
10 Related policies

Key points

- There is a range of policies outside the agriculture portfolio that are often at cross purposes to drought policy.
 - Some of these problems would be rectified by the implementation of the recommendations in this report.
 - Other improvements in coordination require changes to water and natural resource management policies.
- The extent to which irrigators will be affected by future periods of low inflows depends to a large extent on progress with water reform and the implementation of the Water for the Future plan.
- Effective natural resource management policies can potentially reduce some of the negative impacts of drought.
- Many government-provided human services are important for the wellbeing of people in rural and regional areas, including during droughts. In general, it is preferable for these services to be provided on a continuous basis, rather than being temporarily available during drought.

10.1 Introduction

A range of policies outside the agriculture portfolio, such as those related to water, natural resource management and climate, influence farmers' abilities to manage climate variability and change. Other broader policies, such as those related to health, education and industrial relations, influence agricultural performance and/or the wellbeing of people in rural and regional areas more generally (figure 7.1).

The occurrence of drought is but one factor, among many, that needs to be considered within these broader policy settings. As it is beyond the scope of this inquiry to consider all of the relevant factors, this chapter does not make policy recommendations. Rather, its purpose is to explain the influence of non-agricultural policies on drought-related outcomes and identify where better coordination between these policies and agricultural policies is needed.

10.2 Water policy

Water policy is concerned with, among other things, the arrangements for allocating water between individuals and groups that wish to use it for irrigation, industrial purposes, mining, servicing rural and urban households and environmental services. Water policy reform in Australia has been pursued through the National Water Initiative (NWI) and preceding processes established by the Council of Australian Governments (COAG 2004).

Where water policy is well designed, the negative impacts of drought will be less than they would otherwise be. In this regard, some of the hallmarks of good water policy include:

- entitlements and other water products having well defined characteristics (for example, the security of supply) that allow irrigators to understand and manage water-related risks
- trading arrangements that allow water to flow to its highest value use (within constraints, such as the physical connectivity of water systems)
- not unnecessarily restricting irrigators' choices about water use and trade between irrigation seasons (PC 2006).

There is evidence that some of the policy reforms implemented through the NWI, particularly those allowing increased development of water trading, have been of benefit to many farmers during the latest drought. According to the Department of the Environment, Water, Heritage and the Arts:

Water trading has played a vital role in assisting (irrigation) farmers during this period of ongoing drought and very low water allocations, and gives them much greater flexibility in the way they operate their businesses and manage their risks. (sub. 107, p. 11)

A report examining changes in the Victorian Murray Valley found the following:

- With or without water trading, drought would lead to tough times and many property foreclosures. Water trading delays and prevents some of the sales by giving farmers an additional asset with which to manage debt ...
- Without temporary trade the dairy industry would have fared much worse than it did during the past 10 years of drought.
- Even with temporary trading many dairy enterprises collapsed as a result of the extraordinarily low seasonal allocations of 2002-03 and 2006-07. Permanent trading meant that those farmers left farming with more money than they otherwise would have had.
- Without temporary trading many existing horticultural enterprises in the Goulburn system would not have survived the extraordinarily low seasonal allocations.

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- Many mixed farms survived the low seasonal allocations by selling water on the temporary market, thus making more money than they would have done by growing crops. (Frontier Economics 2007, p. xiii)

There would appear to be potential to improve outcomes further by reforming various arrangements that govern or influence water trading. First, there is currently an annual threshold limit on the level of permanent trade out of irrigation districts of 4 per cent of the total water entitlement. In some cases this limit prevents trades from occurring that would be beneficial to both the buyer and seller. Accordingly, the limit imposes costs on the community and it is not clear that there are substantive benefits that offset this. On the release of a National Water Commission (NWC) report on Australian water markets, Ken Matthews (CEO of the NWC) stated:

... the case previously put by the Commission for reviewing the 4 per cent per annum interim threshold limit on permanent trade out of irrigation districts is stronger than ever. (NWC 2008b)

The 4 per cent limit is due for review in 2009.

Second, irrigators who sell their permanent water entitlement are sometimes required to pay exit (or termination) fees. The Productivity Commission has previously found that exit fees constrain trade in entitlements and impede adjustment (PC 2006). The Australian Competition and Consumer Commission is currently considering this issue and its draft advice is that the maximum fee should be reduced by one-third (ACCC 2008).

Finally, the New South Wales Irrigators Council (sub. 62) reports that government departments sometimes take an excessively long time to process water trades and barriers to interstate trade in water entitlements impede the efficient operation of water markets. A report by the NWC confirms that there is room for improvement in some states in these areas (NWC 2008c).

Notwithstanding the benefits delivered by reforms to date, the low inflows over recent years have been exacerbated, in some respects, by deficiencies in water policy. The major problem is that of overallocation, most notably in the Murray-Darling Basin. According to the Department of the Environment, Water, Heritage and the Arts:

This situation has arisen as a result of past decisions by state and territory governments to issue more entitlements than can be delivered by water systems, and by a failure in water sharing plans to set the pool of water available for consumption at sustainable levels. (DEWHA 2008b)

To address this overallocation the Commonwealth Government plans to spend \$3.1 billion on buying back water entitlements from willing sellers as part of the Water for the Future plan. Under this plan, a further \$5.8 billion has been allocated to measures such as upgrading irrigation infrastructure and assisting non-viable irrigators to exit the industry (DEWHA 2008a).

While droughts will continue to have negative impacts on irrigators, the extent of these will depend to a large degree on how the Water for the Future plan is implemented and on the progress of policy reform, through the NWI and other processes. It is not within the scope of this inquiry to make recommendations in these areas.

There is a need for water policy and agricultural policies to be better coordinated to prevent poor outcomes, as discussed below.

Drought relief payments can reduce the gains from water trading

As discussed in chapter 6, current programs under the National Drought Policy, particularly the Exceptional Circumstances Interest Rate Subsidy, have supported some unviable farm businesses. As a consequence, some farmers who would otherwise have exited, or sought alternative management arrangements for their properties, have continued to purchase water for irrigation. Others may have purchased more water than they otherwise would have, due to receipt of EC payments. Where this occurs water prices for other users will tend to increase, making it more difficult to combat overallocation. It can also work against water being allocated to higher value uses. The policy approach advocated by the Commission in this report will reduce the extent of these unintended outcomes.

Assistance with drought preparedness measures can reduce inflows

Some drought preparedness measures, such as laser grading irrigation farms, can reduce the quantity of irrigation water used per tonne of agricultural output. Because of this, it is often thought that assisting a farmer to implement such measures will not only benefit that farmer but will save water that can then be used by other irrigators or for environmental flows. Often, however, such measures actually reduce the quantity of water available to other water users. This is because they tend to reduce the volume of water that leaves the farm to flow back into rivers or groundwater sources (PC 2006; Crase and O'Keefe 2008). When farmers decide to use the water savings to increase their production, the net result is that there is less water available for other water users. Other preparedness measures, such as building farm dams, unambiguously reduce the quantity of water available to other users.

Accordingly, where governments subsidise preparedness measures, for example through irrigation management grants, they may effectively be providing a benefit to one farmer at the expense of other farmers and of environmental flows.

It should be recognised, however, that even without subsidies, farmers may overinvest in such measures compared to what is socially optimal. This is because their decisions are quite legitimately focused on improving their farms and are not generally influenced by the costs they impose on downstream water users. This problem can only be rectified by changes to water policy to address the connectivity of water systems. This issue is recognised in the NWI, but is yet to be adequately addressed (Young and McColl 2008).

Subsidies for irrigation infrastructure can impede adjustment

There is potential for some of the Water for the Future allocation of funds to upgrade irrigation infrastructure to be wasted if there is not effective coordination with agriculture policy and recognition of the various adjustment pressures at play within agricultural industries that use irrigation water. For example, a costly infrastructure upgrade could be made redundant if the farmers it served decided to exit and sell their water entitlements.

Where governments are actively seeking to purchase water, it is counterproductive to improve infrastructure, which then increases the value of water rights. It is essential to make the buybacks before deciding which infrastructure is worth upgrading.

In commenting on the draft report the National Farmers' Federation (NFF) questioned this conclusion, citing an ACIL Tasman report that says:

... to effectively manage the risk of paying too much to return the target flows to the environment, there is a solid prima facie case for considering urgent active investment in identifying and proving up an expanded set of infrastructure projects. (ACIL Tasman 2008, p. ii)

There is a risk that the water buyback program will prove to be more expensive than necessary if it is not well designed. However, the Commission cautions against using investments in water infrastructure to manage this risk. This is because such investments:

- are often a more costly way of 'saving' water compared to buying water in the market (PC 2006)
- can produce savings that are illusory when 'saved' water is removed from return flows to rivers and groundwater sources

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- can be rendered redundant if the farmers it serves decide to sell their water entitlements.

Exit assistance provided through water policy can reduce adjustment pressures in agriculture

In September 2008, the Commonwealth Government announced \$150 000 exit payments for small block irrigators in the Murray-Darling Basin who agree to sell all their water entitlement to the Commonwealth (Rudd and Wong 2008). The assistance will allow eligible irrigators with permanent water entitlements of at least 10 megalitres, who choose to leave irrigated farming, to stay on their land. In addition, grants of up to \$10 000 each will be provided for advice and training, and for removal of permanent plantings (such as grape vines).

If assessed in terms of addressing the overallocation of water, this would appear to be an extremely high cost measure. However, it does have the benefit of reducing adjustment pressures, as it would be expected that many of those who apply would not have a viable future in irrigated agriculture. By allowing people to remain in their home and retain their land, the measure also addresses one of the non-financial impediments that can prevent people from exiting an unviable farm business (chapter 9). Many small irrigators are located near regional centres where alternative employment may be available which, in combination with assistance for training, lessens the chance that recipients will have difficulty finding employment.

Deficiencies in water policy can increase calls for drought assistance

Some inquiry participants expressed the view that government water policy had been deficient and that this justified the provision of drought assistance to irrigators. For example, the Rural Financial Counselling Service Victoria — Murray Mallee argued:

A major factor contributing to the lack of irrigation water is the poor risk assessment associated with the allocation of water rights throughout Australia's irrigation districts by successive governments ... Financial support for farmers in a format which encourages better performance in the future is therefore justified, governments must accept some of the "responsibility" for the current lack of irrigation water, and it is not all due to drought and climate change. (sub. DR151, p. 3)

Water policy is an important avenue through which irrigators' concerns regarding drought should be addressed. In the Commission's view, efforts should be directed to achieving sound water policy, and this leaves no residual role for governments to provide any drought-related assistance to irrigators additional to that outlined in chapters 8 and 9. The NWI sets out a framework for assigning risks to water access

entitlement holders and Commonwealth, state and territory governments regarding any future reductions in the availability of water. Calls for extra assistance to irrigators through future drought policy amount to an attempt to renegotiate this assignment of risk and should be resisted.

10.3 Land-based natural resource management policy

Effective natural resource management policies can potentially reduce the negative impacts of drought in two ways. First, they can result in agricultural land being in better condition at the onset of drought (for example, greater vegetation cover, less soil erosion and less salinity). Second, they might involve payments to farmers for the provision of explicit environmental services to the broader community. Such an additional income stream would likely be relatively independent of climatic conditions and could help to diversify farmers' incomes.

Several inquiry participants argued that government payments to farmers for providing environmental services should be part of the answer to low farm profitability due to drought or other cause. For example, Dragon Point Enterprises stated:

My suggestion is that we should turn the environment card face up: support farming enterprises to regenerate their production environments through stewardship arrangements that provide a return comparable to other investments. (sub. 15, p. 2)

A range of natural resource management and environmental policies seek to improve the environmental management of agricultural and other land. Some of these policies do provide for payments to landowners for the provision of specific environmental services:

The Australian Government has recognised the benefits of incentive-based schemes to improve environmental conservation and management. The Government already has a scheme to purchase high value conservation outcomes for the public good, in the Environmental Stewardship Program under the *Caring for our Country* initiative. (Department of the Environment, Water, Heritage and the Arts, sub. 107, p. 12)

The Environmental Stewardship Program will offer contracts to landholders who can provide environmental services on a cost-effective basis. The targets for investment are:

- nationally endangered or vulnerable species and ecological communities
- migratory species and wetlands for which Australia has international responsibilities
- natural values associated with world and national heritage places.

The budget for the program is \$50 million over four years, with an indication from the Commonwealth Government that this may increase in the future (DAFF and DEWR 2008). In addition to this program, some state governments, such as Victoria, have programs in place that pay landholders for the provision of environmental services.

The question of whether there should be a greater emphasis on payments to landowners to achieve desired environmental outcomes (and perhaps less emphasis on proscriptive regulation) is one that should be addressed in the ongoing development of these policies. The Commission has previously set out some principles for determining who should bear the costs associated with environmental protection that are relevant to this process (box 10.1).

The Commission's preferred approach, therefore, is to develop natural resource management policy based on sound principles and evidence, rather than adjusting policy settings to meet drought-related objectives. It would be poor public policy to pay farmers for providing environmental services on the rationale that this would provide them with private benefits during drought. The Commission's approach would appear to be consistent with that of the NFF, that stated:

... the NFF is cautious in linking environmental conduct to other programs such as drought support ... we do believe the merits of environmental stewardship stand on their own two feet. (sub. DR176, p. 38)

Two coordination issues related to natural resource management policy are discussed below.

Drought assistance can result in environmental damage

Coordination is important because drought policy can unwittingly result in environmental damage (chapter 6). This is acknowledged by the Department of the Environment, Water, Heritage and the Arts:

Every effort should be made when considering alternative drought policy approaches to avoid perversely undermining investments made under the \$2.5 billion *Caring for our Country* and other environmental initiatives. (sub. 107, p. 6)

There is, therefore, a need for natural resource management policy and drought and other agricultural policies to be better aligned and coordinated. The approach recommended by the Commission improves on past policy in this regard, for example, by phasing out fodder subsidies that can promote environmental damage.

Box 10.1 **Sharing the costs for environmental protection**

The Commission's 2004 inquiry report *Impacts of Native Vegetation and Biodiversity Regulations* considered cost-sharing arrangements for protecting the environment and providing environmental services. The following is an extract from that report.

Landholders' responsibilities

In the Commission's assessment, it is reasonable to expect landholders in the aggregate to bear the costs of actions that directly contribute to sustainable resource use and, hence, the long-term viability of their operations. Thus, actions and mechanisms to 'internalise' efficiently what could be broadly described as externalities occurring within and between regions — landholder actions affecting soil and water quality, for example — would constitute the responsibility of landholders individually and/or as a group. This approach does not mean that individual landholders should only be expected to undertake what is in their private interests — it implies a broader responsibility to their neighbours and communities and, indeed, where actions have broader impacts, surrounding communities.

Society's responsibilities

In the Commission's assessment, the wider public should bear the costs of actions to promote public-good environmental services — such as biodiversity, threatened species preservation and greenhouse gas abatement — that it apparently demands, and which are likely to impinge significantly on the capacity of landholders to utilise their land for production.¹

This assessment is not simply based on some notion of fairness (although perceived fairness is not irrelevant when landholders are being relied upon to provide the environmental services demanded by the wider community). It is based on the reality that achieving the environmental outcomes that society desires on private land as efficiently and effectively as possible will require clear specification of the environmental outcomes demanded and the ongoing cooperation, knowledge and effort of landholders who ultimately must deliver those outcomes on their land.

Over and above agreed landholder responsibilities, the Commission therefore considers that public-good conservation should be purchased from individual, or groups of, landholders.

Source: PC (2004, p. XLI).

¹ The context for greenhouse gas abatement has changed since 2004. At that time there was no general requirement for industries to undertake costly action to reduce greenhouse gas emissions. In such an environment, it would be appropriate for the broader community to pay if a particular industry was required to reduce its emissions. Since then the Commonwealth Government has announced that the Carbon Pollution Reduction Scheme will be introduced and this will involve the majority of industries (and indirectly, all consumers) paying for whatever greenhouse gases they emit.

Natural resource management policy have synergies with drought management

A CSIRO report, which was included in an Australian Conservation Foundation submission (DR128), suggested a way that environmental stewardship agreements could be designed to have synergies with farmers' management of drought:

An agreement might set out ... that specified parts of an on-farm conservation area could be moderately grazed on a long rotation — such as at 40 per cent of the normal stocking rate once every nine years — where this was compatible with the environmental outcomes sought. Such provisions might mimic the impacts of natural climate variation. Provisions of this kind would provide improved on-farm management of climate risk (such as by providing additional fodder), making the conservation agreement more attractive to landholders. (Hatfield-Dodds and Procter 2008, p. 28)

This concept, which was also mentioned in an NFF submission (sub. DR176), would appear to be worthy of further investigation.

10.4 Climate policy

Of all the areas of climate policy that can impact on farmers' abilities to manage climate variability and change, two of the most important are:

- research aimed at improving seasonal and interannual climate forecasts
- climate change mitigation measures, such as the planned Carbon Pollution Reduction Scheme.

Research aimed at improving seasonal and interannual climate forecasts is discussed in chapter 8.

The Commonwealth Government has announced that it will introduce the Carbon Pollution Reduction Scheme in 2010. This scheme will impose a cost on those emitting greenhouse gases in certain sectors of the economy. One consequence is that energy and some goods whose manufacture is emissions intensive will be more expensive than they would otherwise be, driving up production costs, including for farmers. Farmers may also have an opportunity to earn income from the scheme if they diversify into eligible forestry activities that remove carbon dioxide from the atmosphere. Such diversification could make farm businesses more self-reliant during drought.

The Commonwealth Government has indicated that agricultural emissions (such as those associated with the digestive processes of livestock and with fertiliser use) may be included in the scheme from 2015, suggesting that farmers may need to be

planning for the possibility that there will be a price signal on agricultural emissions from that time (Department of Climate Change 2008).

10.5 Other policies

The outer ring of figure 7.1 includes the more generic policy frameworks that impact across the entire community, such as economic policies, human services (such as health and education) and the social security safety net. Economic policies influence the operations and profitability of all businesses, including farm businesses. For example, trade policy can increase profitability through improving access to export markets. Human services and the social security safety net, on the other hand, focus on the wellbeing and development of individuals and families. In the context of hardship caused by drought or other circumstances, these areas are of particular importance, as recognised by the Expert Social Panel:

The Panel believes people should be the priority (and not the farm property or the respective industry), and propose future policy be about people: changing perspectives on dryness. (Kenny et al. 2008, p. 1)

The Commission strongly concurs with this conclusion.

Human services

A wide range of education, health and aged care services are provided, or funded (at least in part) by governments. State and territory governments have the major role in delivery of most of these services.

Governments attempt to achieve equitable access to these services. This often entails governments devoting more resources per person to groups in the community that have special needs or are more costly to provide accessible services to. Accordingly, governments often spend more per person on delivering equivalent levels of services, such as school education, to people in rural and regional Australia than people in major cities. For example, expenditure per government primary school student in New South Wales was 14 per cent higher in nonmetropolitan than metropolitan areas, in 2003-04. For Victoria it was 7 per cent higher and for South Australia 10 per cent higher (SCRGSP 2006).

Despite this, people outside the major cities, and particularly those in more remote areas, will continue to have greater travel times and have to go to provincial centres for higher order services.

This context needs to be borne in mind when considering ways to improve services to people in rural areas. One theme of the Expert Social Panel's report is that governments should consider the social impacts of withdrawing services from small towns affected by dryness. This is important, although it is also necessary to weigh up the impacts against the opportunity costs of maintaining services in the face of changing patterns of settlement.

The Expert Social Panel observed that drought-specific human support service providers 'frequently did not appear to have the appropriate training or skills to effectively engage farming individuals or rural communities' (Kenny et al. 2008, p. 37). In the Commission's view, these shortcomings are difficult to avoid when temporary services are set up in response to a drought. In addition to potential training and skills problems, new service providers inevitably take time to become known in the community and to develop relationships with potential clients and other service providers. Appendix E discusses various drought-specific human support services operated by state and territory governments.

In the Commission's view the emphasis should be on human services that are available all of the time, rather than on drought-specific services. Services that operate on a continuous basis should be responsive to community needs. The occurrence of drought is one factor that influences these needs, but chapter 3 indicates it is often not the major driver of need.

The Expert Social Panel also found a need for better coordination and referral mechanisms between service providers. The Commission agrees with this. The Expert Social Panel report includes a detailed consideration of these issues.

Social security safety net

Drought and other circumstances can result in some farm families being in hardship. As discussed earlier, the Commission's view is that there should be a farmer-specific income support program that is able to be accessed on a temporary basis. The design of this program, including how it should be coordinated with the general social security safety net, is discussed in chapter 9. Even with a program designed for farming circumstances, aspects of the general social security safety net, such as the Age Pension, would remain relevant to some farmers. The general social security safety net is also available to support operators of farm dependent businesses and farm employees (and their families) in a range of circumstances.

Tax policy

Tax policy can interact with drought policy in a number of ways and can influence the way farm businesses are managed during drought. Perhaps the most important of these relates to the tax treatment of livestock. The value of livestock that are bred by a farm business (referred to as natural increase) that is used for tax purposes is often substantially less than the market value. For example, cattle can have a tax value of \$20 per head and a market value of well over \$300 per head.

This creates an incentive for farmers to delay the sale of livestock so as to defer the payment of tax. During a drought this can result in farmers delaying destocking, which may cause land degradation (Douglas 2002). There is provision in the tax system for the profits arising from the forced sale of livestock due to lack of pastures caused by drought, fire or flood to be spread over five years. While this may to a limited extent counteract the incentive to delay destocking, it is in itself inconsistent with the principle that the sale of trading stock should be taxed when it occurs, irrespective of the reason for the sale (Douglas 1995).

There would appear to be scope to alter these tax arrangements so as to achieve both a more consistent treatment of agriculture compared to other industries and more appropriate incentives for destocking at the onset of drought. Recommendations for how this could be achieved are, for example, given in Douglas (1995). It is noted that a 'root and branch' review of Australia's tax system is currently being undertaken.

Regional development

As discussed in chapter 2, provincial and coastal centres are growing in part by attracting spending that previously occurred in small towns and by offering commercial services, employment, education, health services and retirement lifestyles. In addition, small towns are feeling the impacts of farm productivity improvements through scale economies and capital substitution for on-farm labour. Some inquiry participants saw these changes in a negative light and argued that drought policy should seek to slow them.

While drought can increase the rate of some of these changes, it is not the main driver and the pressures for change do not dissipate when a drought is over. Accordingly, it is the Commission's view that the maintenance of small rural communities should not be a rationale for drought policy. Any attempt to influence the future of rural communities would be better pursued through regional development policies. These policies need to be developed with an appreciation of the drivers of change.