Rural Debt and Viability: A Conference Summary

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Introduction

Any serious analysis of economic policy must follow a standard framework comprising:

- Policy objective.
- Policy strategy.
- Policy outcome or performance.

Consequently, this summary supplements the major paper presented at the July Rangelands Dialogue which discussed the failure of post-1971 economic philosophies to address the needs of an agricultural sector in an advanced mature economy. Readers are encouraged to read the major paper, available on the Society's website.

Agricultural Policy Background

Post World War II, agricultural exports were an important source of foreign exchange under the Bretton Woods fixed exchange rate regime. Agricultural policy pursued a policy direction of industry protection and closer settlement. The policy strategy comprised orderly marketing of major industries and breaking up by ballot large leasehold properties as leases expired. Dams were built to facilitate development of intensive irrigation regions. The interventionist philosophy of J. M. Keynes underwrote both economic policy in general and agricultural policy in particular.

Following the collapse of the post-World War II fixed exchange rate system in 1971, Australia slowly joined the international move away from Keynesian interventionist demand management polices to embrace monetarism and neoclassical economics of the market. Since 1983, Australia has structurally reformed the Australian economy to join the growing acceptance of free market global monetarism. Global monetarism had been developed over the late 1950s and 1960s by two former Chicago School economists, Robert Mundell and Arthur Laffer. Global monetarism is commonly and loosely referred to as globalisation.

Post 1971, agricultural policy moved from industry protection and closer settlement to a market-based direction of rural adjustment. In 1977, rural adjustment was cemented as the agricultural policy direction. Following the move to globalisation in 1983 and withdrawal of industry protection over 1988 and 1991, the policy strategy of rural adjustment concentrated upon promoting economies of scale to lift sectoral productivity, efficiency and international competitiveness. From 1993 onwards, rural adjustment, along with farmer self-reliance, has underwritten both agricultural and drought policies.

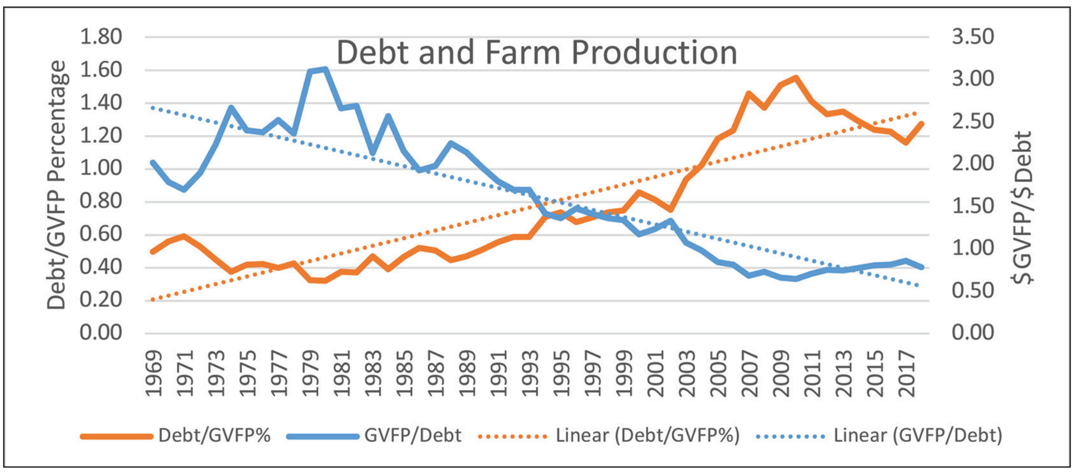
The principles of rural adjustment derive from the neoclassical supply-side free market economics of Thatcherism. Lame ducks are shipped out of the industry whilst enterprise is rewarded. The strategy has been consolidation of enterprises to capture economies of scale. The main policy instrument of rural adjustment has been concessional interest rates to reward long-term 'viable' enterprises. It should not be a surprise that the policy strategy of 'shipping out lame ducks' has had a profound effect upon both agricultural efficiency, employment and population.

Performance Indicator Outcomes

The statistics in Figure 1 indicate:

- Steeply positive orange gradient, long-term trend curve (Debt/GVFP).
- Orange curve suggests that production has been debt dependent.
- Steeply negative blue gradient, long-term trend curve (GVFP/Debt).
- From 1984, declining efficiency as debt relentlessly consumes production.
- In 1989, $1 debt produced $2.14 in output.

Figure 1. An empirical analysis of debt to output as a performance indicator of policy efficiency. The orange curve is Debt/Gross Value Farm Production (GVFP), whilst the blue curve is calculated by dividing GVFP/Debt.



Compiled from: ABARES Commodity Statistics 2017; and RBA Rural Debt Table D9 online 2018.

- By 2003–2004, $1 of debt produced $1 of output.
- In 2010, $1 of debt produced 64 cents in production.
- From 1993 to 2013, sectoral performance lies below the negative-sloping blue trend curve.

By any reasonable assessment, rural adjustment has not delivered the theoretically expected outcomes from economies of scale, increased efficiency and rising productivity. Post 2003–2004, both curves identify debt-funded output as inefficient and unstable. Any other sector would have demanded a change in policy direction, but agricultural leaders appear to have genuinely believed the rhetoric of market theology that structuring economies of scale by reducing the number of farmers would ensure long-term sectoral viability. That simplistic arithmetical approach by industry leaders, major political parties and commentators has been a gross violation of established economic knowledge.

Failed Policy Strategy Explained

Established economic theory readily explains the failure of rural adjustment as a conflict between two laws in economics: Say's Law of Markets (1803) and Engel's Law (1856).

Say's Law of Markets

Say's Law of Markets is commonly referred to as 'supply creates demand' and is particularly relevant to agricultural policy. In a 1995 publication, the National Farmers' Federation restates it in terms of commodities:

> The downward trend in real commodity prices need not of itself produce a loss of national income nor a decline in the profitability of commodity producers if the decline in real commodity or manufactures price is the result of higher productivity (Brennan, 1995).

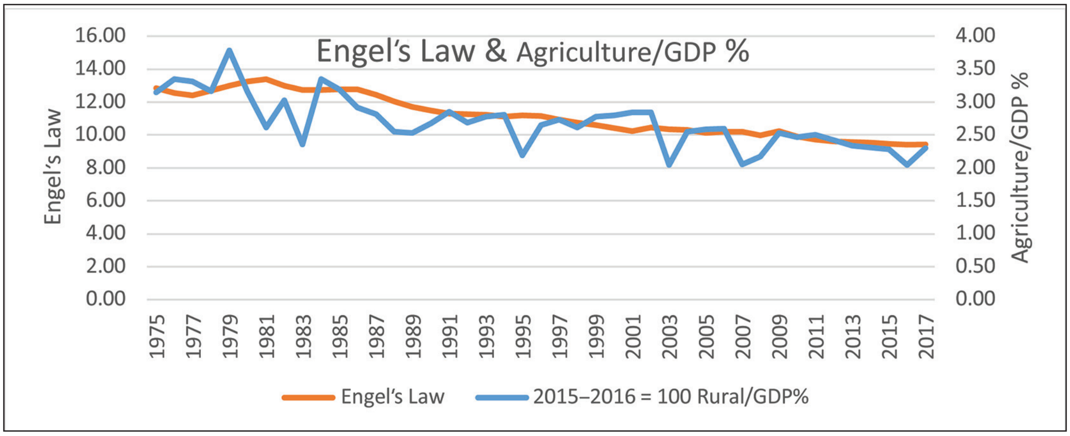
Say's Law of Markets is predicated upon an unrealistic assumption that all markets are purely competitive. A purely competitive market requires a number of strict conditions, one of which is that no one market participant can influence either supply or demand. The very structure and direction of rural adjustment is designed to breach that condition.

Engel's Law

> … as income grows the demand for food grows less than proportionately … This Law of pervasive importance in economic growth … [explains] … necessity of the political importance of farmers to decline [as shown in Figure 2] (Kindleberger, 1973).

In 2011, Richard Anker from the University of Massachusetts, Amhurst, published a research paper (Engel's Law Around the World 150 Years Later) in which he argued that Engel's Law is just as relevant today as the day it was developed in 1857. Moreover, he argues that it applies equally to both domestic and international demand for agricultural products.

Figure 2. Engel's Law demonstrated.



Compiled from ABARES commodity statistics 2018, Table 3.1; and ABARES commodity statistics 1997, Table 23.

For policy to ignore Engel's Law ensured that at some point, applied market philosophies and internationalisation of Australian agriculture would fail the domestic agricultural sector. Empirical evidence presented confirms Anker's findings that Engel's Law overpowered Say's Law in the real world of Australian agricultural production (Anker, 2011).

Employment Performance Indicator

Employment decline in agriculture is euphemistically explained as technological replacement of labour. The populist solution to declining rural employment then becomes education and training in emerging technologies to build new industries and employment, which are expected to stabilise and rebuild regional economies.

Empirical analysis suggests that this is wishful thinking and a contradiction in terms.

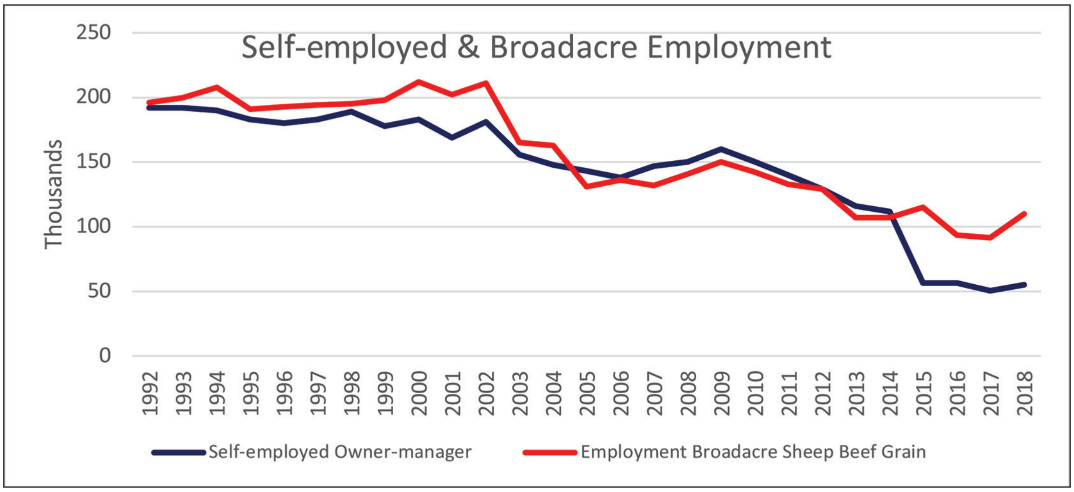
ABARES' commodity statistics for 2018 show agricultural employment peaking historically in 1990–1991 at 387,000 and falling to 279,000 in 2017–2018 (29%). Meanwhile, for Australia over the same period, employment rose from 7.8 million to 12.5 million (60.3%). It stretches the mind to think the decline in agricultural employment alongside such strong national employment growth is explainable by consolidation of farm size and applied technology. Agricultural policy needs to accept responsibility for this employment outcome (ABARES, 2018).

The reality is that structural industry reform began with the 1988 tariff reductions, which were ratcheted up again in 1991. Orderly marketing of major industries wool and wheat was discontinued over 1989–1990. It cannot be explained as mere coincidence that agricultural employment began to decline from its peak in 1990–1991 as a result of technological adoption by the farm sector at the same time structural reform of agriculture began in earnest.

Figure 3 demonstrates empirically that agricultural employment contracted strongly across broadacre agriculture and the self-employed small-scale farmer. Broadacre employment decline appears from 2002 coinciding with the worsening of the Millennium Drought; however, the real loss of employment lies in the self-employed and owner-manager classifications from 1992 onwards. The impact of the self-employed owner-manager is particularly important as that group comprised largely the part-time skilled labour force residing in rural Australia. Policy-driven rural adjustment – 'shipping out' small inefficient farmers – would seem a more logical contributor than technology.

- Long-term decline in broadacre employment: 52% between 1992 and 2018.
- Self-employed fall: 71.4% between 1992 and 2018 (192,000 to 55,000).
- Millennium Drought running from 1997–2009.
- GFC 2009–2013.
- 2013 + current drought.

Figure 3. Empirical demonstration that agricultural employment contracted strongly across broadacre agriculture and the self-employed small-scale farmer.



The decline in agricultural employment whilst employment in the wider economy continued to rise strongly is a damning policy indicator. If agriculture were likened to a private firm, a cleanout of the board, senior management and advisors would be expected.

Conclusions

Agricultural policy since 1983 has seen a redistribution of income away from rural producers:

- The move to monetarism and market-based agricultural and drought policies since the move to globalisation in 1983 has produced rural decline not witnessed since the days of the Great Depression of the 1930s.
- A theoretical explanation of rural decline lies in the incompatibility between two well-established laws in economics: Say's Law of Markets and Engel's Law.
- Engel's Law effectively redistributed agricultural income away from the primary sector to the secondary and service sectors.
- Say's Law of Markets assumes an economy structured upon purely competitive markets whilst Engel's Law describes an imperfect market structure.
- Contemporary agricultural policies structured upon Say's Law must fail in the real world of Engel's Law.
- Corrective policies must redress this established redistributive feature of agricultural production in modern advanced economies, otherwise living standards will continue to decline in regional Australia.

The question of equity – of some approach to equal treatment for all – is not less important than the aggregate income involved (Galbraith, 1976).

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Author Profile

Ben Rees is both a farmer and a research economist. Over the years he has been keynote and guest speaker at national and local rural meetings and conferences. A repository of his work is available at http://benrees.com.au/