairy products. Wheat and oilseed prices were forecast to remain static, although that forecast is based on expectations of the price-dampening impact of a very large harvest.

When it is realised that these projections are being made at a time of already high agricultural commodity prices, the extent and durability of current positive market conditions becomes even more apparent.

These forecasts do not mean that farm commodity prices will lose their normal short-term volatility, but they signal a medium-term future where demand growth will continue to exceed supply growth, therefore putting continual upward pressure on farm commodity prices.

The general consensus is that there are several major factors that are resulting in relatively high farm commodity prices at present. The first of these is the sustained period of economic growth that has

been enjoyed by many nations, including China, over the last half-decade. This has created a growing number of more affluent consumers in developing nations who are no longer satisfied with three meals of rice a day, and who are instead demanding a growing proportion of animal protein in their diets. This is driving demand for livestock products including dairy, but also driving strong growth in demand for feed grains, and putting upward pressure on grain prices.

A second, and related, factor driving higher farm commodity prices is global biofuel production, which has grown significantly in recent years and is predicted to continue that strong growth rate for a considerable period. In the US and the EU in particular, aggressive government biofuel policies are resulting in large amounts of grain and oilseeds being used for that purpose, reducing grain available for exports and in turn impacting on domestic livestock production and global grain and oilseed markets.

To get some idea of scale of the potential extra demand generated by biofuel policies, the Goldman Sachs report estimates that the total amount of land devoted to grain and oilseed production globally will need to triple by 2015 in order to meet stated international biofuel targets, and to continue meeting growing feed and food demand.

Taken together, the combined impact of growing global feed, fuel and food (and, to a lesser extent, fibre) demand is resulting in some fundamental changes in long-term farm commodity price trends, which in the short to medium term look likely to significantly improve potential farm profitability in Australia.

### **Australian agriculture's political environment**

While the more positive global farm commodity price outlook is welcome, it signals future potential, rather than money in the bank. Whether that potential is realised or not depends on a wide range of factors, not the least being the weather, and interest and exchange rates.

The political environment which Australian farmers operate in can also have a large impact on the sector's profitability. Policy issues that are of particular significance to the farm sector at present include water management, climate change policies and agricultural trade reform, and it is these three areas of policy that I want to discuss in a bit more detail.

## **Water policy reform**

Since 1993, Australian governments have been reviewing and reforming water management in Australia. The major focus of water policy reform has been on achieving sustainable levels of water extraction.

While it sounds simple, deciding what is a sustainable level of extraction of water from a creek or river is quite challenging. There is little agreement on what sustainable means, limited knowledge about how changes in water extraction levels effect the environment, and considerable gaps in monitoring data that can be used to measure progress.

To many, sustainability refers to environmental outcomes, which includes both 'in-stream' and 'near-stream' impacts. For "in-stream" impacts, available data shows a significant improvement in water quality of the Murray River over recent years. Whether this improvement is a side-effect of the generally drier conditions is an open question, but the data certainly highlights that claims of a continuing decline in the health of inland rivers needs careful examination.

Deciding what is a sustainable level of water extraction is complex because Australia's inland rivers have the highest flow variability of any rivers worldwide, and in their natural state regularly stop flowing. Such highly variable flow also means highly variable water quality, and highly variable conditions in associated ecosystems.

Virtually all inland rivers in eastern Australia are now managed rivers, further complicating the 'sustainability' question. There is no longer such a thing as the 'natural' state for these rivers, which might be used as a benchmark against which to gauge current conditions.

Irrespective of which government has ultimate responsibility for managing water policy, the question of what constitutes sustainable use of water is likely to remain a contentious issue for a long while, and one that will be determined as much by politics, as it will by science.

The second issue that is a major part of water policy reform is the enhancement of water trading, a key part of which is the need to create secure water rights for farmers and other water users.

This is a particularly important issue because, as water becomes more limited, irrigators are being asked to make bigger and bigger investments on-farm to achieve more efficient water use. Farmers won't make these investments, however, while there are large risks that future access to water will be removed without compensation.

The recent experience of irrigators in New South Wales has highlighted this point. Without warning, the NSW Government confiscated 20% of the water in the water accounts of irrigators, and then imposed a further 30% cut three weeks later, which included water irrigators had just purchased to make up for the earlier cut. The end result was water valued at around \$50 million was simply taken from irrigators by the NSW Government, without compensation.

These events occurred at exactly the time politicians, economists and commentators were criticising farmers for being reluctant to get involved in water trading! These actions have clearly highlighted how far Australia still has to go before some sensible principles of water policy become reality.

There is no doubt that, in future, there will be progressively less water available for agriculture. The inevitable result of that will be

an increase in the long-term average price of water, and a progressive transfer of water from lower value agricultural uses to higher value agricultural uses.

There needs to be a solid dose of reality on this point, however.

Water trading has been possible in various forms since 1983, and there has already been considerable movement of water. The history of water trading indicates that only 1–2% of permanent entitlements are sold each year, while up to 10% of available water is sold on the temporary market.

In combination, these factors suggest that the transfer of water away from low intensity uses, such as pasture for dairy farms, will be a trickle, rather than a flood. The real change I think we are likely to see is strong farmer investment in measures that improve water-use efficiency on existing irrigation farms.

### **Climate change policies**

Another issue that will present a major challenge for agriculture is climate change policies. A clear distinction is needed between the impact of climate change, and the impact of climate change policies. While climate change will undoubtedly have a longer-term impact

on agriculture, it is my view that in the short to medium term, it is climate change policy that is likely to have the bigger impact.

Both the current Australian Government and the Opposition have endorsed a national greenhouse emissions trading scheme for Australia to commence in either 2010 or 2012. Under the Government's proposal, the 900 biggest emitters, which together account for about 55% of national greenhouse emissions, will be required to participate in the national emissions trading scheme.

Those 900 emission trading scheme participants will need to find ways to reduce their net greenhouse gas emissions, either directly by changing their processes, or indirectly by paying for recognised greenhouse offset activities.

The initial impact of the trading scheme will be to increase the price of fuel and energy, and any products or services that have relatively high fuel or energy inputs. This will certainly mean fuel, electricity, chemicals, crop contracting and freight costs will increase for farmers.

The implementation of the emissions trading scheme will also create a market for greenhouse offsets. While the rules are not yet

established, it is likely that permanent tree plantations will be recognised as offsets, but it will be more difficult to have many other greenhouse-positive changes that may be implemented at a farm level – such as adoption of minimum tillage or reduced use of nitrogen fertilisers – recognised as offsets.

This means there will be an additional incentive for tree plantations on farms, but there is a strong chance that administration costs will make small tree lots uneconomic. The farm sector will quickly need to develop greenhouse offset pooling arrangements in order to be able to economically aggregate small plantings of trees into marketable parcels.

Planting trees will not be an option for many farmers. However, unless systems can be developed, such as farm greenhouse ‘best management practice’ standards, that are recognised as offsets within the emissions trading scheme, the farm sector will bear all the extra input costs, but have no opportunity to mitigate those costs by being paid for offsets.

Ultimately, a greenhouse emissions trading scheme will directly reduce Australian farm competitiveness, unless the scheme recognises non-permanent farm offsets. This is particularly

important as some of our major competitors – especially in developing nations such as Brazil and Argentina – are unlikely to be impacted by national greenhouse emissions policies for many years.

### **Agricultural trade policies**

Reducing international agricultural trade barriers has been an objective of the Australian agriculture sector and Australian governments for many years, and achieving this within the multilateral framework of the WTO has always been the preferred approach.

While difficult to negotiate, a multilateral agricultural trade agreement has the potential to simultaneously reduce the agricultural trade barriers of many nations. The alternatives, which are bilateral or regional free trade agreements (FTAs) negotiated directly between Australia and major trading partners, will always be agreements where it is much harder for the farm sector to achieve good results. This is because they will always be less comprehensive, and a very real chance exists that agriculture will be traded off, or left off.

The failure of the WTO Doha Trade Round negotiations, means there is little or no chance that a multilateral trade agreement including agriculture will be negotiated within the next five years. It also means there will be increased attention paid to bilateral trade negotiations, such as the Australia-China FTA, the Australia-Japan FTA, and the Australia-Chile FTA.

Each of these appears unlikely to produce much benefit for Australian farmers, especially as Australia has virtually no trade barriers restricting agricultural imports. On the other hand, it seems unlikely that nations such as China or Japan, which are both already net agricultural importers, see any real benefit in reducing tariffs on their agricultural imports.

There are several risks for Australian farmers. The first is that Australia's quarantine standards might be compromised as part of trade negotiations. Australia is already being challenged by New Zealand on apples and the Philippines on bananas, and it is likely that Australia will be asked to relax quarantine regulations either officially or unofficially part of a negotiated FTA.

An equally large risk arises from the failure of WTO negotiations, and resulting weakening of the WTO rules-based trade system. It is

not hard to imagine Europe incorporating issues such as the environment in future trade regulations, or, alternatively, these being unofficially imposed via supplier contractual arrangements of the major international supermarket chains. Tesco, the major United Kingdom and international food retailer, has already announced that within the next three years all the products on their retail shelves will be required to have information about the greenhouse footprint.

While this may not be an issue for most broadacre farm products, it will quickly become an issue for the dairy, horticulture and wine industries here in Australia that currently export to northern hemisphere markets. Unless effective ways are found to counter these challenges, they will further disadvantage Australian farmers in international agricultural markets.

## **Conclusions**

The three policy challenges identified previously are just a sample of the challenges facing Australian agriculture, even leaving aside things like our highly variable climate. Taken together, they could easily lead to despondency about the future of the sector, especially given the shrinking direct role that agriculture plays in the economy,

and the shrinking proportion of Australians who either understand or care about farming.

However, the very exciting developments that are occurring in global agricultural markets at the moment, and the promise that exists of these being sustained into the future, creates a completely different environment for the sector, than was otherwise the case even a few years ago.

It means that, instead of having to approach policy-makers and the wider community as a sector in decline seeking help, there is now the opportunity for agriculture to adopt a completely different approach.

The very strong growth that is occurring in global demand for agricultural products means the sector can approach policy-makers and the wider community with a very positive story to tell.

Agriculture is a sector facing sustained growth, creating additional regional employment, development and wealth. New investment in agriculture is likely to occur, and that can already be seen in moves by major banks and investment groups to get involved. These developments also create the potential for longer-term increases in

agricultural export earnings, relieving balance of trade and foreign debt concerns.

Agriculture urgently needs to communicate its very positive potential to the Australian community, instead of constantly emphasising its problems. In saying this, the intent is not to ignore or paper over the fact that the recent, and in some cases continuing, drought has resulted in enormous economic and personal hardship. That is well recognised and cannot be ignored.

The intent is, however, to communicate to Australian politicians and the community the enormous potential the agriculture sector now has to grow.

In my experience, politicians are much more interested in finding ways to help industries with great potential to prosper, than they are in providing handouts to industries with never-ending problems.

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