C Exceptional Circumstances triggered business support

Australia's National Drought Policy (NDP) came into effect in 1992. The objectives of the policy are to:

- encourage primary producers and other sections of rural Australia to adopt self-reliant approaches for managing 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.

While self-reliance is a key objective, the NDP allows for short-term drought assistance and support. It states that there are 'rare and severe drought events — Exceptional Circumstances (EC) — that are beyond the ability of even the most prudent farmer to manage'. Support is therefore provided to individuals, farm businesses and farm dependent rural businesses experiencing such circumstances.

In this appendix, the appropriateness, effectiveness and efficiency of the support provided to farm businesses and farm dependent rural small businesses during severe drought events is analysed.

C.1 Available EC business support

Two main assistance measures have been developed by the Commonwealth Government to target farm and farm dependent small businesses that are experiencing an EC event: interest rate subsidies and an exit grant (only farm businesses) for those wishing to leave the industry. When the NDP was agreed in 1992, it was determined that business assistance during EC events would take the form of an interest subsidy so as to avoid ad hoc policy development during times of crisis (Drought Review Panel 2004).

EC programs

As a result of an EC declaration, primary producers (and small business in towns of less than 10 000 people who are reliant on primary production — termed farm dependent rural small businesses) can access a range of support measures (box C.1).

Box C.1 **Commonwealth Government support to farm and farm dependent rural small businesses tied to an EC declaration**

The Commonwealth Government's drought related policies include:

- EC interest rate subsidies
- EC exit package (farm businesses only)
- Early access to Farm Management Deposits funds (farm businesses only)
- Declared drought area incentives: additional commencement incentive for businesses employing apprentices
- Australian Tax Office provisions allowing farm businesses in drought affected areas additional time to lodge tax documents.

Source: DAFF (2008d).

Interest rate subsidies are provided to farmers and farm dependent rural small businesses that are viable in the long-term, but are currently in financial difficultly due to an EC event (DAFF 2008d). A subsidy of up to 50 per cent of the interest payable on new and existing loans (with the exception of new property purchases, which do not attract the subsidy if purchased within the last 12 months) is provided for in the initial year of an EC declaration, with provision for a subsidy of up to 80 per cent in the second and subsequent years. Payments are taxable and are capped at $100 000 in any 12 month period and $500 000 over five years. The subsidy is paid directly to producers and not to the institution to whom the debt is owed. The eligibility requirements of the scheme include:

- an off-farm (or out of small business) asset test of $750 000 applies. This excludes assets held in Farm Management Deposits (FMDs), bona fide insurance and superannuation (this is to be reduced to close to $500 000 post June 2009)
- farmers (and small businesses owners) must, under normal circumstances, have contributed at least 75 per cent of their labour to the enterprise
- they must have derived at least 50 per cent of their income from farming (or the small business).

This policy is 90 per cent funded by the Commonwealth Government, with the remainder funded by state and territory governments. EC interest rate subsidies have been available to farmers since 1993, and to small businesses since 2006, and are administered by state and territory government authorities.

For those farm businesses viewed as unviable whose owners want to leave the industry, an exit package is available. The EC exit package consists of an EC Exit Grant, an EC Advice and Retraining Grant, and an EC Relocation Grant. The Exit Grant provides a taxable one-off payment of up to $150 000 for farmers leaving the industry, and who are selling their farm enterprises (box C.2).

Box C.2 **Eligibility requirements for the EC exit package**

The EC Exit Package consists of a taxable one-off payment of up to $150 000 for farmers within an EC declared area who decide to sell their farm, along with retraining and relocation grants, both up to $10 000. In order to be eligible, the applicant has to have contributed a significant amount of labour and capital to the farm enterprise, and derived a significant amount of their income from the farm enterprise. Other requirements are that:

- the applicant must have owned or held an interest in the farm for at least five years, or inherited/taken ownership of a farm that has been in the family for at least five years
- the applicant or their partner must not have previously received a successful exit-grant, re-establishment grant or restructuring grant under previous Commonwealth Government packages
- the farm enterprise must not be involved in bankruptcy proceedings, involuntary mortgagee possession arrangements, or issued with an eviction order, or lost management control of the farm in any other way

The maximum amount of $150 000 can only be received if the applicant's net assets (including the family home) are less than $350 000. For every $3 in assets above $350 000, the amount of the grant is reduced by $2 up to net assets of $575 000. Successful applicants must agree to exit the industry for at least five years, otherwise the grant must be paid back in full.

To access the retraining grant, the applicant must discuss exit advice, training needs and options with Centrelink. All of the elements of the EC Exit Package are administered by Centrelink.

Source: DAFF (2008e).

The EC Exit Package is also available more widely to all farmers under the Climate Change Adjustment Re-establishment Grant until 2012 (but the retraining grant is limited to $5500). An additional exit package for irrigators in the Murray-Darling Basin is also available under a recently announced exit grant package (box C.3). As with the EC interest rate subsidies, the rationale for the EC exit package has not been linked to the objectives of the NDP.

Box C.3 **Small block irrigators exit package**

The Commonwealth Government recently announced an exit package for small scale irrigators as part of the water buy back in the Murray-Darling Basin. The package is intended to be short term (applications close 30 June 2009) and is available to irrigators farming less than 15 hectares. It consists of:

- a taxable exit grant of up to $150 000
- up to $10 000 for advice and training (including skills development, direction setting plans, business advice and succession planning)
- up to $10 000 for the removal of permanent plantings and other irrigation production related infrastructure.

The program will not require irrigators to move off their land, but does require them to sell all of their water entitlement (must be at least 10 ML) to the Commonwealth Government. As at December 2008, the package was only available in South Australia (available to irrigators in Victoria, New South Wales and Queensland as of February 2009) and, despite many expressions of interest, no payments had yet been made.

C.2 Assessment of EC triggered business support

In this section, the appropriateness, effectiveness and efficiency of EC triggered business support measures are assessed.

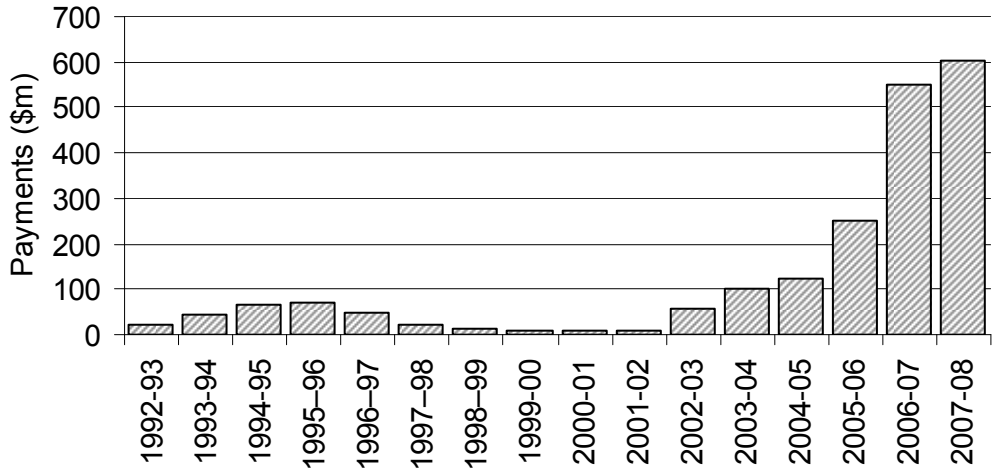
EC Interest Rate Subsidy for farmers

The EC Interest Rate Subsidy (ECIRS) has been in place since 1993. During this period, the eligibility criteria to gain access to the payment have changed several times, altering the potential number of farmers who are eligible. In particular, from October 24 2006 the maximum subsidy payable over 5 years increased from $300 000 to $500 000. Further, over the period from 25 September 2007 to 30 June 2009, the off-farm asset threshold was lifted from double the Newstart Allowance asset test for partnered homeowners of close to $500 000 (in 2008 — Centrelink (2008a)) to $750 000 (DAFF 2008e). As such, changes over time in the uptake of

the subsidy need to be interpreted with caution. Over this period total expenditure on ECIRS has increased significantly (figure C.1).

Prior to the current series of declarations, ECIRS payments reached a high of $69.4 million in 1995-96. In 2007-08, total payments were $604.1 million. As at December 2008, a further $155.3 million in payments have been made to 4758 farmers across Australia.

Figure C.1 **Total ECIRS payments to farmers, 1992–93 to 2007–08**



Data sources: DAFF (2008 unpublished); Manins et al. (2001).

The changes in ECIRS payments reflect, in part, the proportion of Australia's agricultural land that has been declared as experiencing an EC event. The proportion of agricultural land under an EC declaration fell from 30 per cent in 1992 to just under 1 per cent in 2000 (table C.1). Between 2002 and 2004 there was a significant increase in the area of land EC declared, which was matched by an increase in EC payments. However, since 2004 the proportion of agricultural land EC declared has remained at close to 50 per cent. As such, the significant increase in ECIRS payments in 2006-07 and 2007-08, while partly reflecting increased stress on a number of farm businesses because of the prolonged drought in some areas, appears to be largely driven by changes to the design of the scheme.

The average amount received per application in 2006-07 and 2007-08 increased, again reflecting, in part, the increasing generosity of the scheme (figure C.2).

Table C.1 **Agricultural land under EC declaration by state, 1992 to 2008**

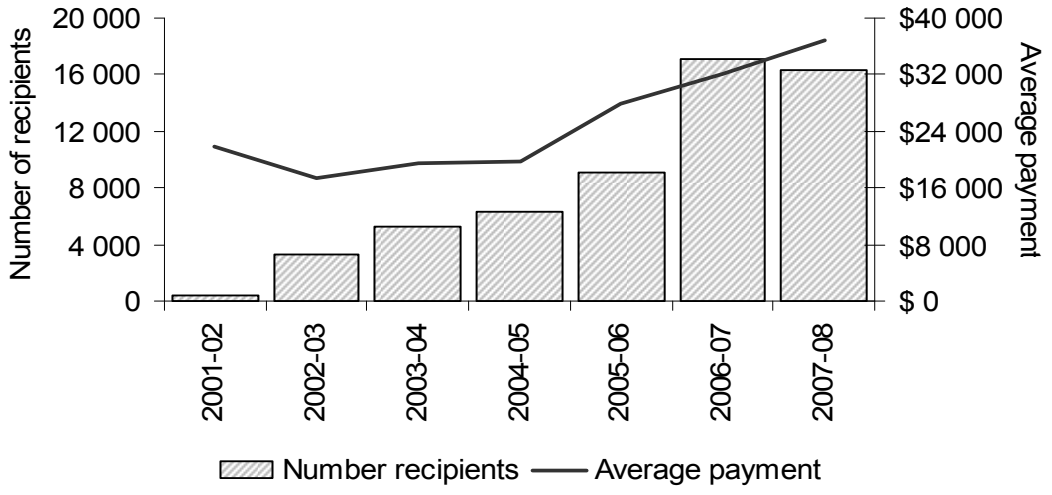
Per cent

	NSW	*Vic*	*Qld*	*SA*	*WA*	*Tas*	*NT*	*ACT*	*Australia*
	%	%	%	%	%	%	%	%	
1992	–	–	100	–	–	–	–	–	30
1993	–	–	100	–	–	–	–	–	30
1994	37	–	100	–	–	25	–	–	36
1995	53	18	100	4	–	25	–	–	39
1996	37	–	72	–	–	–	–	–	27
1997	31	4	64	–	–	–	–	–	24
1998	11	9	11	–	–	4	–	–	5
1999	6	13	6	–	–	4	–	–	3
2000	2	12	–	–	–	15	–	–	1
2001	–	3	2	–	2	11	–	–	1
2002	44	–	3	–	4	–	–	–	8
2003	96	38	50	24	43	–	–	–	44
2004	97	38	57	35	41	–	–	100	47
2005	97	63	59	35	37	–	–	100	47
2006	96	63	59	35	7	–	–	100	40
2007	98	100	61	97	20	47	26	100	57
2008	96	100	41	97	20	47	26	100	50
Average[a]	47	27	52	19	10	10	3	29	29

a Average for 1992 to 2008.

Source: DAFF (2008 unpublished).

Figure C.2 **ECIRS recipient numbers and average annual payments, 2001-02 to 2007-08**



Data source: DAFF (2008 unpublished).

In all states except Western Australia, the number of recipients has increased since 2001-02 (table C.2). New South Wales had the largest number of ECIRS recipients in 2007-08 (8245) while the Northern Territory had the lowest number of recipients (7). Recipients in the Northern Territory, however, received the largest average payment (over $90 000), reflecting the size of their land holdings and thus potential debt levels. This is also the first year that any part of the Northern Territory has been EC declared. Farmers in Western Australia received, on average, the second highest subsidy per recipient (just over $50 000), followed by those in New South Wales (close to $40 000).

Table C.2 **ECIRS payments by state, 2001-02 to 2007-08**

	NSW			*QLD*			*VIC*		
	Recipients	*Total paid*	*Average paid*	*Recipients*	*Total paid*	*Average paid*	*Recipients*	*Total paid*	*Average paid*
	no.	$m	$	no.	$m	$'000s	no.	$m	$'000s
2001-02	–	–	–	285	4	14 993	–	–	–
2002-03	1 320	22	16 836	994	16	16 536	820	13	16 345
2003-04	2 627	52	19 772	1 716	32	18 752	679	12	17 651
2004-05	3 009	68	22 536	2 316	37	16 112	751	13	17 866
2005-06	5 324	155	29 131	2 260	62	27 380	1 247	29	23 089
2006-07	9 686	303	31 250	3 372	113	33 412	3 726	124	33 184
2007-08	8 245	329	39 953	2 638	95	35 966	3 476	116	33 350
	WA			*SA*			*TAS*		
2001-02	172	6	32 842	–	–	–	–	–	–
2002-03	174	5	29 527	19	>1	13 455	–	–	–
2003-04	202	6	27 724	42	1	13 718	–	–	–
2004-05	212	5	25 004	56	1	12 134	–	–	–
2005-06	115	4	37 859	104	2	23 425	–	–	–
2006-07	80	3	33 985	375	10	27 620	–	–	–
2007-08	182	9	50 543	1 669	50	29 964	127	4	32 332

Source: DAFF (2008 unpublished).

Over the period July 2001 to December 2008 the proportion of ECIRS claims approved averaged 84 per cent. Across the states, New South Wales had the highest approval rate of 83 per cent, followed by Queensland and Victoria with 79 per cent and 75 per cent respectively. Western Australia had the lowest approval rate with 71 per cent. The primary reason for rejection in all states was that the applicant was deemed to be 'not in need' of assistance — 50 per cent of total rejections (8 per cent of total applications). This also varied across the states, with the proportion of applicants deemed not in need varying from 74 per cent of total rejections in Victoria (16 per cent of total applications) to 11 per cent of rejections in South Australia (3 per cent of total applications). New South Wales and Queensland also

had relatively low rejection rates due to an assessment of 'not in need' — 6 per cent of total applications in both states. Nationally, 1 per cent of applications were rejected on the basis of the farm not being viable.

Farmers within the mixed farming, beef, sheep and beef and dairy industry groups received the largest ECIRS payments over the period 2001-02 to 2007-08 (table C.3).

Table C.3 **Payments to industry by state and territory**
Total paid from 2001-02 to 2007-08

Industry group	*NSW*	*QLD*	*VIC*	*SA*	*TAS*	*NT*	*Australia*[a]
	$m	$m	$m	$m	$m	$m	$m
Beef	79.8	164.7	13.3	0.8	0.1	0.4	259.1
Cropping	112.0	12.0	53.2	5.6	–	–	182.8
Dairy	58.3	21.8	139.0	3.2	0.3	–	222.6
Fruit and grapes	30.0	7.1	16.5	7.1	–	–	60.7
Mixed	277.7	54.3	51.3	34.2	2.1	–	419.6
Other crops	60.1	43.2	2.7	1.7	–	–	107.7
Other livestock	8.0	6.7	–	0.7	–	–	15.4
Sheep	80.3	15.2	16.5	1.0	0.4	–	113.4
Sheep-beef	204.5	11.2	8.1	8.3	0.9	–	233.0
Other	1.4	0.6	0.3	0.1	–	–	2.4
Total	912.2	336.8	301.0	62.8	3.8	0.4	1 617.0

[a] Excludes Western Australia as industry data from ECIRS recipients is not collected. Excludes payments made in 2008-09 to applications received in 2007-08.

Source: DAFF (2008 unpublished).

The mixed farming, beef, sheep and beef and dairy industries accounted for over 70 per cent of total payments made in the states and territories which recorded recipient industry information. Relative to the total number of farmers in each industry group, dairy farmers and mixed agricultural enterprises received a greater share of payments.

Many recipients of the ECIRS have accessed support on multiple occasions, meaning it is difficult to gain a picture of how many producers have accessed the scheme by examining the number of recipients alone. Where data are available — New South Wales, South Australia, Tasmania and the Northern Territory — examining the number of applicants provides an indication of the coverage and uptake of the ECIRS program. In New South Wales, 25 per cent of all producers had accessed ECIRS payments over the period (table C.4). This proportion was greatest for those in the sheep-beef and mixed industry groups. Mixed agricultural producers also had the highest usage rates in South Australia and Tasmania.

Table C.4 **Total producers accessing ECIRS payments by industry group**
Selected states and territories 2001-02 to 2007-08[a]

Industry group	*NSW*	*SA*	*TAS*	*NT*
	%	%	%	%
Beef	9	2	–	3
Cropping	42	5	13	–
Dairy	45	15	1	–
Fruit and grapes	14	11	–	–
Mixed	54	40	89	–
Other crops	17	6	–	–
Other livestock	6	4	–	–
Sheep	23	3	4	–
Sheep-beef	55	19	8	–
Total	**25**	**13**	**3**	**1**

[a] Includes all farmers who accessed support payments over the period expressed as a proportion of producers in each industry group in 2006-07. As recipient classification is based on individual state agencies' classification, differences are likely to exist between these and those of the ABS. For other states and territories records by applicants are not available. Excludes payments made in 2008-09 in respect of applications received in 2007-08.

Sources: DAFF (2008 unpublished); ABS (*Agricultural Commodities, Australia 2006-07,* Cat. no. 7121.0).

With producers in Tasmania only having access to EC payments in 2007-08 and the relatively small number in South Australia receiving assistance, an examination of the behaviour of New South Wales producers offers the best opportunity to gain an insight into how long producers remain on ECIRS assistance. In New South Wales, the incidence of new ECIRS recipients was relatively high from 2002-03 to 2003-04 and again from 2006-07 to 2007-08 (table C.5). These increases are in line with actual rainfall results despite the proportion of New South Wales under an EC declaration remaining relatively unchanged at over 95 per cent throughout the whole period from 2003 onwards. For example, from the beginning of 2001 to the end of 2002 around 27 per cent of New South Wales experienced exceptionally low rainfall — in the 5th lowest percentile (Hennessy et al. 2008). From the start of 2003 to the end of 2005, less than 1 per cent of the state experienced exceptionally low rainfall, increasing to over 11 per cent over the period from beginning of 2006 to the end of 2007.

Table C.5 **Incidence of ECIRS recipients in New South Wales, 2002-03 to 2007-08[a]**

Number

Industry group	*2002-03*	*2003-04*	*2004-05*	*2005-06*	*2006-07*	*2007-08*
Beef	260	311	85	192	250	229
Cropping	91	292	118	173	324	184
Dairy	133	192	34	36	55	54
Fruit and grapes	19	55	28	25	213	165
Mixed	179	330	169	484	977	520
Other crops	11	29	42	191	162	135
Other livestock	20	24	7	22	24	36
Sheep	119	270	159	237	246	124
Sheep-beef	281	648	159	492	460	303
Total	**1 113**	**2 151**	**801**	**1 852**	**2 711**	**1 750**
Agricultural land EC declared (%)	95.5	96.8	96.8	96.2	98.2	96.0

a Excludes claims made in 2007-08 for which payments were received in 2008-09.

Source: DAFF (2008 unpublished).

While low rainfall is associated with an increase in the number of farmers accessing support measures for the first time, once accessed, many farmers remain on ECIRS assistance. Over the period 2002-03 to 2007-08, many farmers made claims in each year that their area was EC declared. Those that entered the scheme for the first time in 2002-03 made an average of four successful claims (table C.6).

Table C.6 **Successful ECIRS claims per farm business by year of first claim in New South Wales, 2002-03 to 2007-08[a]**

Average number per farm business

Industry group	*2002-03*	*2003-04*	*2004-05*	*2005-06*	*2006-07*	*2007-08*
Beef	3	3	3	3	2	1
Cropping	4	4	4	3	2	1
Dairy	4	3	3	3	2	1
Fruit and grapes	2	4	3	2	2	1
Mixed	4	4	4	3	2	1
Other crops	2	3	3	3	2	1
Other livestock	3	5	3	3	2	1
Sheep	4	5	4	3	2	1
Sheep-beef	4	4	4	3	2	1
Weighted average	4	4	4	3	2	1

a The number of farm businesses that made successful claims prior to 2002-03 is unknown. Excludes claims made in 2007-08 for which payments were received in 2008-09.

Source: DAFF (2008 unpublished).

This was repeated for those that entered in 2003-04. However, those in the sheep and other livestock industry groups made an average of five successful claims. For later periods, those that made their first ECIRS application remained on support for the entire reporting period. Over this period only 39 claimants had both successful and unsuccessful claims.

Is ECIRS appropriate?

The appropriateness of ECIRS assistance rests on whether it is tied to a valid rationale for government intervention. Given the NDP objectives, there appears to be little rationale for the provision of interest rate subsidies. However, as interest rate subsidies has been directed at farmers who are experiencing liquidity problems during severe drought events, it appears policy makers believe that there is some impediment to farmers accessing carry-on finance during these periods.

But given high equity levels of recipients (average of over 80 per cent), and according to the Australian Bankers' Association, the availability of credit to viable businesses in the rural sector both in times of drought and otherwise, it does not appear that significant barriers to accessing carry-on finance normally exist:

> During the drought individual banks have offered:
>
> - to provide carry-on finance to meet short term needs;
> - to restructure existing loans, to reduce annual payments or defer payments without cost;
> - to waive costs on accessing deposits including Farm Management Deposits;
> - no change in risk margins where interest rate subsidies are received …
>
> Banks have also increased their competitiveness for rural business/agribusiness during the past decade by increasing the range of products available. (sub. 76, pp. 2-3)

The Australian Bankers' Association concluded:

> There is no compelling case that there is a failure of rural credit financial markets that warrants Government intervention in the provision of financial services to agribusiness. (sub. 76, p. 3)

The Commission found no evidence that farmers' access to capital departed in any significant way from that faced by other small businesses, even with changes in economic cycles.

Interest rate subsidies also create a number of perverse unintended outcomes, to:

- build debt and/or not reduce debt when faced with drought risk as governments are likely to step in and subsidise costs (having financial reserves has been shown to be an important hedge against drought risks)

- be less responsive to drought conditions as financial support provided in times of drought increases the potential to spend money on additional variable inputs (such as fodder) to maintain production levels.

Overall, these incentives may mean farm businesses adopt less self-reliant strategies prior to droughts in the belief that governments will help to maintain the farm business during droughts.

Effectiveness of ECIRS assistance to farmers

Since 1993, governments have made significant payments to agricultural producers in the form of subsidies paid on the basis of the cost of their debt. Evidence from many participants is that these payments have assisted them to remain in the industry during EC events. As stated by AgForce:

> This assistance proved to be very popular amongst those able to access it. It provided significant relief to producers by providing bulk cash injection to enable them to continue business operations and stay on top of debt during times of extreme cash flow restrictions due to lack of crops and normal stock turnover. (sub. 80, p. 2)

Nevertheless, there is a separate question as to whether these subsidies have been effective in achieving the objectives of the NDP, including whether payments have encouraged a greater degree of self-reliance during, or preparedness prior to, exceptional circumstances.

There are numerous differences between farmers within EC areas who receive interest rate subsidies and those who do not and between those in EC areas and those in areas which have not been declared (table C.7). It should be noted, however, that factors not specific to individual farmers may explain the observed differences between ECIRS recipients and non recipients within EC declared regions, including:

- drought effects within EC declared regions are not uniform
- the large area of the country recently declared as experiencing exceptional circumstances means there is a wide variation in agricultural practices, expected crop yields, stocking rates and farm profitability, making comparisons difficult
- differences exist in administration of the eligibility criteria by the states and territories meaning similar farms experiencing an EC event can be receiving different levels of assistance (discussed later in this appendix).

Table C.7 **Farm characteristics of ECIRS recipients and non recipients**

Average annual data per farm, 2002-03 to 2007-08[a]

		Farms EC declared		
		Receiving ECIRS	*Not receiving EC support*	*Non-EC declared farms*
Physical				
Area of land operated	ha	4 241	5 655	7 320
Scale of operations	sheep eq.	7 431	7 063	10 710
Wheat yield per hectare sown	tonnes	1.1	1.4	1.7
Barley yield per hectare sown	tonnes	1.0	1.6	1.9
Sorghum yield per hectare sown	tonnes	2.4	2.8	3.0
Change in sheep numbers	%	-3.0	-3.0	*1.0*
Wool cut per sheep shorn	kg	4.3	4.4	4.3
Change in beef cattle numbers	%	2.0	*-1.0*	2.0
Milk production	litres	160 712	103 407	144 791
Receipts				
Total cash receipts	$	357 250	355 556	444 748
Costs				
Sheep and lamb purchases	$	9 356	6 489	8 440
Beef cattle purchases	$	27 231	37 807	16 826
Other livestock purchases	$	1 900	821	1 189
Seed	$	4 222	3 729	3 626
Fodder	$	38 365	30 580	22 026
Agistment	$	4 315	2 483	1 695
Fertilizer	$	19 706	21 077	45 755
Sprays	$	14 138	12 472	23 499
Fuel, oil and lubricants	$	23 187	18 954	23 800
Repairs and maintenance	$	25 358	23 327	30 982
Livestock materials	$	5 247	5 772	6 723
Shearing and crutching expenses	$	5 801	5 466	8 786
Administration expenses	$	10 933	9 569	11 882
Freight, handling and marketing	$	15 263	16 992	24 590
Rent and rates	$	14 757	13 613	15 600
Interest payments	$	43 517	23 915	31 926
Hired labour	$	10 062	13 508	15 453
Payments to sharefarmers	$	1 163	3 076	3 041
Other cash costs	$	38 781	42 732	48 380
Total cash costs	$	313 302	292 383	344 222
Farm financial performance				
Farm cash income	$	43 948	63 184	100 527
Farm business profit	$	-40 283	-19 769	16 432
Profit at full equity	$	10 244	10 117	56 928
Rates of return:				
- excluding capital appreciation	%	0.3	0.3	1.6
- including capital appreciation	%	6.8	6.5	8.6
Farms with negative cash income	%	30	30	26

a All estimates, except those italicised, have a relative standard error of less than the estimate.

Source: ABARE (2008 unpublished).

Despite this, it would be expected that, *on average*, farms within any specific EC regions would face similar climatic conditions and have similar productivity and profitability potential. Thus, observed *average* differences for those within EC regions do provide some insight into the types of farms receiving ECIRS assistance and those that do not. Although recipients and non recipients operate similar sized farms (the average size of non recipients is slightly larger on an area basis but smaller on a sheep equivalent basis) and generate a similar amount of on-farm cash receipts, there are some differences (table C.7):

- non recipients have higher average crop productivity levels (measured as yield per hectare) suggesting the possibility of better managerial ability of non recipients or that they are farming more productive land
- average total cash costs are lower for non recipients (in particular for fodder costs) suggesting a greater responsiveness to drought conditions and less effort to maintain production level in the drought circumstances, resulting in higher on-farm cash income.

The proportion of small (average size 1800 ha), medium (average size 2500 ha) and large (average size 9600 ha) farms in EC areas receiving ECIRS assistance — 14 per cent, 20 per cent and 22 per cent respectively — indicates that the small farms are less likely to receive the subsidy (ABARE 2008 unpublished).

Observed differences between debt structures of farm businesses provide an insight into how well the policy has been targeted and how interest rate subsidy payments may have altered behaviour (table C.8).

As the ECIRS is targeted towards those farmers who are currently experiencing financial difficultly due to drought, it would be expected that the liquidity ratio (liquid assets to debt levels partly represent the ability of producers to repay debts and remain operational) would be lower than that of non recipients, with average absolute debt levels being higher. This is seen to be the case with the average liquidity ratio for recipients at 9 per cent, compared to 52 per cent of non recipients, and average absolute debt levels of recipients close to twice that of non recipients (table C.8).

Despite this, the distribution of those earning positive or negative income against equity levels is relatively similar for recipients and non recipients — over 60 per cent of both groups have high equity and positive income. Also, land and improvement values are similar for recipients and non recipients at $2.6 million.

Table C.8 Debt and equity characteristics of ECIRS recipients and non recipients

Average annual data per farm, 2002-03 to 2007-08[a]

		Farms EC declared		
		Receiving ECIRS	*Not receiving EC support*	*Non-EC declared farms*
Farm capital and debt				
Capital value of livestock	$	297 020	316 106	406 708
Capital value of plant & equipment	$	280 834	270 139	354 454
Capital value land & improvements	$	2 565 687	2 572 538	3 065 687
Total capital value	$	3 159 981	3 173 753	3 841 776
Farm business debt at 1 July	$	531 925	279 028	380 950
Farm business debt at 30 June	$	577 514	304 636	422 156
Change in total farm debt	%	9	9	11
Equity ratio at 30 June	%	82	90	88
Distribution of farms by cash flow and equity ratio				
Low equity - negative income	%	8	3	4
Low equity - positive income	%	11	3	6
High equity - negative income	%	21	28	22
High equity - positive income	%	60	66	68
Farm liquid assets				
Liquid assets	$	51 441	159 150	154 572
FMDs at 1 July	$	9 508	26 649	26 873
FMDs at 30 June	$	10 023	27 434	31 130
Change in FMDs within year	%	*5*	*3*	16
Liquid assets to debt ratio	%	9	52	37
Off-farm income				
Investment income	$	4 807	12 527	11 251
Wage and salary income	$	13 933	20 411	16 232
Total off-farm income[b]	$	31 540	34 532	28 830
Farms with off-farm wages	%	42	39	37
Government assistance to farm business				
Total government assistance	$	31 652	1 443	1 084
ECIRS	$	26 262	0	0
Other government assistance	$	5 234	1 282	1 005
Forms of government assistance received				
Farms receiving ECRP	%	53	–	–
Farms receiving ECIRS	%	100	–	–
Capital additions and disposals				
Farms acquiring land	%	4	5	6
Farms selling land	%	3	4	6
Other				
Age of operator	years	50	51	50

[a] All estimates, except those italicised, have a relative standard error of less than the estimate. [b] Includes government household support payments.

Source: ABARE (2008 unpublished).

However, non recipients have higher equity levels compared to recipients — 90 per cent and 82 per cent respectively. They also have higher off-farm earnings (excluding government assistance) and FMD deposit levels than do recipients, suggesting they use non-farm income or investment income sources to manage liquidity problems during drought events in order to be self-reliant.

These characteristics, along with similarities in on-farm cash receipts and farm size, suggest that the liquidity problems experienced by ECIRS recipients may be related to the risk management approach taken. That is, non recipients appear to have diversified their income sources to a greater extent, and held lower absolute debt levels and higher FMD reserves, which has improved their ability to be self-reliant during EC drought events.

But such a risk management approach would not be possible for all producers. In particular, those in a start-up phase, or those who have recently expanded, would not necessarily be able to minimise debt levels, hold sufficient off-farm assets, or generate sufficient off-farm income to be self-reliant. That said, expansion or entry decisions should also be made with consideration to the potential risks, including droughts.

Overall, the characteristics of recipients and non recipients suggest that the targeting of the ECIRS has been effective — that is, those facing a current liquidity constraint are in receipt of assistance. Despite this, assessed against the objectives of the NDP, in particular the first objective of improving self-reliance, it appears that the ECIRS has been ineffective. Farmers in receipt of these payments appear to be, on average, less responsive to drought conditions in terms of altering their cost structures. Payments go to those who adopt a less self-reliant risk management approach. This suggests that the ECIRS program has provided assistance to farmers who may have been less effective in managing their operations for drought. It is unlikely that this form of assistance will encourage these producers to adopt more self-reliant strategies because payments are made as unconditional cash grants based solely on indebtedness — no requirement to undertake plans to improve viability.

Implementation of ECIRS assistance measures

A number of concerns were raised in relation to the implementation of the ECIRS program. Specifically, concerns were expressed over differences in the interpretation of the eligibility criteria between jurisdictions and over the complexity of the application process.

Some producers felt that the administering state body (usually the rural assistance authority or similar) in some states (such as Victoria) had a stricter interpretation of the eligibility criteria than others (for example, New South Wales). Such problems arise as each state has responsibility for implementing the ECIRS program despite it being mainly Commonwealth Government funded. Differences in applying the criteria have the potential to lead to different coverage and effectiveness in different states. For example, it would be possible for two otherwise identical farms in different states, both experiencing an EC event, to receive different levels of assistance.

In Victoria, for example, access to assistance was based on the financial need of the applicant and not only having met the eligibility criteria. This has the potential for some farmers to have an unsuccessful claim in Victoria, whose claim would be successful if located elsewhere given the same circumstances. As claimed by farmers Colin and Mary Fenton based on a farmer that operated in two states:

> We have knowledge of farmers who applied and received a knock back in Victoria for example and applied for support in NSW and gained the Exceptional Circumstances approval. (sub. 64, p. 1)

Indeed, consultations conducted by the Commission as part of this inquiry revealed differences in the interpretation of ECIRS eligibility criteria between jurisdictions. Such differences give rise to criticisms of ECIRS on equity grounds as well. They also lessen the potential for the policy to meet its objectives if less stringent interpretations mean that non-viable producers receive assistance, contrary to the intention of the program.

Another concern raised was over the inefficiencies of the program, in particular the complexity and resulting cost of accessing the subsidy. As payments are only made to those farmers who are viable in the long term, there is a significant reporting requirement placed on applicants. For example, as put by the Mid Lachlan Alliance of Councils:

> The time taken and cost incurred by farmers and farm businesses to prepare the necessary documentation is substantial but is viewed more as a means to an end with the complexity of the application requiring the services of an accountant. The time following submission to the best of our knowledge is measured in months rather than weeks. (sub. 38, p. 8)

Indeed, to overcome the reporting requirements governments have provided grants to the Rural Financial Counsellors Service and run extensive advertising campaigns to encourage farmers to not self assess but instead to seek professional advice. This has led to one government drought support program (the Rural Financial Counsellors) targeted at helping farmers access another program (the ECIRS). And, in the case of the Rural Financial Counsellors, this additional responsibility has

potentially detracted from their intended purpose. As stated by Rural Directions Pty. Ltd.:

> Without a network of rural counsellors in South Australia, many farmers would not have coped with the amount of paperwork required for different application pathways. This has tied up valuable counsellor time in administrative roles which has reduced the time allowed for other essential counselling services. (sub. 35, p. 7)

The complexity in its delivery has led to there being considerable compliance costs associated with the ECIRS assistance program.

The impact of ECIRS assistance on recipients

While having many drawbacks, ECIRS payments have provided valuable support to some. Despite this, the majority of farmers have not received any payments under the scheme. For example, in New South Wales only around 25 per cent of farmers accessed ECIRS at least once over the period 2001-02 to 2007-08 (table C.4). Further, while recipients had relatively poor liquidity positions, only a small proportion appear to be financially vulnerable — 8 per cent had low equity levels and negative incomes — with instead:

- 81 per cent of recipients having high equity levels (table C.8)
- the average recipient having net farm assets of well over $2 million (table C.8).

Coupled with subsidy payments averaging $37 000 in 2007-08, the ECIRS payments are unlikely to represent the difference between viability and non-viability of recipient businesses.

It is interesting, therefore, to examine the effect that ECIRS payments have had on the 'average' recipient. Based on ABARE farm survey data, the characteristics for the average broadacre and dairy ECIRS recipient in 2005-06 is given in table C.9. For a hypothetical average farm, working forward four years and assuming cash costs (including household costs), income and asset values change in line with average ECIRS recipients for subsequent years, those in receipt of the average ECIRS payment over the period would see their average equity ratios fall from 88 per cent to 86 per cent.

In the absence of ECIRS payments, many farmers would likely build any shortfalls into debt. Indeed, a survey of ECIRS recipients found that almost 50 per cent said they would borrow more money to maintain farm operations if there were no ECIRS scheme (SACES 2008a). Assuming that all farmers build any shortfalls into debt (with costs, incomes and capital appreciation remaining as above) the average farm would see its equity ratio fall — from 88 per cent to 83 per cent — but remain within levels considered high. Such averages, however, mask any distributional

effects. It is likely that for many of those 8 per cent of farms that have low equity levels and negative incomes any shortfalls would not be able to be built into debt, resulting in some of these farm businesses exiting.

Table C.9 **Impact of ECIRS for the 'average' recipient**
Base year 2005-06[a]

		2005-06	*Year 2*	*Year 3*	*Year 4*
Income					
Total farm cash receipts	$	336 283	321 123	466 134	..
ECIRS	$	27 906	31 630	36 666	..
Total other income	$	33 306	35 421	30 124	..
Total income	$	397 495	388 175	532 925	..
Expenses					
Total farm cash costs	$	275 412	297 521	418 772	..
Household expenditure	$	60 000	61 752	63 852	..
Assets					
Capital value land & improvements	$	2 440 146	2 629 312	2 884 020	3 025 993
Total farm-related capital value	$	3 040 028	3 258 389	3 509 902	3 660 836
Farm business debt	$	373 633	412 695	471 902	520 379
Net equity	$	2 666 395	2 845 694	3 038 000	3 140 457
Equity ratio	%	88	87	87	86
Equity ratio without ECIRS	%	88	86	85	83

[a] Equity ratios without ECIRS payments assume any shortfall is built into debt levels.

Source: PC estimates using ABARE (2008 unpublished).

Impacts on small communities

ECIRS payments also flow through to rural communities. Many participants believe these payments have been vital in maintaining many small towns and communities during the latest drought. But the extent to which payments flow through to small communities is dependent on the spending behaviour of recipients.

Expenditure by farmers in smaller rural towns, those with a population less than 5000, represents a significant component of their economies compared with larger towns and cities. On average, an estimated 29 per cent of farmers' expenditure occurred in towns with a population of less than 5000 (Levantis 2001). Assuming that ECIRS recipients' spending behaviour followed this pattern and further that they spend half of all their payments, the remainder paying back debt, a total of $91.9 million would flow to towns with populations less than 5000 within EC areas (based on payments received during 2007-08 of $633.6 million including small business interest rate subsidy payments — see following section). This equates to approximately $74 per person living in these towns (based on ABS Census data and

the proportion of agricultural land under an EC declaration giving an estimated 1.2 million people living in towns of less than 5000 people within EC areas).

But not all of these expenditure would remain within the local economy as income for residents or those in the wider region. Much would be 'transferred' out to cover the cost of goods sold amongst other things. In many cases only a retail margin remains within the town. If it is assumed that 50 per cent stays within the town (likely an overestimate) subsidy payments in 2007-08 could have resulted in an average income boost of about $37 per resident of towns with a population of less than 5000 within EC areas. However, given the uneven distribution of ECIRS recipients across Australia, for some small towns increased expenditures would be greater, whereas for others it would be significantly less.

EC exit package

As of 5 December 2008, only 98 applicants have received the exit package from a total of 469 processed claims. Of the remaining claims, 262 were rejected and 109 are in the assessment stage (table C.10). A total of $12.8m has been paid out in exit grants with an additional $108 000 paid in advice and relocation assistance.

Table C.10 **Characteristics of successful and unsuccessful exit package claimants**

December 2007 to December 2008

		Successful	*Unsuccessful*
Average age	years	53	52
Average payment	$	130 956	–
Average assets	$	346 941	671 501
Average liabilities	$	94 244	295 232
Average net assets	$	252 697	376 268
Average time on EC assistance	months	17	18
Applicants	no.	98	262

Source: DAFF (2008 unpublished).

Of those who received exit assistance, 64 of the 98 had also received other EC assistance (ECIRS and/or EC Relief Payment) for an average of 17 months prior to leaving the industry. Not surprisingly given the assets threshold, most EC recipients had low average asset and net asset levels prior to leaving the industry — of around $347 000 and $253 000 respectively. Among those who were unsuccessful in their claims, average asset and net asset levels were higher recognising that assistance reduces to zero for those with net assets exceeding $575 000.

For those farmers who were unsuccessful in receiving the exit package, most were refused on the ground that they did not supply information to support the claim (32 per cent). Following this, the main reason for an unsuccessful claim related to:

- not being a farmer for at least 5 years — 16 per cent
- not deriving sufficient income from farming over the period examined — 13 per cent
- asset levels being too high — 11 per cent.

Close to half of all Exit Package recipients had operated horticultural activities. Other recipients were spread relatively evenly across other agricultural industries.

While recipients were spread amongst a wide range of EC areas, the River Murray and Lower Lakes EC area had the greatest number of recipients — 10 from the total 98. Of those from this area with information recorded on industry, all had been involved in horticultural activities prior to exiting the industry. On a state by state basis, close to half of the recipients were based in Victoria (46), with the majority of the remainder coming from New South Wales (28) and South Australia (20).

Given the similarities, any criticisms made of the EC exit package are likely to equally apply to the Climate Change Adjustment Re-establishment Grant.

Is EC exit assistance appropriate?

Where assets are site-specific or 'lumpy', as for most agricultural producers, exit decisions may be delayed due to expected large capital losses (Industry Commission 1996). Further, information barriers may exist that mean farmers have little information on alternative uses of farm assets or potential alternative job opportunities (McColl et al. 1997). These characteristics create impediments to industry adjustment and, to the extent that they exist, may provide a rationale for government intervention.

However, the Industry Commission (1996) concluded that whilst the above factors could impede adjustment, it is not clear that they present significant obstacles. The Industry Commission examined data on bankruptcies and land sales in the sector and found no indication of significant barriers. Moreover, it points out that where barriers exist it is likely that they also apply to other industries.

Importantly, as financial incentives alone are unlikely to overcome the cultural barriers to adjustment, it is likely that exit grants are an inappropriate means to facilitate rural adjustment. This view was also put forward by the mid-term review of the Rural Adjustment Scheme (RAS) which concluded that grants are not the best

approach (McColl et al. 1997). Instead exit assistance programs should focus on the provision of complementary information and advice to address impediments to movements of people and resources.

Effectiveness of exit assistance for farmers

EC exit assistance has had very little usage, with only smaller farmers, with low asset levels, being able to access these payments. Thus, EC exit assistance has done little to facilitate adjustment within the industry in times of drought. Further, given the similarities with the Climate Change Adjustment program, the problems faced by the EC exit package are equally likely to apply.

There are a number of reasons why EC exit assistance has been ineffective. First, it is likely that the asset limits within the eligibility requirements exclude many farmers who may otherwise wish to exit. As put by accountants Carrigan & Co Pty. Ltd.:

> We believe that the reason why there has been little take up is simple — it is virtually impossible to have net assets under $350,000 and not have already been forced to sell by your bank. We argue that a farmer would need to have at least $500,000 to $700,000 in equity to even contemplate remaining 'on the farm'. Most farmers with lesser equity than this will have already quit the industry or have been advised to quit by their bankers. (sub. 32, p. 4)

Despite industry variations in the equity levels required to remain viable, current asset caps have likely had a significant impact on potential coverage of the scheme — especially since average total capital asset value for those farmers experiencing hardship and receiving the EC Relief Payment is close to $2.3 million.

A number of non-financial factors are also likely to limit the effectiveness of the EC exit package. When considering exiting from the industry, farmers not only face the decision of changing occupations, but more often also need to move away from the family home, lifestyle and the community in which they have lived. These factors make the exit decision complex. As stated in one submission:

> … relocation out of area is proving to be a major sticking point for many … They wish to exit farming and have indicated they are pleased the grant is available to assist them to do so but do not wish to move from the local area to which many have a long term attachment, family, friends etc. (confidential submission)

Also, as put by the Mid Lachlan Alliance of Councils:

> Current exit programs funded by the Federal Government whilst contained within a sound policy framework are insufficient to induce farm families to leave farms and re-establish elsewhere. Further they do not account for the strong connection land holders

> have with the land. Generally this professional loyalty runs very deep, spanning generations throughout the good and bad cycles of farming. (sub. 38, p. 5)

Many farmers also do not see themselves as having the necessary skills for being able to find work in other industries. For these, retraining grants and recognition of prior learning is likely to have been effective in aiding the transition out of farming.

The complexity of the exit decision has been argued to be the reason why, in part, previous schemes aimed at encouraging rural adjustment have not been successful (Botterill 2001). Farmers' attitudes in terms of 'country mindedness', where there are non-economic attributes to working on the land which are valued highly, are believed to be a major impediment to the effectiveness of exit schemes:

> Country mindedness has important implications for farm adjustment policies. Hardship and adversity are seen as character building and part of the moral value of farming. Farming is regarded as a way of life with intrinsic, non-monetary values. Alternative lifestyles are regarded with suspicion and distaste. Under these circumstances, it would seem that offering a reestablishment grant is not the inducement the policy-makers intend it to be. (Botterill 2001, p. 12)

As a result, policies offering economic incentives which disregard non-economic factors are unlikely to be successful (Kerridge 1978; Botterill 2001).

It is also possible that other EC related programs, such as the EC Relief Payment and ECIRS, inhibit the effectiveness of the exit package. Where drought assistance measures enable non-viable farmers to remain on the land longer than they would have otherwise, they impede adjustment. Even with the provision of income support payments, there is the potential for drought assistance to work counter to any exit assistance measures (O'Meagher 2005; Cockfield and Botterill 2006).

Assistance to farm dependent rural small businesses

Between October 2006 and December 2008 a total of 2052 farm dependent rural small businesses had received a payment through the interest rate subsidy assistance package. In total, over this period $60.5 million was paid at an average of just under $30 000 per recipient (table C.11). Over the two and a half financial years of operation, the number of successful claims remained steady.

Most claimants were from New South Wales (close to 65 per cent of claims and assistance paid) followed by Victoria and Queensland. In the remaining states and territories only 62 successful claims have been made. In terms of business types, most claimants operated businesses that provided rural services such as contractors and farm supplies (73 per cent). Following this, 16 per cent of claimants had transport related businesses and 2 per cent were retail businesses.

Table C.11 **Recipient numbers and payments of interest rate subsidies to small businesses**

October 2006 to December 2008

Year	*Recipients*	*Total amount paid*	*Average amount received*
	no.	$ m	$
2006-07	759	23.7	31 242
2007-08	984	29.5	29 999
2008-09[a]	309	7.3	23 781
Total	2 052	60.5	29 523

[a] Figures from July 2008 to December 2008.

Source: DAFF (2008 unpublished).

A number of small businesses have also been unsuccessful in their claim for assistance — 815 over the period. The main reason for rejection was that the businesses were deemed to be not in need of financial assistance (49 per cent). A further 10 per cent were unsuccessful as their businesses were not farm dependent. Only 6 per cent of unsuccessful claimants were denied assistance because they were deemed unviable.

Apart from broad usage data there is little information collected on the financial status of recipients and non recipients. As such, no comparisons can be made between those businesses that are managing drought conditions without assistance and those that receive help.

Appropriateness, effectiveness and efficiency of assistance to rural dependent small businesses

Small business assistance has only been in place since 2007. As with the interest rate subsidy paid to farmers, small business assistance is intended to target those viable businesses experiencing temporary financial difficulty due to an EC event.

Despite a number of businesses accessing EC small business assistance, given the short time in operation there is little available evidence on the characteristics of participants, making an assessment of effectiveness difficult. What evidence is available suggests that the programs have not been a useful tool to help manage drought. For example, a study into the effects of drought on small businesses in the New South Wales town of Wee Waa by Spanswick et al. (2008), found that for those who accessed drought support:

> … over 50% of businesses who accessed this service did not find it useful … One business commented that drought relief seemed to offer no benefit to well run businesses that were doing it tough. (Spanswick et al. 2008, p. 3)

Spanswick et al. (2008) found that business adopted a range of drought management strategies including:

- tighter inventory control
- reduced expenditure and tighter cash flow management
- maintaining good communication with bank or other financial lending institution
- diversifying their business
- reduction in staff numbers and the use of more flexible management options.

These strategies, often developed in consultation with their accountant or bank, were viewed as useful strategies for managing the downturn in income brought about from drought conditions.

Despite this, a number of submissions argued that assistance should be provided to maintain small business in towns during times of severe drought. For example, as put forward by Centroc:

> If government genuinely wishes to maintain rural communities, strategies must be put in place to support their future including research and development to facilitate sustainable farming, training and drought financial assistance measures … The government via drought support measures provides an important means of survival for not only farm families but the Australian agriculture sector. This also extends to rural contractors and businesses that all form part of the agriculture economy and who without their support and service provision the farming process would be incomplete and in some cases obsolete. (sub. 105, p. 2)

But such concerns are generally based on the notion that governments should provide support to rural communities in order to maintain their functioning and social fabric in the face of broader external factors which are inducing change. While it is likely that droughts or other exceptional circumstances exacerbate the forces of change, it is not the usual cause of long-term adjustment. Whether or not government intervention could be justified, such policies should not comprise part of a national drought policy, and indeed, lie outside the objectives of the current NDP.

A lack of data on the characteristics of small business recipients makes it difficult to assess these measures against the NDP objectives. However, as with the ECIRS paid to farmers, it is unlikely that the nature of interest rate subsidy payments made to small businesses, paid as unconditional grants, would be effective in helping develop better drought management strategies in order to improve self-reliance. Further, it is unlikely that appropriate rationales exist for the provision of this type of support in times of drought. Indeed, attempts to pursue objectives of maintaining rural communities through drought policy would likely lead to the delivery of ad

hoc support to different communities at different times and do nothing to alleviate the longer term structural change pressures that are affecting most communities.

Summing up

EC support provided to farm businesses and farm dependent rural small business:

- appears to be well targeted and thus has been effective in providing support to those that whom policy makers intended to help. While little information is available for small businesses, the ECIRS payment has been received by those farmers who are experiencing liquidity problems.
- has been ineffective in achieving the goals of the NDP and has been delivered in the absence of appropriate rationales for government intervention. In particular, the ECIRS has done little to promote self-reliance and may have even created incentives for producers to be less self-reliant in the face of climate variability.
- while government support to promote industry adjustment may be appropriate, the EC exit package has been poorly designed and subsequently ineffective. Moreover, there is little justification for the use of exit grants to encourage such adjustment. Instead, government policies should focus on alleviating impediments to the movement of labour and resources through, for example, training and recognition of prior learning.