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# 11 Implementation and outlook

## Key points

- The exceptional circumstances (EC) declaration process should be terminated.
  - There is no need for a ‘trigger’ for drought relief, nor for ‘lines on a map’ to show eligible areas. The concept of a once in 20-25 year extreme or exceptional drought is unnecessary and unworkable given climate variability, let alone, climate change.
  - Areas currently in EC should continue to be reviewed as to whether EC status is warranted.
- Most current programs to provide support to farm businesses during drought should be wound up as soon as practicable. Any new schemes would require thorough ex ante justification and independent ex poste evaluation of their effectiveness and efficiency within five years.
- It is vital that there is a high degree of confidence that the new policy approach will be consistently and rigorously applied. This is best achieved through an incentives based intergovernmental agreement with independent compliance monitoring.
- Adopting the Commission’s recommended approach would be likely to result in:
  - agricultural production being slightly higher than it would otherwise be.
  - farm families and rural communities, in the longer term, suffering less acutely from the effects of drought because they would be better prepared for the variability and change in Australia’s climate.

## 11.1 Context for reform implementation

Drought policy in Australia since 1992 has pursued reasonably sound stated objectives, but the measures and instruments adopted have been only tenuously related to those objectives and, at times, inconsistent and incompatible with them. In practice, implementation has been shaped more by political considerations and responsiveness to lobbying. Longstanding expectations by many farmers that assistance will be provided during drought events, regardless of the policy architecture, have proved true. Previous reviews of the National Drought Policy, for instance, all recommended the abolition of interest rate and transport subsidies. Yet, both subsidy regimes have been expanded. With the latest drought, ad hoc policy

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changes, without the benefit of review, led to increases in the coverage, quantum and expediency of delivery of assistance.

Despite the compelling evidence from earlier reviews of the need for a policy framework that actually promotes farmers' self-reliance and preparedness, this has not been realised. And a set of recommendations from this inquiry — if driven solely by fiscal stringency — would likely suffer a similar fate. Appropriately, and consistent with its approach more generally, the Commission has balanced effectiveness, efficiency and equity to improve the wellbeing of the community as a whole. This is evident in its proposed income support scheme for farm households which have assets of up to \$3 million, and advocacy for sufficient public funding of advice, training and extension services — particularly given the level of private benefits that arise. Accordingly, this report's proposals should not be viewed as a base from which more munificent policy responses are built.

If the policy recommendations in this report are adopted, the consistency and rigour with which they are implemented will significantly influence outcomes. A successful outcome is critically dependent on two key considerations.

1. *Managing the transition from the current to the new approach.* A balance must be struck between fairness for current beneficiaries of EC assistance on the one hand and, on the other, the costs of a prolonged transition involving dual regimes running in parallel (section 11.2).
2. *The credibility of the new policy direction.* The history of drought policy in Australia (chapter 4) demonstrates the problems with instituting reform — recommendations from reviews have been ignored; policy making has been disjointed and poorly linked to objectives; and commitments entered into by governments have been breached (section 11.3 and 11.4).

## 11.2 Making the transition

The Commission's recommended policy approach does not include any drought-triggered programs. Drought triggers — whether attempted to be defined as 'exceptional', 'extreme' or any other such variation — have proven to be a failure at best and divisive at worst. Further, as this report demonstrates, they are not relevant to the formulation of programs aimed at developing self-reliance, preparedness and sustainability. There is no place for them in any future policy architecture. Accordingly, Exceptional Circumstances (EC) declarations will become redundant. Therefore, no new EC, prima facie or interim assistance, declarations should be made. Areas currently in EC should continue to be reviewed as to whether EC status is extended in duration or rescinded.

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In undertaking the transition however, there should be no sudden change to the arrangements in EC declared areas that would leave people worse off. However, to mitigate the inequities that would inevitably arise between EC areas and non-declared areas, the former should not remain declared for too long.

Under the Commission's recommendations, farm families in hardship could access income support, regardless of drought events, from 1 July 2009 (when the Transitional Income Support scheme ends). But for areas still in EC, relief payment (ECRP) recipients would continue to access assistance different to that available to other farm households — with income and assets tests in excess of those available to the rest of the community, no mutual conditionality and no time limits. In addition, recipients of the EC interest rate subsidy (ECIRS) — for which a valid rationale has never been established — would continue to access unconditional funds, whereas farm businesses in non-declared areas could not.<sup>1</sup>

Moreover, within a given budget constraint, the effectiveness of new arrangements could be constrained if a large proportion of available funding continues to be channelled into the decreasing number of remaining EC areas.

By definition, the inequities and inefficiencies from a dual stream system continue as long as any area remains in EC. In recognition of the undesirability of allowing such arrangements to perpetuate, the Commission proposed in its draft report that, while an area remains EC declared, existing recipients of the ECRP and ECIRS should be able to continue to apply for those benefits, but that the schemes should terminate on 30 June 2010 (PC 2008a).

Two weeks after the Commission released its draft report, Ministers with responsibility for primary industries affirmed that 'the EC rules will not change for those producers currently receiving assistance in existing EC-declared areas' (PIMF 2008b). Subsequently, the Minister for Agriculture, Fisheries and Forestry stated in the Parliament that:

... [the national review of drought policy] is a review of how we will handle the next drought and does not carry changes to the protections people enjoy when they are going through the current drought ... (Burke 2008a).

The implication of these developments is that a 30 June 2010 end date for EC arrangements would not be accepted.

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<sup>1</sup> These anomalies would be exacerbated if small business support schemes were to be extended beyond 30 June 2009.

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## Minimising transitional costs given governmental undertakings

Notwithstanding governmental undertakings, the costs and associated inequities of having farmers in similar situations subject to different arrangements must ultimately be addressed. Allowing such a situation to linger for many years would be costly, inequitable — probably more divisive than the current ‘lines on map’ problem associated with the EC system — and inefficient.

The Commission considers that there are actions that could be taken to reduce these costs, but which are consistent with the undertakings given by government.

- Given the high level of benefits flowing to some producers in EC areas, the pressure placed on assessments of EC status would be amplified. That process has been shown to lack transparency and to have been subject to manipulation. There is a strong case for the assessments made by the National Rural Advisory Council (NRAC) to the Minister for Agriculture, Fisheries and Forestry and the Minister’s subsequent reasoning to be made transparent.
- Given the wording of the Primary Industries Ministerial Forum Communiqué — that ‘EC rules will not change *for those producers currently receiving assistance* in existing EC-declared areas’ — there should be no new enrolments for EC assistance in declared areas. However, in new cases of hardship, ECRP should be available until the new farming family income support scheme is operational.
- The lack of conditionality for farmers receiving EC assistance should be rectified even if support continues until an area’s EC status is rescinded:
  - ECRP recipients should be subject to similar case management as that which will apply to people accessing the new farming family income support scheme
  - ECIRS recipients should be subject to rigorous assessment (as occurs in Victoria, for example) including demonstrating appropriate financial and business management planning.

Ultimately, EC assistance in the residual legacy areas cannot run in perpetuity. A pre-announced date (even some years into the future) for an end to EC assistance would be reasonable in order to facilitate a transition to the new arrangements.

### RECOMMENDATION 11.1

***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:***

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- *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.*

In relation to other EC and climate change related measures:

- EC Small Business Income Support, the EC Exit package and the EC Professional Advice and Planning Grant are all scheduled to end on 30 June 2009. However, given the affirmation by primary industries' Ministers that the EC rules will not change for declared areas, these schemes may be extended.
- The Murray-Darling Irrigation Management Grant and Transitional Income Support programs should end on 30 June 2009, as scheduled.
- Drought-triggered transaction-based subsidies administered by state and territory governments should be terminated as soon as possible — with the timing to be determined through negotiation of an intergovernmental agreement (IGA) (see below).
- Some elements of the Climate Change Adjustment Program (CCAP) should be subsumed within the new Farming Family Income Support program. Others, such as the CCAP exit payments available under this program, do not appear to have a clear rationale and so consideration should be given to terminating them.
- All other new policy measures recommended in this report, together with the recommended policy improvements (such as those relating to the enhanced Farm Ready program) should be introduced as soon as is feasible.

The timing of the recommended transitional arrangements is shown in figure 10.1.

**Figure 11.1 Current and proposed arrangements**

<b>Current</b>				
EC Interest Rate Subsidy (ECIRS)				
EC exit package				
Prof. Advice and Planning Gran				
Transaction-based subsidies				
Irrigation Management Grants				
FarmReady				
Rural Financial Counselling Service				
Farm Management Deposits				
Research, development and extension				
EC Relief Payment (ECRP)				
Small Business Income Support				
Transitional Income Support				
Climate Change Adjustment Program (CCAP) grants for exit & advice				
<i>Jun 2008</i>	<i>Jun 2009</i>	<i>Jun 2010</i>	<i>Jun 2011</i>	<i>Jun 2012</i>

<b>Proposed</b>				
ECIRS		→ transition		
EC exit package		→ transition		
Prof. Advice and Planning Grant		→ transition		
Transaction-based subsidies		→ transition		
Irrigation Management Grants				
FarmReady (with increased scope similar to FarmBis)				
Rural Financial Counselling Service (pending review)				
Farm Management Deposits (retained as is)				
Research, development and extension (enhanced)				
ECRP		→ transition		
Small Business Income Support		→ transition		
Transitional Income Support				
	Farming Family Income Support scheme (proposed) Counselling and Recognition of Prior Learning (proposed) Grants for training, financial planning and advice (proposed)			
CCAP grants for exit & advice				
<i>Jun 2008</i>	<i>Jun 2009</i>	<i>Jun 2010</i>	<i>Jun 2011</i>	<i>Jun 2012</i>

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## 11.3 Ensuring policy credibility

Many of the potential advantages of the recommended policy approach will be realised only if there is confidence that it will be consistently and rigorously applied. Progress towards greater self-reliance and preparedness for periods of financial difficulty would be undermined if there is an expectation that governments will eventually revert to providing reactive support when droughts recur. To date, such expectations have proved well-founded.

The Commission's recommendations are similar to those of past reviews. That such recommendations have not been adopted, or followed only briefly, highlights that policy credibility is a fundamental prerequisite for success. Fortunately, present circumstances appear more favourable for reform than previously. Specifically:

- current projections of climate change add weight to an argument for avoiding government support that impedes innovation, adaptation and industry adjustment
- Australian governments agree that current approaches to drought and EC are no longer the most appropriate in the context of a changing climate
- stakeholders such as the National Farmers' Federation, the NRAC, the Bureau of Meteorology–CSIRO and many individual farmers are also seeking an approach that does not involve an EC trigger.

These circumstances work in favour of achieving a credible commitment to a new approach based around self-reliance, preparedness and equity. Nevertheless, lobbying for reactive drought support could still create media and political dynamics for backsliding that are difficult for governments to resist.

A mechanism for strengthening policy credibility would be for the Commonwealth, state and territory governments to enter into an agreement that committed:

- the Commonwealth to provide funding to the states and territories through, but not necessarily limited to, the Australia's Farming Future initiative
- the Commonwealth, state and territory governments to not (re)introduce or maintain reactive business support for farmers and farm-dependent businesses.

By making full funding contingent on outcomes, an IGA would provide an incentive for state and territory governments to adhere to commitments. There is no complementary measure for achieving such discipline within the Commonwealth Government.

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## 11.4 Intergovernmental cooperation

There are many forms of IGAs with varying degrees of effectiveness.<sup>2</sup> Typically IGAs arise in areas where the Commonwealth Government is best placed to co-ordinate policy, with state and territory governments undertaking much of the implementation. IGAs can therefore improve national consistency — for example, through uniform regulation, harmonisation or mutual recognition.

Various funding models apply to interjurisdictional arrangements. For example, under the IGA establishing the National Transport Commission, the Commonwealth contributes 35 per cent of the budget with the remainder contributed by the states and territories.

Changes to, and derogations from, commitments can be determined by voting arrangements (for example, consensus voting which can allow one jurisdiction to ‘hold out’, compared to majority voting). However, IGAs are not binding — a point the Victorian Government made to an earlier Commission inquiry:

... no jurisdiction can be made to accept a decision that it sees as disadvantageous to its interests, even if supported by a majority of others. This ... places the onus on officials-led coordination to work towards consensus agreement with ministerial negotiation to be used ... where consensus is not achieved. (cited in PC 2009, p. 12)

To overcome such limitations, in certain instances, incentives have been used to encourage states and territories to adopt reforms. For example, under the National Competition Policy (NCP) the Commonwealth made ‘competition payments’ to the states and territories conditional on reforms being implemented. Compliance monitoring was undertaken by the National Competition Council and in some cases payments were withheld. Recently, the Commonwealth indicated that National Partnership Payments (NPPs) could be used to encourage the states and territories to implement reforms with national benefits (Commonwealth Government 2008).

A Commission review of the NCP found that granting (and withholding) incentive payments was an important element for its success (PC 2005a). However, because the Commonwealth did not face financial ‘penalties’, some states and territories were critical of its reform effort.

The Commission’s study on national approaches to regulation arrived at several conclusions that are particularly germane to this review:

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<sup>2</sup> The Commission’s supplement to its inquiry report on Chemicals and Plastics Regulation elaborates on national approaches to regulation, including a summary of forms of national arrangements (PC 2009).

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- Effective national approaches need strong governance arrangements covering the development of a national policy response and its subsequent implementation, monitoring and refinement.
  - Although the states are sovereign entities and hence are not formally bound by [IGAs], they promote transparency and accountability. The more successful IGAs feature ... reporting requirements through which the jurisdictions report back to the Ministerial Council (or equivalent) on implementation issues.
  - ... monitoring the progress of states and territories in implementing agreed reforms, and rewarding those that meet reform goals, can help to progress policies that may otherwise falter. (PC 2009, pp. 37–8)

### **An intergovernmental agreement to promote farm sector self-reliance**

Under the NCP model, incentive payments arose after a comprehensive assessment of the benefits and costs that would flow from achieving a comprehensive reform agenda. A similar approach is envisaged for the NPPs. As a general principle, there should be material net benefits on offer to warrant proceeding to an IGA. Moreover, given that incentive payments have an opportunity cost they should only be used where reform outcomes will deliver significant net benefits to the community.

On these criteria, the case for an IGA to underpin a new policy paradigm for a self-reliant and prepared farming sector appears compelling.

First, Australian agriculture operates in a national (and global) market. Yet in some cases, inputs and outputs are affected by inter-state distortions. For example, the current framework involves border anomalies through inconsistency of administration of national programs such as the ECIRS and the effects of state programs such as subsidies for stock transport. The status quo, therefore, is less effective than it could be.

Second, as noted, policy credibility will determine the success or failure of the recommended shift away from ‘revolving door’ funding unencumbered by any requirement to improve self-reliance, to a regime that aims to promote a farm sector that can better manage climate variability and change. Any reversion to the policies of the past would impose double adjustment costs on the farm sector — the transition towards self-reliance and preparedness would be halted and the sector would need to re-adjust to an environment in which taxpayers faced more farming risk.

Third, under the Commission’s proposals, the Commonwealth would retain primary responsibility for an income support safety net for all Australians. In contrast, policy measures that aim to address weaknesses in business and risk management

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skills, extension services and research and development — with geographic, demographic and localised climate dimensions — are better delivered by states and territories. For example, the Commission’s proposal to improve the reach of Farm Ready would involve program funds being made available to state and territory governments to administer.

Fourth, many current state and territory programs would conflict with the new policy direction. Some involve duplication, others are counterproductive and some — such as fodder and transport subsidies — conflict directly with the objective of self-reliance and preparedness and potentially have adverse environmental impacts. There is also a wide range of state and territory policies that appear to confound regional development and drought assistance objectives. Related to this, all tiers of government provide a range of regional health, social and community services reinforcing that consistency in approach is desirable.

In addition, the need for program funding arising from this review (see chapter 8) in part obviates the need for specific and new targeted ‘incentive payments’. Conditional commitments could be tied to funding that is already necessary.

In summary, there is a powerful rationale for an IGA that embodies a systematic assessment of compliance. It would not be appropriate for the Commission to devise a specific IGA. That is a matter for governments to negotiate. The following sections provide a principles based discussion to help guide the derivation of an IGA with a focus on:

- rationales and objectives
- matters pertaining to the quantum of assistance that might be linked to an IGA
- identifying areas of government activity that should be circumscribed to the extent that incentive payments could be withheld for breaches of commitments
- compliance monitoring.

### *Objectives*

As noted above, the primary rationale for an IGA is to ensure the credibility and sustainability of a long term reform path that recognises that the primary responsibility for managing risks, including those from climate variability and change, rests with farmers. Governments need to agree that the focus of policy should be on people and communities, not propping up the ‘bottom line’ of individual businesses.

An IGA would need to be consistent with the revised and extended objectives of Australia’s Farming Future (chapter 7).

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### *Quantum of assistance*

Specifying 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. Some participants contended that the assistance delivered through current Commonwealth programs should be earmarked for future initiatives — a starting point of well over \$1 billion per year based on 2007-08. For example, responding to the Commission's draft report; the Queensland Farmers' Federation drew attention to farm 'business assistance' and submitted that:

... the only substantive 'new' initiative offered by the Commission is to expand the Australia's Farming Future (AFF) initiative, especially the Farm Ready component. It is the view of QFF that this is neither a reasonable or credible trade-off given that Farm Ready is a \$26.5 million program over four years. ... it seems to us there is about \$1.5 billion of 'business support' being removed without any real replacement programs. This is unacceptable ... (DR123, pp. 1–2)

The Commission does not consider that past expenditures, particularly in recent years that reflect one of the three worst droughts in a hundred years, have validity as an ambit claim. (Nor did the Commission contend that current funding for Farm Ready was an appropriate indicator of future expenditure needs.)

Commonwealth funding for preparedness programs should reflect the actions necessary to meet specified objectives based on robust rationales. That is, the quantum of assistance needs to be sufficient to ensure that warranted programs are delivered effectively and efficiently and also account for the implementation and transitional costs of changing administrative structures. Expenditures in excess of that constitute a transfer of funds for other motivations — such as 'buying reform'.

State and territory governments also provide significant drought-related expenditures, some of which is inconsistent with encouraging self-reliance and preparedness. For example, from 2002-03 to 2007-08, New South Wales and Queensland spent over \$186 million on transport subsidies (chapter 6 and appendix E). Terminating such programs would liberate state funds that could be used for more appropriate programs. Indeed, current state and territory expenditures on drought-related programs are part of the overall funding calculus that leaves open the possibility of an IGA with some matching funding components.

The cost of providing income support for farming families in hardship (chapter 9) is taken as exogenous for the purposes of an IGA-related funding. It is, however, relevant to the extent that, like the objectives of an IGA, it aims to not impede necessary structural adjustment.

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## *Commitments*

Any IGA should:

- incorporate agreed principles relevant to the types of program delivered by state and territory governments — both delivery of national programs (discussed in chapter 8) and jurisdiction-specific programs (see appendix E)
- address overlaps that arise across programs dealing with drought, structural adjustment and regional and community development, including:
  - taking into account matters identified in the Expert Social Panel report (Kenny et al. 2008) that imply Commonwealth and state funding initiatives to meet gaps in social support services available to help people cope with change.

Prior to committing to an IGA, state and territory governments should undertake a stocktake of their drought assistance, drought-related and overlapping regional programs with a view to consistency with the revised principles of the AFF. Consideration should be given to removing all drought triggers (state based drought declarations). Persisting with drought-triggered policy responses after the EC system has been abandoned would be inimical to treating drought as one of many normal risks that must be managed. In relation to this, it is instructive to draw on the Victorian Drought Interdepartmental Committee's proposal that drought assistance:

- should not undermine the incentive for businesses/farmers to prepare for drought
- should not be provided to businesses who have not taken available measures to prepare for drought
- should not set a precedent whereby Government will be responsible for climate related risks (SACES 2008b).

To the extent that state and territory governments consider it necessary to retain any specific drought-centric programs, then these principles have merit.

Most fundamentally, assistance should not involve measures that distort farm business decision making without a valid rationale. Accordingly, an IGA should include commitments that governments will not introduce transactions based subsidies (such as subsidies for interest payments and the transport of fodder, water or stock). This logic extends to other farm business costs such as rates, fees and charges which should not be subsidised by government. While a case might be made for deferring some charges in times of low incomes, they remain legitimate business costs. If farms are not sufficiently viable to prepare for such charges (through for example, Farm Management Deposits or short term business loans),

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shifting these costs onto taxpayers (or other ratepayers) can only impede necessary and desirable adjustment.

If the IGA gives governments sufficient freedom to persist with providing loans and grants to farmers, funding should:

- be conditional on an assessment to ensure that the farm will be self-supporting in the longer term
- be directed to reinforcing longer term outcomes such as capacity building through improving farm business and risk management (see chapter 8), rather than specifying a technology or activity (for example, building silos).

More pragmatically, while government-provided incentives that enable farmers to carry out actions, adopt practices or undertake investments that are privately cost-effective are unlikely to be warranted, they may have a role to play in moving away from current flawed practices.

Greater degrees of freedom should be afforded governments in how they choose to meet the general social, health, welfare and recreational needs of regional communities. While such programs should be based on robust benefit-cost assessments, there may need to be sufficient scope for governments to ‘do something’ if extended drought events adversely affect rural and regional communities.

Rather than revert to assistance measures that are inconsistent with self-reliance and preparedness, it would be preferable — albeit perhaps not always warranted on efficiency criteria — for governments to meet such pressures through more generalised counter-cyclical expenditures via their regional programs. In addition to addressing the social and health needs of affected communities, this could include bringing forward justified regional infrastructure spending and/or increasing funding for catchment management authorities, pasture protection boards and shire councils to assist communities to manage and cope with change. As noted, the focus should be on people and communities, not individual private businesses.

Such actions would help alleviate the social costs of extended drought periods without conflicting with the objective of improving farmers’ self-reliance and preparedness or of impeding necessary structural adjustment. As the rationale for triggering such measures is an assessment of need, a formulaic drought trigger would be inappropriate.

Finally, while an IGA needs to inhibit the parties from engaging in activities that conflict with policy objectives, it should not prescribe uniformity — Western Australian broadacre farms and pastoral rangelands are different to irrigated

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horticulture establishments. States should not be constrained from introducing novel measures (consistent with the overarching principles and objectives of an IGA) that could be beneficial.

### *Compliance*

An IGA can assist state and territory governments to undertake reform. It can put governments in a stronger position to resist lobbying by pointing out that reversion to inefficient assistance measures will have adverse funding consequences for the state. This structure is superior to the strategic incentives within the current EC system which all work in the direction of acquiescing to lobbying (chapter 5).

That said, for policy credibility, there will still be a need for appropriate monitoring of compliance and sanctions for breaches of agreed commitments. This can be viewed as imposing ‘penalties’, but is more correctly akin to withholding some funds for commitments that have not been met.

A weak agreement that is monitored by the parties themselves who assess their own compliance is unlikely to be credible. Ideally, an independent assessor such as the CoAG Reform Council should be charged with assessing whether full payments should be made, some funds withheld, and the validity of any derogations sought and/or extenuating circumstances.

The extent to which an IGA can provide the appropriate incentive structure to discipline the Commonwealth Government from backsliding on commitments is problematic. Independent and transparent monitoring and reporting can help by subjecting the Commonwealth to public scrutiny for breaching commitments.

Finally, evaluating compliance in meeting commitments is one thing. Equally, it is imperative that all governments ensure that their policy frameworks are robust. This means programs are justified, monitored and evaluated. Too often, drought-related programs have been introduced without evidence establishing that they were warranted. Indeed, many drought programs appear to have been based on objectives other than improving outcomes for the community. Also of concern is the lack of evaluation of programs, many of which have run for years. This is primarily a matter for jurisdictions’ regulation impact assessment and gatekeeper protocols.

#### RECOMMENDATION 11.2

***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:***

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- *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 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.*

## **11.5 The outlook under the new approach**

The policy approach recommended in this report places a strong emphasis on self-reliance and preparedness for drought, with farmers and farm-dependent businesses taking responsibility for managing climate variability and governments playing a supporting role to better equip them to do so. The Commission also recommends that a greater emphasis be placed on government support for families in genuine need and less emphasis on supporting businesses that experience financial difficulties during drought or other periods of climatic variability.

This approach is consistent with reforms in agricultural policy over the last two decades that have reduced government subsidies and given greater responsibility and control for managing risks to farm businesses (for example, through the unwinding of statutory marketing arrangements). These past reforms have contributed to productivity growth in the agriculture sector and freed up resources that have then been available to meet other community priorities. There have also been costs at the farm level, however, with some farmers no longer benefiting from government support and, in some cases, leaving farming when their personal preference would have been to continue.

In broad terms, the Commission's view is that implementation of the recommendations in this report would have results in line with those of these past reforms. The likely outcomes for agricultural production, risk management and the impacts of drought are outlined below.

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## Agricultural production

Several inquiry participants suggested that the removal of drought-triggered business support could have a significant impact on Australia's agricultural production and the need to import food. This concern, for example, would seem to be behind this request from the Australian Beef Association:

Before analyzing drought we ask that the Productivity Commission addresses macro issues including: ... Food production – does Government want to import a high percentage of food? (sub. 100, p. 1)

In terms of overall food security it is worth noting that Australia exports around 60 per cent of all its agricultural production (ABARE 2008b). For the removal of drought-triggered assistance to result in a major decline in that production, farmers responsible for producing a significant proportion of production would need to exit farming as a result and be replaced by owners who produced much less food from those same farms.

The ECIRS is by far the most significant drought-triggered business support measure available at present. Appendix C shows that the proportion of producers who accessed ECIRS at least once over the period 2001-02 to 2007-08 was 25 per cent in New South Wales and considerably less in the other states and territories for which data are available (table C.4). Termination of the ECIRS, therefore, would leave the large majority of farmers, at worst, unaffected.

Further, information on the characteristics of recipients suggests that only a small proportion of those on ECIRS were financially vulnerable to such an extent that they might be forced to exit farming in the absence of ECIRS:

- eighty-one per cent of recipients had high equity and only 8 per cent had both low equity and a negative income (table C.8)
- the average recipient had net farm assets of well over \$2 million (table C.8), while the average subsidy payment was just under \$37 000 in 2007-08 (figure C.2).

Further analysis shows that the equity ratio (net equity divided by total capital value) of an average ECIRS recipient was around 0.86 after three years of receiving ECIRS payments. Without ECIRS payments the equity ratio would have been 0.83 — marginally lower but still at a high level (appendix C). Even without ECIRS payments, net assets would have increased in real terms (in other words, these farmers would have become wealthier over the three year period, even allowing for the effects of inflation). There would of course be some recipients who would have been more strongly impacted if they had not had access to ECIRS payments.

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This suggests that removing drought-triggered business support would be likely to result in a very small number of forced exits from farming. This conclusion would appear to be consistent with the statement by the Australian Bankers Association that, while debt levels had increased in recent years, ‘the number of agribusiness customers categorised by banks as being ‘at risk’ has remained at historically low levels’ (sub. 76, p. 2). In addition to forced exits, there might be some other farmers who choose to exit because of the absence of government support.

The influence of this, likely small, increase in farm exits on agricultural production is hard to determine. Many of the farms involved would be purchased by more successful farmers with greater capital backing, who would be expected to increase production. Other farms might be purchased for an alternative use, such as plantation forestry or the provision of environmental amenity.

The net result overall would seem likely to be a small increase in agricultural production. Even where some farms were taken out of agricultural production the outcome for the community would be expected to be positive. If the highest bidder for land has a non-agricultural use in mind, this generally indicates that agriculture is not the highest value use of that land.

### **Self-reliance and preparedness**

The Commission expects that implementation of the recommendations in this report would result in improvements in farm businesses’ and farm-dependent businesses’ self-reliance and preparedness for periods of financial difficulty. This will not, however, occur for all businesses. Most farmers are already self-reliant and prepared and many of these may be only marginally affected by the changes proposed. Others operate businesses that have little chance of being viable in the long-term and so government investment in improving their preparedness would be unlikely to be successful. The Commission instead advocates that, where needed, these farmers be provided with short-term income support and other assistance with transitioning to new endeavours.

The Commission has a five part plan to bring about improvements in self-reliance and preparedness. The first two parts remove some of the impediments to self-reliance and preparedness, and the final three provide active government support to better equip farmers to deal with future climate variability and other risks.

First, current measures such as the ECIRS can impede the development of private arrangements for risk sharing (Malcolm 2006). Removing these measures would increase the incentive for the development of private arrangements to allocate risk

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to those best able to bear it. This might include greater use of alternative forms of farm business activity, such as sharefarming or leasing, that are at present less common in Australia than in many other countries (Agriculture and Food Policy Reference Group 2006). The development of weather derivatives for use in a farming context is another possibility (chapter 8).

Second, the removal of all forms of drought-triggered business support signals the need for all farmers to take responsibility for managing risks associated with climate variability. Provided that this policy change is well communicated and farmers accept that governments will not revert to providing reactive drought support, it would be expected to result in improved self-reliance and preparedness among the current population of farmers. This could occur through changes to on-farm practices and increases in off-farm diversification. In addition, a greater appreciation of the risks faced by farmers may influence exits and entries. Those who are unwilling or unable to accept these risks may be more likely to exit and less likely to enter farming. Over time this would be expected to result in greater levels of self-reliance.

Third, it is recommended that farm management deposits be retained as a risk management tool. These have proven to be effective in helping farmers prepare for and recover from drought events (chapter 8).

Fourth, it is recommended that the most successful elements of FarmBis be brought into the FarmReady scheme to strengthen the program. Grants for business training and professional advice that are well targeted and have an educational outcome can deliver public, as well as private, benefits (chapter 8).

Finally, it is recommended that significant public funding be provided for agricultural research, development and extension. There are sound rationales for governments to assist farmers to build their capacity through funding for research, development and extension (chapter 8).

## **Social impacts of drought**

Droughts have a range of negative social impacts as discussed in chapter 3 and in the Expert Social Panel report (Kenny et al. 2008). As acknowledged by many inquiry participants, government policy can hope to ameliorate these impacts. The relevant question, therefore, is how the recommended approach, including the Farming Family Income Support program, is likely to perform in this regard, relative to current policy or relative to some other benchmark of what might reasonably be expected.

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The Commission's approach places a high priority on assisting those who are least able to cope with loss of income due to drought or other cause. At the same time, the possibility of creating an ongoing dependence on this support is guarded against by requiring that steps be taken towards a self-reliant future and through placing a time limit on it. The Commission also acknowledges the importance of the various human services provided by governments that can be particularly important to people who are vulnerable to the impacts of drought.

Not all farmers or farm-dependent business owners who experience serious difficulties during drought do so because of poor management. Luck and timing also play a part. There have been many sound farmers who have relied on the current assistance measures to help them stay on their properties. The Commission's proposed increase in training, research and development and extension may enable many of these farmers to achieve a pathway to viability. The Commission acknowledges, however, that under its approach there will be some farmers who may leave farming who may have been able to return to viability under the old arrangements.

At the community level, the social impacts of drought under the Commission's approach are likely to be, in the short term, fairly similar to those under the existing arrangements. Removal of ECIRS would be expected to result in a small reduction in expenditure by recipients in some towns, with a consequential loss of income. For example, it is estimated that the annual incomes of people in smaller towns (less than 5000 people) in EC declared areas would have been, on average, around \$37 less in 2007-08 (the peak year for payments) had ECIRS payments not been made (appendix C). For larger towns the effect on incomes would have generally been less than this.

One of the benefits of the proposed changes would be that the social divisiveness created by the inequities of the current arrangements would be largely removed. In the longer term it would be expected that both farm families and rural communities would suffer less acutely from the effects of drought because they will be, overall, better prepared for the variability and change of Australia's climate.