

**SUBMISSION TO THE
AGRICULTURAL COMPETITIVENESS
WHITE PAPER**

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Agricultural producers in the Walgett District of NSW

17 April 2014

PROLOGUE:

This submission is the work of two farmers from the Walgett District who have returned to the land after pursuing careers in business and government.

These are farmers with highly developed business skills and experience who have adopted best practice in their farming operations and are striving for continuous improvement.

The opportunities to improve competitiveness in agricultural can be broadly identified as those that improve competitiveness at the farm scale, within the industry sector, and those opportunities that require more significant investment and policy support to improve the competitiveness of the industry and the nation.

- 1. INTEREST RATE DISPARITY: RURAL MORTGAGE V RESIDENTIAL PROPERTY MORTGAGE**
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1. INTEREST RATE DISPARITY: RURAL MORTGAGE V RESIDENTIAL PROPERTY MORTGAGE

Interest rates, where rural property mortgage is used as security, need to be on a competitive footing with interest rates where residential property or other asset classes are used as security.

The Capital Adequacy provisions require Australian banks to hold higher levels of capital against lending that uses rural property mortgages as security as compared to residential property.

The need for capital adequacy provisions as a policy is not questioned *per se*, but the variation in rates for loans which are both secured by a mortgage over real estate creates a market that discriminates against rural lending.

This occurs as banks can create more credit against residential mortgage security than against rural mortgage security, thus skewing the market to favour lending for residential property purchase. This in turn may assist in leading to the creation of a residential real estate bubble as residential pricing is fed by a market that favours directing funds to this sector.

Lending against rural real estate security is priced at a higher level in order to allow banks to generate sufficient profits against the higher capital adequacy provisions of this lending.

The effect of this is to see variable home loans in today's market of 4.7%5-4.9%, against variable rural loans held by the authors of 6.35%. This is a difference of 1.45%-1.7% per annum, or the equivalent of 14.5% - 17% over 10 years.

This is the equivalent of 3 -3.5 years of ADDITIONAL INTEREST over ten years. To put that into an historical perspective, those savings, if retained within the farm business, would be more than enough to replace the past cost of the interest rate subsidy.

Any argument that rural mortgage security is inherently more "risky" than residential property needs to be closely examined. At a recent presentation Mr Steve Carroll formerly of the Australian Bankers Association presented figures showing that losses on rural loans represented less than 0.5% of the total bank exposure in that sector.

RECOMMENDATION: That policies be put in place to ensure that mortgage lending rates for loans secured by real estate mortgage (whether rural or residential) be placed on an equal footing.

2. INEFFICIENCY IN THE GRAIN SUPPLY CHAIN.

The redevelopment of grain industry infrastructure to ensure both collective economies of scale in supply chain logistics, and increased competition in the use of those facilities to ensure a fair distribution of supply chain efficiencies to farmers.

In the past 12 years the rail freight differential from the Walgett silo to the port of Newcastle has increased by approximately \$25 per metric tonne, to over \$49 per metric tonne. When added to the freight cost from farm of \$16, silo receipt fees of \$6.90, silo out loading fees of \$6.18, and port fees of approximately \$20, this represents a cost path from farm to ship of over \$90.

In the 2012/13 harvest, the two farmers making this submission respectively produced 4500mt and 9000mt of grain. The increase in freight differential alone represents an additional cost of \$108,000

and \$216,000. Reducing supply chain costs by between \$20 and \$30 per metric tonne would make a dramatic difference to the profitability and sustainability of these businesses over time.

The \$49 per mt cost of the freight differential from Walgett to port, when added to the \$16 farm to silo freight gives one of the proponents of this submission \$65 to freight to a domestic market by truck. To put this in perspective, it is enough to send grain north as far as the North Burnett in Queensland, or as far south as the Goulburn Valley in Victoria. This is significant not only for the cost farmer's bear, but also for the cost that the wider community bears through the deterioration of the highway system.

Supply chain analysis is provided in the attached reports *The Cost of Australia's Bulk Grain Export Supply Chains* (Australian Export Grains Innovation Centre 2014), and *Agriculture in Focus : Competitive Challenges* (Rabobank 2014).

The key to lowering supply chain costs is investments to create appropriate economies of scale.

For example:

If real economies of scale were to be developed in the rail freight system to the port of Newcastle We would need to see 5000mt trains (we the ability to upscale to 10000mt trains) with a 24 hr turnaround from an upcountry loading terminal.

With 6 trips per week (one day for maintenance) that would see 30,000mt delivered to port or approximately 1.5 million mt per annum. (With the ability to go to 3million mt per annum by utilising 2 x 5000mt trains or 1 x 10000mt train).

In order to ensure that the train can do one turn around in 24 hours, track quality and distance travelled must be feasible, port unloading speeds must be feasible, and upcountry train loading speeds must be feasible.

Up country loading speeds must be increased to world's best practice. The Canadians have fast load hopper systems that can load a 10000mt train in under 2 hours. We need to be able to at least load a 5000mt train in under 2 hours.

Unloading at port needs to be at the same pace. Under 2 hours to unload 5000mt.

That leaves 20 hours for travel time. The town of Narrabri is approximately 400km from Newcastle. Giving a round trip of 800km, giving a theoretical average minimum speed requirement of 40km/hr. At 50km/hr it is a 16 hour round trip with 4 hours for contingencies. Similar turn around time would be expected from other regional centres such as Parkes, Junee and Dubbo.

In order to achieve these efficiencies it will be necessary to construct a fast loading facility up country. To maintain throughput it will be necessary to ensure that the facility can access a minimum of 1.5million mt per annum.

It will not be economically viable to build fast loaders at every upcountry silo. Walgett silo has a capacity of about 330,000mt. Based on this proposal, if the silo were full the loader would only work for 11 weeks per annum, and then lie idle. In drought year the loader would not be used at all.

If a centralised facility were to be constructed to allow the generation of significant economies of scale, it should not be owned or dominated by one company, or a small group of companies.

The loading facility could be operated like a port facility, and all users would be charged an agreed schedule of fees.

Adjoining allotments on the same site would be operated by a number of merchants and storage and handling organisations, each having access to the fast loading facility by means of a common conveyor belt (similar to a coal mine conveyor). A belt with a capacity greater than 250mt/hr would ensure that the loader was filled in time for the next train.

In this way a facility could be constructed that would maximise the economies of scale for the industry, thus minimising the cost path to port.

It is suggested that road delivery access to the facilities on the site would be through a single sampling stand and weighbridge facility (obviously with multiple sample points and weighbridges). The reason for this is it is at this point that the grower or his representative can make their marketing decision. If one company on the site is offering a significantly better price at the time, then the market will direct grain (i.e.: trucks) to them. The other companies can let their facilities sit idle, or chose to match the price in real time to win market share. If growers are not happy with the price on the day, they may opt for warehousing their grain at the site.

In this way we create a more liquid market at the site, with grain merchants all dealing with the same, more efficient cost path and a level of competition to ensure some of the cost path savings are passed back to growers.

The fate of smaller silos on branch lines needs to be examined. These silos provide a needed surge capacity in the local area at harvest. In some areas we are seeing a trend to further investment in on farm storage to cope with harvest surge, but in other areas, particularly for grain that is to be trucked to domestic markets (e.g. feed wheat, and feed barley) they are needed.

A solution for the branch line silos is to look again at the Canadian model, and running smaller railcars out to these silos and bringing grain in to the fast loading facilities to transfer to the large capacity train. Rather than using locomotives, it may be useful to look at the truck/loco conversions done by the Brandt company (see their website). These can pull significant loads in on branch lines and have the capacity to get off rail and on to the highway to go to where they are needed.

The provision of these vehicles could be by contractors with the view that they are a replacement of road transport, to get grain in from outlying silos to a central hub.

RECOMMENDATION: That investment in grain supply chain logistics be co-ordinated in such a way as to ensure rapid and significant change to create additional value for all parts of the industry.

3. COMPETITION IN THE RETAIL AND WHOLESALE SECTOR.

Due to the fact that there are only two supermarkets that control the majority of the food retail sector in Australia they have significant influence on the prices paid by consumers and the prices paid to the producers.

Producers who have contracts are loathe to give up there deals because the supermarket chains control so much and they need to have certainty in the market .This is coming at a dreadful cost to producers as they struggle with diminishing returns caused by limited competition from domestic purchasers, who purchase most agricultural product in an environment where there is both an

exportable surplus (where the price of the exportable surplus is in turn influenced by protectionist policies in other countries), and subsidised imported product.

We have been letting the market decide our future for decades whereas our competitors overseas do not do that. There has to be some intervention (legal and binding as in the US) If you look at the dairy industry you can purchase milk in a duopoly supermarket cheaper than water! The government look on but this would not be tolerated by some of our competitive countries.

RECOMMENDATIONS:

Smaller local retailers need to be guaranteed access to floor space within shopping centres, and not excluded to appease the large chains.

Licensing agreements could be investigated to help development

Investment by alternative supermarket chains needs to be encouraged to increase competition in this sector . We don't need too much more competition just more than what is currently available to put pressure on prices paid by consumers and prices paid to producers.

Increased competition in the market from overseas supply chains seeking to develop supply chains for Australian product to act as a counter veiling influence of on the domestic market dominance of the Australian supermarket chains.

4. GOVERNMENT IMPOSED REGULATION: NATIVE VEGETATION

The ABS Census of 2011 Walgett was ranked the 3rd most productive agricultural shire in NSW with production of \$434 million (Moree 1st \$1052 mill, Griffith 2nd \$970 mill). This is more than both Narrabri and Gunnedah shires.

The breakdown of the sources of this production is as follows:

Grain is 46% of production

Cotton 30%

Mixed Cropping 17% (oilseeds, pulses etc)

Sheep 2%

Cattle 1%

Cropping in one form or another made up 93% of the agricultural income. This came from only 34% of the land area. The remaining 66% of agricultural land area only produced 3% on the agricultural production.

The above highlights the reason for a switch in land use from a typical grazing enterprise to either predominantly farming or mixed farming that has occurred in Walgett in the last 25 years.

The introduction of the native vegetation Act has limited any future growth potential and economic development in agriculture in 66% of a shire that has a high level of production potential.

The extremely rich soils from natural floodplain that has allowed farmers in Walgett to capitalise on their assets. The introduction of zero till farming has changed the viability of farming in this 450mm annual rainfall area. We are able to hold huge amounts of water in the topsoil of this predominantly grey vertisol soil.

The regulations are limiting growth in a town with high levels of unemployment and an array of significant social problems. As a high proportion of the population has a strong cultural connection to the local area, they do not tend to migrate to seek employment opportunities elsewhere. Third

and fourth generation unemployment/welfare recipients are increasingly common. Alternative development to provide employment opportunities and economic stimulus are not available, the agricultural sector wants to develop further, but is limited by regulation. The community is caught in a poverty trap.

Both producers are in a benchmarking group. Analysis of the 2012 cropping/grazing year highlight the major disparity between farming and grazing.

One property of 10000ha and has an enterprise mix of 30% cropping 70% grazing. The operating return is 8.6% on asset. Where those farmers in the benchmark group whose operations are predominantly cropping return 13.5% on asset and those who are almost exclusive graziers return 2.3% on asset.

The Gross Margin(GM) returns per over the whole property make it very obvious where income is generated

Dry land wheat \$314.39 GM/Ha

Chickpeas \$397.15 GM/Ha

Beef breeding \$30.97 Gm/Ha (and this is 70% of the) area.

You can now see that the income from cropping to grazing is more than 10 times the difference. From a drought preparedness perspective it is also vital to understand that mixed farmers cannot prepare for a drought if they do not crop a significant percentage of their country.

You cannot bale hay, make silage or store grain economically unless you make it yourself and have the option to feed your animals in low rainfall years from produce stored in good years. Graziers are at the mercy of the open market to buy fodder in tough years and can come under huge financial pressure if they do not have options. Graziers also take longer to recover from droughts because there income is so much less.

What the current native vegetation laws costs individual farmers

As stated above this property has an enterprise mix of 70% grazing and 30% farming and based on the figures above, if the mix were to change to 60% farming and 40% grazing the results are significant

Current situation

70% (7000ha) grazing at \$30.97 Gm is \$216790

30% (3000 ha) cropping at \$300 GM is \$900000

Average income is \$1 116 790

The current value of grazing land in my area is \$741 ha therefore grazing land is worth \$5 187 000

Current value of cropping land is \$1827 ha therefore cropping land is worth \$5 481 000

Value of property is \$ 10 668 000

Desired situation

40 % (4000ha) grazing at \$30.97 GM/Ha is \$123880

60% (6000ha) cropping at \$300 GM/ha is \$ 1 800 000

Average income \$1 923 880

The **INCREASE** in overall Gross Margin is **\$807090** per year.

The value in the land would change from grazing land (4000 ha) \$2 964 000

The value of the cropping land (6000ha) \$10 962 000
Value of the property \$13 926000.

The **INCREASE** in land is **\$3 258 000**.

Government policy and overregulation is destroying our competitiveness. The Native Vegetation Act and the Threatened Species Act are two examples of govt legislation that is putting a massive opportunity cost on farmers, a real cost on farmers and government with the administration of the Acts, and an opportunity cost on a community with limited opportunities to develop alternative industry and employment

The “blanket” nature of the current legislation covers the whole state without allowing for different issues in different parts of the state to be managed from a regional perspective. If you modified legislation that was regionally focused there would be far better outcomes from an environmental, social and economic perspective.

There has been talk of developing the north of this country to becoming a rich food and fibre source, but at the same time there are parts of this state that go undeveloped and in a lot of cases become less productive

The price that farmers are paying for the management of native vegetation on behalf of the state is far too high. If there is the social will for farmers to manage their properties for the good of everyone else then they should be paid for it. That payment should reflect the forgone production potential of that land, not some token payment that potentially could be employed by government in some biodiversity fund.

RECOMMENDATIONS:

Native vegetation legislation should be regionally focussed and developed by farmers in their local area. This will allow all regions to be competitive and to improve profitability and therefore viability. Profitability of regions drives employment and resilience

Regulations should be modified to enable proper triple bottom line outcomes. This means a change in land use should be allowed if there can be demonstrated a positive outcome socially, economically and therefore environmentally. Farmers need to be profitable for the environment to be improved.

Threatened species act should be completely overhauled

Regrowth date should be changed to 1950 in central division and 1943 in western division

5. STATE AND FEDERAL GOVERNMENT TAXES, FEES AND CHARGES: A TAX BEFORE PROFIT.

The existing system of government taxes and charges adds a significant cost burden to business, regardless of the profitability of that business. In effect, A TAX BEFORE PROFIT.

Included in this are stamp duty; license fees; motor vehicle registrations; payroll tax; and fuel excise.

Stamp duty in the case of both of the proponents of this submission, has been financed through additional debt in conjunction with property purchase. That is an additional cost that adds an unproductive debt the farm debt burden.

One of the proponents has paid over \$300,000 in loan and mortgage stamp duty since purchasing his existing property in 2005. This has been funded by additional borrowings.

Fuel excise paid on all freight into and out of the farm business. The additional cost imposed on the supply chain by the cost burden of fuel excise and other charges effectively taxes primary producers, even when they are in a loss making situation, for example drought.

The cost burden of state charges such as vehicle registration and licensing fees needs to also be removed. A legitimate fair for service should suffice.

We have created a situation in this country where government charges are helping to destroy our international competitiveness. These charges exist regardless of the profitability of the business. To quote Churchill:

I contend that for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle.

Winston Churchill

RECOMMENDATION: A full review of the tax system is urgently needed, and input taxes should be abolished nationally.

Secure the revenue of the states by increasing GST to 15% on all goods and services. An increase of the GST to 20% could also be envisioned if the additional 5% were for a dedicated infrastructure development fund to only be used to improve our national infrastructure, to increase the international competitiveness of all Australian businesses.

6 . MEAT INDUSTRY PROCESSING AND SUPPLY CHAIN COSTS.

Beef industry processing costs are highest in developed world.

Comparative rates to process a beast are:

Brazil \$40

United States \$80

Australia \$340

Against comparative live weight prices of:

Australia \$2 kg

United States \$3 kg

United Kingdom \$5 kg

On a year in year out basis, the authors of the report market respectively about 100 head and 600 head of cattle. A \$1 kg live weight increase in sales revenue represents an increase in total revenue of \$350-\$450 dollars per head. At an average of \$400, this is an increase in farm revenue of \$40,000 and \$240,000 respectively.

In the USA the price paid for a sirloin steak in the average supermarket is \$9.99/kg. The price paid in Australia is anywhere from \$19.99 to \$24.00/kg for a sirloin. Then on the other hand the price paid to producers on average is approximately \$2.00/kg live weight whereas in the USA it is approximately \$3.00/kg or more. Both the producer and the consumer are not getting comparative value.

Supply chain inefficiencies are passed back to farmers, and improvements in productivity are captured by the other members of the supply chain.

The immediate past chief of the MLA has always justified their existence by saying that the authority has presided over the rise in value of beef in the last couple of decades. What he has not said or perhaps deliberately mislead is that the net return to the farmer from the retail dollar has declined. The price of beef has increased, however the price of cattle has remained stagnant and in real terms declined.

In Australia, the return to the farmer in terms of the retail dollar for beef is somewhere between 10% and 20% whereas in the US is 40% to 50%. Producers margin has been squeezed to hard and beef producers are finding it harder and harder to remain viable. There are many other industries which are in a similar situation.

MLA have received 1.6 billion in levies in the last 15 years and in that time there has been a 40% decline in real cattle price return to farmers. They receive \$170 million a year from levies of which \$3.66 is for marketing, 92 cents R and D, 29 cents for residue levy and 13 cents animal health.

What tangible benefit are we getting at the farm gate for this levy, and should farmers be paying for the advertising for processor and supermarket chains to better market beef.

One way to improve efficiency and competition in the meat industry supply chain is to reform/reregulate to allow an increase in smaller slaughter houses. These can provide value adding opportunities for the farm business, local employment, and real domestic competition to the large abattoirs, as well as being an entry point for new investment.

As an example, small farm slaughter house, conducted as an adjunct to a farm feedlot, could kill say 20 head per week. This equates to 1000 head per annum.

A farm employee/family member could under take a short course on all aspects of slaughter procedure, animal welfare etc. and be quite well equipped to conduct the kill assisted by others in a labouring capacity.

Health inspection regulations would need to be reviewed, the current export inspection level over the top and is a non tariff trade barrier imposed by the USDA. Domestic meatworks/slaughterhouses in the USA that do not export meat across state boundaries do not have to comply with USDA standards.

The fishing industry exists without AQIS being present on site. If necessary local private vets or meat inspectors could provide carcass inspection and records at a commercial rate agreed to with the

slaughter house, or a centrally located inspector could provide real time inspection with the use of video link from the kill floor.

RECOMMENDATIONS:

Government legislation and support is urgently needed.

A review of all supply chain costs to identify inefficiencies.

Uncompetitive work practices, labour costs and penalties need to be addressed.

Levies are high with little value to producers

Increased competition by lowering regulatory barriers to entry in the processing and retail sector should be encouraged.

7 . ACCELERATED DEPRECIATION FOR INFRASTRUCTURE FOR DROUGHT PREPAREDNESS.

In order to promote a greater investment in self reliance in drought, more aggressive policy support through an investment allowance type approach, including accelerated depreciation.

Infrastructure investments such as large capacity grain silos and sheds need to be depreciated much more quickly, and at a rate above 100% to encourage the rapid growth of grain and fodder storage capacity on farm.

Water infrastructure needs to be treated in the same way, particularly with the changes to the Great Artesian Basin cap and piping funding.

There need to be no limits placed on the scale and scope of the infrastructure built at the farm level, as market forces will find the correct level over time. Larger silos have a cheaper unit cost than smaller silos, and some growers will choose to specialise in storage, whilst others will choose to buy grain in rather than store. The important thing is that grain and fodder remain available at the local level during drought periods, and that good local supply and lower average transport cost keep prices reasonable.

8. INFRASTRUCTURE DEVELOPMENT

There is a more general need for the future infrastructure needs of regional and remote areas to be addressed in the planning process. Some work is in progress, however it needs to be reviewed to ensure that there a no “black spots” as we

The inland rail corridor on the east coast linking us to Darwin would enhance productivity due to products (grain, cattle etc) moving south and north. Cattle supply could be maintained into Asia all year round. Even in the wet season cattle and grain could be supplied moving south to north to stockpile for feedlot operations to supply cattle all year round.

There are obviously many other products that could be moved interstate with an efficient rail system operating in this corridor.

Water infrastructure development to improve availability and efficiency of water usage at the national, catchment and farm level.

For example: a national policy focus on increasing the availability of water to the inland diverting the Burdekin, and Clarence rivers inland; at a catchment level by increasing the size of existing dam storage, and developing new dams; and, at the farm level by promoting increases in water use efficiency, and developing viable market pathways for crops with a higher return per mega litre of water used

Major corridors to port and other key transport hubs needs to be developed that can handle road train/b triple transport. Regional Australia is dependent on road transport and it needs to be efficient and cost effective over the longer term. For example, the road network into Sydney over the Blue Mountains may need tunnel.

National Broadband Network must be able to be accessed by regional and remote Australians. Unfortunately in some areas of the state the roll out of Next G mobile coverage has not effectively replaced the superceded CDMA or analogue networks, despite government and telecommunications industry promises.

9. INADEQUACIES IN DEPRECIATION ALLOWANCES FOR MACHINERY AND PLANT

The Australian taxation system does not adequately provide for the replacement of depreciated plant and machinery assets in a business.

An asset is purchased for a business. It can then be depreciated over time (generally the useful working life of the asset), however when it comes time to replace the asset, the business owner finds that the replacement cost of the asset has increased, sometimes significantly.

This effect is magnified over time. The replacement of the asset then requires a new injection of capital to maintain the *status quo*. This increases business debt without necessarily increasing productivity. Lowering of marginal income tax rates and periods of low profitability are additional factors that impact on the business.

For example:

A farmer purchases a 300 horsepower tractor in 1979 at a cost of about \$75,000. He may have rolled this tractor over a number of times, but the cost of the same tractor today is about \$275,000. An increase of \$200,000. The existing depreciation arrangements do not allow him to make provisions to set aside cash to maintain the value of his investment in the tractor. Instead he is always required to fund the increase in price, and write it off retrospectively.

This process becomes difficult when the farmer runs to a series of low income or loss making years. A tax write off (limited to the value of the existing tractor, but not sufficient to make provision for the purchase of a replacement) is of little value when not paying income tax. The purchase price of an item with an effective working life of say five years, cannot be effectively written off over five years if there is say a three year period of low/negative income caused by drought or low commodity prices.

The practical reality is that the farmer has had to fund the increase in the price of the tractor with additional borrowings (ie: his debt has increased by \$200,000 over 35 years). In that period he would also have needed to replace other items of plant and machinery. The increase in the purchase cost of these items all increasing the underlying farm debt, without necessarily increasing productivity.

Over time, a proportion of additional capital (generally through increased borrowings) has been directed to maintaining the existing capacity of a farming enterprise, instead of being directed

RECOMMENDATION: Improve investment incentive and depreciation allowances in the tax system to better support investment in depreciating capital items. This needs to apply to existing items and new investments.