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Department of Agriculture, Fisheries and Forestry

**Submission to House of Representatives Standing
Committee on Infrastructure, Transport,
Regional Development and Local Government**

**Inquiry into the impact of the global
financial crisis on regional Australia**

April 2009

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Executive Summary

The agricultural sector (including fisheries and forestry industries) is a major contributor to the economic health of rural and regional Australia. The sector had a combined gross value of production of \$40.1 billion in 2006–07, with around 60 per cent of the value of production exported. The agriculture sector employs around 359 000 people in rural and regional areas. The food processing industry, Australia's largest manufacturing industry, is also a significant component of regional economies. The food and beverages processing industry generated \$73.0 billion in sales and service income in 2006–07 and employed around 206 000 people in 2007–08, approximately 40 per cent of which were located in rural and regional areas.

The agricultural sector's economic importance in rural and regional Australia is particularly significant because of the income it brings into communities in the form of direct spending on goods and services and on employment, both directly and through service industries.

The sector operates in a dynamic and complex environment with multiple drivers of performance. International commodity prices, foreign exchange rates, climate change, seasonal conditions and severe climatic events, such as bushfires, heatwaves, floods, frosts and widespread droughts, all significantly affect productive output and financial performance. Since 2002–03, prolonged drought conditions across Australia have had a significant impact on rural and regional Australia. On farm, the drought has significantly reduced yields and farm incomes, with farm incomes in 2006–07 at their lowest levels in past ten years. As such, the effect of the drought has, to date, been a more significant factor than the global financial crisis.

The world economy is widely expected to contract in 2009. In March 2009, the International Monetary Fund (IMF) revised its projection for world economic growth in 2009 down to -0.5 to -1.0 per cent. World economic growth is forecast to recover to 1.5 to 2.5 per cent in 2010 in the latest IMF update. The Australian Bureau of Agricultural and Resource Economics has predicted that world economic growth will average close to its longer term potential of around 4 per cent a year toward the medium term (to 2014).

At the Rural Finance Summit convened by the Hon Tony Burke MP, Minister for Agriculture, Fisheries and Forestry on 17 October 2008, major banks and rural lenders expressed cautious optimism for the agricultural sector in the immediate term and strong optimism in the medium-to-long term. This was part-based on the outlook for rate cuts. However, rate cuts have also been tempered by the flow on effects of higher intra-bank interest rates.

For agricultural export earnings as a whole, the adverse impact of the global financial crisis is expected to be less substantial than for other sectors, such as mining, at this stage. While there has been downward pressure on some agricultural prices, such as wool and dairy products, the demand for grains, beef and sheep meat appears to have been largely maintained. In addition, the Australian exchange rate has declined significantly since mid-2008. A lower Australian exchange rate against the US dollar, if sustained, is expected to provide support for farm export earnings, although it can also place some upward pressure on the cost of imported farm inputs.

The role of the Australian Government, through the Department of Agriculture, Fisheries and Forestry, is to develop and implement policies and programs that ensure Australia's agricultural, fisheries, food and forestry industries remain competitive, profitable and sustainable. The department is working to help primary industries prepare and respond to the impacts of the global financial crisis and the other pressures through a range of policies and programs. These include responding to climate change, investment in research and innovation to unlock potential productivity gains and efficiencies, providing access to risk management and planning tools, and disseminating knowledge and information to assist building the skills of Australian farmers, fishers and foresters.

Introduction

The Australian Government Department of Agriculture, Fisheries and Forestry (the department) welcomes the opportunity to provide a submission to the House of Representatives Standing Committee on Infrastructure, Transport, Regional Development and Local Government's Inquiry into the impact of the global financial crisis on rural and regional Australia.

This submission focuses on the implications of the global financial crisis for the agricultural sector, the performance of which has a strong influence on rural and regional Australia. The submission also outlines government initiatives that help primary industries to prepare and respond to challenges, including climate change, and contribute to the overall prosperity and quality of life of rural and regional economies.

This submission includes information and comments from the Australian Bureau of Agricultural and Resource Economics (ABARE).

The role of the department

The role of the department is to develop and implement policies and programs that ensure Australia's agricultural, fisheries, food and forestry industries remain competitive, profitable and sustainable.

The department's policies and programs:

- encourage and support sustainable natural resource use and management
- protect the health and safety of plant and animal industries
- enable primary industries to compete in a fast-changing international and economic environment
- help improve market access and market performance for the agricultural and food sector
- encourage and assist industries to adopt new technology and practices, and
- assist primary producers and the food industry to develop business and marketing skills, and to be financially self-reliant.

The department includes divisions that provide specialist services to portfolio stakeholders such as the Australian Quarantine and Inspection Service (AQIS), ABARE, and the Bureau of Rural Sciences.

World economic developments

The global financial crisis that developed in 2008 has sharply weakened the world economic outlook in the short term. Following the insolvency of several investment banks and other financial institutions in the United States and Europe, financial conditions worldwide have tightened significantly, leading to substantial declines in stock market valuations and marked reductions in capital inflows to emerging economies.

The world economy is widely expected to contract in 2009. In the March 2009 update to its *World Economic Outlook*, the IMF revised its projection for world economic growth in 2009 down to -0.5 to -1.0 per cent (from 0.5 per cent in its January 2009 update). World economic growth is forecast to recover to 1.5 to 2.0 per cent in 2010 in the latest IMF update. ABARE has assumed that world economic growth will average close to its longer term potential of around 4 per cent a year toward the medium term (to 2014).

An important assumption underlying the expected world economic recovery in 2010 is that comprehensive stimulus packages introduced by many world economies, including the United States, Western Europe, China, Japan, the Republic of Korea and Australia, will work over time to stabilise financial market conditions and restore consumer and business confidence. In the

short term, nevertheless, financial markets are likely to remain under pressure. Consumers and businesses will also take time to regain confidence and increase gradually their spending and investment expenditure.

There are substantial risks to the current world economic outlook. The principal downside risk stems from the insolvency of financial institutions in many OECD countries and the likely impact on OECD economic growth. Another downside risk relates to the spill over effects of economic contraction in the OECD region on the emerging economies. If the adverse impact of the global financial crisis on world economic growth were sharper than expected, world commodity demand could be significantly weaker than forecast.

Impact of the global financial crisis on agriculture

Two important features of Australian farming are income volatility from year to year and the long term downward trend in farmers' terms of trade (the ratio of prices received to prices paid). These features are illustrated in figure 1.

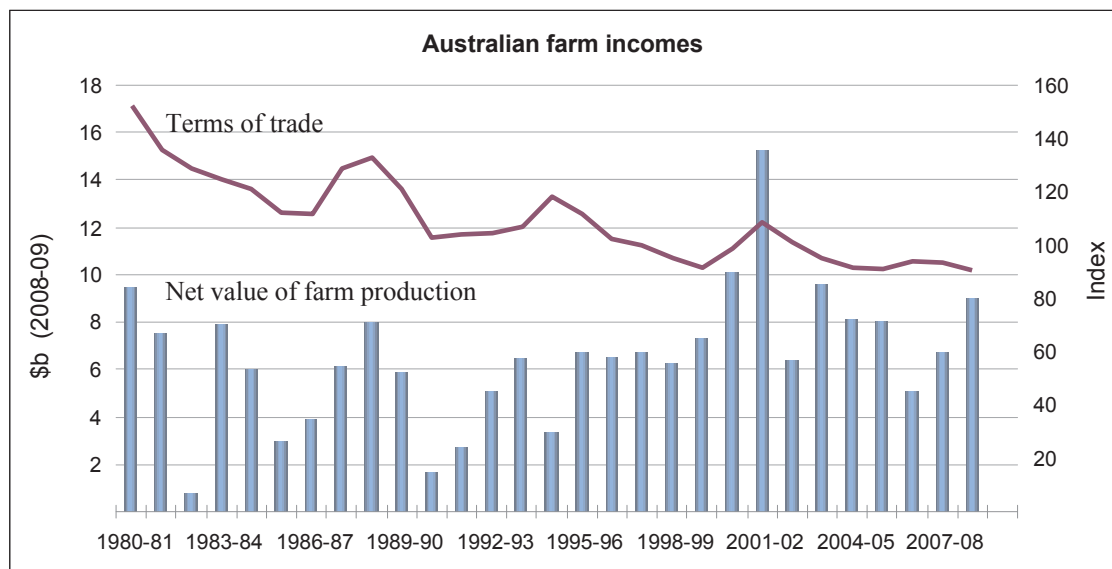


Figure 1: Australian farm sector income

In addition to the influence of weather and climate, policy and market changes have a substantial effect on farm sector earnings.

Impact on farm investment and the availability of credit

While the Australian agricultural sector is widely seen to be better positioned than most other industries and international competitors, it is not immune to the effects of the global financial crisis and the global economic recession.

The sector is expected to experience difficulty through the reduced availability of credit to borrowers such as farmers, processors, distributors and retailers. An erosion in business confidence could lead to businesses scaling back investment, business infrastructure expansion and purchase of inputs such as fuel and fertiliser. However, at the Rural Finance Summit convened by the Hon Tony Burke MP, Minister for Agriculture, Fisheries and Forestry on 17 October 2008, major banks and rural lenders expressed cautious optimism for the agricultural sector in the immediate term and strong optimism in the medium-to-long term.

The banks' and rural lenders' optimism was part-based on the outlook for rate cuts (figure 2). However, rate cuts have also been tempered by the flow on effects of higher intra-bank interest

rates. While agribusiness products are different to residential loans, the four major banks, Westpac, ANZ, Commonwealth Bank of Australia and the National Australia Bank have passed on part of the official cash rate cuts to their business and rural customers.

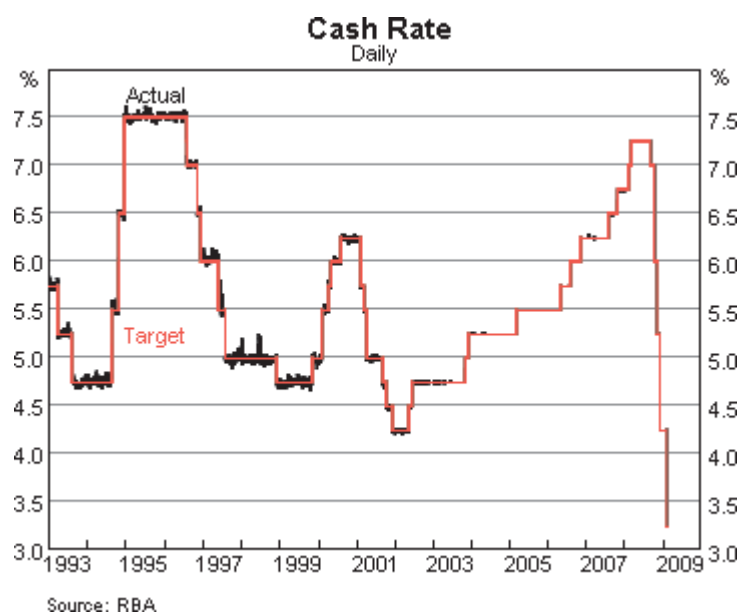


Figure 2: Daily Cash Rate (Reserve Bank of Australia)

The fall in the availability of credit and the lack of household and business confidence has seen a downturn in demand around the world and has placed downwards pressure on commodity prices.

Impact on farm export earnings

Concerns about slowing world economic growth in the short term and an increase in world production of key crops as a result of improved seasonal conditions have led to a softening in world prices for some agricultural commodities, including more discretionary items such as wool and dairy products. In the short term, volatility in commodity prices is likely to continue mainly as a result of increased uncertainty about world economic growth and hence world commodity demand.

For agricultural export earnings as a whole, the adverse impact of the global financial crisis is expected to be less substantial than for other sectors, such as mining, at this stage. While there has been downward pressure on some agricultural prices, such as wool and dairy products, the demand for grains, beef and sheep meat appears to have been largely maintained.

There has been some relief for farmers through lower prices for fuel, fertilisers and chemicals. For example, fertiliser prices have eased over recent months, particularly for urea which was trading on international markets at above US\$800 per tonne during 2008 but declined to around US\$237 per tonne in early 2009. The global crude oil benchmark price (West Texas Intermediate) declined from a high of close to US\$150 per barrel in mid-2008 to around US\$50 per barrel in mid April 2009.

In response to the sharply weaker outlook for world economic growth, the value of the Australian exchange rate has declined significantly since mid-2008, especially against the US dollar. The Australian dollar was trading at around US72c and the Trade-Weighted Index (TWI) 60 in mid April 2009, compared with a high of US98c and TWI 74 in mid-2008.

A sharply lower Australian exchange rate against the US dollar, if sustained, is expected to provide support for farm export earnings, although it can also place some upward pressure on the cost of imported farm inputs.

Under the assumption of favourable seasonal conditions, ABARE forecast that export earnings from farm products will increase by 12 per cent to \$30.8 billion in 2008–09 and by a further 4 per cent to \$32.1 billion in 2009–10. Key agricultural commodity exports are shown in figure 3. Agricultural commodities for which export earnings are forecast to increase in 2009–10 include wheat, barley, canola, lupins, peas, rice, raw cotton, sugar and lamb.

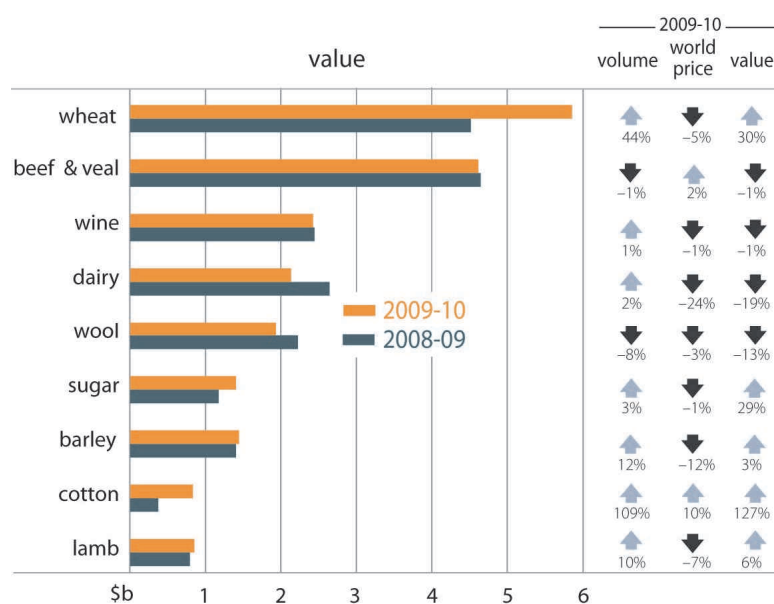


Figure 3: Agricultural commodity exports

Over the medium term (to 2013–14), the value of Australian farm exports is expected to rise in real terms. Australian farm exports are projected to be worth close to \$34.0 billion (in 2008–09 dollars) in 2013–14, around 9 per cent higher than their estimated value in 2008–09.

Forecast for farm production

Historically high grain and oilseed prices in early 2008 led to an increase in winter crop plantings. However, dry conditions in spring resulted in low yields in southern Australia. November rainfall in all states, except South Australia, also interrupted harvest and depending on the stage of crop maturity at the time, resulted in varying degrees of quality downgrading. Total winter grains production is estimated to be 32.9 million tonnes in 2008–09, an increase of 46 per cent from 2007–08.

Total summer crop area in 2008–09 is estimated to have been 1.1 million hectares, similar to the area planted in 2007–08. The area planted to grain sorghum is estimated to have declined as a result of a significant fall in feed grain prices and a reduction in the area of fallow land available. Average to above average rainfall received in late spring and early summer provided an ideal start to the season.

An improvement in water storage levels has resulted in an increase in the area planted to both cotton and rice. Despite the increase, the area planted is still relatively low, as the availability of irrigation water remains a critical issue for both industries.

Farm cash incomes for Australian broadacre farms as a whole are projected to improve in 2008–09 (figure 4) mainly as a result of increased winter crop production in a number of areas with better seasonal conditions in 2008 compared with 2007. These areas include the northern Western Australian grain belt, northern New South Wales and much of Queensland.

However, farm financial performance has remained relatively poor in some other areas including southern New South Wales, central and eastern Tasmania, Victoria and South Australia, mainly as a result of adverse seasonal conditions.



Figure 4: Farm cash incomes by state

In regions dominated by broadacre livestock farms, farm cash incomes are projected to be maintained in the short term with relatively favourable lamb, sheep and beef cattle prices. However, farm incomes are likely to be lower in areas more dependent on wool as a consequence of lower wool prices.

For the dairy industry, farm financial performance is projected to fall in 2008–09 because of lower milk prices, particularly for manufactured dairy products. In addition to the global financial crisis, the outlook for dairy products is also being affected by the issues surrounding dairy export subsidies recently implemented by the European Union.

Most importantly, seasonal conditions will continue to be a major factor affecting farm production and financial performance.

Impact on employment

The current global financial crisis could have an impact on the supply of labour to agriculture. Job opportunities have been growing in the agriculture industry, with ABS data showing that employment in agriculture, in trend terms experienced net growth, albeit with significant volatility, of around 10 000 between November 2007 and February 2009. The mining downturn has led companies in this sector to shed jobs. Some of those displaced workers (with the appropriate skills) could find work within the agriculture industry.

Despite the recent growth in employment, there is still expected to be significant demand for labour and skills across all regions, sectors and occupations of agriculture industries. This will be particularly apparent when meeting the challenges facing agriculture, including climate change and the global food shortage.

Australian Government initiatives and the agricultural sector

The government has a range of initiatives aimed at helping the agricultural sector prepare and respond to challenges, such as the global financial crisis. These initiatives are aimed at increasing the sector's productivity and long term investment, preparedness for climate change and providing support and incentives to manage current and future challenges.

Increasing productivity and investment

The government assists the agricultural sector to increase its productivity by supporting innovation through research partnerships with primary industries and by directly funding programs.

Rural Research and Development Corporations

The rural Research and Development (R&D) Corporations (RDCs) are a partnership between government and industry. The objective of this partnership is to expand Australia's agricultural R&D effort, improve industry efficiency and effectiveness by investing in high priority R&D areas, and enhance industry's international competitiveness through more effective uptake of research results.

Through these partnerships, the government has sought to address the potential for significant under-investment in R&D through market failure and recognise the substantial spill over benefits to others in the industry and the wider community, particularly regional areas. Annual expenditure, comprising government contributions and industry contributions and levies, through the RDCs on R&D exceed \$500 million.

Food industry programs

The government develops and delivers food industry policy and programs that support a globally competitive and sustainable Australian food industry. Key areas of focus include fostering innovation, food regulation reform, improving the environmental performance of the industry and expanding market access.

The government is working on initiatives to equip agricultural industries, and the farmers who work in them, to grow their business productivity and competitiveness and to respond to challenges such as the rising input costs. The food programs, which are delivered by the department comprise:

- Regional Food Producers Innovation and Productivity Program, which improves the productivity, innovation and profitability of Australia's regional food producers and incorporates the Seafood Industry Productivity and Innovation Program
- Promoting Australian Produce grant program, which assists Australian producers to develop their capacity to market and promote premium Australian produce, and
- Promoting Australian Produce (Major Events) program, which assists food and fibre industries to stage major national events that facilitate exchange of information and boost productivity through improved efficiency along the value chain, innovation and adoption of new technologies and management practices.

Caring for our Country

The sustainable management of Australia's natural resources (land, water, marine and biological systems) is vital to ensuring the ongoing social, economic and environmental wellbeing of regional areas and the entire nation. Caring for our Country is the government's natural resource management program and is designed as an integrated package with one clear goal, a business approach to investment, clearly articulated outcomes and priorities and improved accountability. It commenced on 1 July 2008 and integrates the delivery of the

Commonwealth's previous natural resource management programs: the Natural Heritage Trust, the National Landcare Program, the Environmental Stewardship Program and the Working on Country Indigenous land and environmental program.

Preparing for climate change

The Australian agriculture sector will be affected by climate change as much as any sector in the economy. Climate change is expected to affect agricultural productivity through increasing heat stress in animals and crops, decreasing water availability and increasing occurrences of pests and diseases. Helping farmers adapt and adjust to climate change is therefore a key priority for the portfolio. A resilient, adaptable primary industries sector which is able to remain sustainable, competitive and productive in the face of a changing climate will be critical if rural and regional Australia is able to manage the effects of the global financial crisis.

Australia's Farming Future

Australia's Farming Future (AFF) is the government's major initiative to help equip primary industries with research, tools and information to manage their emissions, adapt and adjust to the impact of climate change and maintain productivity. Worth \$130 million over four years, AFF provides support for the following elements: research and development through the Climate Change Research Program (CCRP); training through the FarmReady program; building community networks and capacity to manage climate change; adjustment advice and assistance for those who choose to leave farming; and information services activities.

Funding for research, development and demonstration activities is available through the Climate Change Research Program, which is assisting primary producers to reduce greenhouse pollution, better manage their soils and adapt to a changing climate.

The FarmReady program is boosting training opportunities for primary producers to improve their adaptability, and enable industry, farming groups and natural resource management groups to develop strategies to adapt and respond to the impacts of climate change. This element will help deliver research results to farmers.

Community networks and capacity building activities increase the leadership and representative capacity of target groups to strengthen primary industry productivity and build rural, regional and remote community resilience to a changing climate. The target groups include women, youth, Indigenous Australians and people from culturally and linguistically diverse backgrounds.

Adjustment assistance is available to primary producers through individually tailored professional advice and training to manage the impacts of climate change. Re-establishment assistance is available for farmers who decide not to continue their farm business and leave the land.

Support and incentives to manage crisis impacts

Fiscal responses to the global financial crisis

In response to the global financial crisis, the government announced a \$42 billion Nation Building and Jobs Plan on 3 February 2009. This included the \$10.4 billion Economic Security Strategy, which provides \$4 billion of financial assistance to pensioners, carers and families living in rural and regional Australia.

The new stimulus package includes a \$950 one-off cash payment to farmers receiving Exceptional Circumstances (EC) income support and small businesses in EC declared areas. The other components of the stimulus package that will benefit rural and regional areas include

the boosted investment in regional infrastructure, small business tax breaks and acceleration to the buyback of water.

Drought support and the drought review

Although agriculture accounts for a relatively small proportion of national GDP, the current drought demonstrates the importance of agriculture to overall economic performance in Australia. In 2006–07 the drought is estimated to have reduced the rate of economic growth in Australia by around 0.75 percentage points from what would otherwise have been achieved.

The government supports drought affected farmers, rural communities and agriculture-dependent small businesses through income support, interest rate subsidies and free counselling. These measures recognise the impact of severe drought on rural and regional communities, the environment and the broader Australian economy.

The government is conducting a comprehensive national review of drought policy through three separate assessments. The review will support the development of policies to help better prepare farmers and rural communities for a changing climate. The review includes:

- an economic assessment of drought support measures by the Productivity Commission
- an assessment by an expert panel of the social impacts of drought on farm families and rural communities, and
- a climatic assessment by the Commonwealth Scientific and Industrial Research Organisation (CSIRO) and the Bureau of Meteorology of the likely future climate patterns and the current Exceptional Circumstances standard of a one-in-20-to-25-year-event.

Rural Financial Counselling Service (RFCS) program

The RFCS Program provides grants to state and regional not-for-profit organisations to provide free and impartial rural financial counselling to primary producers, fishers and small rural businesses who are suffering financial hardship and who have no alternative sources of impartial support. As at June 2008, there were 14 service providers employing more than 110 rural financial counsellors. The RFCS Program was established in 1986 in response to drought, depressed commodity prices and increasing interest rates, and has continued because of ongoing need.

Rural financial counsellors can:

- help clients identify financial and business options
- help clients negotiate with their lenders
- help clients adjust to climate change through the Climate Change Adjustment Program, identify any advice and training needed and develop an action plan
- help clients meet their mutual obligations under the Transitional Income Support Program
- give clients information about government and other assistance schemes
- refer clients to accountants, agricultural advisers and educational services, and
- refer clients to Centrelink and to professionals for succession planning, family mediation and personal, emotional and social counselling.

Farm Management Deposits

The primary objective of the Farm Management Deposits (FMD) Scheme is to assist primary producers deal more effectively with fluctuations in their cash flow resulting from climate variations and changes in market prices. The scheme allows eligible primary producers to set aside pre-tax primary production income in profitable years to establish cash reserves to help meet costs in low-income years, facilitating increased financial self-reliance. To be eligible to invest in an FMD, individual primary producers need to:

- be an individual primary producer with no more than \$65 000 in off-farm taxable income when the farm management deposit is made
- make a farm management deposit of \$1000 or more
- hold no more than \$400 000 as farm management deposits at any time
- hold all farm management deposits with the same financial institution, and
- hold farm management deposits for at least 12 months to get the taxation benefits (farm management deposit holders in Exceptional Circumstances-declared areas may be exempt).

Conclusion

The implications of the crisis on the Australian agricultural sector are complex, with falls in some commodity prices being tempered by an easing in the price of inputs. The overall financial performance of the sector can be significantly influenced by other determining factors, particularly seasonal growing conditions.

The department is delivering a range of government initiatives to help equip the agricultural sector to increase its resilience to negative impacts and to take advantage of available opportunities. These initiatives include investment in research and innovation to unlock potential productivity gains and efficiencies, providing access to risk management and planning tools, assistance measures, and disseminating knowledge and information to assist building the skills of Australian farmers, fishers and foresters.