

Pouring cold water on the drought



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Farmers, politicians and the media are doing their bit to exaggerate the crisis.

TALKING to farmers about drought is like talking to fishers about the one that got away. This one is always much bigger than those that went before. And since the hyperbole merchants told us the drought of 2002 was the biggest in 100 years, this one must be the biggest in 1000 years.

Yeah, sure. Thank goodness for the assessments of narky economists, who don't try to humour farmers the way ingratiating politicians and a superlative-seeking media do.

The Reserve Bank offered a dispassionate assessment of the likely severity of the drought in a statement last week. It's pretty bad, but not as cataclysmic as some would have us believe.

The severity of droughts can be judged in different ways. One way is to compare the share of the nation's prime agricultural land suffering deficient rainfall this year with previous years. By that measure this one seems less severe than the droughts at the time of Federation, in the 1940s and early 1980s and in 2002.

It's significant, however, that this drought comes so hard on the heels of the 2002 drought, thus limiting the opportunities for recovery in growing conditions and water storage.

One way to account for this factor is to take for each year the average degree of drought-affected land during the previous five years. Measured this way, the area of land with deficient rainfall in this drought is exceeded only by the drought of the mid-1940s.

A second way of judging the severity of droughts is to look at average rainfall. By that measure, rainfall this year is not as low as in many previous droughts.

But, again, if you switch from annual figures to the average rainfall for the previous five years you find that rainfall in the present drought is the lowest on record. So, by one measure at least, you can say it looks like being the worst we've seen. Phew, that's a relief.

This drought is worst in NSW, Victoria and southern Queensland. But some pastoral areas of northern Australia have experienced a significant increase in average rainfall over the past decade, including more recently. (You'll wait a long time before any bushie tells you that.)

Of course, judging the severity of a drought by looking at the lack of rain and the amount of area affected isn't the same as looking at the amount of lost agricultural production.



Using the latest forecasts from the Australian Bureau of Agricultural and Resource Economics, the Reserve judges that production of wheat and other cereals may be down by 60 per cent on last year. The biggest fall should be in NSW, though a substantial fall is also expected in the largest wheat-producing state, Western Australia.

Wool production is expected to be down 7 per cent, but the production of meat and growing of livestock are likely to be little affected. All told, gross farm product is expected to fall by 20 per cent in 2006-07 compared with last financial year.

So, in terms of impact on rural production, this drought is likely to be less severe than the 2002 drought, which saw farm product fall by 26 per cent.

Remember, however, that agriculture accounts for less than 3 per cent of total gross domestic product these days. So a 20 per cent fall in 3 per cent of the economy amounts to a subtraction of about 0.5 percentage points from growth in GDP.

Of course, that's just the direct effect of the drought. What about the indirect effects of farmers' reduced incomes and spending on the rest of the economy?

Farmers hate it when hard-nosed economists remind starry-eyed city slickers that, thanks to the huge growth in the services sector over the past 30 years, agriculture is now such a small part of the economy (about a quarter the size of our small manufacturing sector).

So rural lobbyists like to claim that agriculture has a big "multiplier effect" through the rest of the economy. I think I've heard it claimed that this takes the sector to the equivalent of 12 per cent of the economy.

Rubbish. All spending has a multiplier effect through the economy, not just spending by farmers. So this is a trick everyone can play. And if each industry similarly estimated its overall effect on the economy, the figures they gave would total way more than 100 per cent of GDP.

No. The Reserve Bank estimates the

drought's direct effect in reducing GDP growth by 0.5 percentage points rises to 0.75 percentage points when you include the indirect effect on other parts of the economy.

When you remember that real GDP has grown at an average rate of about 3.5 per cent a year, that loss is significant but not the end of the world.

The drought's likely effect on the economy's growth isn't the same thing as its effect on the incomes of farmers, of course. After allowing for inflation, net farm incomes are expected to decline substantially to around their lowest level in more than a decade.

But for many farmers there'll be a saviour. The Federal Government runs a farm management deposit scheme where farmers can reduce their income tax in good years by depositing some of their income. They then withdraw that money in bad years, pay tax on it and spend it.

The amount farmers have put away in

this scheme has grown strongly since 1999 and is now about \$2.5 billion, almost the highest it's been.

Why have our poor, struggling farmers been able to stash away so much? Because grain growers did so well from the large harvests of recent years, while beef producers did well from the earlier strength in cattle prices.

Another line we are hearing in the combined efforts of farmers, politicians and the media to give city slickers an exaggerated impression of the effects of the drought is that we're about to see big increases in food prices.

Nonsense. The effect on prices will be small. Why? Because, for instance, the cost of flour accounts for only a small part of the retail price of bread. And because, though grain prices rise during a drought, meat prices usually fall as more animals are sent to be slaughtered.

It'd be more sympathetic if there weren't so many people laying it on too thick.