



australian commodities

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australian agriculture

opportunities and challenges in the medium term

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- *The medium term outlook for Australia's agriculture sector is strong in historical terms as a result of high global commodity prices and continued high levels of farm equity.*
- *Despite rising terms of trade, the farm sector faces a number of ongoing challenges, including increased competition from overseas producers and a strong Australian dollar.*
- *Further challenges emerging over the medium term include increasing farm costs resulting from the introduction of an emissions trading scheme and other policies to address climate change.*
- *Governments can support Australian farmers to adapt to this changing environment by ensuring policies do not impede producers from finding and implementing new approaches to farming that enable the sector to remain competitive.*

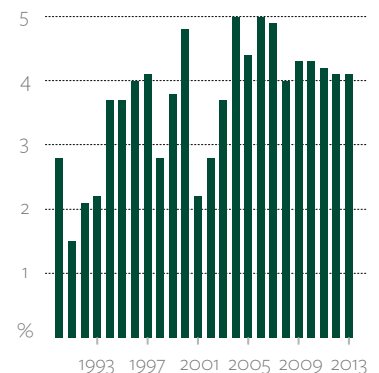
strong prospects for recovery from drought

The medium term outlook for agricultural commodities is very positive by historic standards. Global prices are generally high and expected to remain so for much of the outlook period to 2012-13. Demand for grains to meet government mandated biofuel production targets in many countries has increased global grain prices. This is also driving increases in prices for other crops — such as cotton and soybeans — as land suited to cropping is diverted to produce grain for biofuels production.

Although world economic growth is projected to ease slightly over the medium term, it too remains historically high. Strong growth in income, particularly in China and across much of south east Asia, is generating increased demand for livestock and livestock products, including dairy products. The significant reduction in sheep numbers and low wool stocks mean that wool prices are also projected to remain strong over the next few years.

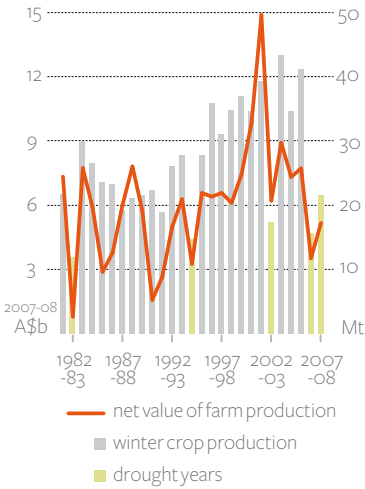
Farmers' capacity to recover from drought also appears to be robust. According to abare surveys of the broadacre and dairy industries, many producers have maintained high levels of equity in their farm businesses, although those affected by two years of crop failure are likely to have fared less well. Farm incomes in 2007-08 are also projected to rise as a result of higher commodity prices and some improvement in seasonal conditions from the widespread drought of 2006-07. The combination of improved

world economic growth



australian agriculture

australian farm performance



cash flows and high equity levels mean that many farmers are reasonably well placed to increase crop areas to take advantage of higher prices, rebuild herds and flocks in anticipation of continued demand for livestock products, and resume investment in technologies and practices that have underpinned ongoing productivity growth.

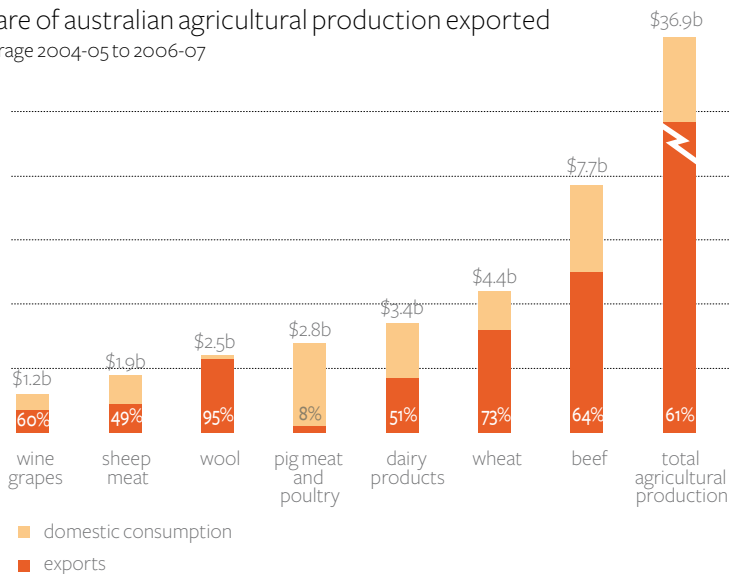
now is not the time for complacency

Declining terms of trade have been a long standing characteristic of Australian agriculture, and historically a significant challenge for the medium and longer term performance of the sector. However, the strong global commodity outlook means that farmers' terms of trade are likely to increase slightly in the coming year and to underpin growth in farm incomes. Despite this, it is not a time for complacency and inaction. Many of the usual challenges facing the agricultural sector remain and new challenges are emerging.

The agricultural sector will continue to be strongly export oriented, with a small domestic market compared with the volume of output that is produced. Securing access to new and existing markets is essential for the viability of the sector. Many markets are protected by trade barriers and production from many competitor countries is subsidised. For example, the OECD estimates that support to agricultural producers in the Republic of Korea and Japan represented around 63 per cent and 53 per cent of gross farm receipts in 2006 respectively.

Given Australia's reliance on export markets, the recent appreciation of the Australian dollar has made exports relatively more expensive on world markets, reducing Australia's competitiveness against similar products

share of australian agricultural production exported average 2004-05 to 2006-07



produced by other countries. While a stronger Australian currency is able to reduce the cost of imported inputs, including fuel, fertiliser, chemicals and capital equipment, it also offsets to some extent the value to Australian producers of higher global prices that are mostly denominated in US dollars. Recent increases in Australian interest rates, accompanied by a significant weakening in the value of the US dollar have contributed to the appreciation of the Australian dollar — this is not assumed to ease significantly in the short term.

The management of Australia's natural resource base also remains a challenge facing the agriculture sector, which is responsible for the management of around two-thirds of Australia's land mass. The provision of environmental services is of growing relevance to farmers, particularly as measures such as reductions in land clearing and expansion of forestry areas are recognised as a means of reducing greenhouse gas emissions.

The management of Australia's water resources, particularly within the Murray Darling Basin, remains an important challenge. Around 40 per cent of the gross value of agricultural production in Australia occurs in the Murray Darling Basin, including around half the area of perennial horticulture and around a third of the dairy herd. The running down of irrigation water storages in the recent drought has reduced irrigated agriculture production. Even with a return to average seasonal conditions it will take some time for storage levels to return to their long term averages.

Record low unemployment in Australia has raised concerns across virtually all sectors of the economy about the ability to attract and retain labour. Strong economic growth, a boom in the minerals and resources sector, combined with an aging population has made it difficult for the agriculture sector to find both skilled and unskilled labour. A decline in the number of students enrolled in agricultural courses and completing training courses means that the challenge of finding skilled labour in particular is unlikely to be resolved in the short term.

In addition, several new challenges are likely to emerge over the medium term. The commitment of the government to implement an emissions trading scheme by 2010 to reduce greenhouse gases will affect the agriculture sector. Irrespective of whether or not the agriculture sector is included in the scheme as an active participant from 2010, emissions trading will lead to increases in a number of farm costs including fuel, fertiliser, chemicals, freight and electricity.

Maintaining export markets may also become more difficult over time. The trend for countries to establish nontariff barriers to restrict trade is likely to continue as some governments respond to community concerns over the way in which agricultural commodities are produced and transported.

Recent examples include restrictions on trade in genetically modified crops to Europe and increasing public debate over animal welfare issues, such as the mulesing of sheep and the transport of live animals to the Middle East and Asia. The concept of ‘food miles’ — the distance that food travels from the point of production to the final consumer and the associated greenhouse gas emissions — reflects a trend toward addressing community concern for environmental issues with policies that could adversely affect trade in Australian agricultural commodities.

priorities for government and industry

For the agriculture sector to respond and adapt to these new and emerging challenges, there are a number of things that governments and industry can do. The key priority for governments is to remove impediments to productivity growth, ensuring that policies do not inadvertently limit farmers’ ability to make changes that increase production or lower costs.

One specific area for focus is drought policy. The current business support measures under the drought assistance program include interest rate subsidies and exit grants. These can distort the decisions that farmers might otherwise make to pursue productivity gains, encouraging the accumulation of excessive levels of debt or delaying adjustment decisions. These measures also appear to reduce the incentive that farmers have to use risk management tools, such as farm management deposits, to manage fluctuations in cash flow caused by climate variability.

Another area for focus is improving the efficiency of water markets to maximise the long term value — both market and nonmarket — derived from water use. In addition to identifying an appropriate split in the allocation of water between environmental and consumptive uses, governments need to facilitate the efficient allocation of water between consumptive users. Policies that provide irrigators with the flexibility to carry over part of their current allocation into the next season, or reduce existing barriers to interregional trade in water, could reduce the costs associated with reduced access to irrigation water.

The adequate provision of infrastructure is also necessary to ensure that the agriculture sector captures further gains in productivity. Governments can minimise regulatory barriers and, where possible, encourage greater competition so that there is sufficient investment in the transport, energy and telecommunications infrastructure for rural businesses to operate efficiently and at full capacity.

In addition to removing impediments to productivity growth, a second priority for governments is to continue working to secure access to export markets. Despite slow progress in multilateral trade negotiations through the World Trade Organisation because of the number of countries and

complexity of the issues involved, it remains a forum with the potential to generate the largest gains for Australia in global trade in agricultural commodities.

Although generally smaller in magnitude, economic benefits can also be secured through the negotiation of bilateral agreements. This includes both the negotiation of free trade agreements and the development of biosecurity and other protocols with individual countries to facilitate direct trade in specific commodities. Assisting industry to address community concerns over animal welfare and environmental issues will also be increasingly important to ensure Australia's access to valuable markets is not hampered by a range of emerging nontariff barriers.

A third priority for government is to decide how much public funding should be allocated to research and development activities and to ensure that those funds generate the greatest possible returns to the Australian community. To appropriately target these investments, a critical evaluation of the benefits and costs of research and development is required, with the results of such evaluations used to refine activities that are not considered effective.

The role for government in addressing the labour and skills shortage is at an economywide level. Economic benefits are generated by allowing resources to move between sectors of the economy according to the greatest return. There may be a role for government to review immigration policies that could help meet Australia's skills and labour needs and the associated taxation arrangements affecting foreign workers that might otherwise be a disincentive.

There is also a role for industry in addressing concerns about labour and skills shortages occurring within the agriculture sector. The sector is likely to benefit from identifying and adapting the innovative remuneration strategies being used in other sectors of the economy. The development of training to improve the skills base of workers, thereby increasing labour productivity, will be an important industry strategy over the medium term. Targeting this training to younger farm workers as part of a succession planning program is likely to be a particular priority given the demographic profile of the agricultural workforce.