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Dear Jared ,

Submission to Productivity Commission on Government EC Drought support

We make this submission based on our experience as a General Practice accounting firm.

Approximately 70% of our business clients are primary producers with many (but not a majority) of them having received some form of drought/exceptional circumstances support over the last 5 years.

We believe that the current National Drought Policy is a well intentioned but sadly ineffectual bandaid solution to a National problem.

It is poorly targeted, difficult to access and has failed to deliver any degree of self sufficiency among the farming community and in fact has made the task of young people looking to enter the farming industry even harder than it should be.

We set out below a summary of issues raised by our representative (the writer) during the course of the National Drought Policy Review meeting held at the Narrabri Rural Lands Protection Board office on the 22nd July 2008. We have attempted to expand on these issues where we see the current National Drought Policy has failed to deliver on its goals.

1) EC Interest Subsidy

- Administration Costs

  We believe that the current EC Interest Subsidy support expensive to administer.

  The application process involves a processor, a reviewer and a manager and in some cases four person review board. Assuming that the salaries of these government staff are paid out of the overall funding package then we contend that this is an unacceptable drain on the funds targeted for the farmers as it is being eaten up in administration costs.

Even with all this bureaucracy and despite the written Eligibility Criteria of needing the applicants to be viable, the reality is that the application process is a very uncertain process with the eligibility ultimately hinging on a review board's judgement of the applicant's degree of financial risk.

If the initial application is rejected then there is a further review process, all of which costs money, money that would be better off spent on the real purpose of the program, helping viable drought affected farmers though the difficult times.

- Applicant's Viability

While the program states that part of the eligibility criteria is that the farm must be viable in the long term, the reality is that a significant portion of the successful applicants are unviable and many viable farmers are having their applications rejected because they are "not considered to be at financial risk" (a quote from the RAA's Appeals Board in rejecting a client's application).

From conversations that the Writer has had with several of the government processing and review staff it would appear that among the reasons why (that are clearly) unviable farmers are being granted subsidies is the reviewer's reluctance to "make the call" that the applicant is unviable and hence being responsible for "forcing" the applicant farmer to leave his/her farm.

In addition some rejected applicants resort to lobbying their local Member of Parliament (MOP), who then puts pressure on the Board to over turn the decision, as the MOP also does not want to be seen as being responsible for forcing farmers to leave their farms.

In short the process creates a situation where emotional blackmail can be employed as ultimately the success or failure of an application boils down to a reviewer's opinion. We believe it is grossly unfair to place this pressure on the reviewer and also unfair on otherwise eligible applicants who are missing out.

We are aware of one case where an applicant (a client of this firm) had his application rejected because he borrowed $100,000 (a material amount for the client) to upgrade silo facilities and set up a small "on farm" feed lot facility. This development has given the applicant a greater capacity to cope with variable seasons and provided him with a finished product to market regardless of the season. The applicant was rejected because his bank would lend him the $100,000 and therefore the logic was, that if the bank would lend him more money then he could not be at "financial risk".

We assert that if a bank will not lend an applicant more money, for any purpose, then that applicant is clearly unviable and as such in ineligible to receive the interest rate subsidy.

The irony is that, as part of the application process, the bank signs a certificate stating that it will continue to support the applicant for the next 12 months. If one uses the same rationale behind the rejection of the applicant as described in preceding paragraphs no applicant would be eligible for an interest subsidy. In short the process is unworkable.

- The support is poorly targeted as there is no requirement that any of the funds received need be spent in the local community.

- **Personal Drawings**.
  Surprisingly the level of personal drawings does not seem to form part of the eligibility criteria.

If an audit of successful applicants was undertaken we believe that it would reveal that many of the successful applicants would have personal drawing amounts of in excess of $120,000 per year. Often this would be before taking into account school fees paid.

If people are genuinely struggling with the drought then surely it is not unreasonable to expect that they reduce their level of personal drawings to a more responsible level.

If the interest subsidy is to be continued there needs to be a limit placed on the level of personal drawings as part of the eligibility criteria. We suggest that this limit should be no more than the AWOTE per household.

- As history has shown, long term subsidies tend to have an artificial inflationary affect on prices. We suggest that the current interest subsidy is no different. Land prices have soared during the current on going drought. The interest subsidy has been partly responsible for the increase in land prices on two levels.

1. Many farms that would normally have come onto the market are not and this reduction in supply is forcing up prices.

2. Some farmers are factoring the receipt of an interest subsidy into their future cash flows when buying a new property. Effectively by factoring in the receipt of the subsidy they are willing to pay more for a property as they "know" that if they go into drought the government will, in all likelihood, pay a significant portion of their interest bill.

   Not surprisingly farm land is so over valued at the moment that it is virtually impossible for any farm to "pay for itself". This is making it extremely difficult for new farmers to enter the industry.

   It is interesting to note that, as stated above, during the current drought property prices have soared. In addition the average age of farmers has also increased. Effectively the increase in land prices is preventing young farmers getting a start in the industry and further exacerbating the aging the problem in the farming industry.

2) The Exit Support Program

We note that the Federal Government "is surprised" that there has been little take up of this program. We believe that reason why there has been little take up is simple - it is virtually impossible to have net assets under the $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 a lesser equity than this will have already quit the industry or have been advised to quit by their bankers. We must be mindful of the fact that banks are not in the business of selling up farms or for that matter any other business. They (the banks) would much prefer to see their respective customers make an honourable exit.

3) Lack of incentive for farmers to drought proof their farms

With depreciation rates of between 5 and 10% for hay sheds and silos there is little tax incentive for farmers to invest in capital that may help them drought proof their farms.

With the costs of steel rising rapidly and zero tillage farming equipment rising even faster, having to write this expenditure off over a 7, 10 or 25 year period offers little incentive for middle to lower end farmers to invest in costly drought proofing capital.

We suggest that the following strategies should form part of any future National Drought Policy. All of these strategies are based on the premise that farmers should be encouraged to voluntarily drought proof their property rather than waiting until they are almost unviable and then seeking Federal and State Government assistance.

- Taxation reform – Accelerated depreciation

  Investment incentives delivered through the tax system would cost little to administer and would deliver positive drought proofing benefits.

  Accelerated depreciation on haysheds, silos and zero tillage farming equipment, including GPS guidance technology, at say, 110% or 125% would encourage farmers to invest themselves.

  An added advantage of this initiative would be that a reasonable portion of the expenditure will stay in the local communities.

We suggest that this incentive should be limited to primary producers with net assets of $12 Mil (including associated entities) as those with equity larger than this should be able to afford such expenditure.

- Expansion of the RAA support (or other state equlivant systems) by.

  - Allowing immediate access to the loans, regardless of their previous income streams, as this is crucial to helping young farmers getting a start. As most properties in a young farmers "price range" are generally under capitalised a young farmer can simply not afford to wait two years to start to improve the property's capacity and drought proof the property.

  - Extend the maximum loan term to 15 or 20 years to ease the repayment burden.

  - Increase the net asset test up to net assets up to $5 Mil.

  - The off farm income limit should be eliminated and replaced with a requirement that the applicant spends at least 16 hours per week on the farm. This will allow for applicants to develop their farm while keeping their job and preventing the "Pitt Street Farmer" becoming eligible.

- Scrapping of the 5 year gifting provisions for access to the pension and for aged care facilities when the family farm is transferred via intergenerational transfer. The only limit we would put in here is that the provisions are reinstated if the property is sold with in the 3 year period.

- Increase in the net asset limit for access to the Exit Industry Program to at least $700,000.

- We suggest that you should scrap the current Interest Subsidy program. If it is to stay as part of the Drought Strategy then it should turned into a HECS type loan secured against the property and unlike HECS the debt remains attached to the property after death. Access to the loan is reliant to on net equity being above 50% this way you avoid the costly application process as applicants are less likely to go into debt if they cannot pay the debt back. If the applicant cannot pay the debt back then this is proof that they were unviable and they will be selling while their equity is still at a reasonable level.

- All primary production businesses large and small to have access to income support for the owners of the business and all of their staff, payable fortnightly (that way they only get paid if the staffs are retained).

This support should also be extended to businesses with at least 70% of their clients being drought affected primary producers. This way there is a much greater chance of this money being recycled within the local community than is currently the case.

- Farm Management Deposits (FMD) should be extended to companies and operating trusts. Given the changing demographics of farming families, companies and trusts are now very common business structures used by such families. Management tools such FMDs should be available to trusts and company structures as well and if the interest subsidy is not available, then farmers will need to use FMDs for the purpose that they were intended, to help carry them though a drought.

  We suggest that the limit of FMDs available to Trusts and companies should be limited to the average number of adult beneficiaries over the last 5 years or the number of adult shareholders.

Finally we would like to thankyou for taking the time to read this submission and we would be happy to discuss any of the issues raised above with you.

Regards,

David Maxwell
Partner
Carrigan & Co Pty Limited