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## THE IMPACT OF THE CHANGED FINANCIAL ENVIRONMENT ON RANGELAND MANAGEMENT AND OWNERSHIP STRUCTURES

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### ABSTRACT

The dramatic change in the western world's economic environment is characterised by lower inflation, unserviceable indebtedness, lower commodity prices, greater environmental awareness and a complete readjustment of values and bank lending policies as an era of greater financial conservatism develops.

An understanding of this historic turning point in economic developments, especially in Australia, brings into question many established concepts of management of our agricultural resources.

This paper questions whether these changes demand a more dramatic rethink of the management of our western lands to ensure that the economic imperative of profit (the driving force for private occupancy of pastoral areas) can sit comfortably with the environmental responsibility being increasingly demanded by society.

### INTRODUCTION

The production of agricultural commodities has been the key to the prosperity of Australia throughout its history.

The Western World has enjoyed a period of remarkable growth since the Second World War and consequently, during most of our lifetimes, we have not been required to deal with major economic upheaval.

Recent events indicate that this period of economic stability has ended, world growth is transferring to the Asian region and Australia has been left well behind in economic adaptation to this changing world.

No longer is the production of basic agricultural commodities seen as providing the future wealth of Australia and recent indications are that manufacturing will overtake agriculture as our second largest export earner after mining by 1995.

These changes have significant implications for how we view our agricultural industries and challenge many well established practices. An understanding of these changes is necessary to enable policy makers to ensure best practices are brought to rangeland management in order to ensure economic viability can exist hand in hand with environmental responsibility.

### WORLD ECONOMIC CHANGES

After the Second World War a period of economic stability with enormous growth occurred. This period was ensured by the agreement at Bretton Woods in 1946 that the US dollar would be backed by gold at a value of US\$35/ounce. The USA had ample gold reserves in Fort Knox to ensure it could redeem offshore US dollars in gold at this value until about 1970.

During the period 1946 - 1970, the USA had been able to print more US dollars without affecting the gold standard or causing inflation to be a problem. However, by the early 1970's offshore US dollars exceeded the value of gold held in the USA and the USA consequently had no choice but to allow the gold price to float. At the same time oil prices were dramatically escalated by OPEC and the runaway inflation of the 1970's occurred.

The fact that this decade of high inflation occurred while both the financial and exchange markets were regulated proved a disaster for attitudes towards savings. With high inflation and low returns being offered on savings the only sensible investment philosophy was to borrow to purchase capital assets. We thus created a mentality, especially in Australia, that it does not pay to save to buy a capital asset in the future.

By the early 1980's it was soon realised that Australia had insufficient savings to continue to finance its living standards, and it had become less attractive for overseas equity investment. This was in fact the case in most of the western world as is now obvious by the indebtedness accumulated in USA, Canada, UK and Australia.

The growth in Asia (Japan in particular) and the EC (West Germany in particular) was causing the world's money supplies to be accumulated in those countries.

If an immediate drop in living standards in western countries was to be avoided, borrowing from the new wealthy was necessary and has occurred on a significant scale. As we all realise, a continuation of this borrowing is not viable in the long term nor desirable if a country is to adapt to changed circumstances in order to maintain its traditional living standards. There is ample evidence worldwide of countries which have overborrowed without internal adjustment to changed circumstances. Lower living standards, social unrest, political instability, a depreciating currency, high inflation and high interest rates are all characteristics of countries which have lost their direction.

The 1980's were characterised by continuing current account deficits, relatively high inflation and high interest rates, rampant speculation using borrowings which were too easily available in a deregulated financial system and a general realignment of world currency values.

The collapse of much of the speculative bubble in the 1987 to 1991 period has now ushered in a potential era worldwide of greater financial conservatism. The realisation that real wealth is only created by genuine productivity and not speculative paper shuffling gives hope for a new era of stability in the decades ahead. Deregulation of financial markets will prove to be a key element in controlling speculation on capital gain in future years. Since deregulation interest rates worldwide have tended to settle at two to three times the rate of inflation. If inflation escalates again then interest rates will rise significantly also, making borrowing to back inflation alone a poor investment. Viable borrowing in future years will be based principally on productivity and not on potential speculative gains.

Current expectations are that this era will be characterised, in the Western World, by slower growth rates, lower inflation, gradual debt reduction, lower capital values better reflecting productivity and a reduction in expectations of higher wages and costs by individuals. The growth in Asian markets will continue and will provide opportunities for those who can adapt to meet the needs of these emerging markets.

#### **WORLD COMMODITY PRICES**

The effective purchasing power of all our major agricultural commodities has been decreasing since the early 1950's, but more rapidly since the 1970's. At the same time, the costs of production have been escalating.

Increases in productivity have allowed production to remain relatively profitable until the last decade when prices in general have fallen below the long term trend line of viability for existing production systems (ABARE 1992).

Gradually falling effective prices were countered in the two main world producing centres of the EC and USA by continuing escalation of support by

Government through subsidies both for production and for marketing.

This was occurring at a time when Australia's capacity to continue its minimal support for agriculture was being reduced because of its poor industrial performance. Agricultural producers in Australia have consequently entered their worst period of profitability since the Second World War.

There is however a realisation worldwide that continuing subsidy of agricultural commodities is extremely distorting to world trade and to efficient and effective allocation of productive resources. Whilst a gradual reduction in support is proving difficult to agree on at GATT, gradual reforms of the EC's Common Agricultural Policy (CAP) are occurring and are likely to be matched in the USA as a result of a final GATT agreement. Developments in the next year or two will indicate if we are in fact at the end of an era of gradually declining real agricultural prices.

Economic rationalism is not the only force at work in pressuring reform in agricultural practices worldwide.

Consumers are not only demanding food safety and purity but are also increasing their concern for lifestyle. This concern is manifested in a growing concern for environmental responsibilities on the part of all those involved in land use throughout the world.

#### **AUSTRALIA'S ECONOMIC DILEMMA**

The Australian economy is undergoing its most dramatic change since the 1940's. The era of relative stability and prosperity through which most of us have lived, has ended. Every aspect of Australia's economic structure is under question. There is a gradual public realisation of the enormity of the economic adjustment which is necessary.

This adjustment must recognise that to compete in world markets our price must be competitive, our quality excellent and consistent, our supply consistent and efficiently transported. These adjustments will require new capital investment as well as changed attitudes to work practices, transport and handling systems and to the expected returns from various enterprises.

Agriculture and mining, which created our relative prosperity during the past 50 years, no longer have the capacity to protect our small manufacturing base from overseas competition nor to provide the total income necessary to maintain past living standards.

Our overseas debt, built up to maintain our living standards while we attempted to adapt to these changing circumstances, is an added burden to our economy.

Australia's competitiveness in terms of productivity per labour unit indicates that we still require significant structural adjustment to take place.

Nevertheless, we have been able in the last three years to increase our exports of manufactured products significantly. Manufactured exports have grown by about 16% per year and if this growth continues, they will exceed agricultural commodity exports by 1994/95 unless there is a considerable recovery in agricultural prices.

This trend is encouraging and is a sign of the type of Australia we will develop as we move into the twenty-first century.

There is an expectation that an era of financial conservatism will ensure lower inflation rates and lower interest rates, resulting in a realignment of capital values to reflect earning capacity rather than a speculative element of capital gain. The lack of savings and investment capital in Australia is likely to ensure that this expectation is fulfilled.

This adjustment in manufacturing, as tariff protection is reduced, is just as traumatic as for individuals involved in rural industry where significant structural adjustment is also occurring.

The economic changes outlined will have significant impact on attitudes to as well as structures for rangeland management throughout Australia.

#### **RANGELAND MANAGEMENT IMPLICATIONS**

The collapse of the wool industry has created severe economic hardship for many in the pastoral areas of Australia. When combined with the recent drought in much of eastern Australia, an immediate crisis of significant proportions exists. Current problems are however not new and are symptomatic of the long term trend in wool and sheep prices.

What are some of the likely implications for the management and ownership structures of rangeland resulting from this period of economic adjustment in Australia and the changing economic world structure?

#### **CAPITAL VALUE ADJUSTMENTS**

Land values and lease values have tended to reflect both the productive value of the land as well as an expectation of future capital gain. If the expected period of low inflation eventuates then we must expect the values of land to remain static or drop to reflect the productivity of the land without anticipation of capital gain.

The adjustment of rural land values to better reflect productivity will be an ongoing process.

Given that there is little likelihood of significant recovery in the wool industry before 1996, this adjustment is likely to continue as smaller and indebted producers are forced to leave wool production in pastoral areas.

Under this pressure both lease payments and restrictions on size of enterprise must both be brought into question.

Economic pressures on smaller enterprises will undoubtedly demand greater aggregation. Although this has been allowed and has been occurring over recent years, there is still a "living area" mentality and a welfare level entrenched from past practices in managing government owned pastoral areas in NSW (Hassall & Associates, 1982).

While aggregation will continue there is likely, under present policies, to be a significant number of small producers who will "hang on" despite inadequate returns.

#### **AGGREGATION OF LANDHOLDINGS**

The aggregation which was financially possible and which occurred following the 1987/88 wool price rise is now essentially completed and further aggregation to assist uneconomic entities to leave the industry will be more dependent on the introduction of outside capital or borrowings by existing producers.

One major source of outside capital in future years will be in managed superannuation funds. In order to allow market forces to aggregate western land holdings, several essential changes would need to be made to government thinking.

Firstly the concept of joint ownership of leases between a corporate investor and an existing leaseholder would need to be allowed. In this way the corporate investor would ensure a holding of a size sufficient to provide an adequate return to investors without debt servicing and the current management expertise of top performers in pastoral areas could be more fully utilised.

Secondly, large holdings would allow stricter controls on stocking rate to be exerted when compared to the current compassionate approach taken to smaller "struggling" landholders. Evidence exists (MacLeod 1990) that larger holdings are more likely to be able to afford to employ long term sustainable stocking rates, a critical factor in ensuring a reversal of land degradation in pastoral areas. Reductions in long term stocking rates could be imposed on aggregated areas much more justifiably than on the smaller less viable or non-viable areas.

In an Australian economy which will be much more market driven it appears as an imperative that the market place be allowed to determine the appropriate size of pastoral leases. Such a move will over time ensure the most efficient and effective long term economic units develop.

The environmental responsibility being demanded by society can best be ensured by this aggregation combined with realistic and consequently affordable stocking rate controls which could ensure a stop to land degradation and a gradual reversal of this trend while ensuring economically viable land use practices.

#### **FINANCIAL MANAGEMENT**

The lower returns to wool and mutton production likely over the next few years will put pressure to varying degrees on those landholders who are small in size or significantly indebted or both.

Lower interest rates have offered some relief, however, the capacity to generate capital repayments from present earning capacities is limited.

The most important management decision at present is to ensure that debt is refinanced under the best possible terms. For those with a viable enterprise, easily able to service their interest payments, private borrowing is now an attractive proposition. The margin between deposit rates and bank lending rates is high and private lenders can provide a significantly cheaper source of finance to secure borrowers than can generally be obtained from the banking system. Such borrowings are not suitable to all and do have some restrictions but should be considered as a possible alternative when refinancing.

Short term financial management options for pastoralists are limited. In the longer term there are significant benefits to be obtained from financial diversification through appropriate provision of working capital and off farm investments. The longer term extreme variability in earning capacity of pastoral enterprises demands that adequate provision should be set aside in profitable years to carry producers through lean price years or drought years. Indebted producers find this almost impossible to achieve.

The monitoring of financial performance is essential to obtaining an understanding of the relative performance of any enterprise compared to normal expectations. For producers to ensure long term viability in the current economic climate they should be above average in production/head, prices received, lambing percentage, weaning percentage and in cull sheep sales. Monitoring of these key production and price elements is essential if a businesslike approach is to be taken to pastoral enterprises.

#### **MARKET RESEARCH AND MANAGEMENT**

Most pastoral areas have a limited choice of enterprises with wool, mutton and beef in some cases the only choices.

Passive price taking has been and still is the normal expectation of most pastoralists.

With the wool market now exposed to free market forces and likely to remain so, producers are faced with making significant choices as to marketing systems which can best ensure optimum returns.

The wool market since June 1991, has already shown considerable volatility. Growers of wool do have a choice as to when they sell their wool. Monitoring of the wool market, combined with some research on past trends, will allow producers to determine if they are selling at a potential low point.

The Sydney Wool Futures Market has provided hedging opportunities over the last twelve months which could have secured from 50 to 100 cents more per kilogram clean to an astute marketer.

The price for the February 1993 contract has varied from 700 cents to 575 cents at time of writing. Given the stockpile and its likely impact on any price rise, seasonal increases in price should be seen as potential opportunities to hedge at least part of a clip.

In the era of market deregulation all producers will need to take greater responsibility to ensure they receive the best market price possible than was necessary under the reserve price scheme.

#### **ENVIRONMENTAL PRESSURES**

Concern for the preservation of our various environments is a worldwide phenomenon and will influence rangeland management policies to a greater degree in future years.

Pastoralists are undoubtedly vitally concerned to ensure long term sustainability of their holdings but are often forced by economic circumstances to stock at levels which lead to degradation of vegetation.

If society genuinely wishes to ensure that degradation is reversed then the economic size of pastoral holdings will need to be significantly increased.

The acceptance of corporate ownership of pastoral leases under strict environmental controls must be given serious consideration in developing new policies which can ensure environmental responsibility.

#### **CONCLUSIONS**

Changes to world economic conditions forcing the Australian economy to undergo a radical change to a world market oriented approach puts into question the suitability of present pastoral land ownership and management.

Deregulation of the financial system, the exchange rate and the wool market is impacting heavily on established practices and structures in pastoral areas.

If a genuine attempt is to be made to match the economic imperative of commercial land use with environmental responsibility, changes to the tenure restrictions of pastoral lands appears necessary. Much larger holdings would allow stricter controls on stocking rates to levels which would ensure land degradation was reversed.

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