



# **Productivity Commission Inquiry into Drought Support**

*August 2008*

## **The Victorian Farmers Federation**

The Victorian Farmers Federation (VFF), Australia's largest state farmer organisation and the only recognised, consistent voice on issues affecting rural Victoria and the VFF welcomes the Productivity Commission's review into the capacity of local governments to raise their own revenue, and to examine the effects of their revenue raising on the community.

The VFF represents 19,000 farmer members across 15,000 farm enterprises. Victoria is home to 25 per cent of the nation's farms. They attract neither government export subsidies nor tariff support. Despite farming on only three percent of Australia's available agricultural land, Victorian's produce 30 per cent of the nation's agricultural product. The VFF represents the interests of our State's dairy, livestock, grains, horticulture, chicken meat, pigs and egg producers.

## Executive summary

The VFF welcomes a review of drought support measures and is in favour of a move to a system that places emphasis on preparing for drought and other severe weather events.

We believe that the current system has served the farm, wider rural and Australian communities well. But in a world of rapid change in markets, community and environmental pressures and particularly climate, a new approach is needed.

The current drought policy encourages Australian farmers to take responsibility. But, sometimes even the best farm managers cannot prepare for the climatic conditions they experience. This is when assistance is of paramount importance. Further, we do not believe the current policy has hindered innovation. Farmers do not make business decisions on business structures, property or machinery investments or any other systems factor with a reliance on drought support in mind.

As the BoM CSIRO report found, the climate risk facing farmers is increasing and an appropriate response is to increase the risk management capacity. Waiting for an event to occur before support is provided is not useful risk management. Therefore, a new model is proposed and should aid industry, farmers and their communities to increase capacity to manage the climate risk.

The VFF support the NFF's proposed way forward of a three arm framework - **Innovate, Preparedness and Response.**

### **Innovate**

- R & D
- This comprises professional advice grants, innovation grants and risk management deposits

### **Preparedness**

- Examples such as further fodder manufacture and retention
- Water supply efficiencies
- Farm exit grant should be seen as increasing industry and community capacity to manage risk by facilitating a decision to exit by those who are not likely to be in a position to implement appropriate risk management strategies.

### **Response**

- The safety net of assistance if needs be; this should be available without a specific time frame
- Eg some farmers may not be able to move towards a preparedness response if they have recently purchased a property.

Further, the VFF proposes that Exceptional Circumstances be removed as a trigger for accessing drought policy.

Preparedness could also take a wider more encompassing policy approach. For example, regional development to decrease rural community's reliance on agriculture would provide many benefits in skills retention, alternative income sources to farmers, and facilitate farm exits by allowing exiting farmers to retain community contact.

Policies and support programs should generally be aimed at outcomes and not stipulate particular actions. Farmers are experienced at finding cost effective solutions to problems. Providing support based on defined outcomes will allow flexibility for farmers to find the solution that best suits their particular circumstance in the most effective manner.

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## Introduction

The Victorian Farmers Federation (VFF) welcomes the opportunity to submit on the pressing matter of the Productivity Commission (PC) drought policy review and the Exceptional Circumstances (EC) payments.

Victoria plays a significant part to much of Australia's agriculture, with it contributing to 26 per cent of the nation's produce, maintaining its position as Australia's largest State food and fibre exporter. Further, Victorian food and fibre exports were valued at \$6.35 billion in 2007. Victoria continues to punch above its weight, with having a 25 per cent share of Australia's total food exports, and a 28 per cent share of Australia's total wool and fibre exports.<sup>1</sup>

## Why agriculture should be supported in times of drought

The Australian Government has over time implemented and refined policies and programs to assist farmers deal with drought. The Productivity Commission acknowledges this in its Issues Paper by stating there are economic, social and environmental justifications for government intervention in cases of severe drought.

Many past studies and reviews have already reflected on this issue and found strong arguments in favour of government intervention. The VFF considers that it is important to periodically reassess the justification for the provision of government assistance to primary producers during periods of severe drought.

The VFF believe it is paramount to continue to support agriculture in times of undue stress. Below is a table of examples from both Urban and Rural business environments. An explanation is offered below the table.

Urban	Rural
Dispersed business sectors	Concentrated in agriculture
Business shocks dispersed	All farms are hit by drought
Alternative employment is available	Limited alternative employment
Diversified multi-industry economy	Community generally reliant on agriculture for its income
Production capacity flexible in the short term	Production capacity inflexible in the short term
Recovery of cash flows fast	Cash flow recovery up to 12 months (or more)

As you can see from the above examples, it is a lot easier for urban communities to weather business shocks that cause impacts similar to the impact of drought on regional economies. The first two points are self explanatory and point 3 examines the availability of alternative employment in the community. For rural areas there is not only limited alternative employment availability in the community, but also that some farmers regard themselves as being unskilled. Many have often grown up on the farm, and have no formal qualifications. This makes it difficult for a farmer to find other employment when the farm is not producing due to drought. Further, a farmer cannot just 'up sticks and leave' a farm for long periods of time, as there are livestock and crops to oversee.

As point 5 shows, it is difficult for a biological system such as a farm to turn its production capacity around quickly. A farmer would need to replace stock sold off or lost during the drought, grow and harvest the next crop, or wait for permanent plantings to recover. This adds significant costs that must be borne before income returns. Cash flows do not restart once it rains.

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<sup>1</sup> DPI, Victorian Food and Fibre Export Performance 2007

There are three drought events in a farming system.

- **rainfall drought,**
- **fodder drought,** which can end a few months after the rainfall drought and
- **cash drought,** which does not end until production returns to normal which can take up to 2 years with permanent plantings.

This whole cycle needs to be taken into account for the implications on the farming families and rural communities to be fully realised.

The thinking of the current Federal Government is that there needs to be more of a preparedness approach. The VFF support this, but there of course needs to be a safety net available in times of undue stress from weather and circumstances.

There are also matters of equity. The current EC payments are not available to all sectors of the farming community. A number of examples are available, farmers with share-farming and leasing agreements are ineligible because these farmers do not own the land. This hinders a number of new-entrants to the market, as the younger farmers often use these agreements as a foot-in-the-door to farming. This needs to be addressed in an environment where the population of the industry is ageing. Incentivising new-comers to the agricultural industries is paramount. Currently, the failure of agriculture leads to the depopulation of rural communities. In addition the current EC measures discriminate against those farmers who invest in substantial risk management strategies.

## **Drought Policy and Climate Change**

In considering the rationale for ongoing Government drought assistance, it is also important to acknowledge that contemporary governments have tended to rely on market forces as the preferred means of dealing with a range of competing alternatives<sup>2</sup>. Therefore, typically government only intervenes where the market cannot efficiently function or where intervention can be justified on the grounds of public interest.

VFF believes there remain public interest arguments, on which to justify continuing government intervention in the future management of severe drought, these include:

- The lack of appropriate insurance products. Currently, farmers are largely unable to access insurance or financial products to underwrite the risks of climatic variability on agricultural production;
- Australia's core breeding stock and genetic resources need to be preserved. This will mitigate the shock effects of drought on the rural economy and allow more rapid and efficient recovery;
- The need to manage potential external effects of drought on the natural resource or asset base;
- Commercial lending agencies' risk perceptions in assessing whether to extend commercial finance to viable farming enterprises, particularly young farmers or industry entrants;
- Due to inequities in the agricultural supply chain by way of the larger supermarket retailers, farmers cannot pass the additional costs of drought management at the farm level on to consumers in the prices paid for agricultural products; and
- The need for farmers to preserve social connectedness in their communities.

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<sup>2</sup> McColl (1997) and O'Meagher (2003)

The VFF believes that the Government's current approach because of the uniqueness of the agricultural operating environment as outlined previously is justified. The role of the farm sector in Australia's sustainable management of land, native animals, plants and water is not replicated in other business sectors.

It is necessary to review how appropriate the current drought assistance measures are, which will ensure that any future assistance measures are capable of achieving the objectives of the National Drought Policy in an efficient and effective manner.

The VFF maintains the need for a robust drought policy model, which forms the basis of a national vision for agriculture. By committing to a long-term drought policy, this will help to secure an agricultural base that is resilient to a changing climate. Similarly, many policies currently being pursued by government and the farm sector will contribute to strengthening the sector's ability to adapt to climatic factors such as drought.

However, the VFF considers that one of the dangers of the government's current Exceptional Circumstances policy package is that some policies which, while bearing an impact on drought management, primarily target other objectives. An example of such policies has been education and training initiatives and industry partnerships. Many policy areas affect agriculture's ability to cope with drought – such as water management, emissions trading schemes, research and development, and others – however; drought should not be the primary focus of such policies. They are important and necessary policy areas in their own right. On this basis, the VFF supports a new approach to drought policy that sees drought policy perceived as part of a coherent national framework of policies.

## **Drought as Part of a National Agriculture Strategy**

Under this model, the National Agriculture Strategy is the over-arching principle, with drought policy as one of the three arms of policy measures. This strategy should have interconnected policies that work together to achieve good environmental outcomes, rather than viewing drought policy as a single stream.

Farmers would be able to access policy measures from a number of sources as applicable to their situation. Such a framework would remove the current situation where if a farm business is no longer considered to be located in an Exceptional Circumstances area, they are immediately ineligible for all sources of drought support, except a means-tested family welfare payment.

Government support is needed to ensure farm families to move from survival to preparedness in this changed climate as smoothly as possible. We note that many families do not have the capital to restock or replant after drought, let alone invest in the important measures necessary for preparedness.

A strategic approach is needed to appropriately support Australian agriculture into the future.

The VFF considers that lessons learnt from delivering Exceptional Circumstances assistance is that it is not appropriate to label all climate change adjustment policies as drought support. Other tools, such as research and development, risk management tools, water management, and education and training to name a few, must be maintained in non-drought years if they are to obtain results. At the same time, it is essential that economic and social policies be put into place to obtain synergies from this approach and to create the necessary environment for business improvement. Climate change, economic and social policies will not all be agriculture-specific, however, they are a vital part of the national policy framework that is necessary to support a reformed drought assistance package. There needs to be recognition by Government that by supporting farms and farmers in times of drought, this not only supports the farmers and their families, but also the communities they are active in.

## Removing the EC Trigger

Taking stock of the Bureau of Meteorology – CSIRO report on Drought and Exceptional Circumstances, the VFF proposes that Exceptional Circumstances be removed as a trigger for accessing drought policy. This is on the grounds that the report states:

“The current EC trigger, based on historical records, has already resulted in many areas of Australia being drought declared in more than five per cent of years, and the frequency and severity are likely to increase. The principle implication of the findings of this study is that the existing trigger is not appropriate under a changing climate.”<sup>3</sup>

Currently, there is a triggered system of Exceptional Circumstances policy measures, costing upwards of \$740 million per annum. The VFF suggests that any future investment by governments into agriculture be targeted towards a policy framework that incentivises innovation and preparedness measures. It should aim towards assisting the farm business to manage the vagaries of a changing climate. This should be about risk management. By any measure, achieving preparedness across the sector represents significant structural change – some of which has commenced during recent the drought event. Australian agriculture is keen to do a lot more to respond to climate change in keeping with sustainable practices.

Along with the Australian Government and the rest of the world, the scope, causes and long-term consequences of climate change are only now being documented. Therefore, it is not reasonable to expect agriculture is ready to move immediately from drought to preparedness. Many other areas of the economy have not suffered the effects of a prolonged drought event or a similar circumstance but are also unready to move unassisted to the new operating models in response to a changing climate.

## Producers’ Choice of Drought Policy Streams

The VFF is suggesting what agriculture needs is an incentivised system that focuses on partnering between government and producers, where co-investment in preparedness measures is the key feature and farmers are encouraged to save to insulate against future risks, including climate variation. Few would argue this proposition; however, it is important to understand that even with a generous transition period, not all farmers are in the same situation.

Drought affects farm businesses differently. For instance, not all businesses are in drought for the same period of time, able to access EC support, equally successful with diversification strategies and so on. Recognising these differences, the VFF considers that one option would be to provide producers with a choice of drought policy streams. Producers would then select the stream that best suits their circumstances and eligibility. This approach recognises that not all farmers are in the same situation and instead identifies three broad groups of producers. Those that will be ready after a transition period to move towards preparedness (Stream 1), those that need short-term government support (eg low-interest loan) to invest in preparedness strategies (Stream 2), and those that must endure a longer consolidation period before moving towards preparedness (Stream 3).

The proposed policy streams are structured in such a way that streams 2 and 3 are time limited and governed by eligibility requirements. Their purpose is to provide a launching pad and safety net respectively for farmers endeavouring, but not yet ready, to move towards preparedness. Like the current package of Exceptional Circumstances policies, Stream 3 recognises that farmers may ultimately choose to leave the land. A farm exit grant is recommended for these situations.

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<sup>3</sup> BOM CSIRO, An assessment of the impact of climate change on the nature and frequency of exceptional climatic events, July 2008, page 1.



The VFF vision is that over time, most primary producers will have opted for Stream 1. This will foster a culture of continuous improvement and innovation built primarily on farmers' own money, with limited industry and government co-funding. Primarily, the overall model is one of producer self-reliance fostered through an industry and government partnership approach. This approach is to ensure risk management at all levels. Note that this approach will only be successful if farmers have sufficient time to prepare their transition to such a model.

Further detail on the three drought streams is discussed below. Costings and grant values are not indicated as these must take into consideration government data, the length of the transition period and the full suite of policy measures ultimately provided under each stream.

## **Stream 1: Innovate**

Policy Stream 1, "Innovate", is the optimal policy stream – from both a government and a farmer perspective. It provides meaningful incentives to achieve three outcomes: government and industry co-funding, saving for a rainy (dry) day and innovating to maximise preparedness.

Importantly, it focuses on increasing farmer accountability and self-reliance. By selecting this stream, farmers are choosing not to access the income support payments with eligibility criteria expanded to suit primary producers.

Selecting Stream 1 is a chance for farmers to work with government and professional service providers to take measures that will, over time, help to improve their risk management for drought. Farmers retain control and accountability over their farm business and are encouraged to save their own money and draw down these funds in hard times. Stream 1 is a long term, ongoing policy strategy that costs governments less per annum than EC but yields tangible results on-farm that are specific to preparedness. Over time, Stream 1 can be expected to have contributed to a significant restructuring of farm businesses so that they are better equipped to survive drought.

To re-emphasise the interdependence of drought policy to other non-drought specific policies here. For example, without meaningful research and development, adaptation and extension, or appropriate risk management tools, the impact of this policy stream will be severely limited.

Policy Stream 1 comprises three policy core elements. Other policy measures consistent with incentivisation and building self-reliance could be added to Stream 1.

### ***Professional Advice Grant***

Farmers to have access to a one-off grant on selection of Stream 1 for to use for obtaining professional advice on maximising farm business preparedness. Such advice should be practical, affordable and customised for the business.

### ***Innovation Grant***

This innovation grant is to be used towards preparedness initiatives that are co-funded by the farmer. This grant is accessible once a year and must be applied for and consistent with broad criteria to ensure that it is delivering genuine preparedness outcomes. This grant is the foundation of incentivising a culture of ongoing focus on and investment in preparedness.

### ***Risk Management Deposit (RMD)***

This tax-linked risk management tool will allow primary producers to deal with variable income. RMDs are like Farm Management deposits in that they allow primary producers to set aside taxable primary production income in profitable years, to be withdrawn (usually) in lower income periods. RMDs are taxed at the rate of year of withdrawal, thereby providing tax benefits as an incentive to farmers. Unlike FMDs, RMDs have no restriction on the deposit size or off-farm income. This recognises that all farmers equally need to insulate their business against climate risk.

## **Stream 2: Preparedness**

The Advance stream is targeted at primary producers that are looking at growing their business but are not yet in a position where they are able to invest in confidence in preparedness and growth strategies. Examples of people that may fall into this category are young farmers, farm businesses undergoing succession or generational change, farmers significantly restructuring their business to promote success in a changed climate.

To ensure that farmers in positions such as these are encouraged and enabled to continue driving for this business success, the VFF recommends a low-interest loan.

### ***Low-interest loan***

The VFF is suggesting a one-off low-interest loan accessible through a business case and broad eligibility criteria. The loan is paid back by the farmer as their income reaches a certain level. The aim of this loan is to advance business success and encourage self-reliance. It is envisaged that after accessing Stream 2, most farm businesses will be confident in accessing Stream 1 (rather than the security offered by Stream 3) and therefore co-invest in preparedness measures sooner than would be otherwise possible. It is important to incentivise the up and coming players to remain in the industry.

To address these issues the VFF approve a policy position to support the provision of low interest loans.

A criteria list for the provision of these loans was established as follows:

- Must demonstrate that the loan is to maintain and enhance production, and farm capacity to manage weather related risk;
- Loan capped at 30 per cent of 5-year average production volume, multiplied by current commodity price value;
- Capped to a maximum of \$300,000;
- Maximum discounted loan term of 5 years;
- Can be for capital purchases such as machinery that improves production, but not for land purchases;
- Open to all farmers;
- Funds initially provided through Rural Finance Corporation, eventually available through all lending institutions; and
- Loans discounted at 50 per cent of the commercial rate.

## **Stream 3: Response**

Balanced against streams 1 and 2 is an option for farmers unready to move towards preparedness. Stream 3 allows farmers to access a time-limited household income support payment. Such a payment ensures that as farmers weigh up their future business options, or await the business cycle in which profits will be made. This ensures that families can be confident of having food on the table and meeting their basic needs. Such a payment would be means-tested and available for a set period of time only. A business plan or viability assessment will be undertaken as part of the application.

The VFF considers that such a payment is equitable on the grounds that it may take a full year to make the profits from investments (eg cropping). Given the lack of extra funds due to prolonged drought, lack of cash flow may not indicate lack of business viability. On the other hand, selling a business is a decision that is best made on the basis of professional advice and careful consideration of options. The household income support payment provides slight relief to families considering or in the process of applying for a farm exit grant.

## ***Income Support***

Income support would be equivalent to Newstart in the amount received, but time limited and involving a mutual obligation (business case/business viability assessment) that assists farmers to understand their position and business prospects. This payment will be asset-tested, including against a cash-flow criteria. This allows farmers to move forwards in their business rather than selling off their farm assets to become eligible for income support. Comment has been made by our members that a farmer who currently prepares for an exceptional circumstance (whether it be flood, fire, hail or drought for example) are often penalised by not being able to access that assistance as they are perceived to not be in dire enough need. In comparison, a farmer who may not have prepared for this event is able to access assistance a lot more easily.

## ***Farm Exit Grant***

This is a one-off payment to support farmers leaving the land. This would be subject to eligibility criteria and means tested. This is an important tool in helping unviable farmers leave the farm. The VFF support raising the EC exit package to \$200,000 tax free per business and the criteria be amended to allow for total off farm assets of the owners not to exceed the number of owners multiplied by the dollar amount set by the Federal Government, which is currently \$750,000.

## **Impacts of Drought Policy Streams**

This combination of three drought streams is structured to provide genuine incentives for primary producers to invest in preparedness and risk management. It aims to create a culture where preparedness and climate risk management is factored into farm business planning on a regular basis and farmers use primarily their own money to manage this risk. The administrative burden on government is low compared to the current EC suite of measures, noting that many policies at one time in the EC package would be delivered as non-drought policies under this model.

Scope also exists to consider a new level of drought policy under this model. There is potential for a commodity group/government partnership to drive extension, restructure and preparedness. The VFF strongly supports moves of this kind that will extend the principles of partnering between government and agriculture on this important issue.

The intention of this proposed framework is that future severe droughts will not be met with an EC-style package, but with a continuation and considered expansion of each of the streams as appropriate. At a sector-level, for the reasons outlined it may be necessary for governments to re-evaluate the mix of policy measures provided under each stream to ensure that food and fibre production and markets are maintained. The VFF recognises that we cannot solve all potential future circumstances in one model and that a degree of flexibility to meet changing circumstances will always be required.

While drought policy is more directly aimed at farmers, it should be viewed as an important whole-of-community support.

## **Transition**

Having made the case above for urgent and comprehensive reform of Australia's drought policy, the question of timing remains a vexed one. Given that most of Australia continues to be suffering under 'exceptional circumstances' of hardship, ending the Exceptional Circumstances (EC) policies designed to cope with these exact circumstances in favour of a suite of policies that is focused more towards future preparedness would hurt the sector immeasurably. The VFF instead considers that the policies must exist in parallel until such time that all of Australia is no longer EC-declared according to the current EC definition.

Potentially, this means an overlap of policies of several years in some regions. The cost to the nation of administering the parallel existence of policies should not increase more than current arrangements. As areas come out of EC-declarations they will be eligible for the new drought preparedness suite of policies and provide the necessary tools and support for farmers to genuinely recover from a period of prolonged drought.

The alternative to this parallel approach is untenable. Leaving Australian farmers without EC support due to a decision that the area is no longer declared exceptional circumstances leave farmers potentially extremely vulnerable. These farmers would be in a position where they are yet to yield a return from their business due to the farming cycle, able – due to new government transitional arrangements to access a welfare payment to put food on the table – but possibly unable to fund the processing, labour or other necessary measures to operate their business.

A situation such as this would be dire for the agricultural sector, regional communities and negate the years of committed EC support provided to those same farmers during the drought. It would also save potentially have an impact on prices and supply beyond the farm gate.

In the interests of genuine recovery, preparedness and respect for the hardship that the farming community is undergoing during this extensive and prolonged drought, the VFF considers that it is imperative that government commits to maintaining Exceptional Circumstances arrangements until areas are no longer EC declared according to the current assessment criteria. If and when this assessment is made, such areas should automatically be eligible for the Drought Reform Policy Model proposed by the VFF. Such a phasing in of preparedness policy is responsible, affordable and necessary to preserve the capacity of Australian agriculture over the long term.