



**NSW GOVERNMENT
SUBMISSION**

TO THE

**PRODUCTIVITY COMMISSION INQUIRY INTO
GOVERNMENT DROUGHT SUPPORT**

September 2008

1. Introduction

This inquiry reflects Australian primary industries ministers' agreement that current approaches to drought and Exceptional Circumstances arrangements are no longer appropriate in the context of a changing climate. Ministers agreed that drought policy must be improved to create an environment of self reliance and preparedness, and encourage the adoption of appropriate climate change management practices.

The ministers' agreement recognises a need to assess current Commonwealth and State drought measures against the principles of the National Drought Policy (NDP) agreed by State and Commonwealth Ministers in 1992. The NDP approached drought as a foreseeable business risk for Australian farmers, and focused on helping farmers to assess, manage and mitigate this risk.

Since then, both Commonwealth and State drought programs have been modified by increasing the availability of welfare to drought-affected farmers, loosening eligibility criteria for assistance, and continuing or reinstating State transaction-based farmer subsidies that had previously been ceased. These changes may have slowed the NDP's drive towards a preparedness and risk management approach to drought.

Since 2002, NSW has provided \$396 million in drought assistance:

- \$298 million has been provided in direct drought assistance to farmers, including \$131 million in transport subsidies, \$21 million in services to farmers, \$90 million in EC interest rate subsidies and \$40 million in fee waivers;
- \$51 million has been provided for assistance to non-farmers including \$29 million on alleviating town water supply problems and \$11 million in payroll tax waivers; and
- \$55 million has been spent on Special Conservation Scheme loans.

NSW is pleased to assist the Productivity Commission by providing a discussion of the basic principles underlying the NSW Government provision of drought support (section 2) and how these broadly interact with preparedness and self reliance measures currently being adopted (section 3). The submission then discusses the major Commonwealth and NSW drought assistance initiatives in the context of environmental change, the principles of preparedness and self reliance, and general economic effects (section 4). This discussion outlines the benefits of these as well as some inefficiencies in their design and operation that the Productivity Commission may wish to consider. Finally, the submission discusses several possible alternate drought support measures that the Commission may wish to consider (section 5).

2. Rationales for government drought support

Traditionally, agriculture has been regarded as primarily a small family business based industry, largely serviced by small towns for which agriculture is a mainstay industry, and with a large proportion of the State's land and water resources under its control. Farmers also control the well-being of large numbers of animals. These characteristics accentuate the potential for the performance of farm businesses and the well-being of farm families to have

significant ramifications for the wider community, the economy, animal welfare and the environment.

However, it is recognised that farming has changed over the past decades and production is increasingly concentrated on larger farms. Regional economies have also diversified beyond agriculture. In light of these economic changes it is appropriate that the effectiveness of drought assistance measures be evaluated at this time.

The NSW Government has had a long-term commitment to assisting farmers and rural communities to prepare for and cope with drought, and is party to the National Drought Policy. These commitments are reflected in the comprehensive, cross-agency, suite of preparedness and relief measures currently in place to reduce the adverse effects of drought on landholders, rural businesses and rural families and communities.

It is considered that a well balanced approach to drought intervention by government will encourage drought preparedness measures, ensure families have access to welfare assistance when needed and include investment in innovation to help industry and the community to manage and overcome drought. Much of the success of Australian primary industries is based on past government investment in innovation. It can also be argued that investment in innovation is an effective form of government intervention given its impacts are durable, promote adjustment and adaptation to prevailing conditions and do not have the economic distorting effects that direct financial assistance can have.

3. Impediments to greater self reliance and preparedness

There is broad agreement that farmers were, in general, better equipped and prepared for the current drought than for previous droughts. Information collected from farmers and industry groups during the process of developing and evaluating Exceptional Circumstances (EC Drought) applications for the current drought provides anecdotal evidence that the level of drought preparedness by many farmers has significantly improved in recent years. There are many reports of substantial investment in drought proofing measures such as improved water supplies and fodder conservation since the 1992-93 drought, accelerated use of Farm Management Deposits and an apparent lower level of animal welfare incidents.

Research and development has contributed significantly; offering improvements in areas such as seasonal forecasting, grain breeding, mechanisation, reduced tillage and weed control practices. Other technologies that improve drought preparedness include lot feeding of animals during drought, modified animal breeding programs and water use efficiency measures.

The task of improving drought preparedness is, however, a continuous process and there will always be scope for further improvement. There is thus a strong continuing demand for good information to underpin farm management and investment decisions. The NSW Government has promoted and facilitated improved drought preparedness and management through research and development, and training and skills development programmes.

An innovative approach to achieving practice change has been to link access to incentive funding programs to completion of relevant NSW Department of Primary Industries training. This approach seeks to overcome impediments to implementation of desirable change by combining transmission of relevant information with training in how to practically utilise that

information with seed funding to ease financial constraints. Thus, for example 66 per cent of the farmers who have completed the Conservation Farming Program have indicated that they will develop or adjust their farming system, with 20 per cent accessing incentive funding to implement on-farm projects.

The rationale for providing assistance during droughts is that there are rare and severe drought events that are beyond the ability of even the most prudent farmer to manage. The resulting economic downturn also affects rural populations and non-agricultural businesses. However, the point at which climatic events are beyond the ability of farmers to manage is a difficult distinction to make and one that is complicated by differences in production, climate and location.

For instance, data from the Productivity Commission Research Paper (2005) *Trends in Australian Agriculture*, shows that the top third of broadacre farms have produced positive returns most years between 1977-78 and 2002-03 despite three major droughts having occurred over that period. Further, the same report shows that the bottom third of farms have not been profitable since the drought of 1991.

Further, in 2006, the Agriculture and Food Policy Reference Group (AFPRG) found that there is frustration among viable farmers that one-off assistance measures to a specific target group can reward those who do not make adequate self-provision to cope with market volatility and seasonal variability. AFPRG also found that preparedness measures such as improved education and training and Farm Management Deposits are more effective than interest rate subsidies or transaction subsidies in encouraging risk management and preparedness for exceptional circumstances.

Anecdotal evidence in NSW and declining requests for farm debt mediation suggest sustained support by banks for their farm business clients, despite the severity and protracted nature of the drought, (although it is also possible they could alternatively reflect a policy of deferring enforcement action until conditions improve). The Productivity Commission may like to consider whether certain institutional, policy and program settings engender greater support from the financial sector. There may also be greater possibility for future in-drought support measures to more explicitly take into account the performance of the financial sector in the provision of carry-on finance.

4. Are assistance measures effective and efficient in severe drought?

Drought assistance measures are delivered in a diverse range of circumstances. As discussed above, they have the potential to interact with the principles of self-reliance and preparedness in unintended ways. In this section, the submission discusses aspects of their design and operation that the Productivity Commission may like to consider when analysing their effectiveness.

EC declarations

To 30 June 2008, EC interest rate subsidies in NSW have amounted to \$913 million in State and Commonwealth commitments to primary producers, with a further \$34 million in commitments to small business. While individual businesses have undoubtedly benefited

significantly from this assistance, there are serious issues with the EC declaration process and eligibility criteria.

(i) EC designation

The current set of criteria for zoning EC in the first instance, and farmers individually qualifying in the second, is overly complex to administer and communicate. Defining what is "normal", "exceptional" and "severe" in climatic terms is also problematic given that the timing of rainfall and the requirements of particular enterprises has a dominant influence on the effects of any climatic event. Declarations based on a science based national system would reduce subjectivity and duplication. This could include an expanded role for the National Agricultural Monitoring Service in indicating when drought conditions exist, which would also bring the administrative benefit of removing the need for States and Territories to make initial EC applications.

(ii) Eligibility concerns

Eligibility is determined by "lines on a map" rather than by the individual needs of farm businesses or households. This creates equity issues as those outside the line can be in similar circumstances to those who are eligible.

A significant proportion of drought relief is provided with minimal means or needs testing. Of the \$298 million provided in direct drought assistance to NSW farmers since 2002, \$199 million or 67% has been provided without direct means or needs testing. Assistance is targeted to drought declared areas and, in some cases, income tests are applied to off-farm income. The Productivity Commission may like to consider whether there would be benefits in basing eligibility more specifically on individual economic circumstances either separately or in tandem with geographically based criteria.

Further complicating access to EC payments are long delays in preparing and assessing EC applications and hence in assistance being actually provided. While the Australian Government introduced 'prima facie' EC and 'interim' declarations during this drought (so that farmers could receive assistance while applications were being fully processed), this did not eliminate long periods during which farmers faced uncertainty about whether or not they would receive a full EC declaration and, therefore, assistance for an extended period.

(iii) Interaction between State and Commonwealth Governments

The issues paper raises the question of whether the process creates an incentive for states to apply for EC declarations. However, the EC declaration process contains impediments to states applying. The costs incurred in applying can be considerable due to the need to divert departmental staff, engage consultants to collect data, and to purchase farm survey statistics. States are also forced to obtain and present detailed climatic and financial information despite the fact that Commonwealth agencies such as Bureau of Resource Sciences and ABARE perform the same analysis for the National Rural Advisory Council. More generally, the involvement of multiple levels of government adds inefficiencies to the declaration and payment process.

Business support measures

Drought assistance measures generally target the farming sector. However, many non-farm regional Small to Medium enterprises are impacted by drought given their reliance on farm products as inputs and/or farmers as customers. A general observation about drought assistance measures is that over time they have become more highly developed for farmers than for the non-farm business sector due to strong links between agriculture and the broader regional economy and the desirability of limiting flow-on costs from agriculture to natural resource management and animal welfare measures.

Jobs in agricultural and connected sectors are impacted by drought conditions and drought assistance does not extend to these employees. Further, the timing of financial assistance does not always allow agricultural operations to recover sufficiently to become significant employers. In recognition of this gap in drought assistance, the NSW Government has implemented a payroll tax relief program, however, this program has had its own difficulties (see discussion below).

As for drought assistance generally, the thrust of government assistance measures needs to shift from being an emergency response to supporting regional small businesses to carry out an informed assessment of the longer term impact of drought and climate change on their operations. The Productivity Commission may like to examine the potential for measures that would assist regional small to medium enterprises to become more sustainable, including education programs on more efficient use of water in production methods or processes.

Example: Payroll Tax Relief

The NSW Government provides payroll tax relief for eligible business with up to 200 employees, aimed at retaining of skilled workers. Since the program began in 2002-03, only 108 offers of payroll tax assistance have been made and the level of program take-up by business has been lower than expected.

Various reasons for the low take-up have been suggested, including: a reluctance to openly admit the impact of drought and an unwillingness to accept “hand-outs”; and overly stringent conditions and lengthy application processes. The measure has also been criticised for favouring medium businesses over larger ones and as an example of a short-term measure that has been extended to the detriment of encouraging businesses to diversify or restructure. The Productivity Commission may like to consider whether these difficulties are common to other business support measures and whether they could be improved through a more formal recognition of the impact of drought on rural businesses.

Effects of input subsidies

The most significant input subsidy in NSW is the transport subsidies scheme. This scheme provides 50% subsidies for the costs of transporting fodder, water and stock to and from agistment, and stock to sale or slaughter. About 1 in 6 farmers has received transport subsidies at some point during the current drought and at 44% of NSW drought assistance, this scheme is the largest single component of state’s drought assistance measures.

Like interest rate subsidies provided under the Exceptional Circumstances program, state-level transaction subsidies similarly reduce the cost to farmers of certain farm inputs. Input subsidies assist farmers to ensure their livestock have access to adequate feed and water and thereby alleviate immediate animal welfare concerns and pasture and environmental degradation. They are also popular with farmers, in part due to their low administrative costs, general accessibility to a wide range of farm businesses, and the timeliness of their provision.

However, as with all input subsidies, transport subsidies have the potential to distort resource use by increasing demand for the subsidised input which in turn increases production costs for other non-subsidised input users. For example, the cost of fodder and transport services may be bid up to the detriment of intensive livestock industries. They could also discourage long-term sustainability by distorting production decisions, for instance encouraging some farmers to delay de-stocking, and placing increased pressures on exhausted land. The simplicity of the program's application also means it can be inequitable as it disproportionately benefits livestock farmers, transport providers, and producers in particular geographical areas.

The Productivity Commission may want to consider whether input subsidies could be better targeted to ensure they remain focused on self reliance and preparedness.

The role of farm financial counsellors

The Rural Financial Counselling program provides grants to non-profit organisations to provide a free and impartial rural financial counselling service in 30 different regions across NSW. NSW considers the program to be equitable, needs driven and cost effective. It is very highly regarded in the community and achieves significant penetration of the farm sector. This Program is considered to be an effective means of facilitating improved farm businesses risk management and adjustment across rural NSW.

The NSW Government has traditionally allocated approximately \$1 million per year in funding, although additional grants have been made available in recent years. As resource constraints have prevented the program from being broadly available to some drought-affected members of the community, particularly small businesses, the Productivity Commission may wish to examine the most equitable and efficient means of funding the program to ensure it remains viable and effective in regional communities.

Maintaining rural communities

Severe drought has a devastating effect on farm families, rural businesses, and rural communities in general. In many cases, the economic effects of drought lead to migration out of the area, reducing the availability of skills and labour and making recovery following the drought more difficult. The effects of drought are experienced in both financial and health stress.

The NSW Government has recognised the importance of maintaining social cohesion and support services in times of drought. The Farm Family Gathering program (see below) is an example of a measure that has successfully combined the distribution of information about drought support services, including preparedness and farm management information, with an opportunity to build communities ties.

Example: Farm Family Gatherings

Farm family gatherings are events where farmers and their families can attend predominantly informal gatherings and access information and services from a wide range of government agencies and non-government service providers. These gatherings have proved to be a highly successful strategy. They provide up-to-date information on drought assistance and welfare measures available to farmers and their families.

NSW Drought Support Workers, Rural Financial Counsellors and the NSW Department of Community Services have all reported that the gatherings have resulted in increased contact with people requiring urgent assistance and increased acceptance by farmers of other Government services, such as Mental Health and Centrelink.

For farmers and other rural families these gatherings also provide the opportunity to re-establish and maintain social ties, together with temporary release from the stresses of drought. The program has been extremely well received, with some 112,459 people having attended the 2,092 gatherings held as at 30 June 2008. The gatherings have been widely spread across the state, but with concentrations in the most severely drought-affected areas. The gatherings are also very cost-effective, representing an average cash cost to the NSW Government of less than \$700 per event.

Income support measures

The Commonwealth Government has primary responsibility for protecting the financial welfare of families. This is provided for through the general social security system and through special provisions for farm families under the Exceptional Circumstances (EC Drought) arrangements. There are, however, weaknesses in these welfare measures, particularly in terms of timeliness and eligibility requirements that impede effective targeting of welfare assistance. Further, many farm households continue to be financially distressed, despite the fact that they may have been in receipt of EC relief payments for some time.

The NSW Government supplements these measures in a number of ways, most particularly through Drought Household Assistance grants. Rural families and individuals are eligible to apply for drought household assistance if they are disadvantaged by the drought, and are located in a drought affected district that is not declared as a Commonwealth Exceptional Circumstance area. The primary aim is to provide emergency assistance for households that have insufficient income and/or cash reserves to meet basic living needs. The payments may not be used for farm operating expenses, business debt servicing, purchase and transport of fodder, or stock water.

The NSW scheme aims to fill a gap in the social security system, particularly in areas that are affected by drought but not yet drought declared. However, the division of responsibilities is complicated by the Commonwealth also providing interim income assistance in areas that are not yet drought declared.

The Productivity Commission may wish to consider how eligibility criteria for farm family welfare measures could best be determined to ensure efficient and effective targeting. One option that could be pursued is a Commonwealth scheme whereby individuals could apply for welfare support on an individual basis without the need for regional EC declarations. This

would avoid the institutional problems associated with EC declarations and may more clearly delineate the role of respective levels of government in relation to drought assistance.

Environmental and natural resource management considerations

As outlined above, assistance measures are delivered in the context of sometimes unintended interactions with drought preparedness measures. As well as considering this relationship, the Productivity Commission may like to consider how drought assistance measures both reflect and affect environmental circumstances, and whether the measures take these factors into account.

In the context of current and future climate change, drought support measures, such as the Exceptional Circumstances arrangements, should be delivered within an overall risk management framework. This would include:

- the development and uptake of the best available information on regional climate change and associated impacts;
- an emphasis on active adaptation management and building adaptive capacity of agricultural and environmental systems;
- avoidance of perverse environmental outcomes;
- recognition that in some cases changes to land management, land-use, and associated businesses, markets and infrastructure, will be inevitable;
- recognition that farmers may seek to establish farm operations in new locations, competing with other potential land-uses such as conservation; and
- effective monitoring and evaluation systems to monitor the performance of adaptation responses.

Australia's agricultural sector and its natural resource base are particularly vulnerable to projected climate change. Some current drought support measures could have unintended negative environmental impacts in New South Wales and conflict with the National Drought Policy's objective of maintaining and protecting Australia's agricultural and environmental resource base during extreme climate stress. For instance, as discussed above, drought assistance may contribute to delays in destocking, which in turn increases grazing pressure and contributes to environmental degradation.

Potential measures to reduce the environmental impact of drought support include improving drought preparedness through more efficient water use and assisting conservation, such as through the NSW Special Conservation Loan scheme (see example below).

In considering the impact of drought support measures on the environment and natural resources, the Productivity Commission may like to consider the potential for positive environmental outcomes from alternative arrangements such as diversifying commodity production and income sources.

Example: The NSW Special Conservation Loan Scheme

The Special Conservation Loans Scheme provides low interest rate loans to fund specific works aimed at promoting improved land management practices in NSW. As part of the NSW drought package announced in 2002, the Scheme was extended to include a range of other drought-proofing measures, including: the planting of long-term perennial pastures; the

construction of on-farm stock feed/fodder storages; and desilting of dams. At present, approximately \$80 million is on loan under this Scheme, however, not all of these loans are drought related.

The purpose of the Scheme is to stimulate certain investments by farmers through relatively low levels of subsidy. Thus, recipients are required to make an up-front co-contribution of at least 10 per cent of the value of the works, and the support provided is a loan rather than a grant. The subsidy component is in the interest foregone by Treasury.

Currently, the environmental effectiveness of the scheme is unclear, but it has been recognised as cost-effective, equitable and efficient, and has the potential to deliver environmental benefits. The new, drought proofing elements of the scheme have so far attracted only modest interest, although the difficult financial circumstances of farmers may have contributed to this low level of uptake. The Productivity Commission may like to consider whether loan schemes such as the one operated in NSW have the potential to encourage environmentally appropriate drought preparedness measures, and what factors may encourage their uptake.

Farm Management Deposits

The amount held by NSW farmers in FMDs has increased significantly since the scheme was introduced in 1999. Further, the total value of holdings has remained relatively constant since 2002, despite the current drought continuing over a prolonged period.

There are a number of possible ways this data can be interpreted. Firstly, the increasing levels of farm deposits could be seen as an indication, for at least some farming businesses, of improved preparedness. In this case, additional drought assistance may be supporting viable farming industries. Alternatively, there is a possibility that the high levels of investment could be related to the interest rate subsidies triggered by EC drought declarations. The EC assistance could result in the debt servicing costs of using a loan for capital investment being more profitable than other options, including withdrawing funds from Farm Management Deposits.

Program implementation

The implementation of different drought support measures by different jurisdictions creates inefficiencies in the delivery of assistance and can reduce the accessibility of programs through the confusion created. In accordance with the National Drought Policy, States are primarily responsible for preparedness and minor drought events and the Commonwealth is primarily responsible for Exceptional Circumstances assistance (i.e. the response to major drought events). Ideally, the roles of the States and the Commonwealth would be clearly separate—the Commonwealth being predominantly responsible for welfare provision and the States/Territories responsible for maintaining and ensuring the provision of basic services such as education, health and community services and the sustainable management of natural resources.

Current arrangements blur the roles. For example, whilst the Commonwealth Government is responsible for addressing welfare issues resulting from severe drought through various income and employment assistance programs, such as the Exceptional Circumstances income support payments, the NSW Government has also introduced some welfare related drought measures (such as the Emergency Relief Fund (Drought Household Assistance)).

NSW has recognised that the range of Commonwealth and state financial and social drought support programs can create confusion. To assist the spread of information, NSW has instituted the Drought Support Worker project (see example below), along with Farm Family Gatherings (discussed above).

Example: NSW Drought Support Worker Project

The Drought Support Worker (DSW) project aims to link the priority needs of farmers and their families, other landholders and rural communities with information and support services provided by Government and non-government agencies and organisations. Since 2003, the NSW Government has committed \$4.6 million to the program.

There are ten DSWs located in rural communities with the most need. They are employed by the NSW Department of Primary Industries to provide personal support to farmers and their families; provide basic information, advice and referral to other services; and work with other local service providers to develop welfare networks to coordinate activities and services.

The DSWs are mostly drawn from the communities where the positions were located, with essential criteria including local knowledge and links to community support networks. The DSWs are often the first contact for organisations or groups who wish to deliver services to rural people and have been able to access a large section of the rural community that previously had little contact with public or private service providers. This program is an effective supplement to more traditional approaches to information dissemination, provision of advice on assistance measures, and family counselling and referral.

The project is highly adaptable to the changing needs of farmers and rural communities. The DSWs have flexibility to develop activities that meet identified local needs and maintain regular contact with local service providers to ensure that all issues and concerns are brought to the attention of the NSW Government. DSWs meet every three months to review progress and be updated on the latest information available on support services.

5. What are the alternatives?

There are a number of alternative drought support measures that the Productivity Commission could consider the benefits of implementing. One option could be to encourage the redirection of the EC Interest Rate Subsidy to preparedness measures such as Research and Development, training and financial assessment and counselling programs. In addition, NSW considers that there could be benefits in pursuing income-contingent loan schemes and small business and organisation support measures.

Income-contingent loans

One drought policy proposal that has been put forward is the possible development of an income-contingent loans scheme for drought relief (similar to HECS for university fees).

Such a scheme would allow farmers who believe that their business is viable to be able to access assistance money, which would only need to be repaid once their income returned to a specified level. Such money could be made available to both farmers and to small rural businesses for a broad range of drought relief purposes. Loans could also be used to assist with drought recovery (e.g. to purchase new crops and/or stock).

NSW considers that there are a number of possible benefits from this kind of drought-assistance, in terms of equity and accessibility, and that it could be implemented at a national level. In particular, an income-contingent loan scheme could replace some aspects of the current EC assistance provided by the Commonwealth, such as the EC Interest Rate Subsidy. There may also be scope for such a scheme to be used to deliver some of the assistance such as drought preparedness and management grants, innovation grants, and recovery grants. A more cost-effective way of providing the same assistance could be through an income-contingent loan scheme. At the same time, disadvantages of such a scheme should be recognised, including administrative costs.

Small business and organisation support

The Productivity Commission may also wish to consider additional small business and small organisation support with a similar emphasis on self reliance and preparedness. In addition to agricultural producers, the drought also has a significant affect on the small businesses and community organisations which service rural communities. Whilst some of the existing state-based measures (e.g. payroll tax relief and small business improvement and recovery advice) provide assistance to such businesses, the majority of assistance is directed towards agricultural producers, and therefore, there appears to be scope for further assistance that will allow the small businesses and community organisations to continue to remain viable.

One option that could be considered is the redirection of funds currently used for payroll tax relief beyond the first year into other measures, such as extending the small business and credit management advice service to a broader range of businesses, as well as providing similar advice and assistance to community organisations such as the Rural Fire Services and other volunteer organisations.