The Policy Slide*

David Trebeck[1]

Earlier this month in Canberra, the head of the Agricultural Directorate of the OECD, Dr Stefan Tangermann, listened to an extraordinary debate. So much so that he thought he was either suffering from acute jet lag, or was on another planet. The occasion was a private luncheon during the Outlook Conference.

In a free-wheeling discussion, those present were giving their views on what everyone hoped would be post-drought recovery and what was needed to hasten it. There was a range of opinion about how rapid the recovery might be, but virtual unanimity that recovery would be facilitated the more governments got out of the way. To a European, such attitudes were breathtaking; later Dr Tangermann told me he found the discussion inspiring. This is one of world agriculture's leading advocates for sensible policy and freer trade — a valuable ally of Australia. I think we can safely say that the cost of his invitation was well and truly recouped.

I mention this story because it provides the flip-side to my main theme today, namely that enthusiasm for rural policy reform — and improved economic policy more generally — has badly stalled in recent years. Before I cite examples, I should take a moment to reiterate why sensible policy matters, especially to farmers. For a while I thought the arguments — which are all old hat — were well accepted, but I have been forced to conclude that this is no longer the case. Otherwise, we wouldn't have the policy vacuum that currently exists.

Why Sensible Policy Matters

Sensible policy is not the end — it is merely a means to the end. The ultimate objective is secure, stable and rising living standards. Australia exports the vast majority of its farm produce, whether as agricultural commodities and raw materials, or in processed form. If we are to be successful in this endeavour, we need free and open markets able to purchase our produce; we need a competitive exchange rate to convert the revenue into Australian currency; we need an efficient transport and handling system to shift product from farm to overseas destination; we need a competitive domestic economy and cost base so that revenue received exceeds cost outlays; we need flexible labour markets to facilitate adjustment to changing circumstances; we need a strong R&D ethos to seek and then adopt new technology; and we need an innovative farmer population to ensure that productivity improvement stays ahead of the inexorable cost price squeeze.

In essence, the role of governments is to deliver those things which only it can deliver — by setting the policy framework, being active in trade negotiations and so on — and then staying out of the road in respect of those matters where farmers, or the commercial sector more generally, should be responsible.

During the 1960s, 70s and early 80s, the Australian economy was a chronic underperformer. Productivity improvement lagged well behind those countries with whom we like to compare ourselves. Whenever some momentum did build, it was quickly crushed either by the blunt instrument of monetary policy or a rigid

* Paper presented to Rural Press Club of Victoria, Melbourne, 27 March 2003

[1] Executive Chairman, ACIL Tasman, Canberra Office, 103-105 Northbourne Ave, Canberra, ACT 2601
Email: d.trebeck@aciltasman.com,au

centralised industrial relations system where pacesetter wage settlements quickly spread, eventually being built into the inflation rate.

This month has marked the 20th anniversary of the Hawke Government and there has been no shortage of adulatory commentary marking the event. The early years of the Hawke Government certainly resulted in some significant and valuable policy reforms, such as the floating of the dollar, substantial reductions in manufacturing protection, and gradual understanding by the workforce that excessive pay claims unrelated to productivity improvements were self-defeating. The Keating era was mixed, but the formal adoption of national competition policy was a major achievement. The early years of the Howard Government similarly resulted in valuable policy reforms, such as cleaning up the budget position and repaying government debt, some liberalisation of labour markets, limited waterfront reform, and the commercialisation or privatisation of various government entities.

As a result, Australia's productivity record has improved greatly and we have been, in recent years, near the top of the class. The Economist recently commented that:

> "Australia is now in its 12th year of uninterrupted economic expansion, having shrugged off both the East Asian crisis of 1997-98 and the global slowdown in 2001…. In part this success is down to sound monetary and fiscal policies, and to structural reforms that have both raised productivity growth and made the economy better able to adjust to shocks. Productivity growth has averaged 2.7% over the past decade, up from 1.6% in the 1980s and well ahead of America's much-acclaimed annual increase of 2.2%" (8 March 2003, p72).

It is this productivity increase that has sustained our improved and more consistent economic performance and, along with it, improved living standards, lower unemployment, low inflation, low interest rates and the like.

However, my concern is that in recent years — especially since the 2001 election — the Government has taken a complete reform tea break. It might still be enjoying the benefits from past reform efforts but it is jeopardising future benefits. Even more worrying perhaps, it is not being held to account by the traditional supporters of reform — such as business leaders and the main industry organisations.

Against that background, let me now turn to some specifics.

Trade Reform and the US FTA

In recent weeks there has been extensive debate about the pros and cons of a proposed free trade agreement (FTA) between Australia and the United States. ACIL Tasman has been part of the debate, courtesy of a report released last month prepared for the Rural Industries R&D Corporation. The purpose of our report was to review the FTA from the farm sector's perspective.

We concluded that the economic benefits to Australia as a whole were, at best, very finely balanced. The impact on Australian farmers appeared likely to be negative. Given this, the case for the FTA must rest on broader strategic arguments, the articulation of which has not been clear to date.

I readily acknowledge that these findings have come as a surprise to some people, especially given the trade liberalisation credentials of my company. They have been publicly criticised by the Trade Minister, Mr Vaile.

There are several reasons underpinning our conclusions.

First, we are concerned that much of the so-called trade gains would actually represent trade diversion — from countries, such as important trading partners in Asia, that are not party to the agreement. That process may cause friction with other countries that we could well do without.

Second, a heavy emphasis on these bilateral negotiations would divert resources from the more important multilateral Doha WTO negotiations, which is already struggling due to the frustrating tactics of the usual suspects. If we reached agreement with the US in ways that involved compromises on important agricultural issues, that might undermine our WTO negotiating position, and hence that of the Cairns Group.

Third, one needs to take a judgement about the likelihood of the US being prepared to concede genuinely free trade for the sensitive agricultural products that matter to us — sugar, dairy and meat. While I accept that there are people in the US Administration that would have a similar outlook to our own on such matters, that does not extend to the Congress, judging by the disgraceful antics that produced last year's Farm Bill. Without such agricultural agreements being reached, a US FTA would be pointless.

And fourth, the economic modelling previously conducted for the Government, which came to a more favourable conclusion, used assumptions for the benefits to the services sector which we felt were implausibly generous. Moreover, qualifications which were stressed in that original modelling work have largely been forgotten since by some who have been promoting a narrow vested interest in support of the FTA.

My main criticism in all this has been the limited public debate encouraged by the Government. Unlike the US, where public hearings involving the main parties have been extensive, here one has almost been made to feel unpatriotic merely by questioning the robustness of the received wisdom. I don't think this is healthy and ultimately it could be counter-productive if the high expectations that have been created turn out not to be justified.

In my view, the WTO negotiations easily remain the main trade policy game. They need great support right now if the potential gains to be had are not to be snuffed out before the negotiations proper even commence.

Wheat Marketing

That is a good point to turn our attention to wheat marketing, because it has been suggested that the American negotiators would love to knock off the AWB single desk as part of the FTA negotiations.

As a long time critic of the single desk policy — because I think it is contrary to the interests of Australian wheatgrowers — this is one concession Australia might willingly make. In case there is any doubt or attempt at mischief making, I stress that this comment reflects my view as a policy analyst with considerable background on the subject and as a wheatgrower, and not as a director of GrainCorp.

The 2001 review into the single desk (by the Irving Committee) was a fairly tame affair because no one really thought the issue was seriously up for grabs. And so it proved. The committee's recommendations were more muted than the analysis which lay behind them, there was little credible evidence brought forward to justify the single desk, most single desk critics kept their head down, and the government ultimately reiterated the single desk's sacred cow status, indeed tightening the noose further in terms of Durum wheat — a case study incidentally which is deserving of close scrutiny and widespread commentary as it demonstrates everything that is wrong with an arrogant legislated monopolist.

Since the 2001 review, however, a great deal has been happening and most of it has not been helpful to the single desk's dogged supporters.

Victorian growers realise that the sun still rises in the east despite the "loss" of the single desk for barley in that State. The deregulation has increased barley market liquidity due to more traders being prepared to take forward positions. Growers now have more risk transfer options and specific marketing products. They are clearly ahead of their counterparts in South Australia. The less said about the single desk previously operated by the NSW Grains Board the better.

Second, ungrateful wheatgrowers have failed to re-elect not only the long-standing chairman of AWB, but also — more recently — two incumbent State-based directors as well as the preferred candidates endorsed by the board. Perhaps understanding why it is so out of touch with shareholder opinion is an appropriate early task for the curious wheatgrower "Ombudsman" about to be appointed by AWB.

Third, major, quantitative and compelling studies have been published by two consulting groups that have seriously challenged the view that the AWB supply chain system is anywhere near as efficient and cost effective as it could be or is alleged to be. To date, AWB has not laid a glove on either report, but has merely sought to belittle them with a mixture of emotional twaddle, and patronising comment that is an insult to the intelligence of today's business oriented wheatgrowers.

Fourth, now that AWB is a publicly listed company, it is being subjected to the scrutiny of the hardest-nosed analysts in the country. Their assessments — to date more private than public — are not too flattering. Were it not for the single desk, they would struggle to find a rationale for the business. They are particularly critical of the duplicated up-country infrastructure being constructed by AWB.

Fifth, AWB's acquisition of 15 percent of Futuris, with an indication that it would like a much bigger stake, should signal to growers that the much vaunted claims of single desk advantage are illusory. What should such corporate intentions have in common with a legislated marketing monopoly? In a nice twist, Futuris has signaled a desire to export significant quantities of bulk wheat itself, but of course it is prevented from doing so by AWB's veto of the Wheat Export Authority. I am told that the AWB chairman recently declared there were no circumstances where AWB would approve a bulk export permit to another party — what one might call the Chirac approach to wheat diplomacy.

Sixth, more growers are gradually understanding the difference between AWB (International) and AWB (Limited) and the conflicts inherent in this structure. There are staff employed by the one contracted to the other. There are so-called incentive payments between AWB (I) and (L), the negotiation of which hardly appears arms length. Growers have no idea whether the contract between (I) and (L) is competitive. The CBH supply chain offer in WA suggests that it is not. Indeed, in these days of heightened criticism of corporate governance shortcomings, how ironic it would be if one of the starkest examples of corporate governance failure turned out to involve a Commonwealth Government entity.

And finally, AWB has recently been worked over by a Senate Committee inquiring into the Wheat Marketing Amendment Bill, which seeks to increase the levy on growers to fund the WEA. Being "mauled by a pussy cat" is a comment circulating in Canberra at present attributed to an AWB representative concerning the Senate inquiry. In my experience, few comments could be more clearly calculated to sharpen the claws of the Committee. AWB may greatly regret so misjudging the degree of political scepticism that currently exists among politicians.

I have seen this type of arrogance among monopolists before — the Australian Wool Corporation and New Zealand Dairy Board being two agricultural examples. Duchessing and bullying are also common manifestations. Misunderstanding the audience until it is too late is a common, and ultimately fatal, mistake.

I have never expected the politicians to lead the single desk debate. There is too much history, politics and almost religion involved. But the politicians will have to respond to the type of commercial developments that I think are now unstoppable. I set out the reasons in a speech I gave three years ago — ironically enough drawing on a strategic review I had earlier undertaken jointly for AWB and GrainCorp. [2]

Whether the trigger will be Futuris, well known for its litigious inclinations, taking on the legislation or AWB in courts, or the current Durum legal appeal being successful, or CBH's proposal gaining increasing grower support, or simply grower commercial democracy asserting itself over political democracy, I don't know. But I am confident that a more competitive environment for wheat marketing lies ahead, possibly sooner rather than later.

At very least, the Government should ensure that the next review of AWB (I)'s performance in managing the single desk should be undertaken by genuinely independent body — such as the Productivity Commission — as the WEA has shown it lacks the resolve or capacity to do the job.

Fuel Tax Issues

During 2001-02 I spent nine stimulating months chairing an inquiry for the Commonwealth into fuel taxation, only to see the committee's comprehensive and, I think, well argued report totally rejected. It is not an experience I would recommend to others.

While I acknowledge the Government's right to do with the report what it wanted, it cannot forever sweep under the carpet the significant distortions in fuel tax structures that presently exist. I would simply make two points here.

First, we analysed carefully the possible justifications for fuel taxation today. Of the externality reasons advocated by various groups — pollution, congestion, road damage, road accidents, noise etc — we were not persuaded that fuel taxation was the appropriate way to deal with them or, in the case of greenhouse gas emissions, we did not support transport fuel being singled out for special taxation treatment.

Inevitably, and however unpalatable the conclusion, that left revenue raising as the continuing rationale for fuel taxation. In turn, we argued that it did not make sense to weaken the revenue base by net indexing or by leaving alternative fuels out of the tax net. These recommendations were politically unacceptable. Of course, fuel taxation could be cut drastically if an alternative revenue stream were proposed — such as an increase in the GST rate — but pursuing this option was outside our terms of reference.

Second, the different taxation treatment of different fuels gives rise to major economic distortions — such as inappropriate activities and disincentives to new investment. LPG, LNG and CNG are examples, and so also is ethanol — of greater interest perhaps to a farmer audience.

I have nothing against ethanol as a fuel, provided it is justified on its intrinsic merits. But at present ethanol receives a massive tax break which I find totally unjustified. Its environmental credentials are questionable. In addition, its proponents want to mandate a certain minimum component of ethanol in all petrol, when the technical consequences for engines are far from clear.

In particular, the suggestion — endorsed by some politicians — that ethanol represents a bonanza for canegrowers or wheatgrowers — is, to me, a cruel hoax of the worst kind. I am, frankly, staggered that the policy debate has reached the position it has without some of this nonsense being knocked on the head.

[2] "Defeating Hanrahan," Address to AgCon 2000: Farming — A New Era," Perth 14 February 2000. Available at www.aciltasman.com.au

At least it is heartening that our report is relevant to the Energy Task Force which is currently re-examining these issues among others. Sooner or later a Government will have to face up to them and put short term political populism to one side.

The City versus the Bush

In recent years, considerable anguish has been expressed, by politicians, farm leaders and, during the drought, by city-based commentators, at the plight of "the bush". Declining country towns, withdrawal of services, high unemployment, and relatively low income levels, have all been cited. Even before the drought, a plethora of largely band-aid subsidies was provided, in an attempt to address these problems.

The disappointing aspect to me has been the generally poor diagnosis. As a result, many proposed solutions have lacked any national interest justification and have quickly sunk without trace. I say this particularly in view of the analysis which colleagues and I did a couple of years ago for the National Farmers' Federation.[3] The report was published by NFF but, after a brief flurry, and for reasons I do not understand, it has slipped below the radar screen. So let me re-state the main arguments as we saw them.

Our assessment was that, virtually since Federation, there have been deep-seated and systematic distortions between country and city Australia which have disadvantaged the country. At different times these have included periods of fixed exchange rates, made-to-measure tariffs and centralised wage fixation. The Grants Commission payments system, microeconomic reform and competition policy have exerted some ameliorating influence.

Today, distortions arise from regulatory decisions or government policy action, such as local government restrictions, regulations causing service level distortions, a range of externality issues such as in the environmental area and capital gains tax exemptions.

Let me amplify this last point because I think it is crucial. The exemption of the family home from capital gains taxation has provided an artificial and cumulative boost to city real estate values. City residents have responded by making what by international standards are massive investments in their dwellings. We see it every day in record sale prices, old houses being knocked over and rebuilt, and expensive renovations and additions. A good indication is that last year the housing sector, which comprises about 5 percent of GDP, accounted for around one third of total economic growth.

Of course, this was also boosted by the Government's first home owners' scheme, a concept that makes as little sense as subsidised interest rates to farmers did in the 1960s. The value of the grant was quickly capitalised into house prices, thus transferring the benefits from buyers — for whom they were intended — to vendors — who presumably were not deserving. I am amazed at the lack of public commentary on this predictable effect.

But back to capital gains tax and the family home. It is my contention that the exemption has provided a wonderful one way bet, the effect of which has been to suck scarce investment capital and people away from the regions and to the cities and the growing coastal centres. It is this distortion, this very uneven playing field, that explains much of the current difficulty the regions are facing in attracting investment capital and people. The visible effects I mentioned earlier are merely the symptoms of this underlying cause.

If I am correct, the so-called city-country divide will not be rectified until the cause of the distortion is addressed. I am not foolhardy enough to advocate imposing capital gains tax to the family home — least of all retrospectively — as this is probably the most sacred of cows in today's political structure. Instead, our paper for NFF advocated revamping the existing income tax zone rebate scheme so that people living and working in regional Australia received an offset, through the tax system, to the distortion.

The questions of what rebate, how much, what are the boundaries, what is the immediate budgetary impact and so on, are all subsidiary to establishing that some type of action is justified in the national, let alone regional, interest. The NFF paper sets out proposals for all these questions.

What I cannot comprehend is why there has not been more debate on the underlying issues, sponsored by those politicians representing regional electorates in either Commonwealth or State Parliaments, and the relevant organisations, led by NFF. Don't they care, don't they understand the arguments, am I wrong, or is it all too much like hard work?

The Image of Farmers

The final topic I would like to address is the contemporary image of farmers. In doing so I acknowledge the seriousness of the drought that hopefully we are now farewelling. But even before the drought, there was an

---

[3] NFF (2001), "Taxation Zones and the City-Country Divide — A Discussion Paper", May 2001. Available at www.nff.org.au.

excessively gloomy debate about difficulties afflicting farmers. A casual observer could be excused for thinking that agriculture is a complete and utter basket case.

This is not my view at all. By and large, 2001-02 was a good income year for most farmers — probably the best in 10-15 years — and despite the drought the majority are itching to make progress once again.

The sad part of the defeatism and pessimism that has been publicly expressed is that it has sent unnecessarily negative signals to young people — and their parents presumably — about future careers prospects in agriculture.

Inevitably perhaps, the gloomier views and the noisier whingers attract the coverage. Those powering ahead are doing just that — in the main, quietly. I think we need more proactive attention to what the top 20 percent of farmers are achieving and less on the problems of the tail. There are farmers in every agricultural activity who are at the cutting edge of global technology and who would hold their own with peers in any other industry. They use sophisticated risk management systems and are business-like in everything they do. They achieve adequate rates of return on their capital in most years and view the future optimistically. They are more resilient to setbacks like the drought than is generally recognised. They are far removed from the traditional hayseed image of farmers, even though they may not wear a pinstripe suit to work everyday.

Presuming the drought does fully break soon and this year is at least a normal rainfall year, Australia's farmers are poised to make a solid contribution to GDP once again. What they need is for their Governments, especially at the Commonwealth level, to assert the policy slide so that farmers' contribution to sustained economic growth can be maximised. That will require a considerable change from recent behaviour.