The Level Playing Field for Agricultural Production and Trade

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Introduction

Recently there has been talk of the need for a "level playing field" in international trade policies. The "level playing field" is one of those ideas that periodically surfaces and seems, after a while, to command general respect. It is in the air. It is of course an American borrowing and it refers to the basic idea that fair competition with equal access by all suppliers to all markets is desirable, both on efficiency and equity grounds. Indeed, this is such a central part of the prevailing orthodox beliefs in increased competition and free trade that it would seem beyond strong criticism. But that is not quite the case. There is a lingering criticism of the virtues of moving towards freer trade and greater competition.

There are in fact two versions of the arguments that we should not follow a level playing field in current circulation in Australia at the present time. One is an international policy argument and the other is a domestic policy argument. I shall discuss them in turn.

The International Playing Field

Periodically one hears the complaint that the governments of other countries assist or subsidise producers of electronic goods or telecommunications equipment or computers or sugar or some other group of products, and hence the Australian government should similarly assist the Australian producers of these products. For example, in commenting on the Garnaut *Report* (Garnaut 1989), the Study for the Australian Manufacturing Council prepared by Pappas Carter Evans and Koop Telesis stated:

> "Zero tariffs and no anti-dumping would, moreover, be an extreme position to take by world standards. No industrial country, despite any amount of rhetoric, actually applies the "Level Playing Field". (Pappas Carter Evans and Koop Telesis 1990, p. 52)

It is certainly true that foreign governments assist various industries. And it is true that the levels of assistance going to agricultural producers are higher than the corresponding levels going to non-agricultural producers. The Organisation for Economic Cooperation and Development (OECD) has series for measures of assistance to agricultural commodities on an annual basis since 1979. They have used the producer subsidy equivalent (PSE) rather than the nominal or effective rate of assistance to measure the effects of assistance on producers, and the consumer subsidy equivalent (CSE) to measure the effects on consumers. The PSE and the CSE diverge in the case of agricultural commodities because of the prevalence of non-tariff forms of intervention. In general, the CSEs are less than the PSEs because much of the support comes from taxpayers via direct payments rather than via consumers in the form of higher market prices.

The latest statistics for the year 1990 (OECD 1991) tell a sorry story. Provisional estimates are available for 1990 relating to the percentage net PSE. This is the measure most comparable with the effective rate of assistance as it includes the effects of some input such as feedstocks and expresses the rate as a percentage of the domestic producer price. These statistics show that the PSE for the OECD countries as a whole was 44 per cent while the CSE was 36 per cent. Moreover, this PSE level is higher than that in the preceding two years and above the average for 1979-86. Thus agricultural protection in the major markets has been getting worse, despite the efforts of the OECD. Worse still, the CSEs have been increasing relative to the PSEs which shows that a larger part of the burden of assistance is being shifted to consumers, thereby depressing demand and contracting the volumes of trade further.

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It should be noted that the OECD adopts the curious custom of expressing the percentages in terms of the domestic support-inclusive price. This has the effect of reducing the rates compared to those which use the world price, though there are difficulties in choosing a world price when the intervention itself changes world prices and exchange rates fluctuate. In 1991 for the first time the OECD has also expressed the rates of output support relative to the border prices to obtain measures that are nominal rates of assistance as we measure them in Australia (OECD 1991, Table IV.4). These show that in 1990 the average nominal rate of assistance for agricultural commodities in the OECD countries was 74 per cent. This compares with the average tariff on manufactures imported into the industrial countries of around 6 per cent. Even adjusting for the omission of non-tariff assistance in the latter measure, there is a stark contrast between low and declining assistance for manufactures and very high and rising assistance for agricultural commodities in the major markets of the world.

The argument that we should respond to this foreign industry assistance by domestic industry assistance is fallacious as any student of international economics knows. We must take the overseas trading conditions as given, even if foreign producers are heavily subsidised or assisted, for the purposes of deciding our optimal national trade policy. Free unilateral trade is generally the best policy for a small country because it maximises the aggregate real income of the country. The same argument implies that if a small country is not trading freely with others it should reform its policies unilaterally towards free trade, irrespective of what other countries do. (For the history of the doctrine of unilateral free trade which dates back to the middle of the last century, see Bhagwati (1988, especially Chapter 2)). To not do so is to forgo some of the potential gains from trade. This line of argument is difficult for a non-economist to grasp but it is nonetheless true. Samuelson (1969) has cited the doctrine of comparative advantage as perhaps the best example of an economic theory which is both true and non-trivial.

It has been suggested that this argument needs to be qualified if the foreign trading conditions are not permanent and resource reallocations are not costless. In this context, it might be that the current General Agreement on Tariffs and Trade (GATT) multilateral negotiations will significantly reduce levels of assistance to our major competitors and the current movement of resources out of some agricultural activities in Australia would, in this event, need to be reversed to some extent at least. The difficulty with this argument is that this event is less than certain and it can only justify a *delay* in the reductions in the levels of assistance to Australian producers. It has also been argued by some economists that the aggregate real income may not be the correct criterion if some particular income earners are significantly harmed by some change in policy and are not compensated. This argument has some force if the incomes are reduced to a level comparable to others in the community who are eligible for income assistance and especially if the resources become unemployed in the medium or long term. Nevertheless, there is a presumption in favour of changes which do increase real aggregate income, provided the worst losers are given some (temporary) assistance. Unless aggregate real income is maximised it is much more difficult for governments to tax some income earners in order to transfer real income to others.

A second aspect of the international version is the concern over the importation of *subsidised* commodities. Such trade is labelled as *unfair*. A corollary of the unilateral free trade reasoning is that, if a foreign country wants to subsidise the price of one of its national products and sell it to the rest of the world, so much the better for the rest of the world. The larger the foreign subsidy on one of our importable commodities, the greater the benefit to our nation's consumers or buyers. But some of our agricultural products are export commodities not import commodities. Does the same argument apply to foreign subsidies of export commodities? The answer is yes in terms of trade policy. The best policy is still one of free trade. However, when the foreign country subsidises a commodity which we export this foreign subsidy harms our exporters obviously and, less obviously, it also harms the country as a whole. Any fall in the price of an export commodity, whether it is due to changes in market demand or supply or to government interventions, makes the nation as a whole worse off.

But, and this is a bitter pill for the exporter to have to swallow, the best national policy is still one of free trade.

There is also a complaint about *dumped* international trade in the agricultural sector. A commodity is dumped in the terminology of international trade if it is sold in a foreign country at a price below the price of the comparable product in the home country or, in some cases, if it sold at a price less than the cost of production. This complaint is heard with respect to citrus products from Brazil for example. Again the standard conclusion of a large body of economic theory is that the best policy for the country in which the commodity is dumped is not to take anti-dumping action, except in cases of predatory dumping or cases in which the dumping is temporary or cases in which the dumping increases the price variability in the commodity market. (For a recent review of this literature, see Hindley 1991). This "no anti-dumping" pill is an even stronger one for the domestic industry to have to swallow.

In relation to the international playing field, Australian agricultural producers should be firmly behind the reforms of the world trading system that are being finalised now in the Uruguay Round. These reforms may, for the first time in the long series of the GATT multilateral trade negotiations since it was established in 1948, achieve substantial reductions in world trade barriers to the agricultural commodities we export. There is a proposal being considered now by GATT to "tariffy" the restrictions on world agricultural trade. The removal of quantitative restrictions and non-tariff barriers such as the European Community (EC) variable levy and export subsidies would greatly improve the access to world markets, leading to an improvement in the average export prices for our agricultural exports and probably in the volumes exported too.

Reform by tariffication would have another benefit. Restrictions such as those under the EC Common Agricultural Policy and in many other countries are designed to insulate the local markets from changes in demand and supply in other countries. This transfers the instability in these insulated markets to the rest of the world and increases the instability in the rest of the world. Johnson (1975) emphasised that the effect of schemes which fix a domestic price for a tradeable commodity is to reduce the price elasticity of excess demand for imports or of excess supply of exports to zero in these countries. Australian farmers have suffered from a high degree of price variability in export markets. Reversing this process by tariffication connects the national markets and reduces the instability in world markets. The empirical work of Tyers and Anderson (1991, chapter 7) predicts that tariffication in agricultural markets would substantially reduce the price variability in world food markets.

The Domestic Playing Field

Concern in Australia over the domestic playing field relates mainly to the recent moves by the Commonwealth Government to lower border protection for Australian industries that produce tradeable commodities. In May 1988 the Government announced major phased reductions in tariffs. Tariff rates above 15 per cent were to be reduced to 15 per cent while rates of 15 per cent or less were to be reduced to 10 per cent in annual steps by July 1992. However, the heavily-protected motor vehicle industry was treated separately and only minor changes were made to the clothing, footwear and textile group. Then in the March 1991 Statement (Department of the Prime Minister and Cabinet 1991) the Government announced that the general level of assistance will be reduced from 10 and 15 per cent in 1992 to a single general tariff rate of 5 per cent by 1996, and quotas will be ended by 1993. These measures are expected to cause the average nominal rate of assistance to fall to 3 per cent and the average effective rate to fall to 5 per cent in 2000. This is one seventh of what it was in the late 1960s (See Industry Commission 1991, Figure 1). This round of tariff cuts, unlike that of 1988, encompasses large reductions in the protection of the heavily protected manufacturing industries - motor vehicles, clothing, footwear and textiles. It is also another instance of reform by means of across-the-board reductions in all rates of tariffs and in as many non-tariff forms of assistance as possible.

The prevalent government view in favour of reduced industry assistance and the resulting trends in the levels of assistance have led representatives of the manufacturing industries, especially those which are more heavily assisted, to protest about the level playing field concept. Some of this protest relates to the need for time to adjust or for adjustment assistance or the need for simultaneous microeconomic reforms but much of it questions the level playing field. To take a solitary example, the Chairman of Pacific Dunlop, a manufacturing company which is substantially reliant on sales of footwear and clothing, called for "silly notions about level playing fields" to be cleared away. Similar calls have come from the motor vehicle industry and electronics and telecommunications and other manufacturers or manufacturing associations. This call has been picked up by some politicians, such as the Leader of the Opposition in the State of Victoria, Mr Kennett:

> "The argument that Australia should be the first in the world towards a flat-earth policy is not in my opinion necessarily the best and most appropriate way to go" (*The Age* 1991).

As a side comment, it appears that the State of Victoria is emerging once again as the centre of protectionist sentiment in Australia, as it was in the 1920s and 1930s - or perhaps it never lost this position. Since it is the centre of manufacturing industry in Australia and more particularly of the heavily protected manufacturing industry groups and the most depressed State at the present time, this is understandable but it is against the national interest and arguably against the long run interest of the State itself. A grossly uncompetitive manufacturing industry will not survive and early reform may be better than later reform.

One objection to the level playing field is that the economy benefits from strategic interventions. A few years ago the idea of "strategic trade policy" burst upon the profession and, mercifully, it has diminished as quickly. This brand of interventionism was based on a very peculiar set of circumstances in oligopolistic markets producing differentiated products which are not features of any Australian industries. However, there is a more virulent brand of strategic intervention to promote new industrial activities, especially competitive export activities. These popped up in *The Global Challenge* report prepared for the Australian Manufacturing Council (Pappas Carter Evans and Koop Telesis 1990). This report favoured "positive measures" to build more export-oriented firms, such as increasing support for R& D and using strategic procurement to build defensible tradeable goods industries. These were justified in vague terms by reference to unspecified "externalities" and "public benefits":

> "Research and development is an area where all countries in the world recognise that there are substantial public benefits that can outweigh the purely private return-on-capital criteria used by individual firms." (Pappas Carter Evans and Koop Telesis 1990)

Grossman (1990) recently provided an excellent survey of the alleged advantages of governments seeking to promote new industrial activities on the basis of market failures associated with learning by doing, incomplete capital markets, research and development and other failures. These are new "infant industry" type arguments. Much of the impetus comes from the loss of market share on the part of countries such as the United States (where almost all of this literature originates), the EC and Australia to Japan and the "dynamic" East Asian economies and which are supposed to have used selective interventions so successfully to start up new firms and exports. Grossman concludes that, while there is theoretical validity to the arguments under the circumstances postulated in the theory, they give little grounds for assistance in practice. The circumstances do not occur frequently and they will need to be evaluated on a case-by-case basis. They do not provide a justification for blanket protection for new enterprises and the appropriate interventions where they occur should be targeted to the particular activities and not in the form of interventions based on output or trade flows. I commend this study to any rationalist who want to fight off another advocate seeking to increase private profits under the guise of the public benefit.

Another of the objections to the reductions in assistance is that other nations have not engaged in unilateral reductions. This is not relevant to the choice of policies for Australia, as noted above. And in fact, it is not true. A number of other countries have undertaken major unilateral reductions in trade barriers over the last decade. These include Japan, New Zealand and Turkey among the OECD countries and developing countries such as Chile, Mexico and Thailand. One could also point out that Australia has largely had a free ride in the GATT Rounds of tariff reductions as our tariff cuts were smaller than the major Contracting Parties and most of our tariffs were not bound against subsequent increases. For these reasons our rates of industry assistance in the manufacturing industries have been much higher than in other developed countries, with the solitary exception until recently of New Zealand. Until the last few years it is Australia and not the Rest of the World which has dragged its feet on reducing barriers to trade with other countries!

Agricultural activities were not substantially affected by the 1988 actions as tariffs account for only a small proportion of the assistance to these activities. Reductions in the tariff rates on imports of citrus juice, on sultanas and currants and raisins and on non-concessional imports of tobacco leaf reduced the derived demand for citrus fruits, dried vine fruits and tobacco used in the Australian production of the manufactured products. However, a number of individual reviews of assistance to agricultural industries have resulted in significant reductions in assistance. The more heavily assisted agricultural industries which derive assistance from border protection have had some of their assistance cut in the last three or four years. In 1988 the domestic pricing arrangements for sugar which included an absolute embargo on imports of sugar were changed. The embargo on sugar imports was replaced by tariffs (and these tariffs are to be cut further under the 1991 provisions). The dairy arrangements implemented in 1986 began reforms of this industry and the Industry Commission has just reported again on the industry.

Nevertheless, the reductions in assistance to agricultural activities have been much less than that to manufacturing. The average effective rate of assistance to agricultural activities in 1989-90 of 9 per cent is about the same as that a decade earlier. But the pace of change in this sector is starting to accelerate, and this is the danger to some. The March 1991 Statement indicated that the assistance for dairy, sugar and tobacco will follow Industry Commission inquiries but it said the Government is disposed to reduce assistance for these industries over the longer term in line with assistance for other industries.

My view on where agricultural producers and producer organisations should stand on this issue of a level domestic playing field is quite clear. I believe it is folly for agricultural producers to oppose reductions in assistance to those segments of the economy which are heavily assisted. Historically, the agriculture sector has complained bitterly about the penalty imposed on efficient producers and especially on exporters by assistance to import-competing producers. This complaint was a genuine one. Agricultural producers would benefit now from further reductions in the Australian border protection of manufacturers. They would get lower prices for importable inputs such as fertilisers and pesticides and for farm equipment. They would also benefit from reduced prices for motor vehicles and clothing and footwear and other consumables. Moreover, if some producers rejected the level domestic playing field and pushed for more assistance it might assist other manufacturing industries with the same argument. It is not at all clear that the agricultural sector would win in this game.

Not all farmers would benefit of course. Many farm products, as we have come to appreciate more in recent years, are import-competing. The boundary between an import-competing commodity and an export commodity is merely a small variation in the world price. Moreover, the same argument that states that the economy as a whole benefits if we reduce the rates of assistance going to the more highly protected sectors applies within the sectors themselves. Variation in the rates of assistance within the group of agricultural producers encourages the production of the more heavily assisted producers at the expense of the less heavily assisted producers because they compete for primary resources. In particular, some land can be switched from the production of one crop or product to another, depending on prices which in turn depend in part on the domestic assistance. One of the features of the assistance to agricultural activities has been the high standard deviation among commodities. This was estimated by the Industry

Commission to be 43 per cent in 1985-6. But it has declined rapidly since then and is estimated to be 16 per cent in 1989-90. This compares with 29 per cent in Manufacturing in the same year (Industry Commission 1991, Tables A10.3 and A10.12).

There is another dimension to the domestic playing field. I refer to the fact that there are large *intra-commodity* variations in the level of assistance. The domestic assistance arrangements for some agricultural commodities give more assistance to some producers of a commodity than to others; for example, those applying to market milk. These intra-commodity variations increase the cost of production by increasing the output of less efficient farmers and reduce the market shares of the more efficient farmers.

Parenthetically, I might indicate here that there is one important change on the horizon which may dramatically increase competition in agricultural markets nationwide. I refer to the adoption of the principle of "Mutual Recognition" by the October 1990 Special Premier's Conference (Special Premier's Conference 1991). Mutual recognition means, in the context of goods markets, that any goods which meet the requirements for sale in one State or Territory can be sold in any other State or Territory of the nation. This principle was first developed in the Single Market proposals for the EC-1992. It was reaffirmed by the Special Premier's Conference recently held in Adelaide. If adopted, it will remove in one sweep all the restrictions and regulations remaining on the inter-state trade in agricultural commodities.

Thus both the domestic and the international playing field arguments indicate that agricultural producers in this country should favour reform of the Australian border assistance for all industries, not excepting agriculture itself.

More Playing Fields

The return on primary inputs in agricultural activities depends upon much more than government interventions at the border. A host of other government policies affect these returns. I contend that the level playing field with respect to these policies may now be more important than the level playing field with respect to trade policies. These policies include tax policies, welfare policies, policies with respect to the provision of transport and other infrastructure used by industries, and labour markets. I shall make some remarks on certain features of these policies.

In relation to tax policies, the taxation of farm incomes is of course a part of the income taxation system of the country. As such it is subject to the same rules as others - definitions of taxable income, etc. Nevertheless, there may be features of the system which could discriminate in favour of or against farm producers as a group vis-a-vis other income earners in the economy. One notable feature of the income of agricultural producers is the annual variability of incomes. Although I do not know of empirical evidence, I believe that this income variability is greater than that of most other income earners, partly because of the greater variability of the prices of agricultural products, partly because of independent fluctuations in volume because of weather and partly because farm income is in part a return on assets rather than labour income and the owners of the farm enterprises are the residual risk bearers. There are provisions for spreading losses over income periods and for averaging income which treat farmers, as far as I am aware, more favourably than most income earners. There are only two categories of income earners who are subject to the averaging provisions - "primary producers" and " artists, composers, inventors, performers, production associates, sportspersons and writers". Owners of other productive assets are not able to use these provisions. The solution in this instance is to extend the averaging provisions to other income earners with marked annual fluctuations in their taxable incomes. With a progressive income tax structure and annual fluctuations, some measure of permanent income should ideally be used as the tax base. The use of unadjusted annual income as a tax base overtaxes income earners.[1]

[1] This is easily proven. Consider the income after tax as a random variable. With a progressive income tax, income after tax is a concave function of income. This function is not strictly concave since the tax function itself is convex and piecewise linear because of the steps in the tax rates and the constant marginal tax rates between the steps. Consequently, applying Jensen's Inequality, the expected value of the income after tax is less than or equal to the income after tax evaluated at the

A similar aspect is drought relief in the form of carry-on loans and restocking, rebates of freight, etc. Such relief is a form of industry assistance even though it is confined to eligible drought-stricken producers. It goes predominantly to the producers of the agricultural products who live in more drought-prone areas. This creates a moral hazard problem as it encourages more production in such areas than would otherwise occur since the occurrence of droughts in such areas, though not of course their exact timing, is predictable. In this instance the appropriate change in policy is to cease this form of assistance. Moreover, one may note that the tourist motel or ski lodge which has a bad season due to unfavourable weather does not qualify for weather relief.

Another area of policy is the welfare system. One of the complaints of some farmers is that they have not in the past been eligible for unemployment benefits. This is a complex area because farm income combines income from labour with other income as a return to capital and risk-taking. In any case, this policy was recently changed.

There is another aspect of the welfare debate which seems to me much more important than eligibility for unemployment benefits. The centralised wage fixing machinery that has operated in Australia provides a floor for real wages in times of decreasing demand in labour markets, although there has been a decline in average real wages for wage earners of about 6 per cent since 1983.[2] However, this reduction in real incomes is very small compared to the reductions in recent years of the real net incomes of many farmers. Many have had drastic reductions in real incomes and many now have negative annual incomes. Average income on family farms (excluding larger corporate farms and smaller hobby farms) has fallen from $46,256 in 1988-89 to $37,180 in 1989-90 and to an estimated $11,200 in 1990-91 (ABARE 1991). That is, by more than 75 per cent in only two years. We should remember that this covers all the farm family workers (but it excludes off-farm income). The average income per work-year of family labour in 1991 is a mere $5,800.

We need also to allow for the investment of capital by farmers. Consider the broadacre farms which represent the subset of farmers remote from the urban dwellers in the main and a group more exposed to the vagaries of overseas market price fluctuations than other farmers who sell more of their output on home markets, such as the market milk dairy suppliers. These are the typical Australian farms. ABARE has forecast that the average broadacre farm will run at a loss of almost $30,000 in 1991 after allowing for the depreciation of the capital and a return to the farm operator and family labour (ABARE 1991). That is, the annual return to the capital invested and associated management is negative: an average of -$24,100 in the latest year. The situation is worst for sheepfarmers. The fall in real incomes is the result of a combination of factors including the fall in major farm product prices (wool, wheat, dairy and sugar), high rates of interest on borrowed capital, and the prolonged drought on the East Coast.

Properly, we should be looking at the changes in real net wealth rather than annual incomes. The situation there is even more unfavourable to farmers as the net wealth of many has plummeted

expected value of the income. If the income variation spans more than one income bracket with a marginal tax rate, the inequality will be strict.

[2] The Government and supporters of the Prices and Income Accord claim this was due mainly to the Accord which was introduced in 1983. They claim that this consensual incomes policy has introduced greater flexibility and permitted a reduction in real wages that would not otherwise have happened. Recent estimates by a team at the Australian National University and the Commonwealth Treasury suggest that the long-run equilibrium real wage has declined by somewhere between 5 and 17 per cent since the introduction of the Accord (Chapman *et al* 1991). This has mostly occurred in the last four years. Whether this reduction is due to the Accord or to recession or to a combination of factors is a moot point. It is undeniable that there has been a substantial reduction in real wages of employed labour, and this has reversed the long upward trend in real wages which continued unabated since the end of the Second World War until 1983 (Treasurer 1991, Chart 4).

The series of real wages is based on the series of real wages from the Treasury NIF database. Treasury use the average earnings of non-farm wage and salary earners deflated by the gross non-farm product deflator. There are a number of problems with this series. The CPI would be a more suitable deflator. More seriously, the income series in the denominator is before-tax income and it excludes some payments which should be treated as income, such as superannuation, fringe benefits and income in kind. This series is especially unreliable when income tax cuts are substituted for nominal wage increases as a way of maintaining real wages, as happened for example in 1991. The construction of an adequate series of real income after tax for various groups of income earners is a major gap in Australia.

because property values have slumped (reflecting the declining annual income from the land and capital assets) and the debt of many farmers is constant or rising. The average loss of capital on broadacre farms in Australia in 1990-91 was $54,400. The nominal rate of return on investments in these farms is now -5.3 per cent. The longer term trends are steadily downwards in most agricultural industries. There is a rural crisis in terms of loss of permanent real income which is much more severe than that experienced in the manufacturing or service sectors. There is no major policy instrument which puts a floor under rural incomes since the ending of the reserve price for wool. (This should not be construed as advocacy for the return of the floor price system.) To date the Government has not responded to this rural crisis with any significant policies. Farmers, unlike wage earners, have had to fend for themselves.

There is an urgent need for the government to respond to the rural crisis and this means much greater assistance to farmers. But this case for assistance is based on welfare grounds not industry protection. It should, as a consequence, go only to low-income farmers and it should be designed to help those farmers whose long-term prospects of earning an adequate income without assistance are poor to move off the farms. Above all it should not be paid on a base related to current output. It should be "de-linked" to use the current jargon.

The final area I shall comment upon is transport and associated infrastructure. Transport is an essential input into the production and sale of all commodities. The transport sector is in general characterised by public ownership of many of the means of transport and a high degree of regulation in all modes of transport. This is a combination which is now recognised as having promoted inefficient production and high prices, though, unfortunately, we do not have measures of the increase in prices due to inefficient production in this sector. Similarly, the ports and waterfront areas are still riddled with restrictive work practices, barriers to competition and other regulations. Under the programme of microeconomic reform, there has been some progress in reforming these areas but it is slow and much remains to be done (See Industry Commission (1991, Appendices 1 and 2) for a report on recent reforms in economic infrastructure and the microeconomy). The use of transport and associated infrastructure is particularly important for agricultural products in general because of the remoteness of production on many farms and the associated high costs of transport. Therefore the inefficiencies in this sector discriminate against agricultural production.

A Programme for Action

What should agricultural producers do in the face of this situation?

They should not in my opinion oppose moves to remove assistance to agricultural producers, such as those proposed in the Industry Commission *Report on the Australian Dairy Industry*, unless they can show that the reforms will not improve the efficiency of resource allocation and aggregate output in the economy.

Farmers will have to accept that the agricultural sector is a declining one in terms of the proportion of national output and employment and exports coming from the sector. This is fundamentally the result of Engel's Law - that the proportion of the household expenditure devoted to foodstuffs is declining because the income elasticity of demand for foods is significantly less than unity at higher income levels. For those agricultural products which have end-uses other than food, such as wool, the end demand for the products may be more income-elastic but there is the threat of competition from other fibre substitutes. GATT statistics show that the volume of world trade in Agricultural Products has consistently grown less rapidly that the volume of trade in other merchandise trade (GATT 1991, Table 1.3) and the comparison is even less favourable with trade in services. This *volume* effect is of course itself partly reduced by the increase in the levels of assistance to agricultural production in many countries which was noted above but, in the long run, the slow growth of demand for most agricultural products is even more important to producers than the restrictions on international trade in these products. In particular, as an exporter, Australia must turn increasingly to exports of manufactures and services which have better long term prospects.

These trends do not mean that there is nothing that should be done.

Agricultural producers should continue to press for the lowering of trade barriers overseas. The reforms in other countries are largely out of our hands but there is a distinct possibility of real progress in reversing the trend in increasing agricultural protectionism in the major industrial countries. The latest reports on the Uruguay Round talks suggest that there may be substantial cuts in export subsidies though they are likely to be far less than the 90 per cent originally sought by the US and Australia.

On this front I might mention one potentially very important development occurring at the OECD. In May 1991 the Economic Policy Committee of the OECD recommended in principle that the OECD should compile an aggregate measure of the support going to all industries in all OECD countries. If this is done, the world will have for the first time comprehensive statistics of assistance going to all industries from all instruments of assistance. This will reveal the global pattern of industry assistance in the same way as the construction of the first series of nominal and effective rates by the Tariff Board in 1969 revealed the previously hidden pattern of industry assistance for manufacturing industries in Australia. This was the prelude to later reform. The generally very high rates of assistance for agricultural commodities in many countries will stick out like a sore thumb. Public information is a necessary ingredient to reform.

I also believe that agricultural producers and producer organisations should be supporting the push for reform of industry assistance within Australia. This should extend to reform of assistance to agricultural producers because it is in the long term interest of the industries as a whole. Inefficient, that is high-cost, producers in an industry harm the industry in two ways. They raise the average costs of production and they increase the aggregate output and depress market prices and thereby reduce the returns to efficient farmers. The supply of some agricultural products must contract and we should ensure that the contraction occurs at the high-cost margins of the industry. This will be acutely painful but without this pain other more efficient producers will suffer to a greater extent.

Agricultural producers should also be paying much more attention to the marketing of their products. There is much more to selling products than producing them at a low unit cost. We should be differentiating our products more to suit the ever-changing demands of the markets. The role of the statutory marketing authorities is at last being seriously questioned. Perhaps they should all be scrapped. We should be processing our products to a greater degree in Australia (see the interesting vision for Australian agriculture by the Secretary of the Department of Primary Industries and Energy 1991).

Agricultural producers and their organisations which represent them should also press for more rapid reforms on the other playing fields. In particular, they should press for more rapid microeconomic reforms. In doing so, they can point out that some of the existing regulations and restrictions on competition, such as those applying to transport, discriminate against agricultural producers as a group, and this is the group which has collectively suffered the largest reductions in real incomes in recent years.

They could press for a reduction in interest rates. At around 10 per cent the real prime borrowing rate in Australia has been the highest of the OECD countries. High interest rates harm agricultural producers in two basic ways. Directly, the high cost of capital makes it difficult for farmers to service their existing debt and to raise new debt to finance capital improvements. Indirectly, the high real returns to investments in this country induce a capital inflow which, with a freely flexible nominal exchange rate, raises the real exchange rate and thereby penalises the producers of both export and import-competing tradeable commodities. The excessive reliance on a tight money macroeconomic policy has reduced the profitability of agricultural production as a part of the tradeable goods sector. I think the indirect effect is the more important since the former affects all industries. The economic problem here is that the increased overseas debt has been largely used to increase personal consumption and some state government expenditures rather than private capital formation in industries which will increase the productive capacity of the country. We need to ensure that there is a level playing field in terms of the incentives to invest in productive activities rather than to consume or to overinvest in office blocks and other real estate or in activities with a low rate of return.

In short, my firm conviction is that the playing fields which have been discussed in the public arena are not the important ones now. Rates of assistance for all industries have been substantially leveled in recent years in Australia. The debate should in the future concentrate on how to raise productivity and process and sell the products which are in demand in world markets.

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