

## **Victorian Government submission to Productivity Commission drought inquiry**

*As set out in Victoria's recently released Future Farming strategy, Victoria supports the Commonwealth Government's national review of drought policy and the call from many parts of the agriculture sector for a re-think of drought assistance. The Productivity Commission's drought inquiry is an important part of the Commonwealth's review.*

*Victoria is seeking to focus on longer term perspectives for families and communities coping with the temporary impact of exceptional circumstances. We are moving forward by strengthening our longer term assistance for structural adjustment for farming and other businesses whose ongoing viability is threatened by adverse climatic conditions.*

*This is evident in our newly announced \$115 million drought relief package that strengthened targeting for short term financial assistance and extended our funding for longer term structural adjustment support.*

*This submission reflects Victoria's policy directions for the challenges facing rural and regional Victoria as outlined in the Future Farming strategy. In respect of drought policy, this means strengthening on-going support for productivity, competitiveness, and the wellbeing of farm families and communities, and encouraging widespread adoption of broader risk management by farm businesses.*

*By shifting to a system that supports the development of new technologies, practice change and productivity growth, farm businesses will be better able to manage risks and capture the opportunities presented by change.*

*It is appropriate for governments to provide farmers with the tools and incentives to manage the impact of change while a welfare safety net is available to farmers (as for the rest of the community) based on need, not weather.*

*Where particular communities suffer significant hardship caused by adverse seasonal conditions, assistance to support these communities would also be appropriate.*

### **Introduction**

There have been regular droughts in Australia over the last three decades (1981-82, 1993-95, 2002-03 and 2006-08). Droughts can have severe financial impacts on individual farmers that extend to agribusinesses, rural and regional communities and state and national economies. Droughts can also lead to significant environmental, social and animal welfare costs. For those farmers dependent on water allocations, successive years of low inflows in the Murray Darling catchments have magnified the challenges of the current drought.

Rural and regional Victoria has been particularly hard hit. Victorian output for agriculture, forestry and fishing fell by 18.2 per cent in 2006-07 compared with 2005-06 (ABS 2007). Similarly, nominal farm cash income for Victorian broadacre and dairy farms fell 29 per cent over the same period (ABARE 2008).

### **The role of Government in drought policy**

The rationales for government drought support in the Productivity Commission's (the Commission) issues paper are noted. They include:

- addressing market failure, such as providing public good R&D (climate forecasts);
- addressing policy failures – intervening to correct conflicting incentives, perverse outcomes, or reducing regulatory burden, and;
- addressing social objectives by intervening to ensure a minimal level of individual wellbeing (safety net payments).

While government may choose to intervene in the economy to influence the distribution of wealth across members of society on social support grounds, the economic efficiency arguments for direct government intervention in drought risk management are less clear (Ha, Stoneham, Harris, Fisher and Strappazon 2007 and Freebairn 1983).

Drought is only one of a number of factors impacting on farm businesses. Competition for land, labour and capital, as well as import competition must all be planned for and managed. The *Future Farming* strategy acknowledges these pressures and seeks to improve the productivity, competitiveness and sustainability of farm businesses. The strategy also identifies a role for government in facilitating more efficient markets, such as by reducing impediments to efficient markets for land and water.

It is increasingly accepted that direct financial business assistance during adverse seasons can undermine incentives for recipients to manage their business risks and prepare for inevitable dry periods. In particular, previous reviews of drought policy have found no market failure for commercially available finance in time of drought. Most farms have a high equity to debt ratio and have good access to capital markets, even during downturns associated with drought. Banks will typically provide finance to farm businesses expected to be viable.

A key role for government, therefore, is to ensure that markets are working as efficiently as possible and that there are minimal barriers to industry structural adjustment and farm adaptation.

If governments choose to provide direct financial assistance, it is probably better focused on household support and communities rather than to businesses and industry. This maintains the equity focus and lessens the chance of creating perverse incentives for farm businesses.

Another possible role for government in removing barriers to structural adjustment and adaptation in agriculture arises when existing farmers and new entrants are making their business decisions based on outdated, incorrect or incomplete information.

Governments can assist farmers' decision making by generating and distributing information that is not otherwise available in the market. An example is the Planning for Climate Change Action of the *Future Farming* strategy. This provides \$5.2 million over four years to provide information, and research and develop tools and techniques to build skills of rural stakeholders.

## **Recent drought policy and the need for reform**

### National Drought Policy and provision of Exceptional Circumstances assistance

The changes to Australian national drought policy in the past two decades have been well documented (see for example Botterill 2003 and Botterill and Fisher 2003). One of the more fundamental changes was the 1992 National Drought Policy (NDP) agreement among the Commonwealth, States and Territories that redefined drought from being regarded as a 'natural disaster' to a normal part of the farm operating environment, to be managed like other business risks (Ha et al 2007).

However, the NDP agreement provided for 'exceptional' droughts for which farmers could not be expected to prepare or manage and for which Government assistance would be available, via Exceptional Circumstances (EC).

The intended basis for an EC event triggering government assistance is that it is rare and severe, occurring on average once in 20 to 25 years. Despite this, 29 per cent of EC assistance recipients across Australia have received continuous assistance for the last two to five years. Furthermore, some regions in Australia have been EC declared for more than 10 years. Since 2001, over \$3.5 billion in Commonwealth Government drought assistance has spent across Australia. Victoria has committed over \$500 million on drought assistance since 2002-03.

While the objective of the NDP is to promote self-reliance in farm risk management by (appropriately) shifting more of the risk burden of drought events from taxpayers onto farmers, there are questions whether the EC provisions and associated government payments have been undermining farmer's incentives to do this.

In part, this reflects the reality that there is no clear way of defining exceptional circumstances. Ambiguity will always exist in the concept. The EC declaration process can also lead to inequalities. Some businesses and households within EC declared areas will not be in hardship, while some outside the boundaries will be.

Climate change, too, has exposed the weaknesses of current drought policies that rely on exceptional circumstances to trigger assistance. If climate change causes an increase in the frequency of droughts, the cost of drought policy may escalate to unsustainable levels. Victoria notes the joint Bureau of Meteorology (BOM) and CSIRO report released in July 2008 – *An Assessment of the Impact of Climate Change on the Nature and Frequency of Exceptional Climatic Events* – which concludes “that the current EC trigger is not appropriate under a changing climate and that future drought policy may be better served by avoiding the need for a trigger at all”.

### Impact of current policy on structural adjustment and adaptation

The challenges facing current drought policy and associated assistance measures have been extensively and repeatedly documented (Ha et al 2007; Botterill 2003 and Botterill and Fisher 2003). Principal among these is that business assistance in the form of direct farm input subsidies can impede structural adjustment and undermine incentives for farm businesses to manage their own risks.

While input subsidies such as for fodder and transport provide short term support to farm businesses, they also artificially increase the price of inputs and are inevitably

capitalised into the price of assets used in the subsidised industry/sector. Traditionally, subsidies are capitalised into the price of farm land (and possibly water).

Although structural adjustment and adaptation can be stressful for those involved, it is important to not impede adjustment choices being made. Structural adjustment facilitates ongoing growth and development of the economy. As less efficient businesses exit an industry, resources (labour, land and capital) are released for those businesses that are more productive and effective at meeting market demand. The growth of these successful businesses drives overall economic growth and development (Parham 2004). Governments can reduce the impact on those involved by providing appropriate social and adjustment support.

### **Reforming current arrangements**

In February 2008 PIMC ministers agreed that current approaches to drought and exceptional circumstances are no longer the most 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 (Primary Industries Ministerial Forum communiqué – 29 February 2008). Noting the BOM and CSIRO climate change assessment, it would be worthwhile for the Commission to examine removing the distortions and inequalities inherent in the Exceptional Circumstances (EC) declaration process to achieve meaningful reform.

Policies that assist households and communities that are genuinely experiencing hardship, without having geographical constraints and weather related triggers, should be considered as part of the Commission's inquiry. Replacing direct farm business drought support with universal income support available continuously to those who qualify could eliminate the need for EC declarations or related assistance. It would seem appropriate that such assistance would continue to be provided by the Australian Government through Centrelink. Removing EC declarations could also improve the timeliness in providing assistance.

This could be supported through specific community or social support programs that assist regions suffering hardship. Nationally consistent methods of determining eligibility for regional assistance may be helpful.

Victoria has advocated this view through the *Future Farming* strategy. All farmers must prepare themselves for drought and the longer term impacts of climate change as a normal part of business planning. At the same time, governments must ensure farmers have the incentives to manage the impact of drought while maintaining a welfare safety net to support farmers (rather than farm businesses) based on need, not weather.

PIMC has agreed that the framework for improving drought policy must include a strategy for managing any transition to new arrangements. It has also agreed that rules for those producers currently receiving assistance would not be changed.

A transitional approach that phases away from direct business subsidies, towards income support that is continuously available on the same basis as for the broader

non-farm community is preferred. Such an approach would assist farm businesses to become more self reliant and accustomed to managing their own risks.

The *Future Farming* strategy recognises the need for farm businesses to be better prepared for and better able to manage the threats and opportunities of drought and climate change. It also reflects the current thinking of the PIMC regarding how best to support rural and regional communities to become more productive and sustainable. The \$205 million strategy includes \$103.5 million to boost farm productivity, through technology and changes in farming practices, and a further \$11.4 million to help farmers understand and manage climate change. More strategically focused extension services will be provided by DPI to assist farmers operate successfully in the expected future environment.

### **Consideration of family and community support policies**

In light of the preceding discussion and in addition to the productivity and practice change initiatives referred to above, social support policies dealing with drought and climate change are also key considerations. While acknowledging the separate assessment of the social impacts of drought as part of the Commonwealth review, it is important that all aspects of drought assistance are considered as part of the Commission's inquiry.

#### Health and wellbeing support

Health and wellbeing support is an area where the Victorian Government is making an important contribution to both farmers and non-farmers facing emotional hardship, principally through counselling services.

Gaining maximum benefits of health and wellbeing initiatives requires a sufficiently long time frame to attract, train and retain suitable counsellors. Recognising this, the Victorian Government, through *Future Farming*, has committed more than \$8 million over four years across three programs, dealing specifically with rural health and wellbeing:

- Farm family health – *Sustaining Farm Families* – \$2.18 million;
- Case management for farmers – *Rural Financial Counselling* – \$3.46 million, and;
- New National Centre for Farmer Health – \$2.4 million.

#### Community Initiatives

A recent OECD report (2006) notes that there has been a gradual shift in some countries from industry (e.g. agriculture) based rural policies to place based rural policies. The aim is to help the local communities thrive economically and socially, rather than supporting a particular industry. There have been some successful place based policies such as the LEADER program in the European Union. Victoria has also adopted place based programs such as the *Community Building Initiative* and the *Rural Futures Initiative*.

#### *Community resilience*

To cope with the emotional difficulties that come from a drought, some people turn to their community for help. Accessing support networks can be more difficult in rural areas because of the low and shrinking population density and the distances involved.

The decline in the number of rural sports clubs (quite often the hub of a rural community's social network) is an example.

To help support community networks the Victorian Government assists in providing social infrastructure for local communities in drought affected areas. This assistance includes:

- grants to rural sporting groups negatively affected by drought to help make their facilities drought resistant (e.g. Drought Relief for Community Sport and Recreation and the Regionally Synthetic Surfaces programs);
- appointment of additional drought coordinators through the Building Resilient Communities program, and;
- supporting councils in drought affected areas to assist their communities to plan strategically for longer term consequences of sustained drought (e.g. Planning for Change program).

#### *Community adjustment*

With the impacts of drought and climate change rural and regional communities need to continue to move away from dependence on agriculture and diversify their activities to become more resilient to the constantly changing environment. In the recent past the Victorian Government has facilitated this change process through various initiatives, including:

- subsidising skills training so that people can re-train for a new employment (e.g. Rural Skills Connect), and;
- funding to support training and professional advice for new and small businesses with growth potential (e.g. Business Transitioning Program).

*Future Farming* continues to recognise the importance of supporting rural and regional communities in dealing with change and adjustment. In particular, the \$3.74 million – *Rural Futures Initiative* will assist communities, agricultural industries and farmers make decisions about their future and adjust to change. The initiative provides key information relevant to those experiencing change, as well as encourage dialogue between farmers, communities and stakeholders.

These rural based family and community initiatives complement similar existing Victorian programs including, the *Provincial Victoria Growth Fund*, the *Small Towns Development Fund*, and the *Victorian Community Support Grants* program.

Australian Bureau of Agricultural and Resource Economics 2008, *Australian Farm Survey Results 2005-06 to 2007-08*, Canberra.

Australian Bureau of Statistics 2007, *Australian National Accounts State Accounts • 5220.0 2006–07*.

Barr, N. 2002, 'Going on the land – and getting off it: farm incomes and farm adjustment', Faculty of Agriculture and Food Systems Australasian Agribusiness Journals – Online, University of Melbourne, [http://www.agrifood.info/connections/winter\\_2002/Barr.html](http://www.agrifood.info/connections/winter_2002/Barr.html).

Botterill, L. C. 2003, 'Uncertain climate: The recent history of drought policy in Australia', *Australian Journal of Politics and History*, vol. 49, pp. 61–74.

Botterill, L. C. and Fisher, M. 2003, 'Beyond Drought: People, Policy and Perspectives', CSIRO Publishing, Collingwood.

Freebairn, J. W., (1983), 'Drought Assistance Policy', *The Australian Journal of Agricultural Economics*, 27 (3), pp. 185-99.

Ha, A., Stoneham, G., Harris, J., Fisher, B and Strappazzon, L. 2007, 'Squeaky Wheel Gets the Oil: Incentives, Information and Drought Policy', *Australian Economic Review*, vol. 40 no. 2 pp 129-48.

McColl, J.C. and Young, M.D. 2005, 'Managing Change: Australian Structural Adjustment Lessons for Water', CSIRO.

Organisation for Economic Co-operation and Development 2006, 'The New Rural Paradigm: Policies and Governance', OECD Publishing.

Parham, D., (2004), 'Sources of Australia's Productivity Revival', *The Economic Record*, vol. 80 no. 249, June 2004, pp 239-257.