

SUBMISSION TO THE PRODUCTIVITY COMMISSION INQUIRY INTO THE
IMPACT OF COMPETITION POLICY REFORMS ON RURAL AND REGIONAL
AUSTRALIA

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This submission reports on some findings of the authors' recent and ongoing research into the impacts of financial globalisation upon rural communities and farm families that we felt may be relevant to the Commission's deliberations. While this research does not specifically address the Commission's focus on National Competition Policy reform *per se*, we nevertheless feel that our findings offer some portents for the likely complex (and often unexpected) ways in which the Competition Policy reforms will affect the many and diverse rural economies of Australia.

Our submission is structured as follows. First, we present a brief recommendation in favour of a rigorous, *geographical* definition of rural Australia. Second, using the farm and rural sectors' experience of financial deregulation as an analogy for the potential impact of competition policy reforms on rural Australia, the submission addresses the Inquiry's first and third terms of reference. Two particular aspects of the deregulation of the financial system's impacts are discussed: its broad impact on farm credit markets and farmer/creditor relations; and its effects upon financial service delivery in rural New South Wales.

1. Defining Rural and Regional Australia

There is no one universally accepted objective definition of 'rural' or 'regional'. Indeed, both terms often tend to be bandied about in public discourse with little regard to any consistent and verifiable criteria. However, given that the Commission is inquiring into the potential for *National* Competition Policy reforms to impact differentially (i.e. more or less severely or favourably) in rural areas compared to metropolitan areas, then not just any definition will do. We believe that any rigorous definition of 'rural' must take account of one of the central defining features of rural and remote Australia: its relatively low population densities and concomitant high levels of inaccessibility to crucial public and private goods and services for selected communities. Fortunately, the Federal Departments of Primary Industries and Energy and Human Services and Health have produced just such a classification (DPIE and DHS & H, 1994). The Departments' Rural, Remote and Metropolitan Areas (RRMA) Classification uses population size and an index of remoteness

to categorise each Australian statistical local area according to its relative degree of remoteness.

The need for a rigorous geographical classification of rural and remote Australia is no minor academic quibble. Argent and Rolley (1998) used the RRMA Classification in their examination of the changing bank branch network in rural New South Wales from 1981 to 1998 to reveal that the Reserve Bank of Australia's (RBA) long-standing classification of bank branch numbers into 'metropolitan' and 'non-metropolitan' had actually served to disguise the degree of bank branch withdrawal from rural and remote New South Wales. A comparison of both classification systems – the RBA's 'metropolitan/non-metropolitan' split and the RRMA Classification – when applied to the NSW bank branch data found that the RBA's system overstated actual rural and remote branch numbers by between 300 and 350 over the study period (Argent and Rolley, 1998). Therefore, without a sufficiently meaningful and accurate classification of rural and remote Australia, there is a real possibility that important impacts of, and responses to National Competition Policy reform may be only partially recognised or, at worst, obscured.

2. Financial Deregulation and Rural Australia: Some Portents for National Competition Policy Reform?

In many respects, it is simply too early to be able to report definitively upon any geographically-specific impacts – positive or negative – of the National Competition Policy reforms. By the Inquiry's own admission, "... the bulk of the NCP reform task lies ahead" (Productivity Commission, 1998, 7). Nevertheless, some instructive and salutary points can be drawn from the long-run effects of a macro-economic reform analogous to the proposed competition policy programme: the deregulation of the Australian financial system in 1983. Two aspects of the financial deregulation's impacts on rural Australia are discussed briefly here: its broad impact on farm credit markets and farmer/creditor relations; and its effects upon financial services provision in rural and remote areas of New South Wales.

2.1 Financial Deregulation and the Farm Sector

This section of our submission addresses the Inquiry's first and third terms of reference:

“(a) the impact of competition policy reforms on the structure, competitiveness and regulation of major industries and markets supplying to and supplied by regional and rural Australia; ...

(c) possible differences between regional and metropolitan Australia in the nature and operation of major markets and in the economic and social impacts of the reforms promoted by national competition policy...” (Productivity Commission, 1998, 2).

Although there have been few detailed analyses to date of the impact of financial deregulation upon the farm sector, the post-deregulation era has been marked by a considerable unease in bank-farmer client relations. With the gradual abolition, privatisation or commercialisation of the wide array of public farm lending institutions and programmes, the major trading and savings banks developed their own financial products for the farm sector, seeking to meet the particular needs of farmers and agribusiness in the new regulatory milieu. For example, foreign currency loans were widely encouraged by banks and independent financial advisers in the early 1980s as the \$A was floated and the exchange controls on foreign currency borrowing were removed.

These loans were used relatively widely by large corporations, governments, semi-government bodies, importers and exporters prior to deregulation but required considerable financial expertise to manage successfully. This was particularly the case given the generally harmonious and trusting relationship between bank managers and farmers prior to this period. Many farmers preferred to concentrate on managing the farm's physical operations and left the financial management of the farm to their bank manager (House of Representatives Standing Committee on Finance and Public Administration (HRSCFPA), 1991, 276-277). The gap between many farmers' financial acumen and that required to manage the increased complexity of financial products following deregulation has often been pointed out, but the gap between the *appropriate* level of fiduciary duty owed by financial institutions to their farm clients in promoting such complex packages and the *actual* responsibility taken has also tellingly been revealed.

For instance, the merchant bank arm of the Australia and New Zealand Bank (ANZ Bank), ANZ McCaughan Ltd. has recently lost one important test case and settled out-of-court in another over its lack of fiduciary responsibility to its foreign currency loan clients. Both cases involved farmers from the South-East of South Australia taking up loans for the purchase of additional property, which subsequently "blew out" as the A\$ plummeted in relation to the Swiss franc during 1985 and 1986 (from \$850 000 in 1984 to \$1.7 million by 1986 (Stock Journal, 1995, 7) and from \$380 000 in 1985 to over \$1 million by 1991 (Megalogenis, 1995, 1) respectively.

Such was the level of public animosity towards the banks that a House of Representatives Standing Committee on Finance and Public Administration was formed in 1990 to address these community concerns. In reviewing the impact of financial deregulation on the farm and rural sector, the Standing Committee encountered a bewildering array of

accusations and counter-accusations. Farmers accused the banks of foisting credit upon them in a cavalier fashion; of adjusting the interest rate margins of farm borrowers without prior discussion or consultation with the client; of refusing to negotiate with financially-troubled borrowers and of being insensitive to the effects of bank branch rationalisation on local communities (HRSCFPA, 1991).

While deregulation did not immediately (nor necessarily) alter the roles of the various public farm financial institutions established by State and Federal Governments over the past 40 years, the logical extension of deregulation was, nevertheless, the gradual commercialisation and eventual privatisation of these institutions. The Commonwealth Development Bank, established in 1959 to encourage longer-term farm investment and development via the provision of credit to farmers denied capital elsewhere, was fully privatised in 1996 (Downey, 1996, 23). The Primary Industry Bank of Australia (PIBA) was created in 1978 by the Federal Government to help refinance long term loans, particularly for farm purchase. Ownership of PIBA was originally divided between eight trading state savings banks and the Federal Government, with the loan funds drawn from the Income Equalisation Deposit Trust Account (Hefford, 1985). PIBA was granted its own banking licence in 1987 (Powell and Milham, 1990, 242-243), but was sold to the Dutch agribusiness bank, Rabobank Nederland, in 1994.

Although little has subsequently been written about the demise of these public farm financial institutions and programmes, there is evidence to suggest that a residual demand exists for some form of institutional, secure, long-term and concessional finance, particularly for younger farmers and in times of severe financial crisis. While it is widely recognised that deregulation has facilitated the development of more innovative and flexible credit and saving products (HRSCFPA, 1991), recent proposals for a farmers' credit co-operative (Ambrose, 1994), calls for a public regional bank for South Australian agriculture (Hill, 1993) and the South Australian Farmers' Federation's proposal of a US-style farm mortgage corporation (Mitchell, 1993, 3) show that the creation of a commercialised and privatised credit market has not been in the interests of farmers as a class.

Research into the rural crisis on Kangaroo Island, South Australia has demonstrated that a new generation of Island farmers had been effectively discouraged or excluded from the farm succession process or from establishing a farm independently due to the difficulties in obtaining credit on suitable terms. The 'credit risk rating' policies of most financial institutions, adopted since financial deregulation, also disproportionately penalise younger,

less experienced farmers (Argent, 1998). To try and circumvent these factors and facilitate young farmers onto their own properties, the Brown Liberal Government of South Australia in 1994 established a 'Young Farmer Incentive Scheme'. While initially well-received, the Scheme was widely criticised for favouring already financially-secure farmers while offering little to young farmers who fell outside of financial institutions' lending criteria (Gale, 1994).

These trends are distinctly at odds with the forecasts made by many agricultural economists about the likely financial environment after financial deregulation. For example, Adams and Minnis (1982) contended that deregulation would ensure that agricultural credit was rationed more efficiently and would no longer be allocated on a non-price basis, and would force farmers to become more astute financial managers. Overall, Adams and Minnis (1982) concluded that deregulation would raise interest rates slightly on both loans and deposits, producing a small but negligible net cost to farmers.

Herr and Woodward (1983) arrived at similar conclusions to Adams and Minnis (1982) on the overall effect of deregulation on the farm sector. However, Herr and Woodward's (1983) more intensive analysis revealed that there would be significant proportions of winners *and* losers from deregulation because of the evolving importance of concessional farm credit from the early 1950s. Around two-thirds of all farm credit in the early 1960s was provided under some state-assisted programme: this proportion rose to around three-fifths by 1980-81. Herr and Woodward (1983) predicted that, with the repeal of state-backed finance mechanisms, those farmers reliant on such credit could be substantially affected. Herr and Woodward viewed this new era with some apprehension, conceding that credit would be rationed more efficiently, but that it would not be rationed more equitably, with large farmers more likely to benefit from this re-organisation.

Clearly, then, deregulation has not solved the many structural problems of the farm sector (as many of the deregulation's promoters forecasted it would), nor has it prevented the perceived need for government to intervene in the farm credit market to deal with periodic economic and social crises. While financial deregulation cannot of itself be said to have caused all the financial problems being experienced by heavily-indebted farmers, it has been fundamentally implicated in the ongoing farm and rural crisis in Australia.

2.2 Financial Deregulation and Financial Provision in Rural New South Wales

With regard to the level and degree of financial service provided to rural Australia following financial deregulation, Argent and Rolley (1998) have demonstrated that rural and remote areas of New South Wales have borne a disproportionately large share of the

rationalisation of bank branches that has occurred throughout the State over the past five years. The 'Other Rural Area' and 'Remote' zones of the RRMA Classification together contained half of the total 'non-metropolitan' NSW bank branches in 1981. However, localities in both zones that have become branchless since this time account for 64.2 per cent of all non-metropolitan NSW centres stripped of their bank branches (Argent and Rolley, 1998, 12). The argument from the banks is that branch closures need not (in fact *do not*) lead to the exclusion of rural customers or the imposition upon these customers of extra inconvenience and cost in accessing financial services because of the residual role of the Australia Post in rural areas as a provider of basic financial services and the increased availability of electronic delivery channels. However, given the relative paucity and reliability of the telephone network throughout rural and remote Australia; the generally high levels of resistance (particularly among the rural elderly (Joseph and Chalmers, 1998)) to, and security concerns about such electronic banking methods; and the inability of electronic delivery channels to process cheques or cash or Australia Post to handle business banking, the bank branch remains as the key financial service delivery point for most rural Australians. Evidence for this point can be found in the many rural communities who have actively attracted credit union branches via the joint Federal and State Government CreditCare scheme, and the smaller number who have invested their own capital to establish one of the Bendigo Bank's 'Community Banks' in their towns.

3. Conclusion

We recognise that the National Competition Policy reforms may vary so significantly – in intent, form and impact – from the 1983 deregulation of the financial system so as to render our foregoing analysis redundant. However, we believe that the example of financial deregulation's spatially-uneven effects is instructive for a number of reasons. First, the abolition of public loan programmes and institutions supporting the farm sector has increased the pressure on farm families to increase their scale economies amidst ongoing declining terms of trade, climatic fluctuations and the like. Given rural towns' historically high level of dependence upon the farm population (Smailes, 1979), these forces will affect (indeed, are) the social and economic viability of many rural service centres. Of course, there are many processes and events driving the trend towards larger farm sizes and the concomitant decline of the farm population, and it is almost impossible to single one out as a direct cause, but the

impact of National Competition Policy reform on rural areas is unlikely to be any different to financial deregulation in this sense.

Second, via the increased competition within the banking sector and an apparently deliberate strategy of 'regionalising' service delivery by the banks (see Argent and Rolley, 1998), many rural consumers have lost access to vital financial services. The loss of bank branches in many rural New South Wales towns has underlined rural communities' comparative disadvantage (in terms of relative inaccessibility to vital goods and services) and their vulnerability to marginalisation through highly centralised corporate decision-making.

The corollary of these remarks is that it is not sufficient to leave equitable service provision in rural areas to the private sector alone, or to the long-run effects of major macro-economic structural reform. Most parts of rural Australia lack the necessary population densities and technical and transport linkages to provide the full range of goods and services that metropolitan Australia take for granted. Given the substantial loss of public and private services which rural communities have experienced over the past decade, our contention is that many rural residents would prefer and probably benefit materially and emotionally from a decline in the level of competition in the banking sector if this meant simply maintaining reasonable access to what service they have.

In summary, rural Australia suffers from such problems of inaccessibility that it is difficult for many services to attain commercial economies of scale, let alone support a variety of providers of the same service for residents to choose from. This implies that some form of government intervention is (and indeed, has been) necessary if rural communities are to provide their residents a suite of services comparable with the rest of society. If those responsible for the implementation of National Competition Policy are not cognisant of this fact, there is a real chance that the proposed competition reforms will lead to an enervation of rural and remote economies and communities and a further concentration of economic power in metropolitan areas. We are encouraged by the Commission's apparent desire to learn more about the geographically-specific and –sensitive nature of major regulatory change, and hope our submission is a positive contribution to the Inquiry.

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