Select Committee on Lending to Primary Production Customers

Department of the Senate

PO Box 6100

Parliament House

Canberra ACT 2600

Submission of the Citizens Electoral Council, registered independent political party.

16 June 2017

To solve the credit crisis that threatens Australia's primary producers and national food security, enact a moratorium on farm foreclosures, parity pricing, a national bank and Glass-Steagall

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Introduction

Australia's rural sector has contracted for decades. The raw numbers tell a terrible story: whereas census figures showed the nation had 194,000 primary producers in 1971, the CEC calculated that by 2010 the number of viable primary producers was no more than 40,000.

While numerous factors have contributed to this loss of primary producers, the rural debt crisis is foremost among them. In a 2013 submission to the Senate Economics Committee Inquiry into the RBA Amendment Bill to establish the Australian Reconstruction and Development Board, economist Ben Rees highlighted that in the same four decades, while the net value of farm production had increased from $1 billion in 1969 to $12 billion in 2011, rural debt, which was also $1 billion in 1969, had increased to more than $65 billion in 2011[1].

The debt crisis has intensified in recent years, resulting in a wave of foreclosures on primary producers. Rees attributes this to a post-2008 Global Financial Crisis shift in the policy of banks away from lending against equity to suddenly demanding that loans be repaid from farm income.

The CEC points to a fundamental structural problem in the banking system, which motivates banks to foreclose on primary producers. That is, that Australia's banking system is dominated by four Too-Big-To-Fail (TBTF) universal, or vertically-integrated, banks, which hold 80 per cent of deposits. Their TBTF status constitutes moral hazard, which tempts them to use their deposits to fund financial activities other than traditional lending, including increasingly risky speculative activities, knowing they will be bailed out in the event of a crisis. This has led to a massive distortion of the economy.

For more than a decade in Australia the banks have primarily speculated in the property market. This has gone far beyond normal lending, and is best characterised as speculation, because the banks have lowered their lending standards in order to justify loans to marginal borrowers. Prior to the GFC, the banks were increasingly dependent on low-doc and no-doc loans, which have been called Australia's sub-prime; since the GFC, and especially recently, banks have increasingly depended on making interest-only loans, and loans to investors, to grow their businesses, of which mortgages now account for more than 60 per cent (compared with just 22 per cent in 1990).

The big banks have been incentivised to speculate in the property market by APRA-approved risk weighting models, which stipulate the minimum capital requirement the banks must hold against different categories of loans. Until 2015 APRA allowed the Big Four banks and Macquarie to risk weight mortgages at 16 per cent, but in response to concerns expressed to the 2014 Financial System Inquiry (FSI), APRA raised the risk weighting of the

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[1] Rees, Ben. Rural Australia: the Path Forward, Submission to the Senate Economics Committee Inquiry into the RBA Amendment Bill to establish the Australian Reconstruction and Development Board, 2013.

big five banks' mortgages to 25 per cent. Even slightly raised, the risk weighting for mortgages is far below that of other types of loans, such as to small business and primary producers. This is an incentive for the banks to withdraw credit from other sectors of the economy, such as primary producers, to direct into more profitable mortgage loans. At the time of the 2014 FSI former ANZ Bank director and past chairman of Woolworths and the *Herald* and *Weekly Times* John Dahlsen attacked APRA's risk policies, and the banks' denying financing to business to focus on more profitable home loans. "I think there are sectors that are being left out", Dahlsen told ABC 7.30 on 12 April 2014. "The figures show quite significantly that whilst the mortgage loans have risen, the loans to small business and business generally have dropped."

With the incentive to speculate on the domestic property market, which is actually a bubble, the banks have become increasingly aggressive in foreclosing on primary producers. They have used various ploys to force the foreclosures, including asset revaluations by real estate valuation companies working for the banks, penalty interest rates, and the triggering of questionable loan covenants. In April 2013 a crisis erupted in Western Australia's wheat belt when at the start of the planting season the banks tried to force between 600 and 1,200 wheat growers off the land by refusing to finance that year's crop. At the time WA's 4,300 wheat growers were collectively carrying $12 billion in debt, on which they were paying 9 per cent interest. A wave of foreclosures ensued, but final numbers are unclear.

The dramatic loss of primary producers that Australia has suffered over recent decades is a clear threat to national food security. Only ideological extremists would claim that the loss of family farms does not matter because they can be replaced by corporate agribusinesses or by imports. Strong family farms are the backbone of a strong agricultural sector, as, unlike corporate agribusinesses, family farmers are committed to producing for the local market, to investment in their regions, and to land management.

It must also be acknowledged that primary production is not just another sector of the economy. Its output—food—is more important than many other sectors, especially the services sector. And while it is buffeted by the same economic conditions as all sectors, on top of that it has to deal with the weather. To ensure food security, it is incumbent on the government to prioritise primary production, by providing infrastructure and establishing a credit system that fosters the productivity of family farms. In this submission, the CEC presents a number of proposals to achieve this.

Moratorium on farm foreclosures

To stop the haemorrhaging of family farms, and to create space for the implementation of policies that can address the rural debt crisis, the federal government should declare an immediate moratorium on foreclosures of family farms. If necessary in the short term the government could borrow against its credit rating to allow farms to roll over debt at low interest. The government could also direct the banks to refinance loans, with the

Commonwealth as guarantor, rather than foreclose. Given the Commonwealth government guaranteed the banks in 2008 to the tune of hundreds of billions of dollars, there is no good reason *not* to also guarantee farmers, but there is a powerful moral reason to do so.

It is worth noting that with calls for either a royal commission or parliamentary inquiry into the banks, many of the banks' present practices, including their aggressive foreclosures on primary producers, could soon be called into question. A moratorium on foreclosures would save many farmers from becoming victims of an action that could soon be judged to be an injustice.

A public credit institution to finance primary producers, preferably a national bank

The centrepiece of the CEC's proposal is the establishment of a public credit institution to finance productive industries. While there are ways to ensure private banks direct more credit to industry (see Glass-Steagall, below), private banks will always put their own profits first, and cannot be relied upon to provide the volume of credit that primary producers and other industries require. As agriculture is more important than most other sectors of the economy, essential to national food security, the government must establish a credit mechanism that meets its needs. The government has a low-interest concessional loan scheme for primary producers, for debt relief and reconstruction, but at a few hundred million dollars per year it is wholly inadequate to address the $65 billion debt burden that is crushing Australia's primary producers.

Setting up such a credit mechanism is straightforward. Given that the Commonwealth already has the Clean Energy Finance Corporation to invest in so-called renewable energy, the government could quickly establish a similar corporation for making low-interest loans to primary producers.

The CEC however proposes a more comprehensive approach to solving the problem, which addresses the credit needs of all industries, not just primary producers—a national bank. Australia owes much of its economic development to a national bank, the original Commonwealth Bank. Established in 1911, the Commonwealth Bank provided credit for the Commonwealth government and the general economy during World War I, which was indispensable to Australia's war effort and economic survival. It gradually acquired more powers until it became a fully-fledged national bank in WWII, when it was central to the success of Australia's miraculous wartime economic mobilisation that not only met the needs of the war but also permanently transformed the economy into a high-skill, high-wage industrial powerhouse. The Commonwealth Bank retained its national banking powers until the establishment of the Reserve Bank in 1959.

The CEC has drafted legislation for a national bank called The Commonwealth National Credit Bank Bill (see Appendix I). It proposes a bank with eight divisions, including a Primary Industries Division: "Responsible for assessing the nation's need for credit to provide for the

costs of land, buildings, plant, machinery, other tangible items, and for working capital for the Primary Industries of the nation."

A national bank functions independently of the economic cycles of the financial system, and indeed has the effect of mitigating those cycles. It can supply credit when private credit is contracting and moderate credit when private credit is plentiful. More importantly, the national bank can direct credit to productive economic sectors and to nation-building initiatives that private banks are unwilling to finance, but which are crucial to Australia's productivity and economic growth. It would have the power of a central bank to create money, much as central banks have created trillions since the 2008 GFC through quantitative easing, but the national bank would direct that money as credit into productive industries and infrastructure, which would increase productivity and therefore not be inflationary. The government could also use the national bank to harness some of the $2 trillion that Australians have tied up in superannuation for investment in Australian industries and development, by issuing bonds that provide a government-guaranteed return on investment for superannuants, the funds from which the government would inject into the national bank to lend and invest.

By whatever mechanism the government chooses, it can and must provide public credit for Australia's primary producers, for the national interest.

Parity pricing

Deregulation and free trade have left Australia's family farmers at the mercy of the Coles-Woolworths retail duopoly, and of speculators who dominate, and often game, international commodity markets. Primary producers are consistently forced to take prices below cost of production, which has driven the massive expansion of rural debt.

The solution is parity pricing, as it operated in the United States during and just after WWII, when by legislation farmers were guaranteed a price that covered their cost of production. The US Congress legislated parity pricing to help the war effort, in two ways: to guarantee food security; and to boost national income. The architect of the scheme, Carl Wilken, proved that every dollar earned on farms generated $7 in national income—the highest multiple of any sector. Parity pricing worked so brilliantly that farm borrowing dropped dramatically, because the farmers were able to finance their crops and production from farm income; this is known as the Golden Era for US agriculture. The Congress scrapped the system in 1952 under intense pressure from the banks, which were getting less farm business.

Attached (Appendix II) is an address on parity pricing by US farm leader Frank Andres to the June 2013 San Francisco Schiller Institute Conference.

Parity pricing is not a subsidy, as the primary producers are the original creators of the wealth from which many interests, so-called "middle men", end up making lots of money. It

is a recognition that the original producers need enough of the final revenue generated from their production to stay in business.

A Glass-Steagall separation of Australia's banking system

As stated, Australia's TBTF universal, or vertically integrated, banks are able to use their deposits to fund activities other than traditional lending. This has distorted the economy, by leading to a property bubble that has sucked up almost all bank credit at the expense of farms and small businesses, and also placed bank deposits at risk.

Australia needs to implement a separation of the banking system modelled on the US *Glass-Steagall Act* of 1933. This would involve breaking up the Big Four banks into separate commercial banks with deposits, and, on the other hand, investment banks, insurance companies, wealth management firms, etc. This would protect deposits from being used to subsidise non-bank activities, including risky speculation in financial derivatives. The deposits would be reserved for traditional bank lending, which would make more bank credit available for primary producers and small businesses.

Conclusion

For too long Australia has been crippled by economic ideology, which seeks to apply economic rules and beliefs to crises rather than common sense solutions. These include the belief in the "market"—as if it is acceptable for Australia to lose all of its farmers if the "market" wills it—and the rule that governments should not be involved in banking.

To address the crisis of rural debt, so as to preserve our primary producers and secure national food security, Australia must abandon such ideology and embrace policies that work. The above proposals of the CEC all meet that criteria—they work.