Agricultural Competitiveness White Paper Submission - IP347
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The Agricultural Competitiveness Taskforce
Department of the Prime Minister and Cabinet
PO Box 6500
CANBERRA, ACT, 2600

Re: Development of an Agricultural Competitiveness White Paper to grow agriculture's competitiveness, farm gate profitability and contribute to Australia's prosperity 2014

Summary:

Agricultural policy failure in Australian Agriculture is indicated by increasing Australian rural debt (now approaching $65 billion), low commodity prices & farm incomes, mass bank foreclosures & other administrative arrangements, decreasing land & equity values, rural depression & increased suicide rates, increasing age of farmers, lack of farm succession plans, loss of rural farm-support businesses & services and decreasing rural populations.

This billowing rural debt is a symptom of long-term and continuing lack of profitability in all agricultural sectors, government policy changes with inadequate lead times for slowly responding agricultural production systems and the lack of a banking system that can have the patience to support the vagaries associated with agriculture.

The proposed ARDB, currently before a Senate Committee Enquiry, would be able to provide this type of banking support as well as a mechanism to stabilise land prices in the face of downturns, such as we are now seeing, caused by unusual climatic or financial conditions.

2012/13 saw the almost perfect 'storm' affect farming in many 'hotspots' around the Nation: drought, record high $A, low farmgate prices and high grain & fodder costs. Fortunately we are in a low interest cycle, except for those farmers, deemed to be in default or in adverse equity positions by bank land revaluations, which have had penalty interest rates of up to 15% applied.

Australian agriculture has been in decline now for some time with the average loss of approximately 300 farmers per month in the past 3 decades. This cannot be allowed to continue for the sake of Australia's food security!

Australian milk production which had steadily grown from about 1980 to peak at about 11.3 billion litres in 2002 has since been in decline and is now back to about 9.2 billion litres. Production can be expected to continue to decline as a result of the current spate of bank foreclosures which appear to be severely affecting the large scale (high milk volume) operations and the lack of buyer interest in these properties, coupled together with low profitability and an aged farmer population, many of whom will try to exit dairying as soon as an opportunity presents.

These bank foreclosures, a symptom of poor profitability, and the subsequent mortgagee property sales are further decreasing land values and hence equity for all farmers. If allowed to continue we can expect a cataclysmic collapse of the entire agricultural sector.

Major changes need to be made to Agricultural policy if we are to reverse the trends in Australian agriculture and take advantage of the Asian food boom and to live up to Julia Gillard's declaration that "Australia will be the food bowl for Asia". These policy changes will need to be smart if we wish to ensure our own food security as consumers are very opposed to the notion of subsidy. *These same consumers will be yelling loudly when most of our food is being imported from countries where the quality control is much less rigorous*.

Australian farmers do not want grants when drought, flood or fire destroy a year's work and income but a banking system that understands the short-term fluctuations as a consequence, fair market access and the provision of low interest loans with a long-term view to recovery.

The proposed Australian Reconstruction & Development Board (ARDB) could provide such a banking institution outside the normal commercial, short-term thinking, profit-driven banking system.

Recommendations:

1. Debt Stabilization
    - (a) Immediate establishment of the Australian Reconstruction & Development Bank (ARDB)
    - (b) Debt reduction – minimal tax rate on debt repayment
2. Encourage Agricultural Investment
    - (a) Immediate repeal of NCL legislation
    - (b) Increased investment allowance &/or tax deductions
    - (c) Access to finance for young people seeking to purchase farms.
3. Reinstated & improved Exceptional Circumstances (EC) support
4. Farmer Profitability & Food Security
    - (a) Increasing farmer profitability will drive expansion & productivity
    - (b) Improving farmgate returns
    - (c) Improved transport & port infrastructure
    - (d) Competitiveness through the value chain
5. Encourage expansion of regional communities
    - (a) Effectiveness of incentives for investment and job creation
    - (b) Improved profit of farmers will result in additional expenditure in local regional businesses

But of course, most of all, we need forward-thinking policy makers to enact other intelligent legislation for the future to ensure we can feed our own Nation. <u>We need to act fast as we are not far from the point of no return!</u>

Contents

Professional History:

I graduated from the University of Melbourne with a Bachelor of Veterinary Science degree with honours in 1975 and commenced work in a mixed but predominantly dairy cow practice in Southwest Victoria late in that same year. In December 1978 I became a partner in the same practice where I have practised ever since. The business currently employs 45 people and is one of the largest veterinary practices in rural Victoria.

In the last 17 years I have worked full time in dairy farm advisory work assisting farmers in an attempt to increase their profitability. As such I have been intimately involved with farm budgeting, liaising with the farmers' accountants & bankers and benchmarking client financial performance in addition to trying to improve farm performance in many other ways.

I am also a partner in a large equity partnership dairy farm established in 1989 and now milking more than 1,300 cows. As such I have experienced the lack of profitable years and the need to continually extend bank finance &/or inject additional off-farm equity to ensure the business' survival.

Background:

Agricultural policy failure in Australian Agriculture is indicated by increasing Australian rural debt (now approaching $65 billion), low commodity prices & farm incomes, mass bank foreclosures & other administrative arrangements, decreasing land & equity values, rural depression & increased suicide rates, increasing age of farmers, lack of farm succession plans, loss of rural farm-support businesses & services and decreasing rural populations.

My personal view is that Australian Agriculture is in an almost irreversible slide to where we will need, within a very short period of time, to import a large majority of the food we eat. This would have been almost unbelievable just a few short decades ago in a country with as much space, fertile soils and as many riches as this country has.

The big problem is that we lack visionary leaders – particularly politicians that look way past the next election to where Australia will be in 20-50 years' time.

Many agricultural sectors, not just dairy, are in serious decline: beef, wheat, fruit, milk & vegetables have all been in the press recently.

Year 2013 was a difficult year in many different respects and one of the major consequences has been numerous farm foreclosures or administrative arrangements with banks (actually, <u>mainly</u> one of the big four banks). As each of these farm businesses collapses so too does the equity of all other farmers (and the banks' loan books) and a serious impact is made on all the other farm-support businesses in the local rural towns and we have seen these towns suffer significantly also.

It was reported recently in the local Warrnambool newspaper that as many as 72 business premises in the city of Warrnambool (a city of approximately 33,000 people) lay dormant – a scary number in anyone's mind! And of course with the winding-up of these businesses there are more people requiring social support – all with a reducing Australian working force!

Many of the foreclosed farms are sitting dilapidated with no buyers in sight because the potential purchasers see no future in agriculture i.e. no prospect of profitability on a sustainable basis. Those farmers that might consider taking up their neighbour's properties even at 'fire-sale' prices have seen those that were previously encouraged by Government and industry representative bodies calling for extra productivity to service the oncoming Asian boom, fall in the current slump because of strangling debt and bank downgrading of their asset values.

Where are the children of these farmers? The majority, encouraged by their parents who are aware of the struggles their children would endure by taking on the family farm, have gone away to be educated in other fields and sought urban employment.

Rural populations continue to fall making businesses in regional towns less viable and on and on this vicious cycle goes.

Time then to do something about it before it is too late!

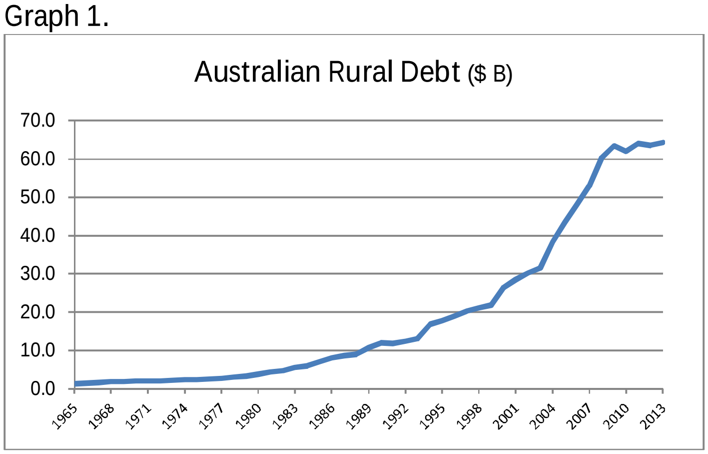
The National Picture:

The Problems:

(a) Increasing Rural Debt

Rural debt as monitored by ABARES has risen significantly, particularly since around the turn of the century (see Graph 1.).

Graph 1.

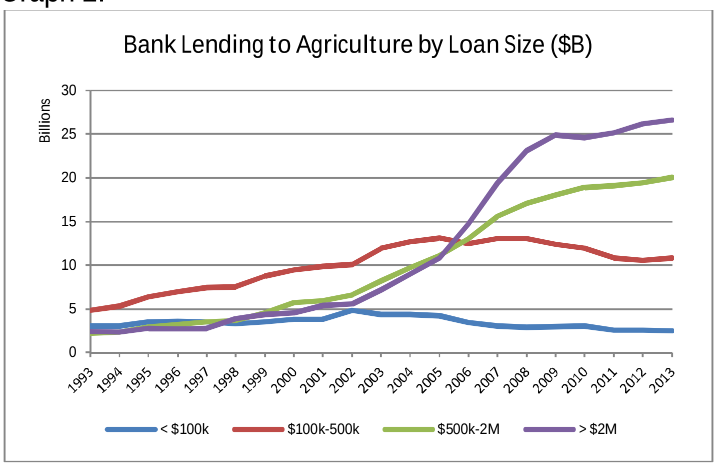


Source: ABARES (RBA Table D9)

Of this rural debt figure of more than 64 billion dollars ($64.3B) it is estimated that 7-10 billion dollars ($7B-$10B) represents "contested" or bad debt loans.

Graph 2 shows Agricultural <u>bank debt alone</u> broken down by size of loans. What is obvious is that farming businesses with debt of greater than half a million dollars, and particularly greater than 2 million dollars, have escalated massively since about 2005. It is also shows, as economist Ben Rees concludes, that 'the large borrowers drive the shape of the total curve. Consequently, the debt problem is in the 20% that produce 80% of production'.

Graph 2.



Source: ABARES (RBA Table D7)

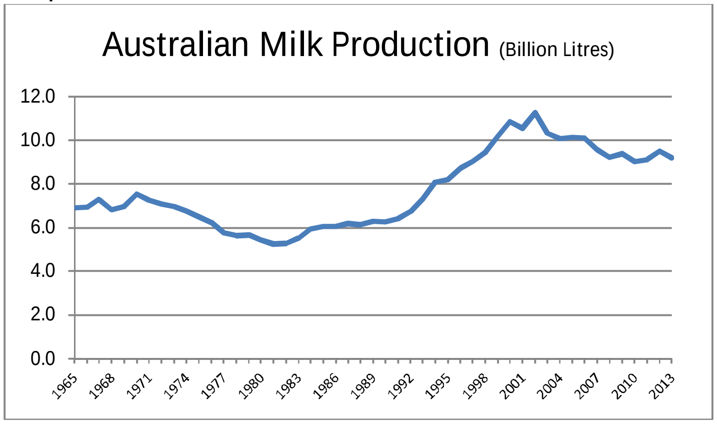
(b) Decreasing Productivity (Milk)

Australian milk production rose sharply, despite reducing dairy farm numbers, from the early 1980's through until the turn of the century peaking at 11.3 billion litres in 2003[1] (see Graph 3) but is now in steady decline despite the rapidly increasing Asian demand for milk products.

Why is this happening? Certainly dry seasonal conditions in 2013 have contributed but the reality is that profitability has declined in the face of uncertain milk prices, unfair milk factory price signals, Government policy demands for cheap food, the supermarket duopoly's continued use of milk as a loss leader, an increasingly un-level playing field (with respect to other countries continued subsidisation of their farming industries) and ever-escalating cost increases, including 40% increases in power costs with the introduction of the carbon tax in 2012/13.

[1] ABARES Reserve Bank of Australia (RBA), Table G9, http://www.rba.gov.au/statistics/tables/index.html

Graph 3.



Source: ABARES (RBA Table G9)

(c) Decreasing Farmer Numbers

The number of farmers in Australia has been declining for decades. Over the 30 years to 2011, the number of farmers in Australia declined by 106,200 (40%)[2]. This equates to an average loss of 294 farmers per month over that period. In the past many of these farms have been incorporated into existing neighbouring farms but industry statistics indicate this trend is less likely to continue to occur with thousands of farm properties currently formally & informally up for sale. Many more aging dairy farmers in South West Victoria intend to exit dairying as soon as sale prospects improve.

(d) Aging Farmers

The median age of farmers in 2011 was 53 years, compared with 40 years for people in other occupations, with almost a quarter of those over 65 years of age, compared with just 3% of people in other occupations. In the past, farm succession involved younger generations returning to work on, and ultimately taking over, family farms. The low profitability of farming enterprises plus the associated long, hard hours of work have meant that most farmers have encouraged their children to be educated in other fields and seek work other than in agriculture.

The Causes:

(a) Lack of Profit in all agricultural sectors

As a result of poor commodity prices, ever-increasing cost of production, continually increasing debt (in an effort to build the 'mythical' economy of scale), increased cost (Award conditions) of & decreasing skills associated with the limited availability of labour (decreasing rural population), anticompetitive predatory pricing of the supermarket duopoly, difficult climatic conditions and the need to continually source more capital to survive.

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[2] Australian Social Trends, Dec 2012 (Australian Bureau of Statistics)

Sourcing more capital = more debt servicing = more debt required and on and on it goes!

(b) Government policy

Agriculture is like a big ship which is very slow and cumbersome to turn around. Preparation for crops commences a year or two ahead whereas changes to calving/lambing patterns need 5-10 year lead-time to change. Agriculture policy changes therefore need to provide adequate lead-time to allow farmers to make the necessary preparations or changes to enable them to adapt. Government often makes changes within days (e.g. suspension of Indonesian Beef Trade), within months (e.g. Exceptional Circumstances changes) or in some cases (e.g. Non-commercial loss legislation) retrospectively. In agriculture these rapid policy changes are a disaster.

i) Non-commercial Loss Legislation (NCL) – in its wisdom, the Gillard Government retrospectively introduced NCL legislation which effectively prevented rich Australians investing in Agriculture. The spirit of the Legislation was to prevent rich hobby farmers from evading tax but because it was poorly thought-out and developed it has trapped hundreds of legitimate farmers into continued farm losses and the need to continually inject outside funds into their farming businesses with no prospect of being able to sell their operations in the current market.

Anyone who tries to tell you running a 450 cow dairy farm is a hobby only need be assigned to milk for a day to realize that it is a serious farming enterprise. By their very nature these enterprises are highly geared, large and totally run by employed labour – hence the extreme difficulty in making a profit in the current agricultural environment.

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Several of these large businesses have been forced into liquidation in the past twelve months in South West Victoria. Furthermore, this legislation now stands in the way of rich Australians investing in the huge numbers of currently financially stressed farm businesses which would help stabilize the current decrease in land values caused by the banks' forced 'fire-sale' farm sales.

ii) Removal of Exceptional Circumstances (EC)/Drought provisions in favour of self-help. Again these changes were not given sufficient lead-time to enable farmers to build up a nest egg. As was bound to happen, despite the generous increase in Farm Management Deposit (FMD) limits, the majority of the country was immediately besieged in drought. The simultaneous crash of farmgate prices associated with the effects of the record high Australian dollar meant a massive draining of FMD funds rather than a build-up for future self-determination.

Our farmers expect vagaries of weather and fluctuations in the market place and don't want handouts but they do want a fair go. Fair market access, the prevention of overseas dumping of product onto our markets, cessation of predatory behaviour by the supermarket duopoly, less restrictive non-essential red tape and governmental help to get our products into overseas markets is what they crave.

No grants when drought, flood or fire, in the blink of an eye, destroy a year's work but a banking system that understands the short-term fluctuations as a consequence and low interest loans with a long-term view to recovery would seem a 'no-brainer'.

Global warming and the consequent more extreme weather events will make farming increasingly more volatile as time proceeds. We need to ensure our farmers can survive these events if we are to be a significant contributor to providing feed to the growing world demand.

The current drought definitions, like the relief measures, are totally inept if we want Australia to play a major part in feeding the World. Drought should not be as simple as the amount of rain that falls between January the 1st and December the 31st each year but needs to be more tied to growth season rainfall which will be significantly different for different regions. For example, the rainfall in SW Victoria for Spring, Summer & Autumn of 2012/13 was in the lowest 5% of recorded rainfalls but because of a better than average previous Winter no consideration was given by the bureaucrats and boffins in their cosy offices to the calls for drought relief. Yet 60% of SW Victoria's growth and hence fodder reserves are created from Spring rainfall and much of the balance from Autumn growth. We would do well to consider NZ's drought definitions which appear much more appropriate.

We must find ways to ensure our farmers survive these increasingly likely weather events that are outside their control if we are to ensure even our own food security.

iii) Clearly rural debt is a major problem to agriculture in Australia and yet the Taxation System actually discourages businesses from reducing debt. Debt reduction must of course come from profits which also incur tax at the taxpayer's marginal rate. Despite the benefits of averaging and Farm Management Deposits this actually discourages farmers (and other Australian businesses) from paying down debt in favour of increasing expenditure in good times on repair and maintenance items that provide an immediate tax deduction.

iv) Managed Investment Schemes (MIS) Schemes – Government policy allowed these schemes to try to aid rural investment but in many cases they fostered industries that without tax advantages were unstainable and led to collapse (e.g. Blue gums in SW Victoria). In SW Victoria these MIS Schemes, together with the then Government's reduction in water availability for agriculture in the Murray River

Basin, resulted in significant competition for good farming land and were a large cause of the massive inflation in agricultural land prices that occurred at that time.

Had these investment schemes been made available to conventional farming enterprises they may have proven more successful and actually helped grow our nation.

v) Free Trade Subsidies – Australia's leaders continue to advocate for nil agricultural subsidies and a level playing field. Clearly the rest of the World is not listening or more likely, they are smart enough to realize their own population's food security is vital. They know they need to keep their farmers producing. When will we wake up?

Of course we have the 'free-traders' in Australia refusing to hear calls for support for farming in this country but I wonder what they will be calling when the majority of our food is imported.

On this topic, I had this quote from a representative of a small cattle drug manufacturing company employing about 120 people the other day worried about the impending doom that appears to be descending ever closer in Northern Queensland: "*Imagine the uproar from Australians when their milk is powder from China or their beef or lamb is from Brazil*".

Remember the woman & her daughter that died recently from food poisoning in Bali and the melanin scare in China and the enzootic diseases in other countries that do not have the costly, stringent hygiene and chemical safety regulations that we have to ensure our food is safe.

And it's a reality if we continue to lose farmers at the current rate of nearly 300 per month. We must stop this happening! We need to have people moving back into the rural areas where there is plenty of work to produce food for the World: the farmers just need to be rewarded for their work. Just something most of us take for granted without even thinking where everything in that supermarket comes from: it all comes from a farmer!

The US and Europe continue to support their farmers despite the call from their urban populations for the abandonment of subsidies but they continue to find innovative ways around it such as the US latest crop insurance, and why not?

Fonterra NZ has been able to negotiate a Free Trade Agreement (FTA) with China for dairy products to be exported – a significant competitive advantage over Australia. Why have we been unable to do the same? Have we been lazy or is it merely to keep uncompetitive industries, such as our car industry, alive?

Our Government is currently negotiating FTA's with Korea, Japan and China but appears happy to accept compromises claiming success despite only achieving modest decreases in tariff rates and/or small increases in import volumes (e.g. Cheese). Clearly they have a very different definition of the word "*free*". All the fuss & backslapping is unlikely to see great benefit to the profitability of Australian farmers.

vi) The Australian dollar ($A) clearly has significant impact on agriculture which, because of our small population, relies largely on export of product for its return. Although largely outside Australia's control, our nation's management of financial policy and foreign debt clearly needs to be exemplary. *The effect of the strength of our currency is further exacerbated by the exchange rate difference between Australia and New Zealand, our biggest competitor*.

vii) Government is apparently powerless, or does not have the inclination, to prevent the profiteering of the middlemen between the farm gate and the plate. The producers' percentage return of consumer buying price in Australia is the lowest in the developed World indicating major middleman profiteering and/or red tape cost, inefficient processing or work practices and other excessive farm to consumer cost that needs to be investigated with vigour by the ACCC.

viii) Shutdown of Indonesian Beef Trade – it took 6 days for the Labor Government's hysterical shutdown of the beef live export trade after a negative TV report doing irreparable damage to the industry and our country's reputation. It actually caused significantly more animal cruelty by destroying the orderly market and leading to mass feed deprivation for these animals due to the enforced overstocking and fodder shortage – not to mention no income to the producers!

The current government has worked hard to restore this trade but never-the-less these northern beef farmers are still on the brink of oblivion with bank foreclosures still proceeding. Urgent action is required or this industry will be left obliterated!

ix) Market Corruption – the supermarket duopoly of Coles & Woolworths, who together own 80% of market share, dictate what products consumers can buy by their manipulative use of shelf space and what they will pay for products by their bullying contracts with farmers. The predatory pricing of milk is a classic example of their power to distort a market. The ACCC appears powerless, or does not have the inclination, to intervene.

Milk production is expensive and yet bottled water is dearer than milk! How can this be? Loss-leaders in Australian supermarkets have placed extreme pressure on the price received for domestic produce e.g. home brand milks sold at $1/L. How do we prevent them from wrecking our markets?

x) Unfair Processor Payment Systems

- Processors or supermarket duopoly making deals with individual farmers to secure supply which unless consistent should be regarded as anticompetitive.
- Loyalty payments – in dairying milk processors have declared the former milk price step-ups to be loyalty payments despite the fact that they have already received and sold the milk product. This forces the farmers to remain with the company long after they have supplied the milk to the processor. This should be ruled as anticompetitive as it severely financially limits the ability of farmers to change to other processors.
- Seasonal incentives are being used by milk companies to "force" farmers to change their supply patterns to produce product out of season. This can markedly increase the farmers' cost of production and hence reduce his/hers profitability.

Dairying in South West Victoria

Overview

There are approximately 1,650 dairy farms in South West Victoria which is Australia's largest dairy region, producing over 2.2 billion litres of milk in 2011/12.

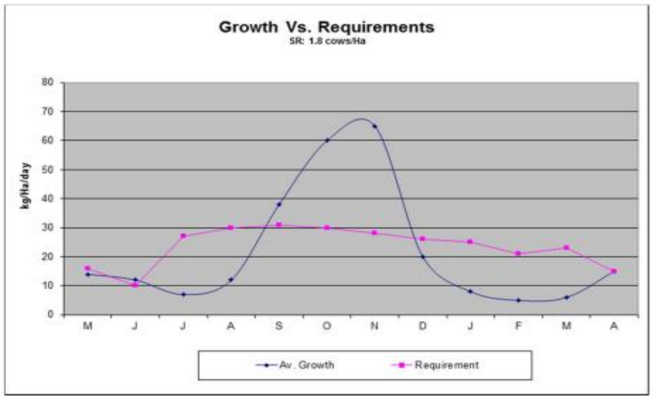
Approximately 8% of milk produced in the state is used for drinking milk with the balance manufactured. Almost 50% of Victoria's total milk production is exported as manufactured product with dairy products being the biggest export through the Port of Melbourne. The remaining 43% of milk produced in the state is manufactured and sold into the domestic market.

The majority of milk manufactured in South West Victoria is used to produce milk powder for the export market.

South West Victorian farms are larger than those in other regions averaging 197 hectares compared to 162 hectares for all of Victoria. Average herd size was also greater at 312 cows compared with the state average of 220.

The majority of dairy farms in South West Victoria have no irrigation and rely on calving their cows in autumn/winter to maximize pasture consumed; the cheapest feed source available. Rainfall is the major contributor to pasture growth and hence profitability. Pasture growth typically exceeds herd requirements for only three or four months of the year (see Figure 1). Periods of feed shortage in early and late lactation must be supplemented with grain and conserved pasture (silage and hay.) Any shortfall must be covered by purchasing additional fodder. Significant rain is required in late spring to ensure adequate fodder reserves (silage and hay) are conserved.

Figure 1.



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In 2010 there were 1651 dairy farms in south west Victoria (Source: Dairy Australia Industry Statistics) with the region directly employing 5,160 people on farm and a further 2,240 in the processing sector. These figures represent approximately 15 per cent of the work force in South West Victoria.

The dairy industry is a strong contributor to the South West regional economy, estimated to contribute $905 million per annum whilst the dairy processing sector is estimated at an additional $1.128 billion. In addition, the service sector is estimated to contribute a further $1.586 billion to the regional economy. The total economic value of dairying to the region is estimated at $3.619 billion.

Land Values

SW Victorian land values increased rapidly from 2006/07 to 2009/10 (see Graph 4) as a result of:

- The proliferation of Managed Investment Schemes (e.g. Blue gum plantations)
- Migration of New Zealand dairy farmers to Victoria, particularly SW Victoria due to the high price of land in NZ and the predictions of buoyant times ahead for dairying
- Superannuation funds investment in dairying
- Competition from Australian farmers expanding to take advantage of economies of scale and the forecasts of government and industry that were strongly signalling the increasing World demand for dairy products and many farmers responded by increasing the size of their operations and purchasing neighbouring land again contributing to the rising land price.

Banks, buoyed by these increased land values, readily advanced funds to finance this expansion simultaneously increasing farmer debt levels.

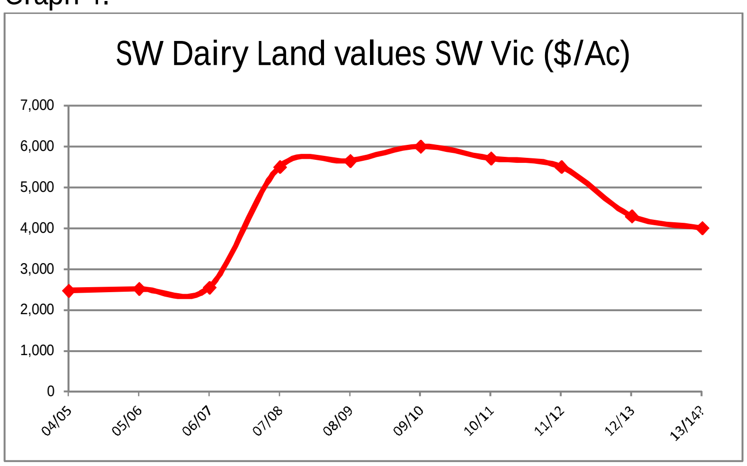
Since 2009/10 however, land values have been in decline as a result of the Global Financial Crisis (GFC), the failure of MIS blue gum plantations, drought, flood, $A and government policy (e.g. Non-commercial Loss Legislation) as outlined above. They are now estimated to be about 35-40% below their peak values although there have been so few sales, until the recent spate of bank mortgagee 'fire-sales', that the 'true' values are currently unknown.

With the sudden decrease in farm profitability, the only investors interested in purchasing South West Victorian, and indeed much of Australian, farmland are from overseas. And up until recently, we did not even keep a register of foreign ownership unless the deal was worth over $244 million.

We can be sure foreign investors are not purchasing Australian farms to ensure Australian food security!

Why is it that foreign countries recognize the importance of securing their food security and yet successive Australian governments are prepared to allow our farmers to go to the wall?

Graph 4.



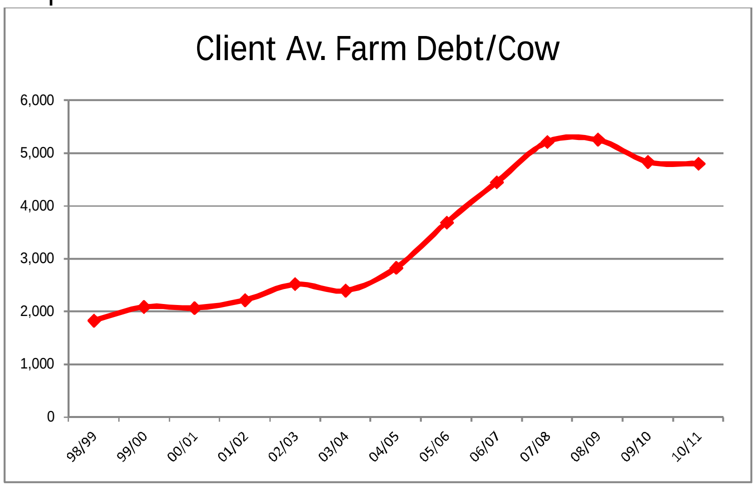
Source: Personal Client Data

Debt

Typical of Australian rural debt the debt levels of South West Victorian dairy clients' farms, as measured by debt per milking cow, has also risen sharply from about

2004/05 to about 2009/10 (see Graph 5). Clearly this continuing increase in debt is not sustainable and all efforts must be made to reduce it.

Graph 5.



Source: Personal Client Data

- Despite decreased interest rates, average clients' debt servicing costs have risen from $185,331 (15.1% of Goss Farm Income (GFI)) in 96/97 to $336,425 (22.1% GFI) in 10/11 as a result of a series of climatic & World economic factors viz. drought, GFC, flood, water shortage, high Australian dollar, etc. A 15-20% decrease in farm gate milk price in 2012/13 meant debt servicing costs rose to approximately 25.3% of farmers' gross farm incomes (GFI). Clearly this is unprofitable and unstainable and has led to a significant number of disastrous bank foreclosures and other arrangements.
- Debt servicing costs of greater than 20% means the business is in serious difficulty.
- In addition over the past decade or so there has been a shift to interest-only finance meaning there has been little or no debt reduction over this period. This must remind us of the "tip of the iceberg" principle and set rural Australia on a potential debt spiral out of control unless immediate action is taken to stabilise agriculture and improve long-term profitability of enterprises.

The Dairy Crisis in South West Victoria 2013

2012-2013 saw the almost perfect storm for agriculture in SW Victoria with all 'storm' factors, except high interest rates, coinciding:

Drought

SW Victoria rainfall for the combined Spring, Summer & Autumn seasons of 2012/13 was in the lowest 5 percentile recorded by the Bureau of Meteorology (pers com;

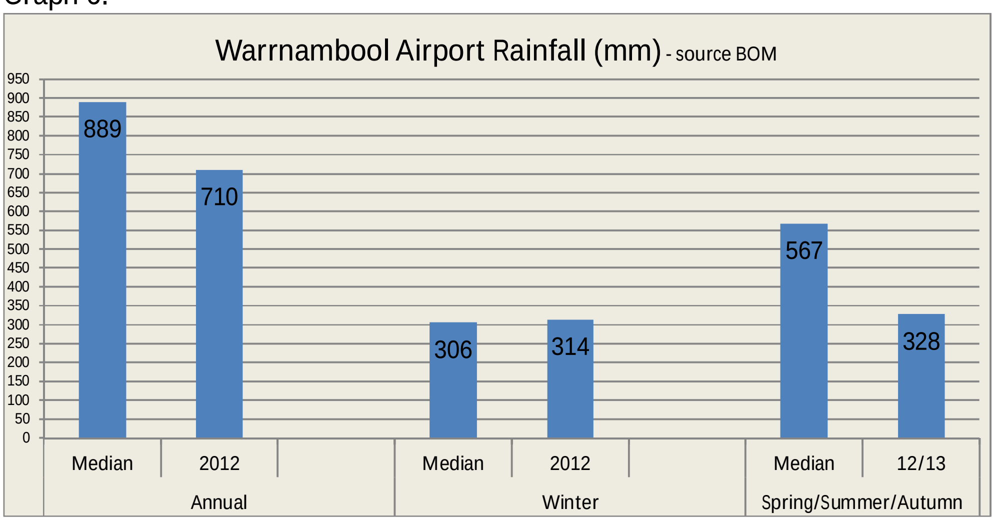
Graph 6). Even if drought/EC policy had not changed, this extraordinary event would not have qualified for assistance because Australia measures drought between January 1st and December 31st. The growing seasons in SW Victoria are Spring and less so Autumn so the critical rains fall then and determine not only production (income) but amounts of conserved fodder and therefore the deficiency of fodder that needs to be purchased (expense).

In 2012 the Warrnambool area received 710 mm rainfall which is 79.9% of its 100 year median rainfall whereas for the period September 1st- May 31st only 328 mm or 57.8% of its 100 year median rainfall fell. This meant very little fodder was able to be conserved on reasonably/heavily stocked dryland dairy farms in SW Victoria.

The extremely late Autumn break (opening rains) meant a further delay to adequate pasture for now-calving dairy cows and in many cases saw the death of pasture species as a result of the prolonged dry and consequent need for pasture resowing, even further delaying the provision of feed for hungry herds.

Together these factors led to the need for most SW dryland farmers to purchase records amounts of scarce hay that was rapidly becoming more expensive.

Graph 6.



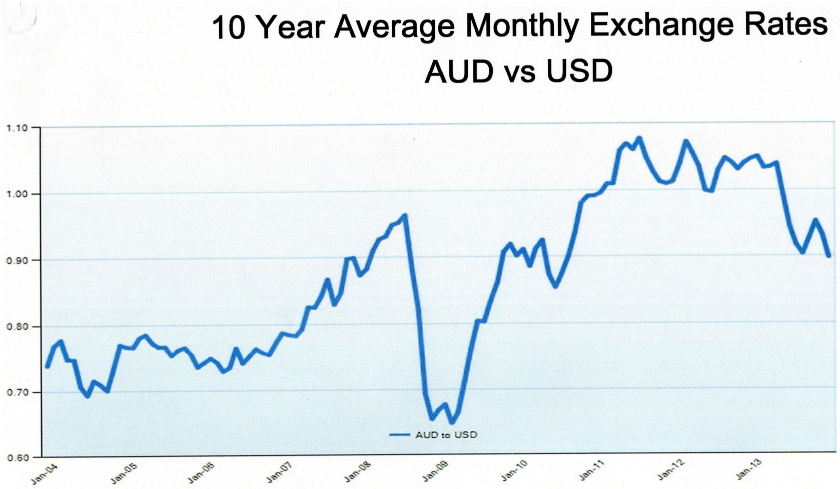
Interest Rates

Fortunately we are in a low interest cycle or the list of bank foreclosures would have been endless and the results for Australian agriculture catastrophic. Except of course for those farmers, deemed to be in default or in adverse equity positions by their bank's land revaluations, which have had penalty interest rates of up to and greater than 15% applied against their accounts. This certainly ensures there is no recovery for them! How is this fair?

High $A

The record high Australian dollar (see Fig. 2) clearly put pressure on Australia's terms of trade and was significant in decreasing farm gate milk price.

Figure 2.



Low milk prices

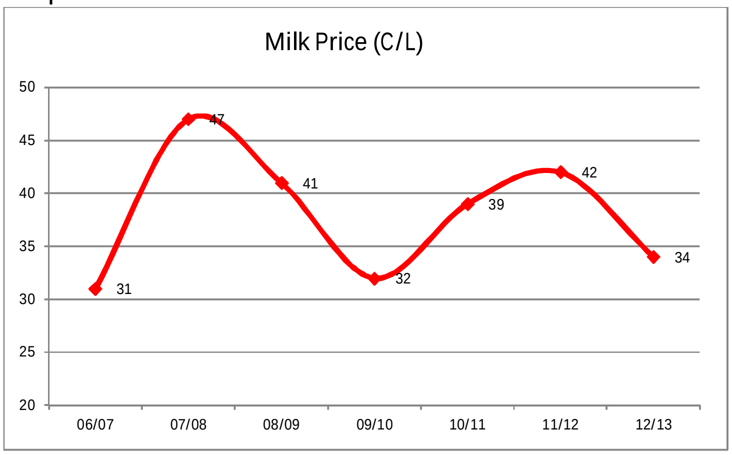
Season 2012/13 saw a 20% drop in milk prices (see Graph 7) on top of decreased production associated with limited green pasture as a result of the low rainfall resulting in dryland dairy farm incomes being substantially down on the previous two years. The reduction in farmgate milk price of 8 cents per litre across the 2.2 billion litres of production in South West Victoria effectively removed $176 million from the local economy. At the same time farmers were forced to purchase record amounts of imported grain and hay that was rapidly becoming more expensive and exposed traders themselves to serious liquidity problems as farmers struggled to pay their creditors. Many hundreds of thousands of additional debt clearly still exists outside the banking system which is unaccounted for in the rural debt totals in Graph 1.

In addition milk processor payment systems designed to create more level supply patterns for processors are significantly affecting profitability of traditional Winter-calving SW Victorian dairy farmers.

So called growth & flat milk supply incentives and other inducements such as fixed milk price contacts paid by milk processors to entice new supply are effectively mechanisms which cause 'normal' suppliers to receive less money for their milk to 'subsidise' these new suppliers.

So called Loyalty Payments restrict the ability of farmers to change milk processors by not paying traditional 'Step-ups' to suppliers if they are not supplying the processor on the day the milk price increase is paid despite the milk having already long-ago been processed by the factory. This appears to me to be clearly a breach of competition laws. Again, the ACCC does not have the inclination or is powerless to intervene. The market screws the farmer again!

Graph 7.



Source: Personal Client Data

High imported fodder (grain & hay) costs

As mentioned above, farmers were forced to purchase record amounts of imported grain and hay that was rapidly becoming more expensive in an attempt to generate an income (milk).

Other Problems

- Many farmers have sold young replacement stock to the lucrative export markets over the past year or so to survive. In the coming years they will need these animals but many will be unable to afford to buy them back.
- Most farmers have had to savagely cut costs over the past decade or so and particularly last year and this will affect their productivity going forward. Things that have been forgone include the following: capital fertiliser, lime applications to control soil pH, effluent systems, drainage, track maintenance, stock water, building & other infrastructure maintenance, energy mitigation (solar, heat exchangers), road underpasses, dairy & house upgrades, etc.
- Additional imposts for 2013 – with farm gate milk price already down 15-20% other costs still soared:
    - i) Power – many client accounts showed increases of 35-45%. The then Government claimed only 9.7% of the rise was due to the Carbon Tax.
    - ii) Dairy Australia Levy – increased 10%. Many farmers believe they are not getting value for money.

iii) Carbon Tax & other cost increase pass-on from all other suppliers & contractors.
iv) Continued cost-of-living pressure – groceries, insurance, schooling, etc.

In an industry that was already in decline, the collision of these four factors simultaneously in 2012/13 has had a cataclysmic effect on the incomes, debt and equity of SW Victorian dairy farmers and banks were forced to tighten lending practices. Most banks have taken a fairly long-term view but one of the 'big four' has clearly decided to reduce its market exposure.

Bank Actions

In the past 12-18 months, most South West Victorian dryland dairy farmers have needed to go back to their banks (or other credit sources such as their milk processors) to borrow additional funds. Some banks have maintained a hard-line and refused to extend further essential credit in a significant number of cases which has caused additional difficulties for creditors of these operations. Other banks took a far more long-term view and advanced additional funds in most cases and sought help (rural counsellor, accountancy or farm advisory) for their clients. The hard-line tactics applied by some banks (well mainly one of the 'big four') included:

a) Forced sale of some farms in a very depressed market resulting in 'fire-sale' prices & further district land asset devaluation.
b) Subjected farms to administration/insolvency firms that have charged exorbitant fees to farms that were already cash-strapped.
c) Put management companies in to run some farms with in some cases limited expertise with anecdotal reports of significant cow health issues including increased death rates.
d) Paying farmers large salaries to remain on their own farms to continue to operate these farms until a reasonable sale price can be realized.
e) Destocking large dairy farms of dairy cattle and installing agisted beef cattle on such properties until a reasonable sale price can be realized. The dairy infrastructure on these farms will rapidly fall into disrepair if not being used & maintained on a daily basis further detracting from a sale price down the track.
f) Starving farmers of funds resulting in poor-conditioned cows & deaths and putting farm creditors' businesses at risk also.
g) Driving service provider businesses into a position where they are forced to take action against farmers in an attempt to recoup what they are owed.
h) Bullying farmers by insisting on "confidentiality" at meetings.
i) Mediations solutions with very short turnaround times and set sale dates that will be too short to allow asset price recovery despite improved return outlooks.

j) Demanding short-term overdraft reductions that cashflow projections clearly show are not achievable. In one case a harvest contractor had overdraft timelines set in Winter before a machine could possibly even get on the paddocks.
k) Reneged on verbal offers of increased overdraft limits.
l) Closed accounts without warning transferring loan amounts to internal accounts and charging highly inflated interest rates approaching 15%.
m) Using customer commodity providers to report transactions with a farmer.
n) Convincing farmers to withdraw their requests for mediation.
o) Shocking communication/public relation skills shown by banks in their dealings with customers.

I read with interest a report in The Farm Weekly 9th February, 2014 by Andrew Marshall headed "No rural debt 'crisis'" which reports:

Seasonal stresses and commodity price slumps are always part of the agri-banking picture and frequently required bankers to work with clients on management strategies says National Australia Bank's agribusiness general manager Khan Horne. "Banks periodically get together to look at the big picture, but there is nothing out of the ordinary being dealt with at the moment - there are certainly no crisis talks," he said.

The article goes on:

But Rural Finance Round Table chairman and Queensland grain grower, Rowell Walton, Condamine, said there was strong evidence banks were readying themselves for a wave of foreclosures in 2014, especially if seasonal conditions improved to provide a better setting for property sales.

"Information we've got suggests about 150 cattle stations are likely to go on the market in Queensland alone - one bank was preparing its staff for foreclosures on 20 properties in one area of North Queensland," he said.

Suncorp Bank's agribusiness head Greg Leahy said there was "a bit too much hype" about the size of the debt problem and a pending wave of foreclosures, noting farm debt was not out of kilter with the rest of the lending market. While drought put more uncertainty and pressure on the farm sector mood, he said it wouldn't last forever and there was always strong banking sector interest in well run farming businesses.

Mr Leahy's comments seem a little contradictory to the article published in The Courier-Mail by Liam Walsh on 13th June, 2013 and headed "Suncorp offloads $1.6 billion of non-core, or 'bad' bank loans".

The report in the Warrnambool Standard 8th August, 2013, by Sean McComish also seems at odds with the comments from the 2 bankers above:

Liquidator Phil Mc-Gibbon from Geelong receivers Jirsch Sutherland told the Standard the situation in the agriculture industry was the worst he had seen in his 30-year career.

"I have never been as busy as I have with the dairy farms," Mr McGibbon said. "I get enquiries daily from across the Western District from Colac to the South Australian border and as far north as the Grampians."

In an article headed 'Banks dismiss debt fears' again by Andrew Marshall on Farmonline 10th February, 2013 he quotes Australian Bankers Association (ABA) policy director Stephen Carroll as saying “less than 1pc of farming sector loan repayments failed to occur within 90 days during 2012-13. Agriculture's repayment record was better than other sectors of the market”.

There are anecdotal suggestions that as many as 40 farms in South West Victoria have been foreclosed upon or are under some other bank administrative arrangement. I am personally aware of a good number of these which appears to be at odds with the statements reported above.

I have worked in this area for 38 years, 35 of which have been running a business supplying veterinary and advisory services to dairy farmers, and prior to this past 12-15 months I have been aware of no more than a handful of bank foreclosures.

Our business’ overdue debtors and debtor days and written-off bad debts indicate there has been, and still is, a major liquidity problem in the local dairy industry.

Farmer personal accounts are hard to come by as affected farmers feel ashamed of the position they find themselves in, feel they may be victimized by their banks should they come forward and feel bullied that any discussions with their bank must remain confidential. In addition of course mediation settlements must remain confidential. All this concocts to keep the real story of the current rural financial fiasco from seeing the light of day.

In the past 2-3 years I have had 3 clients referred to me by banks concerned for their financial wellbeing – so far so good with them and their banks have remained generally supportive. However, through this difficult time I have had approximately 10% of my clients who had undertaken large expansion programmes around the time of the GFC put under bank administration.

This is a very stressful time for affected farmers who have little support in their corner to take on the might of such large corporate monsters. Due to their financial plight of course they have no money to afford adequate support and advice – legal, accounting or psychological – their bank has already paralysed them for cash! The Australian & Victorian funded Rural Financial Counselling Service is the only available support and in one case I witnessed did as good a job as her time allowed. This client was also represented by the businesses’ accountant and myself (farm adviser) on a pro bono basis plus a lawyer at mate’s rates and a relatively good outcome was achieved. Pity help those that are left to fend for themselves through this process with no advice or support even from their own representative body, the United Dairyfarmers of Victoria (UDV) who, for some reason, do not see the support of their members in this situation as their role.

I would like to recommend that the Agricultural Competitiveness Taskforce take another road trip through South West Victoria (and other hotspots around Australia such as the Northern cattle areas, the Goulburn Valley fruit growing area and the grain belts in WA & SA) and ask affected farmers to come forward guaranteeing confidentiality to uncover the real situation. It would be well worthwhile subpoenaing and speaking to rural financial counsellors also. I am also happy to be interviewed.

Recommendations

Agricultural policy failure in Australian Agriculture is indicated by increasing Australian rural debt (now approaching $65 billion), low commodity prices & farm incomes, mass bank foreclosures & other administrative arrangements, decreasing land & equity values, rural depression & increased suicide rates, increasing age of farmers, lack of farm succession plans, loss of rural farm-support businesses & services and decreasing rural populations.

Great opportunities exist in the Asian Century and yet it appears unlikely, unless immediate action is taken, that Australia will be able to take advantage. Our agricultural industries are in serious decline and in need of immediate stabilisation and stimulation.

1. Debt Stabilization

Rural debt, a symptom of a lack of profitability in agricultural industries, has exploded since the early 2000's and is clearly out of control (see Graph 1, above). The current spate of farm foreclosures demands immediate action to prevent the accelerated decline of farmer and farm numbers, the continued aging of the farming population and the escalating drain of people from the country to the large cities of Australia.

(a) Establish the Australian Reconstruction & Development Bank (ARDB)

In the first instance, the immediate establishment of the proposed Australian Reconstruction & Development Board (ARDB) introduced into the Senate late last year by senator Nick Xenaphon is required to stabilize land values amid the current rash of bank foreclosures, which appear set to continue for some time. This hopefully would allow time to put long-term profit-generating agricultural policies in place to ensure Australia's food security and allow us to provide surplus food for the World's rapidly growing population.

The ARDB was first proposed by the Rural Finance Roundtable Working Group established by Bob Katter, Wayne Swan and Joe Ludwig and recommended another board be established under the auspices of the Reserve Bank of Australia. Bob Katter introduced a bill proposing the ARDB's establishment into the lower House in June 2013, at which time I flew to Canberra to combine with members of the Rural Finance Roundtable Working Group to spend 2 days informing politicians on both sides of the House of Representatives and the Senate as well as a number of Independents of the plight of our agricultural industries and the need for the ARDB.

This visit was highlighted by:

- The number of important doors that were open to us which showed the high respect of parliamentarians for the work of the Rural Finance Roundtable Working Group.
- Every parliamentarian we met with was aware of the magnitude of the problem and the potential to spiral rural debt out of control (domino effect) but appeared to have little idea how the problem might be solved.
- Most politicians indicated they could readily see the simplicity & apparent effectiveness of the proposal. Senator Fiona Nash remarked *"it's so simple, why hasn't it been done already?"*
- A meeting with Duncan Fraser & Matt Linnegar, then president & CEO respectively of the National Farmers' Federation who indicated that their priority for farming was "increased funding for R&D" and that rising rural debt "had not been raised as an issue by their members". This was despite them informing us that they had met the previous day with the Australian Banking Association (ABA) who had indicated that 'rural debt was now exceeding bank equity in rural properties'. This appeared to us to be an alarming statistic that should have immediately become a priority for the NFF to take back to their members.

The proposed Australian Reconstruction & Development Board (ARDB) is only part of the story. It will need to be augmented by the introduction of policies that make agriculture profitable into the future.

The proposed ARDB could:

i) Provide short-term stability, particularly to land values, whilst more lasting agricultural policies are implemented to regenerate profits into the agricultural sectors. In simplistic terms the ARDB would buy 'bad loans' from the commercial banks that it is envisaged will take a 'haircut' of 30-40% (as was done by Suncorp which offloaded $1.6 billion of non-core, or 'bad' bank loans last year) and aim to trade these businesses out of trouble with low-interest loans on a significantly lesser debt.

ii) Provide funding at very low interest rates to assist the entry of young/new farmers to farm ownership and to assist succession to retirement for older farmers.

iii) Could also be used to provide a new way of funding agricultural projects that have a longer-term payback or prolonged setup phase before they can harvest their rewards. Conventional commercial banks with profits dictated by shareholders appear to no longer be suitable to slow payback projects involved in agriculture.

iv) A monitoring mechanism to predict and react to events such as occurred in Australian farming in the past 2 years (2012-2014).

The ARDB would act similarly to the old Commonwealth Development Bank (CDB) which my parents made use of – how else could they have got a start in dairying? The proposed ARDB can provide all the CDB provided and more.

(b) Debt reduction – minimal tax rate on debt repayment

Clearly rural debt is a major problem to agriculture in Australia and yet the Taxation System actually discourages businesses from reducing debt. Debt reduction must of course come from profits which also incur tax at the taxpayer's marginal rate. Despite the benefits of averaging and Farm Management Deposits this actually discourages farmers (and other Australian businesses) from paying down debt in favour of increasing expenditure in good times on repair and maintenance items that provide an immediate tax deduction.

Changing the tax structure so that agricultural debt reduction incurs nil or at least only a minimal tax rate of perhaps 10% would reduce the discouragement for farmers to reduce debt.

What is the payback for this? Farmers would be encouraged to pay down debt which would make them more profitable (less Finance costs) and less vulnerable to foreclosure in difficult times but would also allow banks the opportunity to extend new borrowings to the farmers to allow productivity improvements due to their improved equity.

2. Encourage Agricultural Investment

(a) Immediate repeal of NCL legislation

In its wisdom, the Gillard Government retrospectively introduced their non-commercial loss legislation (NCL) which effectively prevented rich Australians investing in Agriculture. This legislation discourages agricultural investment by rich Australians by disallowing investors earning > $250k outside agriculture from claiming its agricultural losses against their other income. The spirit of the legislation was to prevent rich hobby farmers from evading tax but because it was poorly thought-out and developed it has trapped hundreds of legitimate farmers into continued farm losses and the need to continually inject outside funds into their farming businesses with no prospect of being profitable or being able to sell their operations in the current market.

By their very nature these enterprises are highly geared, large and totally run by employed labour – hence the extreme difficulty in making a profit in the current agricultural environment. What they do provide is jobs to local economies, directly through labour employed and indirectly through purchase of goods and services from other rural businesses. In addition they provide the opportunity for young dairy farmers to develop their skills by progressing through the ranks from farm labourer to manager to share farmer.

Several of these large businesses have been forced into liquidation in the past twelve months in South West Victoria. Furthermore, this legislation now stands in the way of rich Australians investing in the huge numbers of currently financially stressed farm businesses which would help stabilize the current decrease in land values caused by the banks' forced 'fire-sale' farm sales.

Rich investors are discouraged from investing in farming preferring, understandably, to negatively gear residential or commercial property.

This legislation could be repealed with the swipe of a pen to provide significant immediate investment incentive to rich Australians and provide some stability for the current ailing land prices.

(b) Investment allowance or increased tax deductions
Investment allowance or increased tax deductions on farm capital improvements could be increased to encourage productivity gains and environmental protection initiatives. Applying these to Australian made machinery and vehicles, where they exist, would also potentially stimulate Australian manufacture. This could have been used to stimulate the local car industry with farmers given large investment incentives or tax breaks to purchase Australian made utilities. This could have been taken further to apply to all Australian businesses who would be able to claim tax deductions on vehicles (or other plant) used in their business. Furthermore, governments & local agencies could also have been mandated to purchase Aussie made vehicles.

(c) Access to finance for young people seeking to purchase farms.
As mentioned above the ARDB could have a significant role in this allowing very low-interest, long-term loans to new farmers. Alternatively Australian superannuation savings could be used to fund new entrant farmers. Perhaps a return to the system where say 20% of self-managed superannuation funds would be mandated to be used to finance infrastructure projects (10%) and agricultural investment (10%).

3. Reinstated Exceptional Circumstances Support

Our farmers expect vagaries of weather and fluctuations in the market place and don't want handouts but they do want a fair go. No grants when drought, flood or fire, in the blink of an eye, destroy a year's work but a banking system that understands the short-term fluctuations as a consequence and low interest loans with a long-term view to recovery would seem a 'no-brainer'.

The proposed ARDB can provide these low interest, long-term recovery loans. The commercial banks on the other hand, make short-sighted fiscal decisions based around short-term (*obscene*) profitability and shareholder returns and are inherently unsuitable for agricultural recovery or development.

Farmers should be encouraged to ensure they drought, flood & fireproof themselves against such tragedies. Thus incentives for building dams to catch water to irrigate land to grow crops, water stock or fight fires should be subjected to much less prohibition and red tape and perhaps financial support. Installation of drainage systems to minimize flood damage should also be encouraged. The ARDB could be used to finance these developments by providing low interest loans.

The definitions of drought need to be redefined and perhaps be based more on seasons (see above).

Consideration should be given to insurance to cover farmers for exceptional circumstance occurrences similar to 'crop insurance' in the USA. Farmers could perhaps part fund this by taking some of the levies they pay towards research & development.

4. Farmer Profitability & Food Security

Fair market access, the prevention of overseas dumping of product onto our markets, cessation of predatory behaviour by the supermarket duopoly, less restrictive non-essential red tape and governmental help to get our products into overseas markets is what farmers crave.

(a) Increasing farmer profitability will drive expansion & productivity.
The law of diminishing returns proves there is a limit to the productivity gains from research & development and from increasing scale. We cannot rely on these small future gains to return our agricultural businesses back to profitability.

(b) Improving farmgate returns.

- Enhancing agricultural exports by continuing to negotiate true free trade agreements (FTAs).
- Processor unfair practices – processors or supermarket duopoly making deals with individual farmers to secure supply which, unless consistent, should be regarded as anticompetitive.
- Loyalty payments – in dairying milk processors have declared the former milk price step-ups to be loyalty payments despite the fact that they have already received and sold the milk product. This forces the farmers to remain with the company long after they have supplied the milk to the processor. This should be ruled as anticompetitive as it severely financially limits the ability of farmers to change to other processors.
- Seasonal incentives are being used by milk companies to 'force' farmers to change their supply patterns to produce product out of season. This can markedly increase the farmers' cost of production and hence reduce his profitability.

(c) Improved Transport & Port Facilities
Transport & port facilities need to be improved to facilitate transport and export of agricultural products. Milk companies need to be encouraged to work together to streamline the pick-up of milk to reduce costs to farmers and to governments in road maintenance.

(d) Competitiveness through the value chain
- Work practices - need to be consistent with maximizing efficiency particularly in dairy which is a twice a day, every day of the year business.
- Profiteering – mark-ups/profits need to be transparent with farmers receiving a higher percentage of the sale price.
- Reduction of inefficient regulation

5. Encourage Expansion of Regional Communities

(a) Effectiveness of incentives for investment and job creation
- Employment
- Housing
- Travel subsidies

(b) Improved farmer profit will result in additional expenditure in local areas

Conclusion

The Treasurer of Australia, Mr Joe Hockey, was quoted in an article by Colin Bettles in 'Farmonline' on 7th February, 2014 saying: "*If people are having problems coping with interest rates now, then there is a bigger systemic issue at play, because interest rates now are at an all-time low*."

Well Mr Hockey, you are right, people are having problems with their finance costs right now, not because of high interest rates, but because of the lack of profitability and burgeoning debt levels – much bigger systemic issues.

Let's do something right now to save our agricultural industries and ensure Australia's food security into the future.

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[redacted]