Commentary

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Re-regulation the biggest threat

In the Great Depression that began in 1929, crop prices fell by 40 to 60 per cent. If the US goes into a nasty recession and drags the rest of the world down with it, as many economists are predicting, will Australia's agriculture sector suffer a similar fate?

The farm economy generally operates on a separate cycle, being more affected by seasonal fluctuations in supply than variable demand. In a recession everyone still continues to eat and wear clothes, which means demand for food and fibre is less affected by rises and falls in prosperity than most other sectors.

Nonetheless, Australian agriculture is heavily reliant on exports and also depends on finance for working capital. Any interference to export markets or disruption to credit could have serious implications, as the Great Depression demonstrated.

A short sharp recession, by itself, may not be too troubling. There have been quite a few since the Great Depression and none have had anything like the same effect. Similarly, there have been previous credit squeezes. Provided the banks get over this one fairly quickly, particularly if the central banks increase money supply, there will be no lasting damage.

The bigger risk is that governments will react to the recession with regulatory impositions that magnify and prolong its effect. This was a major factor in the Great Depression when there were frantic attempts to shore up the economies of individual nations through protectionist policies, like the 1930 US Smoot-Hawley Tariff Act and retaliatory tariffs in other countries. These exacerbated the collapse in global trade and prolonged the depression by many years.

Although protectionism in general has receded due to the World Trade Organisation and other international agreements, it remains an issue in the agriculture sector. Governments still blatantly manipulate agricultural markets through subsidies, tariffs, import restrictions, export restrictions, quarantine standards and other means.

World prices for commodities such as grains, oilseeds and many livestock products have risen markedly over the past few years. The world indicator price of wheat, for example, has increased by around 74 per cent in nominal terms since mid-2006, while prices for corn, soybeans and major dairy products have risen by 70 to 140 per cent over the same period.

These rises are a response to stronger food demand from emerging economies such as China and India as well as to industrial demand in the form of government-subsidised biofuel production.

Meanwhile the prices of inputs such as fertilisers, herbicides, machinery, fuel and freight have also soared, driven by a combination of rising demand, higher oil prices and limited supply growth. The cost of producing a crop has never been higher, which means demand for credit is also high.

Although the higher commodity prices have generally benefited farmers, a number of countries have assumed there will be shortages and responded by restricting exports to guarantee supplies and keep local prices down. Others have increased restrictions on imports to ensure local producers remain viable, in order to maximise self-sufficiency. Quite a few also subsidise the cost of inputs such as fertilisers and fuel.

The risk is that, if food affordability declines as a result of recession and growing unemployment, the preoccupation with food security may prompt more measures along the same lines by more countries. For Australia's export-dependant producers, that could be quite serious.

Against that, the drought seems to be ending and bumper crops are anticipated. While that will obviously reduce grower returns, it may also head off any inappropriate government responses.

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