
OVERVIEW

Key points

- Many Australian farmers and rural communities have been experiencing hardship from the latest severe and prolonged drought. While this is not new to dryland farming, 'irrigation drought' is uncharted territory.
- Australia has always had a variable climate, with drought being a recurring feature. Looking to the future, experts predict higher temperatures and, for some regions, more frequent periods of exceptionally low rainfall.
- Most farmers are sufficiently self-reliant to manage climate variability.
 - In 2007-08, 23 per cent of Australia's 143 000 farms received drought assistance, totalling over \$1 billion, with some on income support continuously since 2002.
 - In drought declared areas, most farmers manage without assistance. From 2002-03 to 2007-08, on average, about 70 per cent of dairy and broadacre farms in drought areas received no drought assistance.
- The National Drought Policy's (NDP) Exceptional Circumstance (EC) declarations and related drought assistance programs do not help farmers improve their self-reliance, preparedness and climate change management.
 - EC interest rate subsidies and state-based transactions subsidies are ineffective, can perversely encourage poor management practices and should be terminated.
 - EC household relief payments are limited to those in drought-declared areas, ignoring hardship elsewhere or for other reasons. They should be replaced.
 - The EC declaration process is inequitable and unnecessary. It should not be extended to new areas. Current declarations should lapse as soon as practicable.
- Governments need to commit to a long term reform path that recognises that the primary responsibility for managing risks, including from climate variability and change, rests with farmers. To this end:
 - research, development, extension, professional advice and training to improve farmers' business management skills and build self-reliance warrant significant government funding where they deliver a demonstrable community benefit.
 - Farm Management Deposits, notwithstanding their use for tax management, have encouraged farmers to save and to be more self-reliant, and should be retained.
 - policies relating to water, natural resource management and climate change, which all impact on farm businesses and local communities, are often at cross-purposes and need to be better coordinated and integrated.
 - all farm households in hardship — regardless of cause or location — should have access to an income support scheme that is designed for farming circumstances.
- Similar recommendations from the previous reviews of the NDP have not been adopted. To ensure that this new policy direction is credible and enduring:
 - the NDP should be replaced with extended objectives for Australia's Farming Future.
 - an intergovernmental agreement with independent monitoring and financial incentives for complying with agreed commitments should be established.

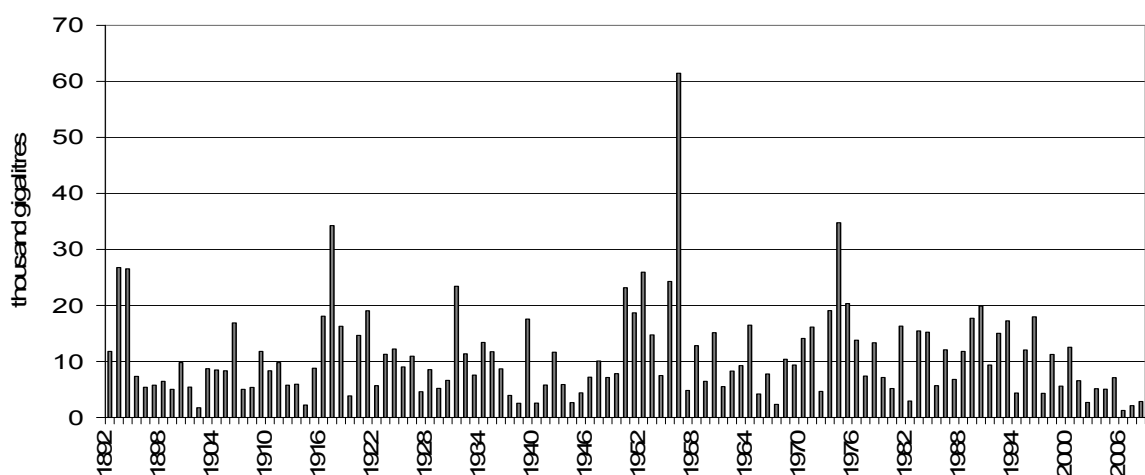
Overview

Droughts can have devastating social and financial impacts on farmers and their communities, as well as adverse environmental effects. Australia has one of the most variable climates in the world, with wet years, and even wet decades such as the 1950s, contrasting with dry periods. In terms of rainfall in south-western, southern and eastern Australia, the latest drought has been severe and prolonged, and has been compared with the Federation drought and the drought of the 1940s. One difference this time is that it has been hotter — by about one degree Celsius.

Another significant feature of the latest drought is its impact on many irrigators, especially in the Murray-Darling Basin. Severely reduced water allocations that have occurred in the last three years represent uncharted territory as low rainfall has interacted with policy failure. The river system is grossly over allocated.

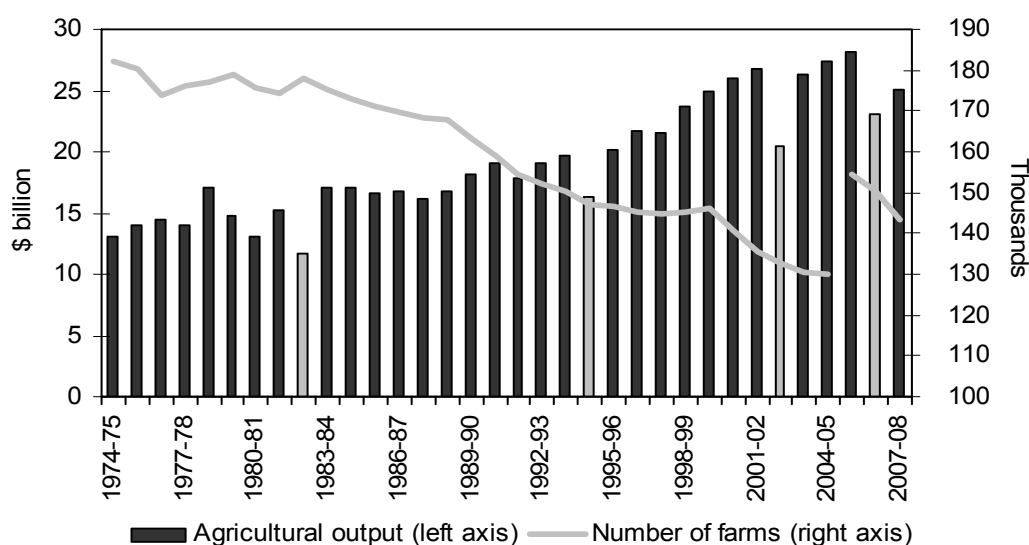
The variability of Australia’s climate, and the frequency of droughts, is reflected in Murray system inflows over the last century (figure 1).

Figure 1 Murray system inflows (including Darling), 1892 to 2008



Given the frequency of drought, it is easy to overlook that the Australian agriculture sector is highly successful. It leads domestic productivity growth, is an innovative adopter of technologies, and has proved resilient to myriad forces of change. For example, despite facing long-term pressure on commodity prices and rising input costs, sectoral output continues to increase — with more than half of that exported.

Figure 2 **Agricultural output and farm numbers, 1974-75 to 2007-08**



Agricultural output is value added in 2006-07 prices. Comparable time series data on farm numbers are not available after 2004-05, and so Australian Taxation Office business numbers are used. Light shaded bars indicate drought years.

The rural sector has always adjusted to changing circumstances, including drought which is one of many risks inherent in farming. In the main, this adjustment occurs autonomously through the independent decisions of farmers and others. Resilience to the impacts of the droughts of 1982, 1994, 2002 and 2006 is demonstrated by agricultural output (figure 2). Indeed, although 2002 to 2007 is regarded by many as one long drought, it includes three of the four highest ever years for total agricultural output. Moreover, notwithstanding the severity of the latest extended dry period, in 2007-08 only about 23 per cent of farms received drought assistance.

This sectoral success masks a complex story of diversity and contrasting fortunes:

- in 2005-06, the largest 30 per cent of farms generated 82 per cent of the value of agricultural operations, whereas the smallest 50 per cent generated 7 per cent
- as a group, the bottom 25 per cent of broadacre farms has not recorded a profit in any year from 1988-89 to 2007-08.

Farm performance is strongly correlated to vulnerability to drought. Apart from local climatic circumstances, how drought affects farming families and farm businesses depends on farm management practices, the degree of income diversification and the store of capital that farmers can draw on — the natural and physical capital of their farm, their financial and human capital and that embodied in their social networks.

The National Drought Policy

Governments' responses to droughts are guided by the National Drought Policy (NDP). Adopted in 1992, the NDP is based on a recognition that drought is a recurring feature of the climate. Its objectives, which correspond to phases associated with farming in a variable climate — preparedness before drought, managing and coping during drought, and recovering after drought — are to:

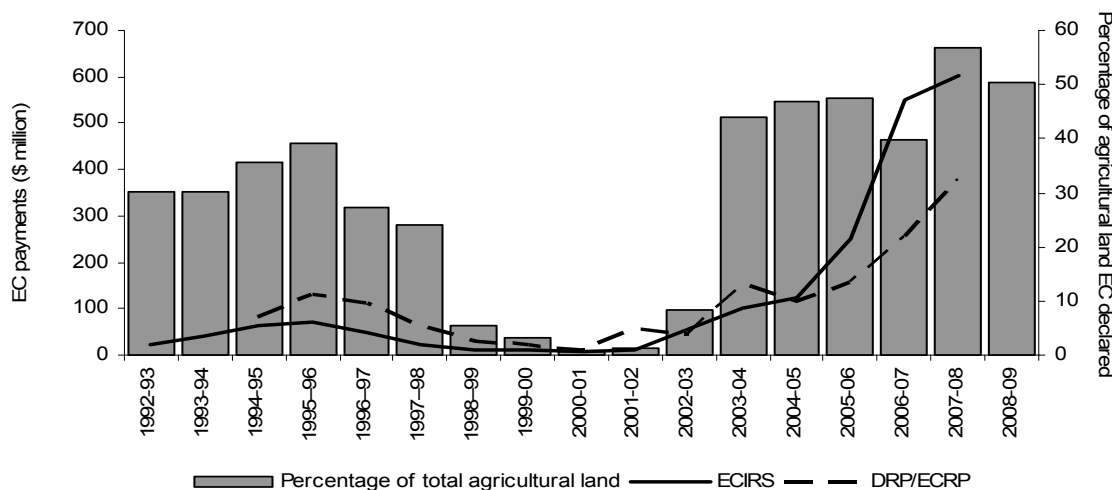
- encourage primary producers and other sections of rural Australia to adopt self-reliant approaches to managing for climatic variability
- maintain and protect Australia's agricultural and environmental resource base during periods of extreme climate stress
- ensure early recovery of agricultural and rural industries, consistent with long-term sustainable levels. (Crean, Minister for Primary Industries and Energy 1992)

In contrast to its objectives, the NDP's programs focus on providing relief primarily to farm households and farm businesses suffering hardship during severe drought.

To be eligible for assistance, a farm must be in an area declared as being in Exceptional Circumstances (EC) — the 'trigger' — and satisfy the eligibility criteria of the individual programs:

- The *EC Relief Payment* (ECRP) provides up to \$405 per fortnight each for the farmer and partner. While the payment is equivalent to that provided to unemployed people in hardship under Newstart, the ECRP's assets and income thresholds are more generous. In 2007-08, around 29 000 farm families received payments at a cost of approximately \$380 million (figure 3) — by the start of 2009, this had fallen to around 20 000 families.
- *EC Interest Rate Subsidies* (ECIRS) are provided to farm businesses and farm dependent rural small businesses that are in financial difficulty but deemed viable in the long-term. A subsidy of up to 50 per cent of the interest payable on loans (excluding recent property purchases) is provided in the first year and up to 80 per cent in subsequent years. Recipients' payments are capped at \$500 000 over five years. Total ECIRS payments have grown substantially to around \$604 million in 2007-08 (figure 3). In that year, average payments of around \$37 000 were made to about 16 000 recipients.
- The *EC Exit Package* is available for farm businesses whose owners are willing to leave the industry. This little used package (around \$10 million has been paid since 2007) consists of an Exit Grant, which provides a taxable one-off payment of up to \$150 000, an Advice and Retraining Grant, and a Relocation Grant.
- Other EC programs include a *Professional Advice and Planning Grant* scheme and a *Small Business Income Support* scheme.

Figure 3 EC declared area and total EC support payments, 1992-93 to 2008-09



DRP/ECRP includes payments to farm households made through the former Drought Relief Payment (DRP).

Review of drought policy

There is a mismatch between the NDP’s policy objectives and its programs. From its inception, policy has ostensibly centred on helping farmers build their self-reliance to manage climate variability and preparedness for droughts. Program expenditures, however, have not been directed to this end but have mainly flowed as emergency payments to a minority of farmers in hardship and to stressed farm businesses. The National Farmers’ Federation submitted that:

Committing to a long-term drought policy is vital to securing an agricultural base that is resilient to a changing climate ... one of the dangers of the government’s current Exceptional Circumstances policy package is that it includes policies which, while bearing an impact on drought management, primarily target other objectives. (sub. 51)

Ministers with responsibility for primary industries consider that the current approaches to drought are no longer the most appropriate. They have concluded that policy must be improved to create an environment of self-reliance, preparedness and adoption of climate change management practices. These views are echoed in governments’ submissions (box 1).

Given these concerns, Ministers’ asked for three reports. The first two — from Bureau of Meteorology–CSIRO and from the Expert Social Panel — were completed in 2008 (box 2). The Commission’s report completes the series and:

- reports on the appropriateness, effectiveness and efficiency of governments’ business and income support measures to help manage drought

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- identifies impediments to improving self-reliance and preparedness for periods of financial difficulty
 - identifies the most appropriate, effective and efficient responses by governments to build self-reliance and preparedness to manage drought.

Box 1 Governments' views on the NDP and self-reliance

Victorian Government

While the objective of the NDP is to promote self-reliance in farm risk management by (appropriately) shifting more of the risk burden of drought events from taxpayers onto farmers, there are questions whether the EC provisions and associated government payments have been undermining farmer's incentives to do this. (sub. 110)

Western Australian Government

Collectively the money spent, over the past decade on Exceptional Circumstances ... could have, arguably, been better spent on bolstering public sector research and development, and building farm business and financial management capacity ... (sub. DR186)

South Australian Government

While the current suite of national drought support programs has assisted many businesses and families in need, they will not facilitate the level of reform required to meet these new and emerging challenges [of climate change]. A new approach is required. (sub. 91)

Tasmanian Department of Primary Industries and Water

The current assistance programs are proving to be disincentives for self reliance and drought preparedness strategies because safety nets are there to help farming businesses through difficult periods. (sub. 85)

Most farmers manage without EC assistance

The concept of EC was developed for droughts of such severity that they would be 'beyond the ability of even the most prudent farmer to manage'. And yet, during 2007-08, nearly half of Australia's dairy and broadacre farms in drought-declared areas did manage without EC assistance. Over the six years to 2007-08, on average nearly 70 per cent of these farms managed without EC assistance (table 1).

Overall, of the 143 000 farms in Australia (with an estimated value of agricultural operations of \$5000 or more), only 23 per cent received EC support in 2007-08. Farmers in EC declared areas who did not receive support were generating higher farm net cash incomes, had higher off-farm investment income to draw on and were earning more off-farm wage and salary income (figure 4).

The analysis of farm liquidity and debt tells the same story. Unassisted farmers in drought areas had higher liquid assets than those on EC support in the same areas, and had the lowest debt levels (and interest payment obligations) of all groups of farmers.

Box 2 Climate science and the social impacts of drought

The BoM-CSIRO report

The joint assessment by the Bureau of Meteorology (BoM) and CSIRO reports:

- the extent and frequency of exceptionally hot years have been increasing and this is projected to continue, with exceptionally hot years likely to occur every one to two years, on average, over the period 2010–2040
- while trends in rainfall are highly dependent on the period of analysis due to large inter-decadal variability, exceptionally low rainfall years are projected to become more frequent in southwest Western Australia, the South Australian agricultural region, Victoria and Tasmania
- exceptionally low soil moisture is projected to become more frequent in line with the projected increase in exceptionally low rainfall years.

The Expert Social Panel report

The Expert Social Panel consulted widely across the country and found:

- there is widespread distress in drought-affected rural communities and too many farm decisions are made under stress
- while it is hard to separate the social impacts of drought from long-term trends contributing to decline in some rural populations, drought adversely impinges on the wellbeing of farm families and communities
- policy needs to address the social needs of farm families, rural businesses and communities in ways that do not inhibit the efficiency of agricultural industries
- the connection between the farm as a place of work, residence and family tradition has important implications for the effectiveness of institutional support.

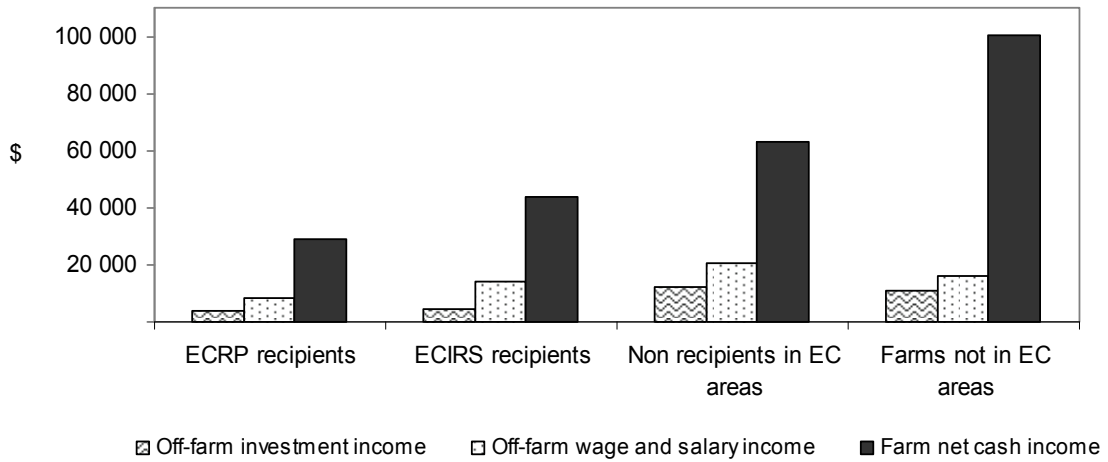
Table 1 Drought assistance recipients, 2002-03 to 2007-08

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	Annual average 2003-08
<i>Farms on ECRP and/or ECIRS</i>	9 094	12 508	11 143	19 243	21 791	25 517	16 549 (32%)
<i>Farms in EC areas not on EC payments</i>	46 696	41 980	34 971	28 597	25 378	31 438	34 843 (68%)

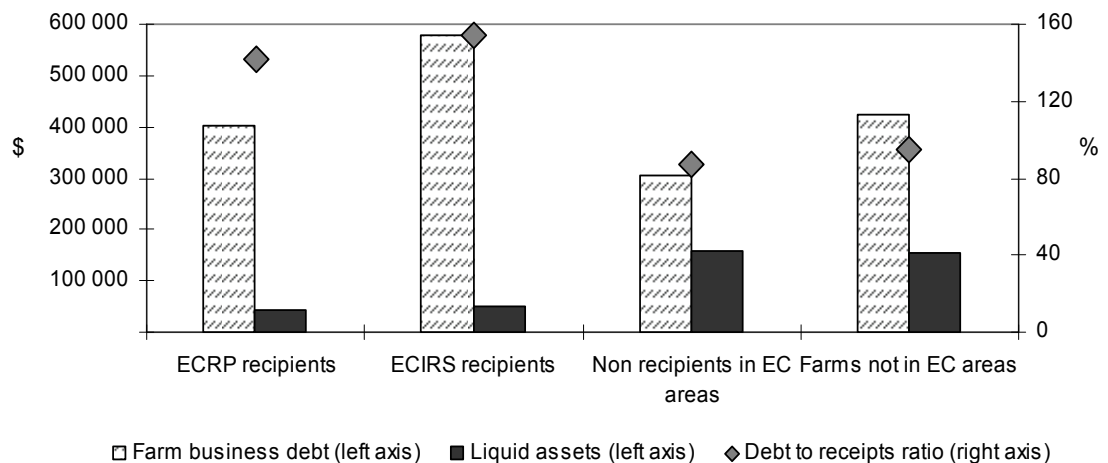
Estimated number of broadacre and dairy farms. Horticultural and other farms are not included in totals.

Figure 4 Income levels, liquidity and debt

Income levels



Liquidity and debt



This high level of preparedness reflects an accumulated understanding of Australia’s climate variability. Many farmers have rainfall records going back 120 years and, depending on where their farms are situated, can readily point out the Federation drought and the long dry spell in the 1940s. Most were farming through the droughts of 1982 and 1994.

The impact of climate change

The BoM-CSIRO report presents projections for changes in temperature, rainfall and soil moisture. The meteorological evidence is that the geographic extent and frequency of exceptionally hot years has been increasing rapidly over recent decades. The report predicts that temperatures will keep rising.

Rainfall in most regions is expected to remain highly variable. While periods of exceptionally low rainfall are projected to increase in the southwest of the country (including southwest Western Australia and the South Australian agricultural region) and Victoria and Tasmania, BoM-CSIRO caution that these projections are less reliable than the temperature outlook. The pattern of exceptionally low soil moisture years is projected to be similar to, though more pronounced than, that for rainfall.

Given the implications of this outlook for agriculture, it is even less appropriate to continue with programs that target those least prepared to manage climate variability, and to do so after droughts have arisen.

Assessment of current programs

Exceptional Circumstances declarations

The institutional arrangements underlying the EC application process provide strong incentives for applications to be submitted. Local communities initiate an application and are the beneficiaries of the subsequent programs. State and territory governments assessing and endorsing such a declaration are acknowledged by the local communities as understanding their plight, yet are responsible for only 10 per cent of the cost of business assistance. The Commonwealth Government contributes all of the household relief funding and 90 per cent of the business assistance, leaving it with the fiscal and political consequences of accepting or rejecting an application.

There is no formal requirement for transparency of the advice to the Commonwealth Minister from the National Rural Advisory Council and others on which the decision was based. To illustrate, in September 2007, the then Commonwealth Government declared 14 interim assistance areas (encompassing 46 per cent of agricultural land in Western Australia and 51 per cent of Tasmania), thus triggering a round of non-recoverable interim assistance for additional areas. None of the communities in those areas subsequently applied for formal EC status — in refusing to do so, the Tasmanian Minister for Primary Industries and Water described the interim EC declaration as ‘an election stunt’.

Despite the NDP’s one in 20 to 25 year criterion for an area to be EC declared, it has been common for 30 per cent or more of Australia to be declared (figure 3). In June 2008, more than half of the country was declared and some areas have been declared for 14 of the past 17 years. It appears that a generous interpretation of the criteria, rather than protracted low rainfall, is mainly responsible for this.

Looking ahead, the BoM–CSIRO report concludes:

The current EC trigger, based on historical records, has already resulted in many areas of Australia being drought declared in more than 5% of years, and the frequency and severity are likely to increase. The principal implication ... is that the existing trigger is not appropriate under a changing climate. (Hennessy et al. 2008)

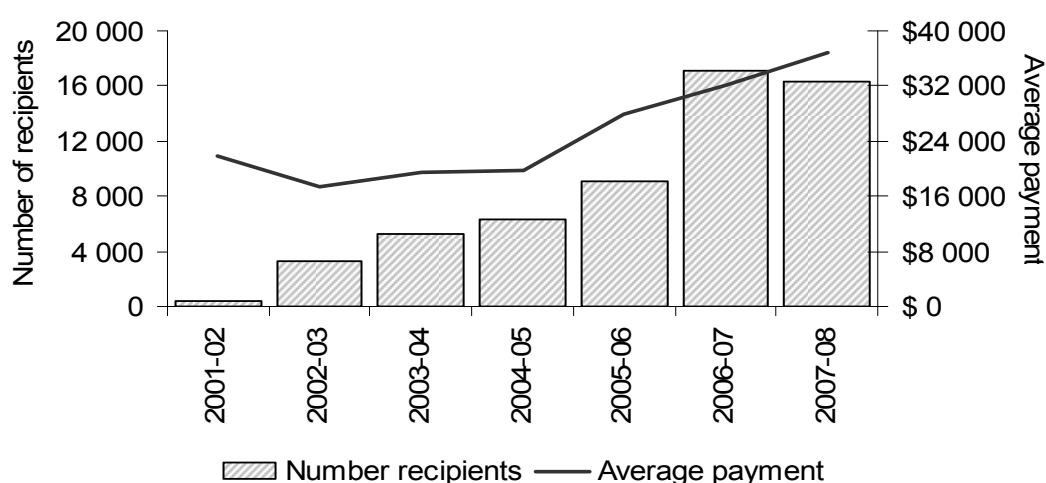
Several participants indicated that EC declaration has intrinsic psychological value in that it sends a message to the wider community that farmers in a declared area are facing difficult times because of drought. Against this, declaration raises significant equity issues inherent in any approach that relies on delineating specific areas ('lines on maps'). Farmers who are experiencing largely the same drought circumstances but are on the other side of a boundary road are ineligible for assistance and are seen as not being in drought.

It is evident that attempts to declare areas according to the severity of drought is inappropriate, ineffective and inequitable.

EC Interest Rate Subsidies

The ECIRS scheme directs assistance only to those in debt. Average payments and the number of recipients increased rapidly over the three years to 2007-08 even though the extent of EC declared land remained fairly constant (figure 5).

Figure 5 **EC interest rate subsidy recipients and average payment, 2001-02 to 2007-08**



Much of the expenditure increase appears to have been driven by changes in scheme criteria. For example, in late 2006 the maximum subsidy payable over five years was increased from \$300 000 to \$500 000. A year later, in September 2007, the

off-farm asset threshold was lifted from \$500 000 to \$750 000. (A similar trend is evident with the relaxation of the off-farm income test for ECRP.)

The ECIRS has proved highly divisive in rural communities. Those who have benefited endorse the program as a means to address a short-term liquidity crisis. Non-recipients are highly critical of this measure. Box 3 presents a range of views from broadacre farmers, graziers and orchardists.

Box 3 Farmers' views on drought assistance

Farmers in favour of drought assistance

The support we have received with Interest Subsidy was vital in assisting us. With this assistance we have utilised the drought as an opportunity ... For without the Interest Subsidy assistance this knowledge gained would not have happened. (D. and T. Allen)

... interest subsidy is useful and practical. It is helpful the way it is because much debt is because of farm-build-up to remain viable ... (Crocker Farming Co.)

The existing interest subsidy and household support have been very useful in getting through the difficult time, with our business ready to produce again when it rains. (Belalie Pastoral Company)

Farmers not in favour of drought assistance

The same producers are queuing every time assistance is offered which proves there is no adapting to seasonal variability. ... Those of us who have embraced new technology and diversification are excluded from assistance as [we] are self-sufficient. (G. Schmidt)

It is disconcerting to see a number of 'inefficient' graziers ... receiving drought assistance when they have done little to plan and manage the risks of drought ... (J. Cooper)

... the current exceptional circumstances assistance system does not encourage the efficient operation of farm businesses through economies of scale, in fact they encourage the opposite. (L. Mann)

Efficient farmers who save and invest off farm are penalised, whilst farmers who waste money [and] spend everything get more help. (H. Clark)

A farmer who has diversified risk, managed borrowings conservatively, kept operating costs low and planned a financially secure retirement is less likely to qualify ... (P. Wallace)

While the ECIRS aims to assist otherwise viable farmers who are experiencing liquidity problems, the evidence shows that the average recipient has an equity level of over 80 per cent of the total farm asset value. Any rationale for a scheme that rests on farmers' inability to access carry-on finance requires evidence that capital markets are unwilling to extend credit in the face of such balance sheet strength. To this end, the Australian Bankers' Association submitted that, in times of drought, viable farmers should be able to access carry-on finance, have loans restructured to

reduce repayments or defer payment without cost. The Commission found no evidence that farmers' access to capital differed in any significant way from that faced by other small businesses, even with changes in economic cycles.

Contrary to the objectives of the NDP, there are no requirements on recipients of ECIRS to demonstrate that they are improving their farm management practices or, in other ways, increasing their self-reliance. Indeed, the ECIRS generates perverse incentives in that it can lead to:

- some farm businesses failing to adopt self-reliant strategies, such as earning off-farm income or building financial reserves as a hedge against drought risks, in the belief that governments will support them during droughts:

If we had not carried out farm contracting during the 2007 year it is quite possible we would have received the maximum interest subsidy of \$100 000 ... other farmers ... made more money from receiving interest subsidy than we netted from farm contracting. (S. and A. Boardman, sub. 43)

- recipients being less responsive to drought conditions and being financially assisted to continue business-as-usual;

[EC interest rate subsidies] promote 'worst practice' farming i.e. To overgraze and overspend in good times, knowing the criteria for subsidy will be met in the drought (D. and M. Geldard and T. Reid, sub. 46).

Interest rate subsidies were criticised strongly in the reports to government of the Drought Policy Taskforce (1997), the Mid-Term Review of the Rural Adjustment Scheme (1997), the Drought Review Panel (2004), and the Agriculture and Food Policy Reference Group (2006). On the evidence provided to this inquiry, and its own analysis, the Commission agrees with the findings of these reviews.

Exceptional Circumstances interest rate subsidies should be terminated, subject to transition arrangements.

Transactions subsidies

New South Wales, Queensland and the Northern Territory provide subsidies for the transport of fodder, water and livestock for farmers in drought-declared areas. This is despite previously agreeing to end such subsidies in the face of evidence of perverse consequences and the potential for misuse, including:

- exacerbating environmental damage from retaining excessive stock for the prevailing conditions. As one participant noted 'one can see adjacent properties that have been subjected to very different land management regimes, one with many starving cattle picking at round bales brought in by subsidised freight, next door to a few fat unsubsidised cattle' (P. Morris, sub. 23)

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- bidding up the price of fodder in regions where there is no subsidy, thereby increasing costs for other users, particularly the intensive livestock sector.

Fixed water rates and municipal rates are legitimate and known business costs that should be budgeted for, yet some states also provide rebates and waivers on these. Where there are concerns about hardship, deferred payment models would be preferable to shifting the burden onto other ratepayers and/or the wider community.

States and territories should, as previously agreed, terminate transactions-based subsidies.

EC Exit packages

At December 2008, around 100 applicants had received an EC exit package from nearly 500 processed claims. One reason for the low uptake of the package is the grant's strict eligibility requirements. The program also fails to address the non-monetary reasons why many farmers remain on the farm — the lack of formal recognition and portability of the skills learned during farming and the reluctance to move away from the family home and local community. (The Australia's Farming Future initiative includes a similar package badged as Re-establishment Grants.)

The Exceptional Circumstances exit package should be terminated, subject to transition arrangements. The Re-establishment grants that are provided under the Australia's Farming Future initiative should similarly end.

Recently the Australian Government announced a program for small irrigators in the Murray-Darling Basin involving purchase of their water entitlements, assistance to remove permanent plantings, training services and an exit grant. Recipients can remain in the family home on their farms. As many of these 'blockies' are located near settlements where alternative employment may be available, the scheme addresses some of the failings of the EC exit grant. The Commission considers that this scheme, which is intended to run for a short period, should be evaluated.

The appropriateness, effectiveness and efficiency of the Small Block Irrigators Exit Grant package should be evaluated following its conclusion.

Irrigation Management Grant

The Irrigation Management Grant program provides up to \$20 000 to Murray-Darling Basin irrigators. At December 2008, around 9 500 irrigators had accessed the program, which is scheduled to end on 30 June 2009. By any measure the grants are generous and largely unrestricted in eligibility and use.

There are no obvious constraints that prevent irrigators from undertaking infrastructure improvements. The grants assist farmers to increase returns from their water allocations and they appropriate the benefits. The evidence for any broader environmental benefit is ambiguous at best. The grants support businesses in their current location and reward irrigators who have not updated their infrastructure. It can also lead farmers to delay their decisions to leave the industry and/or to sell water entitlements, thereby increasing the costs of eventual adjustment.

The Murray-Darling Basin Irrigation Management Grants program should conclude, as scheduled, on 30 June 2009.

EC Relief Payments

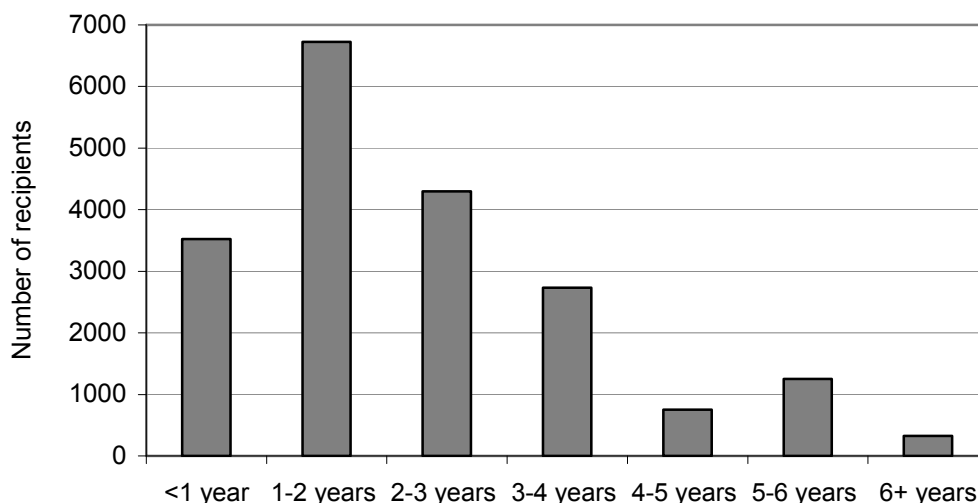
The ECRP scheme treats farmers in EC areas very favourably relative to others in hardship in the community. Owners of other businesses that fail (other than farm dependent rural small businesses) and others in the labour market who have no significant income, are not entitled to support unless they meet the standard safety net criteria. To receive income support under Newstart, an unemployed couple must seek work, have assets valued at less than \$243 500 (excluding their own home) and can only jointly earn \$62 per week before their benefit reduces.

Under ECRP, a farming couple is not required to seek alternative employment, partly in recognition that in drought, farmers still need to manage their land and stock and maintain the underlying viability of their farms. The value of a farming couple's farm is not assessed for eligibility purposes, they also can own up to \$243 500 in off-farm assets and can earn over \$400 per week in off-farm income before incurring any loss of benefit. While almost half of ECRP beneficiaries have received support for one to two years, around half have been supported for longer, with almost ten per cent having received payments continuously since 2003 (figure 6).

Long-term government support encourages dependency that is inimical to self-reliance and preparedness, perpetuates many social problems identified by the Expert Social Panel and generally impedes adjustment.

Exceptional Circumstances relief payments should be replaced, subject to transition arrangements.

Figure 6 **Length of time in continuous receipt of ECRP**
Recipients current at 9 January 2009



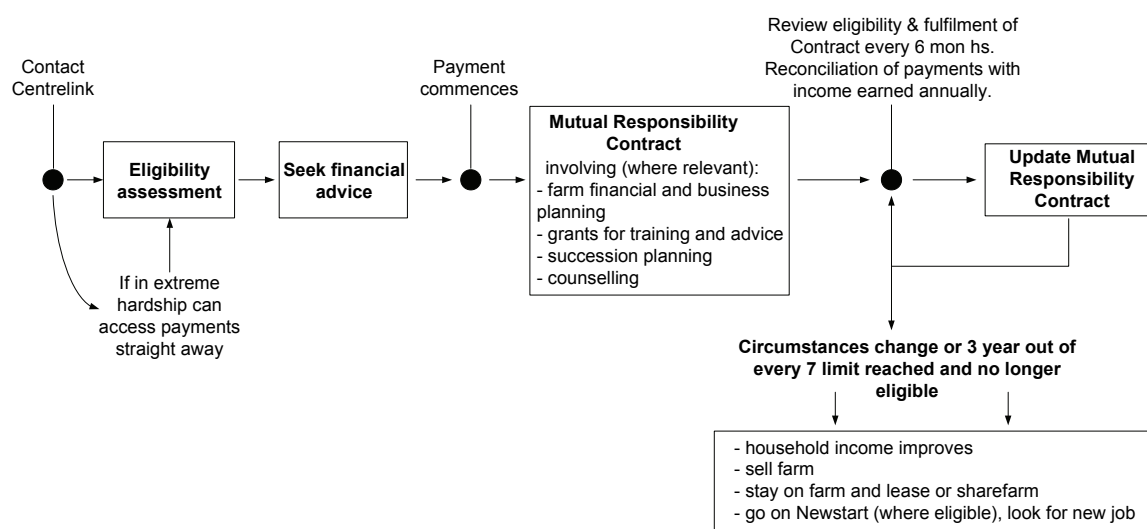
The Commission proposes that the ECRP scheme be replaced by a Farming Family Income Support scheme that aims to achieve a balance between four objectives:

- equity — by enabling all farming families in hardship to access income support, not just those within administratively-determined drought boundaries
- recognition of farm viability — by setting the asset threshold at a higher level than Newstart
- avoidance of welfare dependence — by limiting the duration of income support and assisting farmers to undertake farm planning or training suited to earning off-farm income
- helping recipients determine their future in farming — by providing support for viability assessments, counselling and succession planning.

The expression of these aims underpins the recommended scheme (figure 7).

The Commission considers that, on equity grounds, farming families experiencing hardship should apply for assistance like other Australians and be subject to the same income test — with support starting to taper after a household earns \$62 per week (where both adults receive assistance) from other sources.

Figure 7 Farming Family Income Support scheme



The assets test under Newstart, however, does not sit easily in the farm sector. Given the usually high level of farm assets, Newstart's asset threshold of \$243 500 (not including the house) would render most farm households ineligible for support. Running down the capital value of the farm to that threshold could jeopardise future farm viability. In recognition of this, and that hardship may be only temporary (about half of all ECRP recipients receive support for one to two years), the scheme should depart from Newstart's asset threshold.

The net asset threshold under the Transitional Income Support (TIS) scheme, which is scheduled to end in June 2009, is \$1.5 million. The Commission considers, however, that a net asset threshold of \$2 million, tapering out at \$3 million, would best meet the objectives of its proposed scheme. A liquid asset sub-cap of \$20 000, the same as for TIS, recognises that farms require more working capital than, say, urban households, but also requires that funds in excess of \$20 000 (including Farm Management Deposits) be drawn down before taxpayer support is provided.

Unlike the unconditional ECRP scheme, the Commission's recommended scheme would involve mutual responsibility. Many farmers and the National Farmers' Federation supported some form of mutual conditions. Others were of a similar view. For example, the ACT Department of Territory and Municipal Services said:

Encouraging self reliance may be enhanced by a mutual obligation approach to future drought assistance e.g. assistance measures will be dependent on the implementation of a business plan incorporating risk management strategies. (sub. 101)

Income support beneficiaries would have to develop a ‘Mutual Responsibility Contract’ specifying the actions that are to be taken to improve self-reliance. For most, the contract would require a household financial plan and/or a farm financial and business plan to, at least, indicate the sustainable earning potential of the farm business. For viable farmers this requirement would not be particularly onerous — most would have such plans already.

The contract would make allowance for particular farmers’ circumstances and preferences. Hence, it could involve commitments to gain skills suited to earning off-farm income or participation in programs such as Landcare or those conducted by Catchment Management Authorities. To help farmers determine their future, assistance would be available to assess farm viability, for counselling, and to encourage the preparation of succession plans.

Assistance would be re-assessed every six months on the basis of compliance with conditions — including actions set out in the contract. Acquittal of payments against income earned would occur annually. To ensure that assistance did not become entrenched, assistance would be limited to three years out of every seven for a farm household. After that period, members of the household would no longer be eligible for assistance until they met the income, assets and activity requirements of other generally available income support programs.

The regular assessment of the farm’s financial position in tandem with the time limit on the more generous asset threshold would encourage the owners of non-viable farms to investigate alternative management arrangements, such as leasing or sharefarming, or exiting the industry. For farmers wishing to leave the industry, access to counselling, training and advice would be available in conjunction with income support.

All farmers facing hardship should have access to a Farming Family Income Support scheme designed for farming circumstances. It would provide payments and have income eligibility thresholds at Newstart levels, subject to:

- ***an overall net asset cap, inclusive of the value of the farm house, beginning at \$2 million with a taper to \$3 million***
- ***a liquid asset sub-cap of \$20 000 inclusive of bank balances and Farm Management Deposits balances.***

While the scheme should operate at the farm household level, eligibility and payments should be on an individual basis and conditional on:

- ***meeting the definition of a farmer, based on a similar test to that used currently for the Transitional Income Support scheme***

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- *seeking independent financial advice on the viability of the farming business*
 - *developing and carrying out a plan of action to improve household self-reliance*
 - *eligibility being reviewed, mutual responsibilities being met and plans updated every six months.*

The scheme should be limited to a maximum claim per farm household for three years out of every seven. The seven year period should commence from the date of receiving the first income support payment. Payments should be acquitted annually.

The Farming Family Income Support scheme should commence on 1 July 2009 in conjunction with programs to provide counselling, the recognition of prior learning and grants for training and professional advice.

Small Business Income Support

At present, agriculture-dependent small business operators based within or outside EC declared areas can apply for small business income support. The scheme was introduced with little justification in late 2006 and expanded in September 2007 to allow non-agriculture-dependent business operators to apply. It is scheduled to end in June 2009. Across Australia, other small businesses are not afforded such treatment — as evidenced by bankruptcies in any given year.

The scheme is intended to assist with living expenses, rather than business operating expenses. However, small business operators do not generally face the same constraints as farmers in accessing broader income support measures — they generally do not have such lumpy non-divisible assets; do not face the same difficulties in diversifying income; and are usually located in towns and so would be more able to meet program obligations, such as those that are required of Newstart recipients. Preferential access to income support for these small businesses is not justified.

Exceptional Circumstances small business income support should be terminated, subject to transition arrangements.

What about regional communities?

Some participants proposed that a rationale for drought assistance is that the injection of funds into regional areas helps communities retain a critical mass of

population and preserve their social fabric. Clearly, droughts can add to pressure for change, but the underlying long-term economic and social forces appear inexorable.

Over the last 100 years, small rural towns have felt the impact of bigger and better machinery, farm amalgamations and the reduced need for on-farm labour (see figure 2). Better roads and vehicles have made it easier for farmers to conduct their commerce in larger regional centres. Reliance on agriculture is falling in many rural areas relative to other economic activities. Growth from ‘sea change’ and ‘tree change’ is altering some rural profiles. Adding to this, climate projections indicate that current agricultural practices in some regions may not be sustainable.

Economic activity and industry fortunes will continue to wax and wane and the pattern of settlement will change regardless of intermittent funding tied to climatic events. Against this backdrop, the efficacy of using temporary drought relief as a regional development tool is most unlikely.

If governments are committed to supporting small towns per se, then more enduring regional development initiatives and policy consideration would be needed. In the short term, the Expert Social Panel cautioned:

... state and territory governments must consider the unintended consequences of withdrawing services and infrastructure during periods of stress, such as dryness. The Panel is supportive of any Australian Government initiatives which will provide incentives to consider the social impact of decisions regarding the provision of rural services and infrastructure (for example, schools, school bus services and local hospitals). (Kenny et al. 2008)

Governments’ attempts to achieve equitable access to a wide range of services can entail them devoting more resources to certain groups in the community. For example, governments often spend more per person on delivering equivalent services to people in rural and regional areas than people in major cities. While this can be appropriate, it is also important to consider the opportunity costs of maintaining services in the face of changing patterns of settlement.

Terminating the EC process and transition of current declared areas

The Commission’s analysis concludes that an EC trigger is not an essential element of any future programs. When coupled with the inherent flaws in the declaration process itself, the Commission considers that the EC trigger should be dispensed with. In transitioning from the current arrangements to the new approach, however, there should be no sudden change to the arrangements in currently EC declared areas.

Under the Commission’s recommendations, farm families in hardship could access income support, regardless of drought events, from 1 July 2009. But for areas still under declaration, ECRP recipients would continue to access assistance under much more favourable conditions than those available to the rest of the community. Similarly, current recipients of the ECIRS would continue to access unconditional funds, whereas farm businesses in non-declared areas could not. To mitigate the inequities that would inevitably arise between EC areas and non-declared areas, a dual stream regime should not run in parallel for longer than absolutely necessary.

However, given the high level of benefits flowing to some producers in EC areas, the pressure placed on assessments to extend EC status would be amplified. That process has been shown to lack transparency and to have been subject to manipulation. This also needs to be addressed.

The Exceptional Circumstances (EC) declaration process should be terminated. No new areas, full or interim, should be declared. Currently declared areas could have their EC status extended where they meet the criteria. To mitigate the inequities and costs of running two regimes in parallel:

- ***assessments and advice made by the National Rural Advisory Council on extension or revocation of EC declarations and the Minister’s reasons for the subsequent decision should be made public***
- ***in areas that remain declared, only active recipients of EC assistance measures should be eligible to reapply, but enrolments for EC relief payments should cease once the Farming Family Income Support scheme commences***
- ***continuing recipients of EC interest rate subsidies should be subject to rigorous assessment including demonstration of appropriate financial and business management plans***
- ***continuing recipients of EC relief payments should be subject to similar case-management arrangements as those applying to recipients of the Farming Family Income Support scheme***
- ***an end date for all EC arrangements that provides sufficient time for a transition to the new arrangements should be pre-announced.***

Drought triggers — whether attempted to be defined as ‘exceptional’, ‘extreme’ or any other such variation — have proven to be a failure. They are not relevant to the formulation of programs aimed at developing self-reliance, preparedness and sustainability and there is no place for them in any future policy architecture.

The future policy framework

The Commission has argued for the termination of the EC declaration process and the various programs that it triggers. Yet, the rationale underlying most of the NDP's objectives are sound. Accordingly, the Commission considers that there is a case for extending the Commonwealth Government's Australia's Farming Future initiative to embrace risk management and climate variability more broadly.

The objectives of the Australia's Farming Future initiative should be revised and extended to the following:

- *assist primary producers to adapt and adjust to the impacts of climate variability and climate change*
- *encourage primary producers to adopt self-reliant approaches to managing risks*
- *assist primary producers to manage greenhouse gas emissions and other adverse impacts on the environment*
- *ensure that farming families in hardship have temporary access to an income support scheme that recognises the special circumstances of farmers.*

Measures to facilitate self-reliance and preparedness

Farmers in drought-declared areas who cope without support from EC programs generally have stronger natural and physical capital on their farms and greater financial and human capital to draw on. Governments have a role where market failures impede farmers building that capital, or where policy settings and programs inhibit its growth.

Research, development and extension

There are sound rationales for governments to assist farmers to build their capacity through funding for research, development and extension services. While governance structures of the Rural Research and Development Corporations (RRDCs) are reasonably sound, improvements to ensure that researchers, businesses and governments come together and disseminate information can improve outcomes further.

Given the projected climate outlook, sufficient funding needs to be directed to agricultural research, seasonal forecasting, and development and extension activities designed to improve risk management for climate variation and change.

Agricultural extension services and their delivery have changed markedly from the era of linear, top-down advice on how to improve yields and apply fertiliser and pesticides. There is now more private sector delivery, use of fees for service and more emphasis on information flows and stakeholder participation. Whatever the format, there need to be effective two-way links between researchers and farmers.

Public investment in agricultural R&D to manage climate variability and climate change should be pursued such that:

- programs are subject to monitoring and evaluation to ensure funds are expended where there are net public benefits — where research provides private benefits, contributions from beneficiaries should be required
- excessive use of short-term funding arrangements is avoided because it hinders effective relationships developing between researchers and primary producers
- there is integration with extension services to ensure researchers are aware of farmers' priorities and farmers are able to appropriately adopt new practices
- funding is channelled through a few well functioning institutions (such as several of the RRDCs and Co-operative Research Centres rather than having multiple funding pools.

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

Information and advice

With the increasing complexity of farming, farmers need more than public advice, information and extension services. Indeed, the largest 30 per cent of farms that generate most of Australia's output 'buy in', often multiple, forms of advice — agronomic, business, financial and marketing. At the other end of the spectrum, however, many small and middle tier farmers do not seek much outside advice.

The Rural Financial Counselling Service (RFCS) can meet a need for objective information in some areas. For its clients, the RFCS provides information, acts as a referral point for other services and helps clients unable to pay for financial and other advice services.

The largely private benefits from financial counselling suggest that the rationale for government provision is weak. The Expert Social Panel recommended that the role played by the rural financial counsellors be reviewed 'as soon as practical'. The Commission concurs, but acknowledges that the RFCS is moving to a new case management approach with funding to 2011.

The Rural Financial Counselling Service program should be reviewed prior to the end of its current funding. The review should assess whether the program delivers net benefits to the community and, in doing so, examine:

- ***the extent to which alternative sources of information are lacking in certain areas***
- ***whether counsellors refer their clients to relevant services in a timely and effective manner***
- ***the future role of the service in view of the wide ranging case management options under the Farming Family Income Support scheme.***

Professional Advice and Planning Grants of up to \$5500 allow farm businesses to obtain professional advice for drought management and recovery. The grants, which are only available in EC declared areas, have helped some farmers manage for, and recover from, drought. Nevertheless, there are better ways to meet educational and training needs than through reactive support based on drought boundaries.

Exceptional Circumstances professional advice and planning grants should be terminated, subject to transition arrangements.

Education and training

The FarmReady (and former FarmBis) programs provide financial assistance to primary producers and rural land managers to undertake business and natural resource management training and education activities. FarmBis was strongly endorsed across the agricultural community on the basis that the financial and business training had led to improved drought preparedness.

Grants for business training and professional advice that are well targeted and have an educational outcome are likely to provide private and broader community benefits. A continuous learning program for farmers can provide a mix of public and private benefits. The more specific the training is to a particular farmer's circumstances, the more likely it is that they would choose to undertake the training without government funding. In these circumstances, a co-contribution would mean that recipients would have a greater stake in the outcomes of education and training activities and would be more likely to ensure that training met their needs. The most successful elements of FarmBis should be brought within FarmReady in a strengthened program.

Significant public funding should be directed to a continuous learning program, incorporating the successful elements of the former FarmBis within an enhanced FarmReady platform. The revised program should encompass advice and training

for managing climate variability and for farm business management. Funding should be provided in the form of a subsidy which covers a proportion of the cost of training, with the recipient contributing the balance.

Farm Management Deposits

The Farm Management Deposits (FMD) scheme enables individual farmers to deposit up to \$400 000 of pre-tax income into an FMD for later withdrawal. The scheme plays a positive role in encouraging self-reliance and preparedness.

Some of the criticisms of FMDs revolve around their evident use for tax deferral and tax saving, particularly given that an income tax averaging scheme for farmers already exists. Nonetheless, FMDs may contribute to tax equity, especially for the minority of farmers who do not practise tax averaging.

More importantly, evidence points to FMDs encouraging farmers to save for periods of low income (such as drought) and for recovery (such as replanting and restocking). While the aggregate level of FMD holdings could suggest that they are not being drawn down in drought periods, the sectoral data indicate that the pattern of deposits and withdrawals is generally consistent with preparedness for, and recovery after, drought events.

FMDs do not generate the perverse incentives and outcomes for resource use decisions that are characteristic of other government business assistance (such as interest rate and transport subsidies). FMDs are therefore likely to be a more efficient means of encouraging financial self-reliance than some other measures.

Some participants called for an increase in the cap on funds that could be held in an FMD and/or submitted that other forms of farm structures should have access to the scheme. The Commission found no compelling case for either of these proposals.

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

Making the transition

The Commission's recommendations are consistent with the findings and recommendations of previous reports to government on drought. That such recommendations have not been adopted, or followed only briefly, highlights that the potential benefits of the recommended policy approach will be realised only if there is confidence that it will be consistently applied. Progress will be undermined

if there is an expectation that governments will revert to providing reactive support when droughts recur. To date, such expectations have proved well-founded.

Following reaction to the draft report, the Commission has come to the view that there is a strong case for an intergovernmental agreement (IGA) that embodies a systematic assessment of compliance. The principle arguments for this are: the benefits on offer from reform; the adverse consequences of reverting to past policy stances; and the benefits from policy coordination between Commonwealth, state and territory governments.

The Commonwealth, state and territory governments should enter into an intergovernmental agreement linking Commonwealth funding to the states and territories to a range of commitments. These commitments should include:

- ***ensuring policies and instruments are compatible with the extended objectives of the Australia's Farming Future initiative***
- ***avoiding the use of reactive business assistance measures such as interest rate subsidies and other transactions-based subsidies, including waivers for legitimate business expenses***
- ***ensuring that if assistance is provided to farm businesses rather than farm households, it is conditional on an assessment of whether the farm will be self-supporting in the longer term and be directed to reinforcing longer term capacity building.***

The disbursement of funds linked to an intergovernmental agreement should be dependent on an arms-length evaluation of the extent to which the parties have met their agreed commitments. The agreement should be established, and independent monitoring and assessments undertaken, at the Council of Australian Governments level.

The quantum of funds that should be linked to any IGA is properly a function of governments to determine, taking into account commitments entered into and the relative roles and responsibilities ascribed to the Commonwealth, state and territory governments.

A further new pool of dedicated incentive payments for an IGA would not be required. Conditional commitments could be tied to the funds identified as necessary to meet the specified objectives of the new suite of programs aimed at improving farmers' self-reliance and preparedness. Past expenditures — especially the peak expenditures of recent years — are not a relevant basis for ascertaining future funding needs for refocused programs. State and territory governments also provide significant drought-related expenditures, some of which are inconsistent with the new policy framework. Terminating such programs would liberate state

funds that could be used for more appropriate programs. This is part of the overall funding calculus and leaves open the possibility of an IGA with some matching funding components.

The Commission's recommendations refocus drought policy on the broader issue of climate variability and change. Within this revised framework, the Commission has proposed removing impediments to self-reliance and preparedness and providing support to better equip farmers to deal with climate and other risks. The removal of reactive drought-triggered measures (such as the ECIRS) which impede the development of private arrangements for risk sharing will encourage alternative forms of farm business activity — such as sharefarming or leasing. More generally, it will improve the self-reliance and preparedness of the current population of farmers. Those who are unwilling or unable to accept these risks may be more likely to exit and, importantly, less likely to enter farming in the first place.

In terms of building financial capital, FMDs will become more attractive in this changed risk management environment. Further, incorporating the most successful elements of FarmBis into an enhanced FarmReady scheme will improve the human capital of the lower to middle tiers of farmers. The linkages between continuous learning and agricultural research and development will be enhanced by significant funding initiatives. These measures focus on the achievement of the policy objectives proposed for the Australia's Farming Future initiative. Figure 8 summarises the nature and timing of the proposed changes.

The broader policy context

Agricultural policy must be developed and managed within the context of economy-wide policy frameworks (figure 9). The new objectives that the Commission has proposed for Australia's Farming Future focus on the centre ring of the figure. But, as many participants properly pointed out, there are concerns about the uncoordinated impacts of other government policy 'silos'.

While it would not be appropriate to redefine other policies in the context of this inquiry, the Commission notes that disparate policy areas including water, natural resource management and climate change all impact on the agricultural sector.

Irrigators, in particular, stressed the interactions between water and other policies — from state water trading rules to local land use and zoning regulations — and drought policy. For example, water trading has presented some farmers with greater financial and production options during drought, while allowing water to move to higher value uses. Yet these options can be constrained by barriers to water trades, the imposition of exit fees and the time taken to process interstate trades. EC

programs have also supported some farmers who may otherwise have exited, allowing them to retain water for irrigation or to purchase more water than they otherwise would have. And, where governments subsidise preparedness measures, such as farm dams, this can benefit one farmer at the expense of others where on-farm water capture reduces run-off.

Figure 8 Current and proposed arrangements

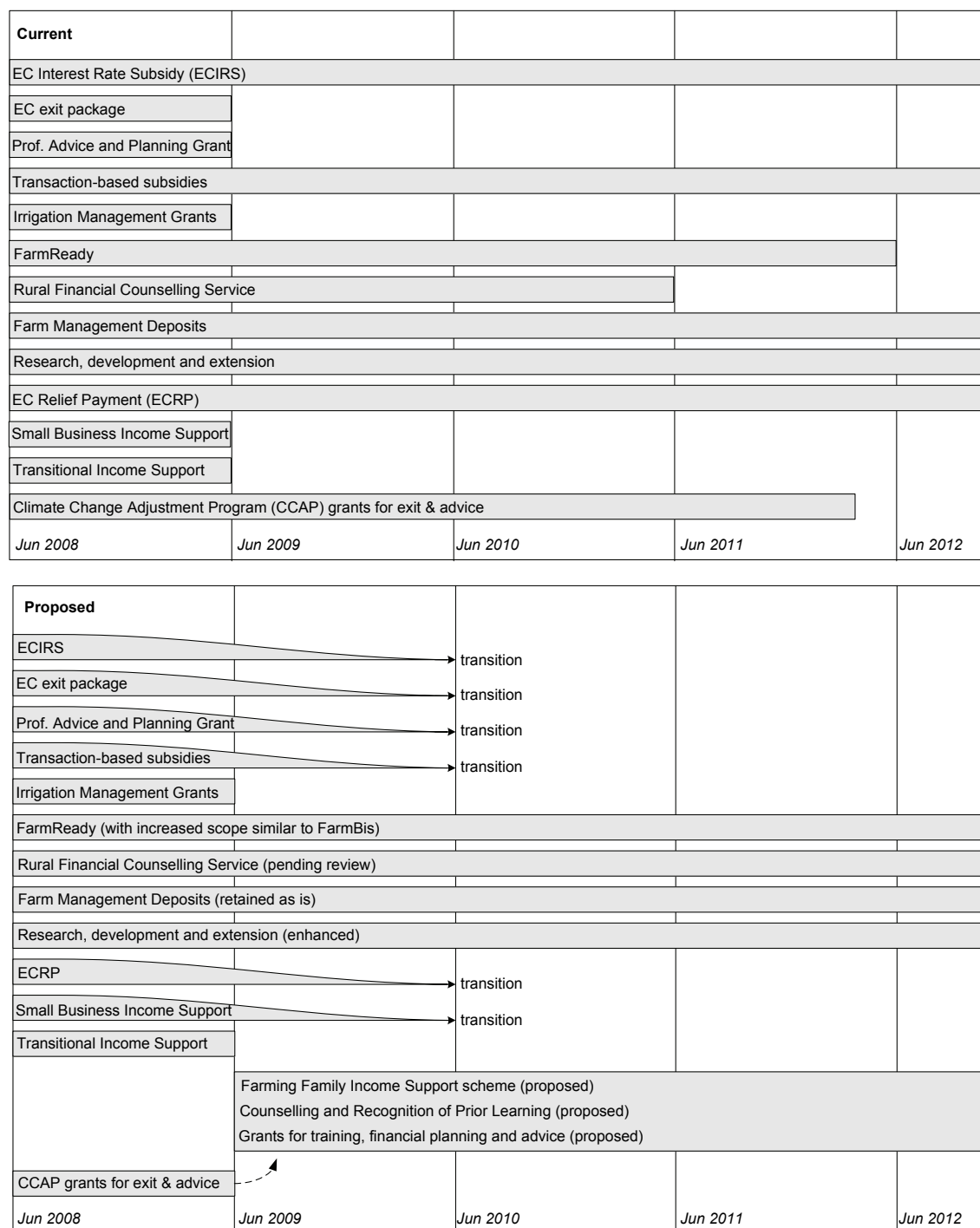
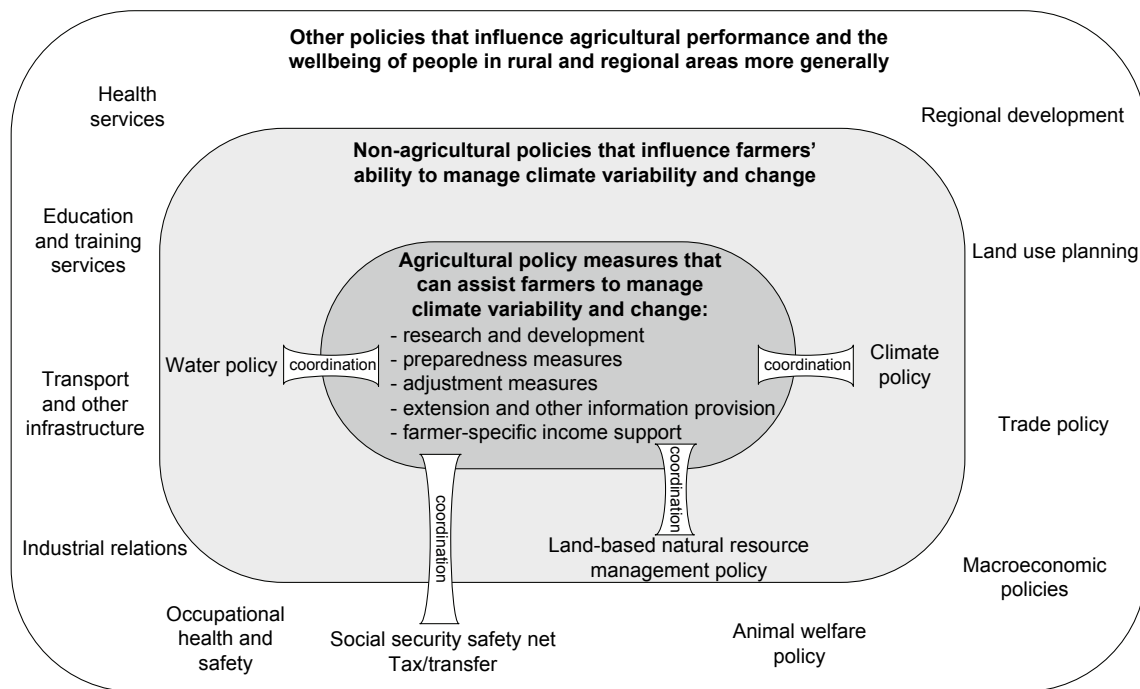


Figure 9 Policy elements of a new approach



Natural resource management policies is another area that can either ameliorate or exacerbate environmental damage from drought. To this policy mix must be added the potential impacts on farmers of the impending Carbon Pollution Reduction scheme.

A self-reliant and prepared farming sector that is well placed to manage risks will benefit farmers, farm businesses and rural communities. Achieving this outcome, however, will require a degree of policy coordination that is not yet evident. Currently, different policies are providing signals and incentives that are potentially conflicting, or worse still, clearly at cross-purposes. Jurisdictional variations add another layer of complexity to this. Better communication, coordination and in some cases integration, between policy areas is needed.