



Australian Government
Productivity Commission

The Productivity Commission

Inquiry into Government Drought Support

Draft Report at a Glance

Review of National Drought Policy

Australian Ministers for primary industry have agreed that:

“current approaches to drought and Exceptional Circumstances are no longer the most appropriate in the context of a changing climate.”

Ministers have asked for three reports:

- BoM-CSIRO – which forecasts higher temperatures and more frequent periods of exceptionally low rainfall for many agricultural districts
- Expert Social Panel – which has reported on its assessment of the social impacts associated with drought
- Productivity Commission – inquiry into government assistance for drought events

Productivity Commission Draft Report

This brochure sets out the key findings of the Draft Report.

The Commission:

- is seeking your views on these draft findings
- will hold further meetings in November and December 2008
- will present the final report to the Commonwealth Government at the end of February 2009.

Turn to the back page for details on how to send us your views.



The Commission's Draft Findings in a Nutshell

Many Australian farmers and rural communities are experiencing hardship as a result of a severe and prolonged drought. While this is not new to dryland farming, the 'irrigation drought' is uncharted territory.

Drought has always been part of Australia's agricultural landscape, but there appears to be worse ahead. A minority of farm businesses need to be even better prepared and farming families in hardship will continue to need help. Government programs need rebalancing – to help build a more self-reliant and innovative sector – instead of mainly focussing on emergency support.

The business of farming is challenging, requiring an ability to deal with many risks – whether those risks be related to climate variation and change, input costs, commodity prices, exchange rates or other forces.

To be successful, farm businesses need a strong capital base – good natural and physical infrastructure, a sound balance sheet and up-to-date skills. Governments should help farmers build that capital by:

- providing the information they need about their local climate, the latest agricultural research and the extension of that knowledge to their own farms, and
- enabling them to operate a tax-deferred deposit account for their financial risk management.

Farming families in hardship need help, irrespective of whether the cause of their hardship is drought or other factors.

Governments should help all farm families in hardship. Given that such hardship may be short-term and recognising the issue of farm viability, a new income support scheme should be designed for farmers' circumstances:

- an asset test should involve a higher threshold than those in the general community safety nets
- an activity test should focus on helping farmers to understand their options and improve their situation
- services should be available that help farmers to: access counselling when needed; draw on community support; better understand their farm's viability and their future in farming.

Australia's farmers have a long history of innovation. They are also resilient – farm production has always bounced back after drought.

You are invited to provide feedback on this draft report and help shape the Commission's final recommendations on how government support can best help farmers to manage climate variability and other challenges that lie ahead.

Mike Woods
Commissioner

Dr Neil Byron
Commissioner

Bob Granger
Associate Commissioner

30 October 2008

Drought in Australia

Australia has one of the most variable climates in the world.

Whereas drought is a recurring feature for dryland farmers, the current 'irrigation drought' is uncharted territory.

Droughts can have devastating social and financial impacts on many farmers and their local communities, as well as adverse environmental effects.

The current drought, with especially low rainfall in 2002 and 2006, is comparable to the Federation Drought and the drought of the 1940s. Other widespread droughts have occurred in 1982 and 1994.

Droughts reduce Australia's economic growth in the short term through their effects on agricultural production and employment.

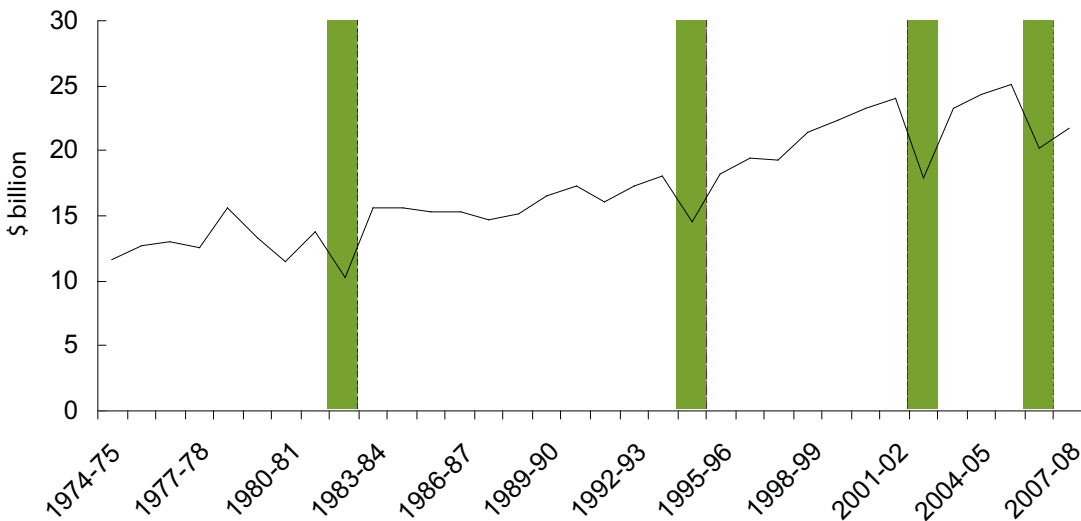
But despite the impact of drought, agricultural output has continued to grow. After each drought, production has consistently recovered and reached new record levels.

Agriculture has achieved annual productivity growth of 1.8 per cent over the last three decades – well above the market sectors overall average of 1.1 per cent.

This productivity growth has been associated with a trend to fewer, larger farms with fewer people employed in farming.

During the current drought, most farmers have managed without assistance. In 2007-08, only 20 per cent of all farms received drought assistance – totalling over \$1 billion.

Agricultural output, 1974-75 to 2007-08 (2005-06 prices)



Exceptional Circumstances Programs

The programs

Drought relief programs are delivered under the National Drought Policy (NDP). The NDP sought to help build greater self-reliance, but also allowed for emergency payments in times of severe droughts – giving rise to Exceptional Circumstances (EC) declarations.

The current EC programs include:

EC Relief Payments – provided to households that meet the financial hardship criteria in EC declared areas.

EC Interest Rate Subsidies – provided to businesses in EC areas that are deemed viable in the long term, but which are in financial difficulty.

EC Exit Package – retraining, relocation and one-off grants to those wishing to leave the industry.

Some state and territory governments also subsidise the transport of livestock, fodder and water.

Emerging support for change

Australia's primary industries Ministers, BoM-CSIRO and the Expert Social Panel have all put forward a case for change – droughts are likely to be more frequent and government assistance needs to be rebalanced.

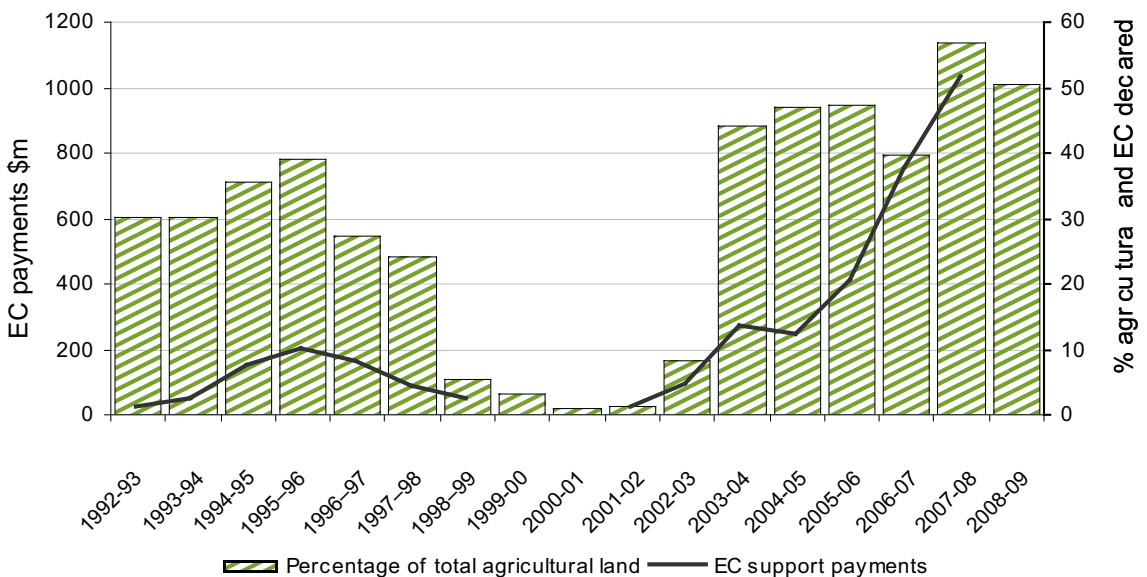
Farm groups such as the Victorian Farmers' Federation supported a new approach:

“We believe that the current system has served the farm, wider rural and Australian communities well. But in a world of rapid change in markets, community and environmental pressures and particularly climate, a new approach is needed.”

While some have supported the status quo, many submissions to this inquiry have revealed a ‘grassroots’ mood for change with a number of individual farmers expressing concerns about the current schemes.

EC declared area and total EC support payments

(Includes payments to farm households made through the former Drought Relief Payment)



EC Relief Payments (ECRP)

The experience

ECRP has helped many farm families cope with financial hardship brought on by drought. In 2007-08 around 29 000 farmers received payments, totalling close to \$380 million.

Around 10% of farm families have been supported for over 5 years. Compared with those receiving support, farmers in EC areas who managed without support had higher incomes from:

- net cash from their farm
- off farm wages and investments.

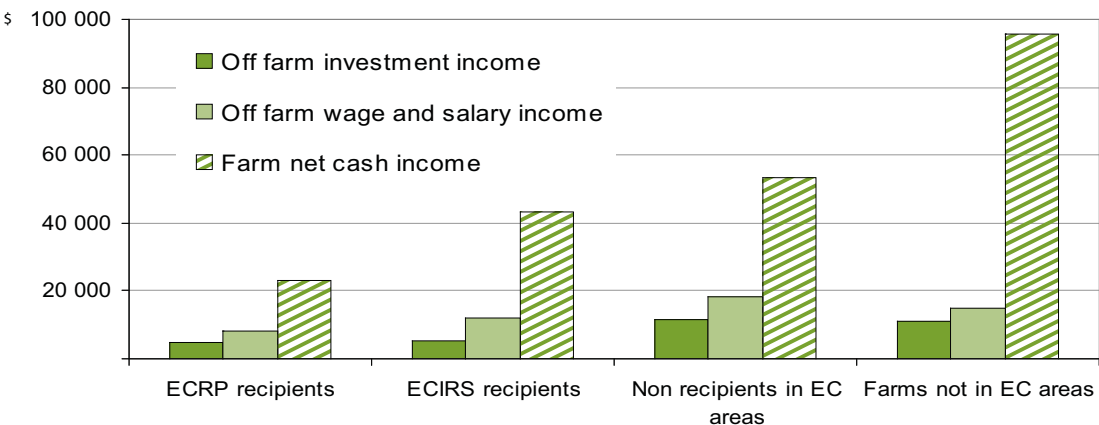
But the program is limited to those in EC areas. Recipients have no limits on the net value of farm assets, can earn off farm income and have no mutual requirements beyond their farming commitments.

Key features of an alternative

The Commission is proposing a temporary income support scheme which:

- is not limited to EC areas
- recognises that hardship can be a result of more than just drought
- does not require farmers to prove the cause of their financial hardship
- sets an asset cap that recognises the issue of farm viability
- allows farmers to choose actions to improve self-reliance and preparedness, that are relevant to their individual circumstances
- is subject to six monthly reviews and payment acquittal
- is time limited, to avoid long term dependency.

Income of recipients and non recipients: average 2002-03 to 2006-07



PRODUCTIVITY COMMISSION DRAFT RECOMMENDATION

The current EC relief payment scheme should conclude by June 2010.

From July 2009 all farmers facing hardship should have access to temporary income support designed for farming circumstances, at Newstart income levels, subject to:

- an asset cap, inclusive of the farm home, beginning at \$2 million with a taper
- a liquid asset sub-cap of \$20 000
- independent financial advice on the viability of the business
- developing and carrying out a plan of action to improve self-reliance
- eligibility being reviewed, payments acquitted, plans updated, every six months.

The scheme should be limited to a maximum claim of three years out of seven.

Those considering leaving farming should be assisted with counselling, training suited to earning off farm income and the recognition of prior learning.

EC Interest Rate Subsidies (ECIRS)

The experience

For recipients, the ECIRS has been valuable in addressing a short term liquidity crisis during drought.

The number and value of payments has increased rapidly over the last 3 years, in part due to an increase in the maximum payable to \$500 000 per farm and raising the off farm asset cap to \$750 000 (all farm assets are exempt from the cap).

In 2007-08 close to 17 000 farmers received interest subsidies, totalling around \$620 million.

Compared to those receiving the subsidy, farmers in EC areas who managed without support had a stronger capital base, with:

- higher levels of liquid assets
- lower farm business debt.

Support is also provided to farm dependant rural small businesses with the aim of maintaining rural communities, but this has had limited uptake.

Assessment

While ECIRS recipients have a weaker capital base, average equity of recipients still exceeds 80 per cent of farm value.

To get ECIRS, farms must demonstrate long term viability, and yet evidence from banks is that they have continued to provide finance to viable farms.

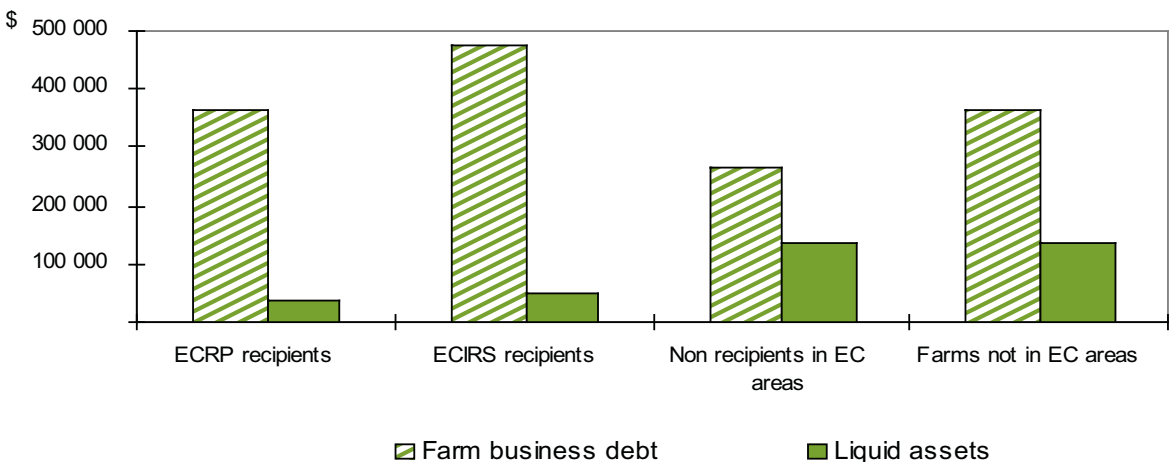
The scheme is not directed to achieving greater self-reliance or preparedness – there is no requirement to improve farm management practices. Assisted farms often continue ‘business as usual’.

The scheme can act as a disincentive for some to build their capital base as a hedge against drought.

This suggests that there is scope to shift the focus of business support away from emergency payments towards pre-emptive programs.

Maintaining rural communities through the provision of periodic drought support payments is not the best approach to achieving these outcomes.

Liquidity and debt of recipients and non recipients: average 2002-03 to 2006-07



PRODUCTIVITY COMMISSION DRAFT RECOMMENDATION

EC interest rate subsidies should be terminated, with the last year of eligibility for those in EC declared areas being 2009-10.

EC Exit Package and Transport Subsidies

EC Exit Package

As of September 2008, only 75 farmers across Australia had used the exit package. Many others were not successful because they were not full time farmers or because their net assets were too high.

While the EC exit package has elements focused on training and relocation assistance, it has failed to address the non-financial reasons why many do not want to leave their farms:

- it is the family home and part of the local community – often for generations
- there is no recognition of skills that can lead to other employment
- there is often a lack of awareness of, and anxiety about, alternative lifestyles.

Transport Subsidies

Transport subsidies are popular with recipients and extensively used in Queensland and New South Wales. In New South Wales alone, around 1 in 6 farmers had accessed payments.

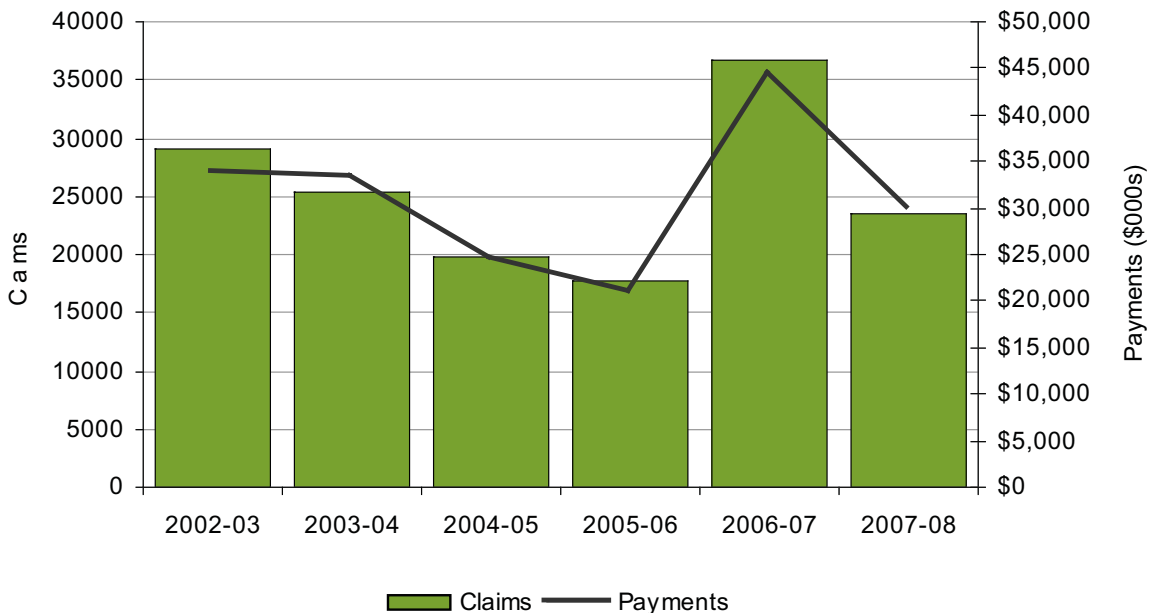
Transport subsidies have created a number of problems of their own.

The subsidy can be absorbed in higher transport and fodder costs, thus impacting on those who do not receive the subsidy.

They have the potential to create negative environmental outcomes by retaining stock on the land for too long during a drought.

States and territories have previously agreed to end transport subsidies but some have not done so.

Transport subsidies: 2002-03 to 2007-08



PRODUCTIVITY COMMISSION DRAFT RECOMMENDATION

EC Exit Package should not be continued after applications close in 2009.

States and territories should, as previously agreed, terminate transactions-based subsidies, effective by 30 June 2010.

The EC Declaration Process

The experience

As at June 2008 more than half of all Australia's agricultural land was EC declared, with some areas declared for 13 of the past 16 years.

Most farmers in EC areas manage without assistance. From 2002-03 to 2006-07, on average more than 70 per cent of dairy and broadacre farmers in EC areas received no drought assistance.

EC declaration does send a message to the wider community that farmers in the area are doing it tough.

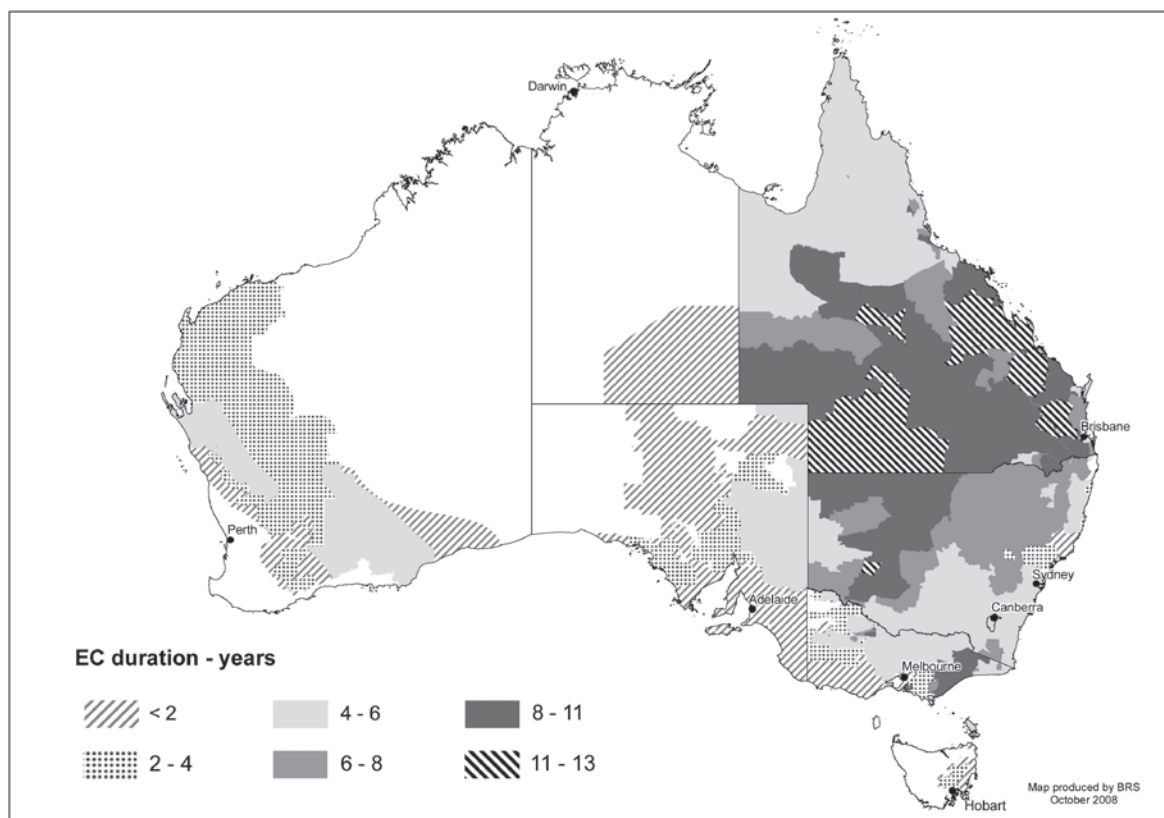
Assessment

The process has failed to limit EC declarations to those areas experiencing rare drought events where even the most prudent farmer would be unable to manage.

Lines on maps fail to recognise the needs of those in similar circumstances outside the EC area, and exclude them from assistance programs – creating divisions within communities.

The process has built-in incentives to maximise the area declared and lacks transparency.

Frequency of EC declarations (1992 – 2008)



PRODUCTIVITY COMMISSION DRAFT RECOMMENDATION

The Exceptional Circumstances (EC) declaration process should be terminated. No new areas, full or interim, should be 'declared' and current declarations should cease by 30 June 2010. In areas that remain declared, recipients of EC assistance should continue to receive assistance until declarations terminate, but not beyond 30 June 2010.

Preparing Financially for Drought

The Commission believes that government drought support for farm businesses should shift away from reactive emergency payments to programs that foster greater self-reliance and preparedness.

Maintaining Farm Management Deposits (FMDs) provide one means to do this.

FMDs enable farmers to deposit up to \$400 000 of pre-tax income for later withdrawal. In June 2008 there were 40 000 farm management deposits with an average of \$70 000 per holding.

FMDs have encouraged some farmers to save during periods of higher income for use in response to drought events.

FMDs have been criticised as being a measure used to defer tax.

Assessment

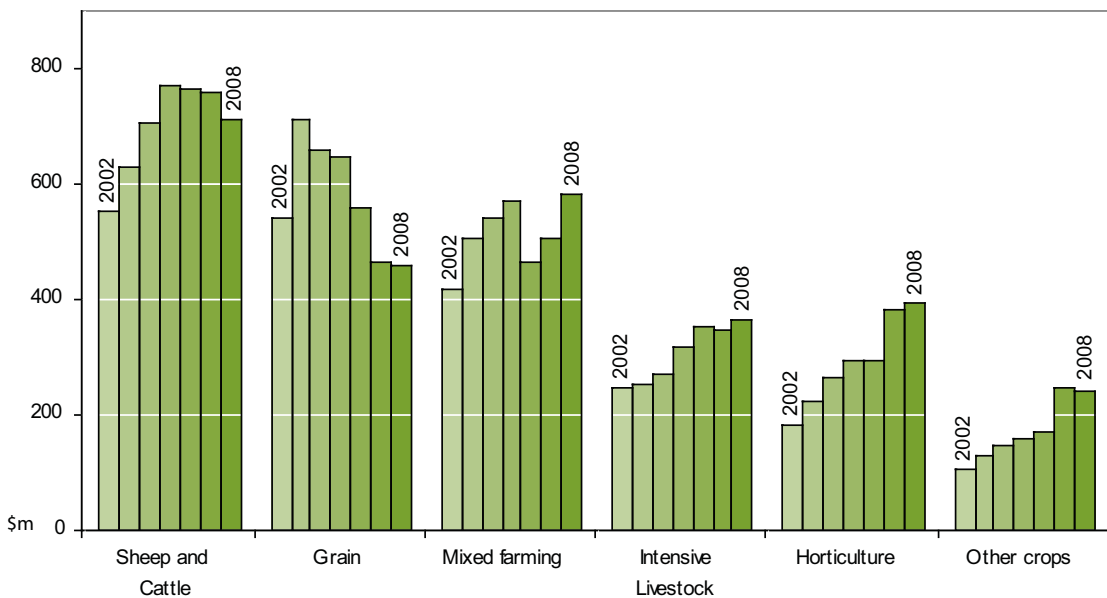
An analysis of FMD use suggests they have played a positive role in encouraging self-reliance and preparedness.

FMDs have been progressively drawn down by grain growers as the current drought has continued.

Livestock farmers have deposited the proceeds from destocking during the drought into FMDs, to be drawn on when pastures improve.

Non-recipients of assistance in EC areas have higher FMDs than recipients.

Total Farm Management Deposit holdings: 2002 to 2008



PRODUCTIVITY COMMISSION DRAFT RECOMMENDATION

The Farm Management Deposits scheme should be retained with its current cap of \$400 000 and no widening of its eligibility criteria.

Building Capacity to Manage Drought

There are other ways that government can assist farmers to improve their capacity to prepare for and manage drought.

Research is being undertaken to better understand the impact of climate variability and climate change.

Rural financial counsellors provide objective advice in some communities and act as a referral point for other services.

Self-reliance and preparedness is enhanced through the provision of well targeted grants for training that provide benefits for individuals and the wider community. The former FarmBis training program was received positively by many.

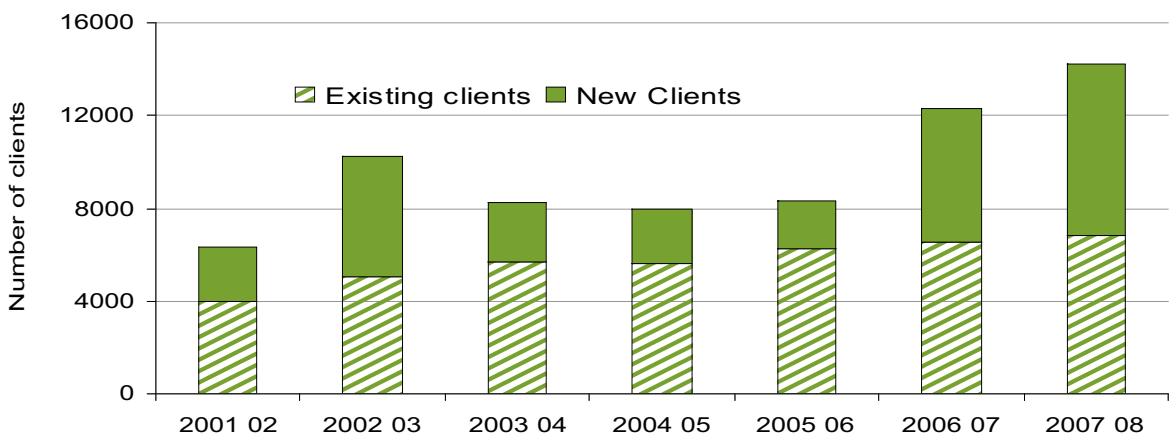
Potential for improvement

Significant effort should focus on applied climate and weather research that is directed at farm risk management, and is understandable.

Referrals by rural financial counsellors to other services may not always be occurring when necessary, and this should be reviewed.

Significant public funding should be directed to building the positive features of FarmBis into the Farm Ready initiative. The revised program should encompass advice and training for managing climate variability and for farm business management.

Rural Financial Counsellor client numbers



PRODUCTIVITY COMMISSION DRAFT RECOMMENDATION

Significant public funding should be directed to R & D and extension to assist farmers prepare for, manage, and recover from the impacts of climate variability and change.

Several features of the rural financial counsellor scheme should be reviewed, including impediments to private sector provision and the level of referrals to other services.

Significant public funding should be directed to a continuous learning program, incorporating the successful elements of the former FarmBis within the Farm Ready platform. The revised program should encompass advice and training for managing climate variability and for farm business management. Funding should be by way of subsidy and recipient contributions.

What to know more?

The full draft report including key points and overview is available on the Commission's website at www.pc.gov.au

To have your say

Submissions can be made:

By email: droughtreview@pc.gov.au

By fax: (03) 9653 2305

By post: Government Drought Support Inquiry
Productivity Commission
Locked Bag 2, Collins St East
Melbourne Vic 8003

All public submissions will be available for reading and download from the inquiry website at www.pc.gov.au/inquiry/drought

Contacts

For administrative matters:

Yvette Goss: (03) 9653 2253

For other matters:

Rick Baker: (03) 9653 2146

Freecall number: 1800 020 083

Telephone Typewriter (TTY): 1800 803 344

Key dates

Public hearings for draft report

November-December 2008

Final report to Government

27 February 2009