
OVERVIEW

Key points

- Many Australian farmers and rural communities are experiencing hardship as a result of a severe and prolonged drought. While this is not new to dryland farming, the 'irrigation drought' is uncharted territory.
- Australia has always had a variable climate, with drought being a recurring feature. Looking to the future, most agricultural regions need to prepare for higher temperatures and for some, more frequent periods of exceptionally low rainfall.
- Most farmers are sufficiently self-reliant to manage climate variability.
 - In 2007-08, 20 per cent of Australia's 150 000 farms received drought assistance, totalling over \$1 billion, with some on income support continuously since 2002.
 - Even in drought declared areas, most farmers manage without assistance. For instance, from 2002-03 to 2006-07, on average, more than 70 per cent of dairy and broadacre farms in drought areas received no drought assistance.
- All governments agree that the current approaches to drought and Exceptional Circumstance (EC) declarations are no longer the most appropriate in the context of a changing climate. In marked contrast to the policy objectives, current drought assistance programs are not focussed on helping farmers improve self-reliance, preparedness and climate change management.
- EC Interest rate subsidies and state-based transport subsidies are ineffective, can perversely encourage poor management practices, and should not extend beyond 2009-2010.
- EC household relief payments are limited to those in drought declared areas.
 - All farm households in hardship should have access to temporary income support designed for farming circumstances, after which the standard community safety net should apply.
- The EC declaration process is inequitable and unnecessary. It should not be extended to new areas and existing declarations should terminate by the end of 2009-2010.
- The National Drought Policy should be replaced with expanded objectives for *Australia's Farming Future*. These would recognise that the primary responsibility for managing risks, including from climate variability and change, rests with farmers — underpinned by more appropriate forms of government support.
- Research, development, extension, professional advice and training to improve business management skills can help build farmers' self-reliance and preparedness.
 - These areas warrant significant government funding provided they are well targeted, area appropriate and deliver a demonstrable community benefit.
- Farm Management Deposits, despite their use for tax deferral, have encouraged farmers to save and to be more self-reliant, and should be retained.
- Policies relating to water, natural resource management and climate change all impact on farm businesses and local communities and need to be better integrated.

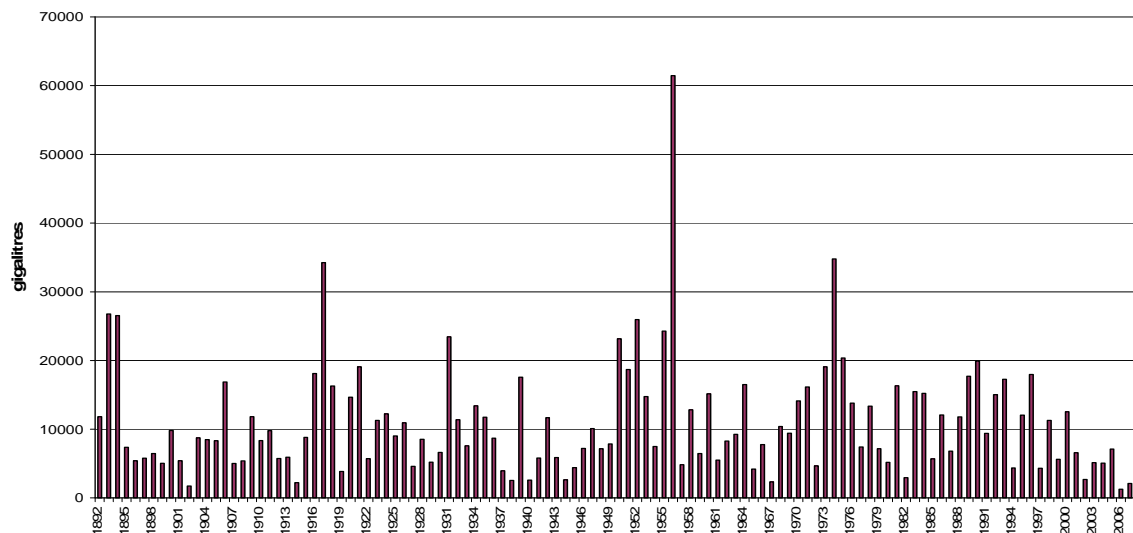
Overview

Droughts can have devastating social and financial impacts on farmers and their local communities as well as adverse environmental effects. Droughts also reduce Australia’s economic growth through forgone production and reduced employment.

Australia has one of the most variable climates in the world, with wet years, and even wet decades such as the 1950s, contrasting with dry periods. In terms of rainfall in south-western, southern and eastern Australia, this current drought has been severe and prolonged, comparable with the Federation drought and the drought of the 1940s. One significant difference this time is that it has been hotter — by about one degree Celsius.

The variability of Australia’s climate, and the frequency of droughts, is reflected in the peaks and troughs of surface water availability in the Murray system inflows over the last century (figure 1).

Figure 1 Murray system inflows (including Darling)



Droughts affect individual farming families and farm businesses differently. The impacts depend on local climatic circumstances, farm management practices and the degree of income diversification. Importantly, they also depend on the store of capital that farmers can draw on — the natural and physical capital of their farm, their financial and human capital and that embodied in their social networks.

Notwithstanding the severity of the current extended dry period, in 2007-08 about 20 per cent of all farms received drought assistance. The majority did not.

Governments have responded to recent droughts through a series of programs established under the National Drought Policy (NDP) framework. Adopted in 1992, the NDP is based on the recognition that drought is a recurring feature of the Australian climate. Its objectives correspond to phases associated with farming in a variable climate: preparedness before drought; managing and coping during drought; and recovering after drought. The objectives are to:

- encourage primary producers and other sections of rural Australia to adopt self-reliant approaches to managing for climatic variability
- maintain and protect Australia's agricultural and environmental resource base during periods of extreme climate stress
- ensure early recovery of agricultural and rural industries, consistent with long-term sustainable levels. (Minister for Primary Industries and Energy 1992)

The programs established under NDP focus on providing relief primarily to farm households and farm businesses in hardship and help some families to leave farming. Some state and territory governments also subsidise other farm business costs, such as the transport of fodder or shire rates.

Exceptional Circumstances programs

To be eligible for assistance, a farm must first be in an area declared as being in Exceptional Circumstances (EC) — the 'trigger' — and then satisfy the eligibility criteria of the individual programs.

The EC Declaration process involves three basic steps:

- initial identification of a drought event by a local community
- assessment and, if justified, endorsement by the state (or territory) government
- declaration by the Commonwealth Minister based on advice, including from the National Rural Advisory Council, that the area meets the declaration criteria, including that it is experiencing a one in 20–25 year event.

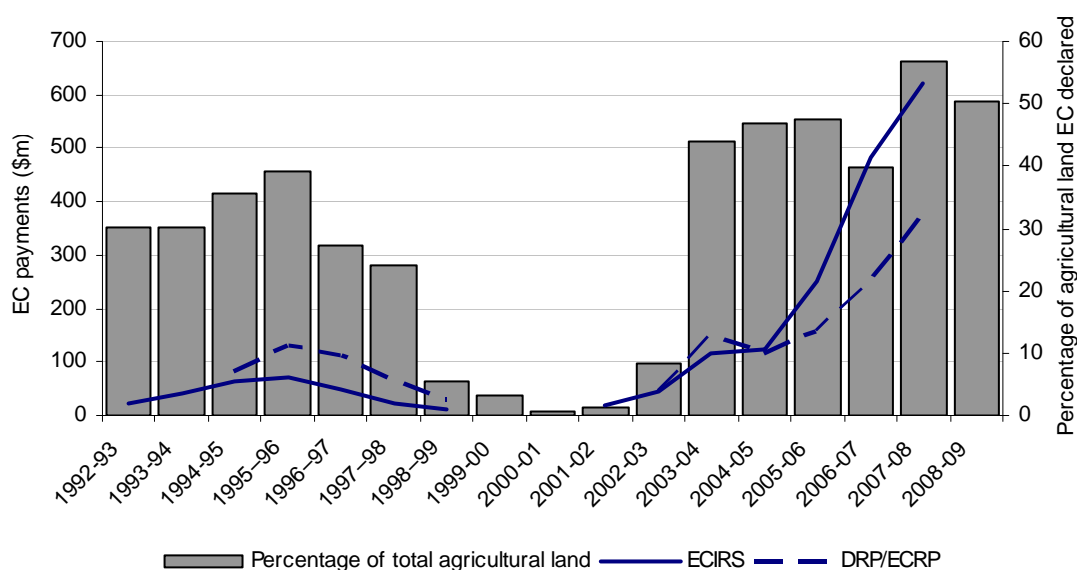
The *EC Relief Payment* (ECRP) is provided to farm households that meet the financial hardship criteria in drought declared areas, but excludes those on the other side of the EC boundary. It provides up to \$405 per fortnight each for the farmer and partner. While the payment is equivalent to that provided to an unemployed person in hardship under Newstart, the ECRP's assets and income thresholds are

much higher. In 2007-08, around 29 000 farmers received payments at a cost of approximately \$380 million (figure 2).

The *EC Exit Package* is available for farm businesses whose owners are willing to leave the industry. This little used package consists of an Exit Grant, which provides a taxable one-off payment of up to \$150 000, an Advice and Retraining Grant, and a Relocation Grant.

EC Interest Rate Subsidies (ECIRS) are provided to farm businesses and farm dependent rural small businesses that are deemed viable in the long-term, but which are in financial difficulty. A subsidy of up to 50 per cent of the interest payable on loans (excluding property purchases in the previous 12 months) is provided in the first year and up to 80 per cent in subsequent years. Recipients' payments are capped at \$500 000 over 5 years. Total payments under ECIRS have grown substantially in recent years (figure 2). In 2007-08, they exceeded \$620 million.

Figure 2 EC declared area and total EC support payments



DRP/ECRP includes payments to farm households made through the former Drought Relief Payment (DRP). Excludes \$9.9 million paid in Exit Grants since the scheme's inception in September 2007.

Review of drought policy

A striking feature of the NDP is the mismatch between its policy objectives and its programs. From its inception, the policy has centred on helping farmers build self-reliance to manage climate variability and preparedness to cope with droughts. Program expenditures, on the other hand, have not been directed to this end but

have predominantly flowed as a series of emergency payments to a minority of farmers in hardship and to stressed farm businesses.

Government ministers with responsibility for primary industries have observed that the current approaches to drought are no longer the most appropriate. As stated in the terms of reference for this inquiry, they have concluded that policy must be improved if Australian agriculture is to successfully create an environment of self-reliance, preparedness and the adoption of climate change management practices.

These views are evident in submissions from governments and are shared by peak agricultural bodies and by many farmers themselves. The South Australian Government submission states that:

While the current suite of national drought support programs has assisted many businesses and families in need, they will not facilitate the level of reform required to meet these new and emerging challenges [of climate change]. A new approach is required. (sub. 91)

Similarly, the Tasmanian Department of Primary Industries and Water (DPIW) concluded that:

The current assistance programs are proving to be disincentives for self reliance and drought preparedness strategies because safety nets are there to help farming businesses through difficult periods. DPIW has received numerous comments from a range of stakeholders that the current system rewards rather than discourages poor performance and lack of preparation. (sub. 85)

The view of the National Farmers' Federation is that:

Committing to a long-term drought policy is vital to securing an agricultural base that is resilient to a changing climate ... However, the NFF considers that one of the dangers of the government's current Exceptional Circumstances policy package is that it includes policies which, while bearing an impact on drought management, primarily target other objectives ... (sub. 51)

The views of many farmers, both in support of the current programs and critical of them, are drawn on throughout the report.

Given the ministers' concerns, they have asked for three reports. The first two — from BoM–CSIRO on climate change and from the Expert Social Panel — have already been completed (box 1). This draft report from the Commission, which completes the series, is to:

- report on the appropriateness, effectiveness and efficiency of governments' business and income support measures to help manage drought
- identify impediments to improving self-reliance and preparedness for periods of financial difficulty

-
- identify the most appropriate, effective and efficient responses by governments to build self-reliance and preparedness to manage drought.

These issues are to be considered in relation to the circumstances of farmers, farm businesses and farm dependent rural small businesses. The Commission is to take into consideration the objectives of the NDP and the Commonwealth Government's Expenditure Review Principles.

Box 1 Key messages from the reports on the climate science and the social impacts of drought

The BoM-CSIRO report

The joint assessment by the Bureau of Meteorology (BoM) and CSIRO reports that:

- the extent and frequency of exceptionally hot years have been increasing and are projected to continue, with exceptionally hot years likely to occur every 1-2 years, on average, over the period 2010-2040
- while trends in rainfall are highly dependent on the period of analysis due to large inter-decadal variability, exceptionally low rainfall years are projected to become more frequent in south west Western Australia, the South Australian agricultural region, Victoria and Tasmania
- exceptionally low soil moisture is projected to become more frequent in line with the projected increase in exceptionally low rainfall years.

The Expert Social Panel report

The Expert Social Panel consulted widely across the country and found that:

- there is widespread distress in drought-affected rural communities and too many farm decisions are made under stress
- while it is hard to separate the social impacts of drought from long term trends contributing to decline in some rural populations, drought adversely impinges on the wellbeing of farm families and communities
- policy needs to address the social needs of farm families, rural businesses and communities in ways which do not inhibit the efficiency of agricultural industries
- the connection between the farm as a place of work, residence and family tradition has important implications for the effectiveness of institutional support.

Most farmers manage without EC assistance

The concept of Exceptional Circumstance was originally developed for droughts of such severity that they would be 'beyond the ability of even the most prudent farmer to manage'. And, yet during 2006-07, half of Australia's dairy and broadacre

farms in drought declared areas did not receive EC assistance. Over the five year period 2002-03 to 2006-07, an average of over 70 per cent of these drought area farmers were not assisted (table 1).

Table 1 Drought assistance recipients, 2002-03 to 2006-07
Estimated number of broadacre and dairy farms

<i>Population</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>	<i>2005-06</i>	<i>2006-07</i>	<i>Annual average 2003-06</i>
<i>Farms on ECRP and/or ECIRS</i>	9 083	12 384	10 870	18 589	20 504	14 286 (29%)
<i>Farms in EC areas not on EC payments</i>	43 857	38 447	30 541	22 861	20 779	35 112 (71%)

Note: There will be horticultural and other farms that are not included in the totals.

Overall, of the 150 000 farms in Australia, only 20 per cent received EC support funding in 2007-08, amounting to over \$1 billion.

The extent of preparedness by most farmers is evident from figure 3. Compared with those receiving assistance, farmers in EC declared areas who did not receive support:

- were generating higher farm net cash incomes
- had higher off farm investment income to draw on
- were earning more off farm wage and salary income.

The analysis of farm liquidity and debt tells the same story. Unassisted farmers in drought areas had much higher liquid assets than those on EC support in the same areas (and had similar levels of liquid assets to farms not in EC areas), and had reduced their debt levels (and interest payment obligations) to the lowest of all groups of farmers.

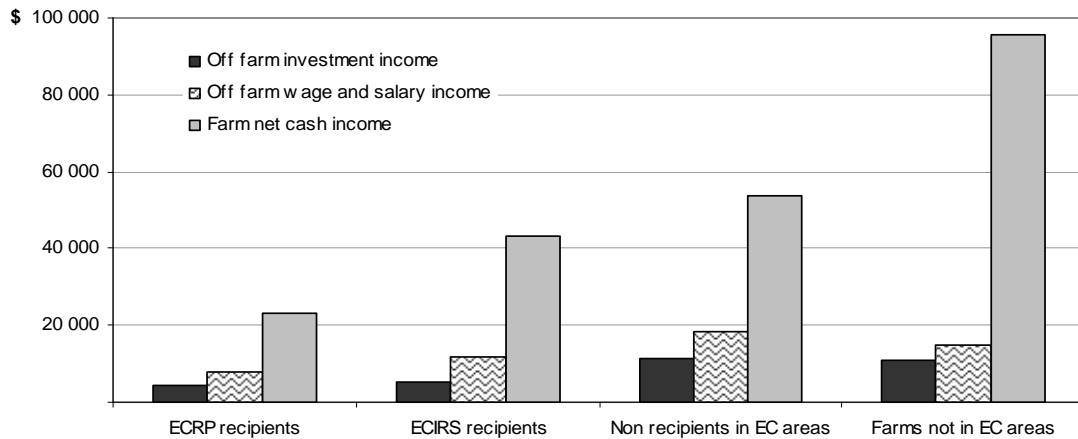
This high level of preparedness is not surprising, reflecting an accumulated understanding of Australia's climate variability. Many farmers have rainfall and temperature records going back 120 years and, depending on where their farms are situated, can readily point out the Federation drought and the long dry spell in the 1940s. Most were farming through the droughts of 1982 and 1994.

The significant exception this time is the impact on many irrigators, especially in the Murray-Darling Basin. The severely reduced water allocations that have occurred in the last two years represent uncharted territory. Low rainfall has interacted with policy failure. The river system is grossly over-allocated,

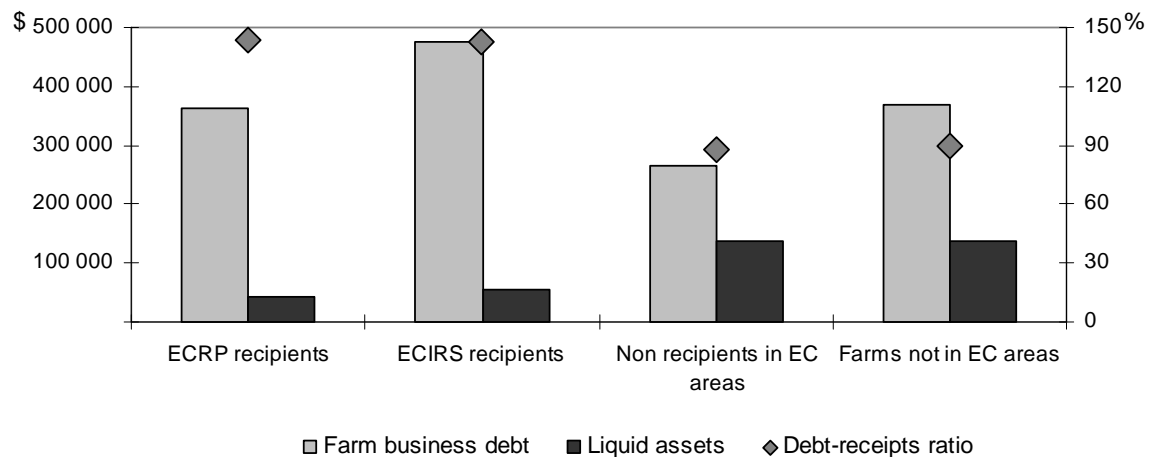
groundwater extraction has increased and farm dams have multiplied and reduced rainfall run off.

Figure 3 Income levels, liquidity and debt of recipients and non recipients of EC support

Income levels



Liquidity and debt



The impending contribution of climate change

The BoM-CSIRO report presents projections for changes in temperature, rainfall and soil moisture. For temperature, the meteorological evidence is that the geographic extent and frequency of exceptionally hot years has been increasing rapidly over recent decades. The report predicts that temperatures will keep rising.

Rainfall in most regions is expected to remain highly variable. While periods of exceptionally low rainfall are projected to increase in frequency in the south west of the country (including southern Western Australia and the South Australian agricultural region) and Victoria and Tasmania, BoM-CSIRO caution that these projections are much less reliable than the temperature outlook. The pattern of exceptionally low soil moisture years is projected to be similar to, though more pronounced than, that for rainfall.

Given the implications of this outlook for agriculture, it is even less appropriate to have a suite of programs, that target those least prepared to manage climate variability, after droughts arise. The imperative for governments is to assist farmers to be more self-reliant and more prepared to manage the risks of farming, including those associated with future climate variability and change.

Assessment of current programs

Exceptional Circumstances declarations

The institutional arrangements underlying the current ‘exceptional circumstance’ application and endorsement process provide a strong incentive for applications to be submitted. Local communities initiate an application and are the beneficiaries of the subsequent declaration.

State and territory governments assessing and endorsing such a declaration are acknowledged by the local communities as understanding their plight, yet are responsible for only 10 per cent of the cost of business assistance, and none of the costs of household relief. The Commonwealth, on the other hand, contributes all of the household relief funding and 90 per cent of the business assistance, leaving it with the fiscal and political consequences of accepting or rejecting an application.

Currently there is no formal requirement for transparency of the advice to the Commonwealth Minister from the National Rural Advisory Council and others on which the decision was based. In September 2007, the then Commonwealth Government declared 14 interim assistance areas (encompassing 46 per cent of agricultural land in Western Australia and 51 per cent of Tasmania), thus triggering a further round of non-recoverable interim assistance for additional areas of rural Australia. None of the communities in those areas subsequently submitted an application for formal EC status — in refusing to do so, the Tasmanian Minister for Primary Industries and Water described the interim EC declaration as ‘an election stunt’.

Despite the NDPs stringent one in 20–25 year criterion for an area to be EC declared, it has been common for 30 per cent or more of Australia to be declared (figure 2). Indeed, as at June 2008, more than half of the country was declared and some areas had been declared for 13 of the past 16 years. When compared with rainfall records, it would appear that a generous interpretation of the criteria, rather than protracted low rainfall, is mainly responsible for such widespread declarations. The process has failed to differentiate between severe and lesser droughts.

In terms of the EC's relevance in a changing climate, the BoM–CSIRO report concludes that:

The current EC trigger, based on historical records, has already resulted in many areas of Australia being drought declared in more than 5% of years, and the frequency and severity are likely to increase. The principal implication ... is that the existing trigger is not appropriate under a changing climate. (Hennessy et al. 2008, p. 1)

Several submissions to the Commission argued that the EC declaration process has some intrinsic psychological value in that, when an area is declared, it sends a message to the wider community that farmers in that area are facing difficult times because of the drought.

The declaration process does, however, raise significant equity issues inherent in any approach that relies on delineating specific areas ('lines on maps'). Farmers who are experiencing largely the same circumstances but are on the other side of a boundary road are ineligible for assistance — notwithstanding recent attempts to extend the 'in' areas through buffer zones.

The effectiveness of the declaration process is limited if an underlying objective of government is to provide temporary income support for farm households in hardship. Drought is just one of the factors that can lead to such hardship, but currently is the only one singled out for special recognition.

EC Interest Rate Subsidies

The appropriateness of the ECIRS scheme have been questioned by many. As the assistance is directed to those more heavily in debt, farmers who have strong balance sheets are ineligible. This has proved divisive in rural communities. Those who have benefited strongly endorse the program as a valuable means to addressing a short term liquidity crisis. Non-recipients are highly critical. Box 2 includes a range of views from broadacre farmers, graziers and orchardists.

The number and value of ECIRS payments has increased rapidly over the last three years (figure 4). Over the same period, the amount of farming land that is EC declared has remained fairly constant, at close to 50 per cent. Accordingly, while

there would have been an increase in farm businesses suffering stress as the drought continued, much of the expenditure increase appears to have been driven by changes in scheme criteria. For example, in late 2006 the maximum subsidy payable over 5 years was increased from \$300 000 to \$500 000. A year later, in September 2007, the off-farm asset threshold was lifted from \$500 000 to \$750 000.

Box 2 Farmers' views on drought assistance

Farmers in favour of drought assistance

The support we have received with Interest Subsidy was vital in assisting us. With this assistance we have utilised the drought as an opportunity ... for without the Interest Subsidy assistance this knowledge gained would not have happened. (D and T Allen)

... interest subsidy is useful and practical. It is helpful the way it is because much debt is because of farm-build-up to remain viable... (Crocker Farming Co)

The existing interest subsidy and household support have been very useful in getting through the difficult time, with our business ready to produce again when it rains. (Belalie Pastoral Company)

Farmers not in favour of drought assistance

The same producers are queuing every time assistance is offered which proves there is no adapting to seasonal variability. ... Those of us who have embraced new technology and diversification are excluded from assistance as [we] are self-sufficient. (G Schmidt)

It is disconcerting to see a number of 'inefficient' graziers ... receiving drought assistance when they have done little to plan and manage the risks of drought ... (J Cooper)

... the current exceptional circumstances assistance system does not encourage the efficient operation of farm businesses through economies of scale, in fact they encourage the opposite (L Mann)

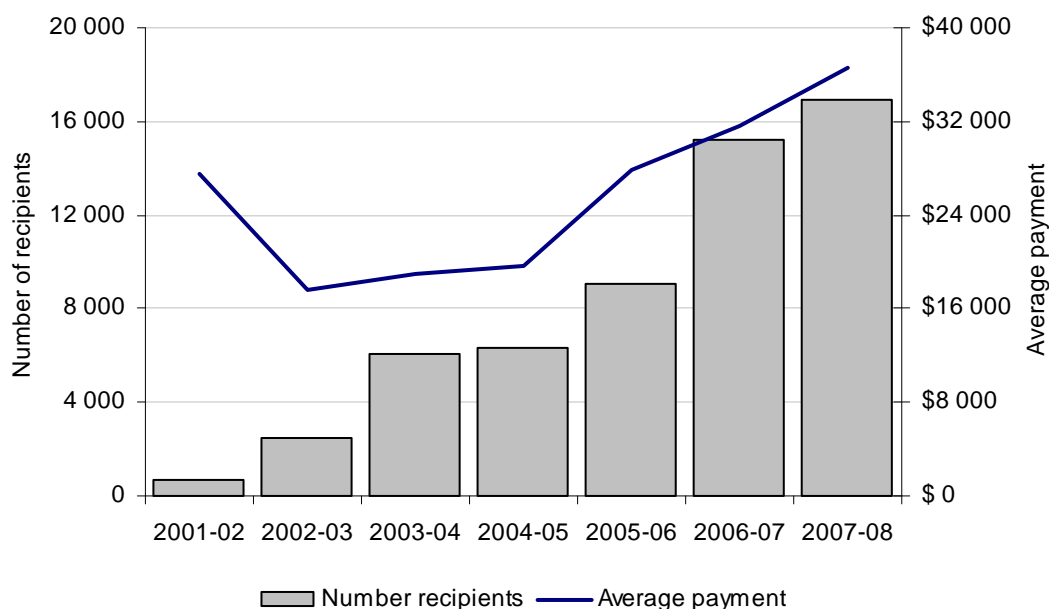
Efficient farmers who save and invest off farm are penalised, whilst farmers who waste money spend everything and get more help (H Clark)

A farmer who has diversified risk, managed borrowings conservatively, kept operating costs low and planned a financially secure retirement is less likely to qualify... (P Wallace)

While ECIRS recipients have a weaker capital base, the evidence shows that the average recipient still has an equity level of over 80 per cent of the total farm asset value. Accordingly, any rationale for a scheme that rests on farmers' inability to access carry-on finance requires evidence that the capital markets are unwilling to extend credit in the face of such balance sheet strength. To this end, the Australian Bankers' Association submitted that, in times of drought, viable farmers should be able to access carry on finance, have loans restructured to reduce repayments or

defer payment without cost — and it is a condition of the ECIRS scheme that farms must be assessed as viable to receive funding.

Figure 4 **EC interest rate subsidy recipients and average payment**



The effectiveness of the scheme is compromised in that there are no requirements that recipients of ECIRS demonstrate they are improving their farm management practices or, in other ways, increasing their self reliance.

The ECIRS also generates perverse incentives in that it can lead to:

- some farm businesses failing to adopt self-reliant strategies, such as building financial reserves as a hedge against drought risks or undertaking off farm employment, in the belief that governments will support them during droughts. For instance:

... the [EC declaration] can cause debt to be held in place for longer than normal to 'position' for potential assistance (Rural Directions, sub. 35)

If we had not carried out farm contracting during the 2007 year it is quite possible we would have received the maximum interest subsidy of \$100 000. ... other farmers ... made more money from receiving interest subsidy than we netted from farm contracting. How unfair is this? (S and A Boardman, sub. 43)

- recipients being less responsive to drought conditions and being financially assisted to continue 'business as usual'. For example:

[ECIRS's] promote 'worst practice' farming i.e. To overgraze and overspend in good times, knowing the criteria for subsidy will be met in the drought (D and M Geldard & T Reid, sub. 46).

Interest rate subsidies have been criticised strongly in previous reviews, including: the Drought Policy Taskforce (1997); the Mid-Term Review of the Rural Adjustment Scheme (1997); the Drought Review Panel (2004); and the Agriculture and Food Policy Reference Group (2006). On the basis of the evidence provided to this inquiry, and the Commission's own analysis, the Commission agrees with the findings of the earlier reviews.

Exceptional Circumstances interest rate subsidies should be terminated, with the last year of eligibility for those in EC areas being 2009-10.

Transactions subsidies

New South Wales, Queensland and the Northern Territory provide subsidies for the transport of fodder, water and livestock for farmers in drought declared areas (including in state-specific declaration areas). This is despite state and territory governments previously agreeing to end such subsidies in the face of compelling evidence of perverse consequences and the potential for misuse, including:

- bidding up the price of fodder in states where there is no subsidy, thereby increasing costs for other users of fodder, particularly in the intensive livestock sector
- exacerbating environmental damage from retaining excessive stock for the prevailing conditions. As one participant noted 'one can see adjacent properties that have been subjected to very different land management regimes, one with many starving cattle picking at round bales brought in by subsidised freight, next door to a few fat unsubsidised cattle' (P Morris, sub. 23).

States and territories should, as previously agreed, terminate transactions-based subsidies, effective by 30 June 2010.

EC Exit Grants

The take up rate of EC exit grants has been low. To date, only 550 applications have been received and, of those, 75 have been paid and a further 136 have been approved subject to the sale of the farm.

One reason for the minimal interest and uptake is the grant's strict eligibility requirements. The current program design also fails to address the non-monetary reasons why many farmers remain on the farm — the lack of awareness of occupations other than farming, the lack of formal recognition and portability of the skills learnt during farming and the reluctance to move away from the family home

and local community. These factors reduce the effectiveness of exit schemes and mean that financial incentives alone are unlikely to encourage many departures.

Exceptional Circumstances exit grants are concluding on 30 June 2009 and should not be extended.

Recently the Australian Government announced a revised program targeted at small irrigation holdings in the Murray Darling Basin, to purchase their water entitlements as well as provide an exit grant. The program is only intended to run for a short period. Those opting to leave irrigated farming will be able to remain in the family home on their farms and would be given assistance to remove permanent plantings and to undertake training. As many of these ‘blockies’ are typically located near rural settlements (and some significant provincial cities) where alternative employment may also be available, these scheme features appear to address some of the design failings of the current EC exit grant.

The Commission considers that this scheme should be evaluated at the end of its short period of operation.

EC Relief Payments

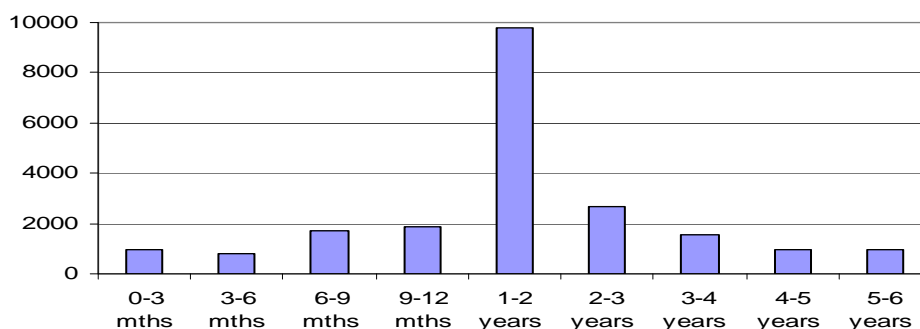
Throughout the inquiry there has been broad endorsement from participants for income support to be provided to farming families experiencing hardship. The extent of that hardship has been well documented by the Expert Social Panel.

The current ECRP scheme, however, does not treat farmers in EC areas the same as the rest of the community. Owners of other businesses that fail (other than farm dependent rural small businesses) and others in the labour market who have no significant income, are not able to receive support unless they meet the standard safety net criteria. To receive income support under Newstart, a couple who are both unemployed must seek work, have assets valued at less than \$243 500 (where they own their own home) and can only earn \$62 per week before their benefit reduces.

ECRP is available to farmers who are in hardship and whose businesses are temporarily generating very low (or negative) income. A farming couple is not required to seek alternative employment, partly in recognition that in drought, farmers still need to manage their land and stock and maintain the underlying viability of their farms. The value of a farming couple’s farm is not assessed for eligibility purposes, the couple can hold large sums of money in special farm deposits or off farm investments and can earn over \$400 per week in off farm income before incurring any loss of benefit.

While almost half of supported farmers have received support for 1 – 2 years, more than 4 000 received payments continuously for over 3 years and nearly 10 per cent have been on income support since 2003 (figure 5).

Figure 5 **Length of time in continuous receipt of ECRP^a**
Number of recipients current at 18 July 2008



Long term government support encourages dependency that is inimical to achieving the policy objectives of self-reliance and preparedness; perpetuates many problems identified by the Expert Social Panel; and generally impedes adjustment.

Exceptional Circumstances relief payments should be terminated, with the last year of eligibility for those in EC areas being 2009-10.

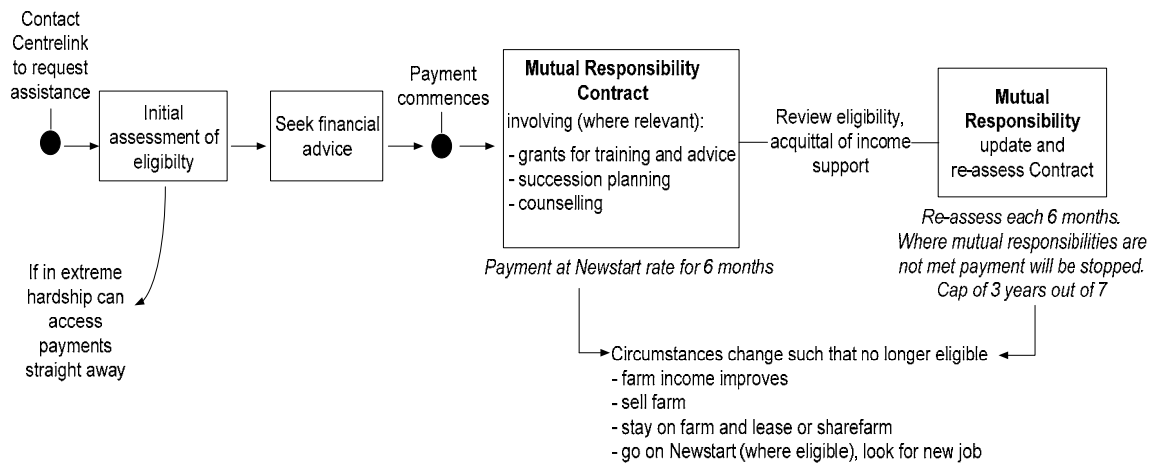
The Commission proposes that the ECRP scheme should be replaced with a broad based temporary income scheme designed for farming circumstances that aims to achieve a balance between four objectives:

- greater equity — by enabling all farming families in hardship to access temporary income support, not just those who fall within administratively-determined drought boundaries
- recognition of issues of farm viability — by setting the asset threshold at a higher level than Newstart
- enhanced self-reliance — by allowing farmers to undertake appropriate farm planning or training suited to earning off-farm income and by limiting the period of access to temporary income support so as to avoid welfare dependence.
- ability to determine the future in farming — by providing support for viability assessments, counselling and succession planning.

The expression of these aims is outlined in figure 6 which details stages of the Commission’s proposed farmer specific temporary income support scheme.

On equity grounds, farmers experiencing hardship should, like other Australians, apply for assistance and be subject to the same income test — with support starting to taper after a household earns \$62 per week (where both adults are receiving assistance) from other sources. However, farmers’ assets would render most ineligible for Newstart’s threshold of \$243 500 plus the house. Running down the capital value of the farm to that threshold would not be conducive to its future viability. In recognition of this and that hardship may be only temporary (about half of all EC relief payment recipients receive support for one to two years), the scheme should provide for a tapered total net asset threshold, that while low, is appropriate for a temporary relief scheme.

Figure 6 Proposed farmer specific temporary income support



The Commission notes that the asset threshold currently applying under the Transitional Income Support (TIS) scheme, which is scheduled to end in June 2009, is \$1.5 million. *The Commission would welcome participants’ views on whether this, or a higher level of, say, \$2 million (tapering out at \$3 million) would best meet the scheme’s objectives.* A liquid asset sub-cap of \$20 000, the same as for TIS, would recognise that an operating farm requires more working capital than, say, an urban household, but also requires that funds in excess of \$20 000 be drawn down in times of need.

In the pursuit of greater self reliance, farmers would need to be assisted to develop and carry out a plan of action, such as to prepare a household financial plan (including a plan to diversify sources of income) and/or a farm financial and business plan (to demonstrate what realistic sustainable income can be sourced from the farm business). The plan could involve the gaining of skills suited to earning off-farm income, or participation in programs such as Landcare or those conducted by Catchment Management Authorities.

Assistance would be re-assessed every 6 months, on the basis of compliance with conditions, completion of action plans and acquittal of payments against actual income earned.

To help farmers determine their future in farming, assistance would be forthcoming to assess farm viability, to receive counselling, and to encourage them to prepare succession plans. To ensure that assistance did not become entrenched and dependency increased, it would be strictly time limited such that it could only be accessed for three years out of every seven. After the three years, farmers who sought income support would no longer be eligible for assistance until they met the income, assets and activity requirements of other generally available income support programs.

Many participants, including farmers, acknowledged that income support should not be unconditional:

... encouraging self reliance may be enhanced by a mutual obligation approach to future drought assistance e.g. assistance measures will be dependent on the implementation of a business plan incorporating risk management strategies (ACT Department of Territory and Municipal Services, sub. 101).

Under the proposal, assistance would be provided to those farmers wishing to leave the industry. The combined effects of the continuing assessment of the farm's financial position in tandem with the absolute time limit on the more generous asset threshold would encourage the owners of non-viable farms to investigate alternative management arrangements, such as leasing or share farming, or exiting the industry.

All farmers facing hardship should have access to temporary income support designed for farming circumstances. It would provide income at Newstart levels, subject to:

- an overall asset cap, inclusive of the value of the farm house, beginning at \$2 million with a taper to \$3 million***
- a liquid asset sub-cap of \$20 000 (inclusive of bank balances and Farm Management Deposit balances)***

and be conditional on the applicant:

- seeking independent financial advice on the viability of the business***
- developing and carrying out a plan of action to improve self-reliance***

and on eligibility being reviewed, payments acquitted and plans updated, every six months.

The scheme should be limited to a maximum claim of three years out of seven. It should commence on 1 July 2009.

Governments should ensure that there are adequate programs to assist those considering leaving farming, including counselling, training suited to earning off farm income and the recognition of prior learning.

Small Business Income Support

Agriculture-dependent small business operators based within or outside EC declared areas are eligible to apply for small business income support (SBIS). The scheme was introduced with little consultation or justification in November 2006 and expanded in September 2007 to allow non agriculture-dependent business operators to also apply. The scheme, which will end in June 2009, is intended to assist with living expenses, rather than business operating expenses. Across Australia, other small businesses are not afforded special treatment.

Small business operators do not face the same constraints that farmers do in accessing the broader income support measures — they generally do not have such lumpy non-divisible assets; do not face the same difficulties in diversifying income sources; and are usually located in towns and so would be more able to meet program obligations, such as those that are required of Newstart recipients.

Preferential access to income support for some small businesses is not justified.

Terminating the EC process and transition of current declared areas

The Commission's analysis of EC programs concludes that an EC trigger is not an essential element in the design of any future programs. When coupled with the inherent flaws in the declaration process itself, the Commission considers that the EC trigger should be dispensed with.

However, it would be unreasonable to terminate EC programs immediately for those areas that remain declared. Equally, it would not be appropriate, on commencement of new arrangements, to create two classes of beneficiaries for an extended period. Accordingly, current programs should be continued in an EC area until its declaration finishes, but not beyond 30 June 2010.

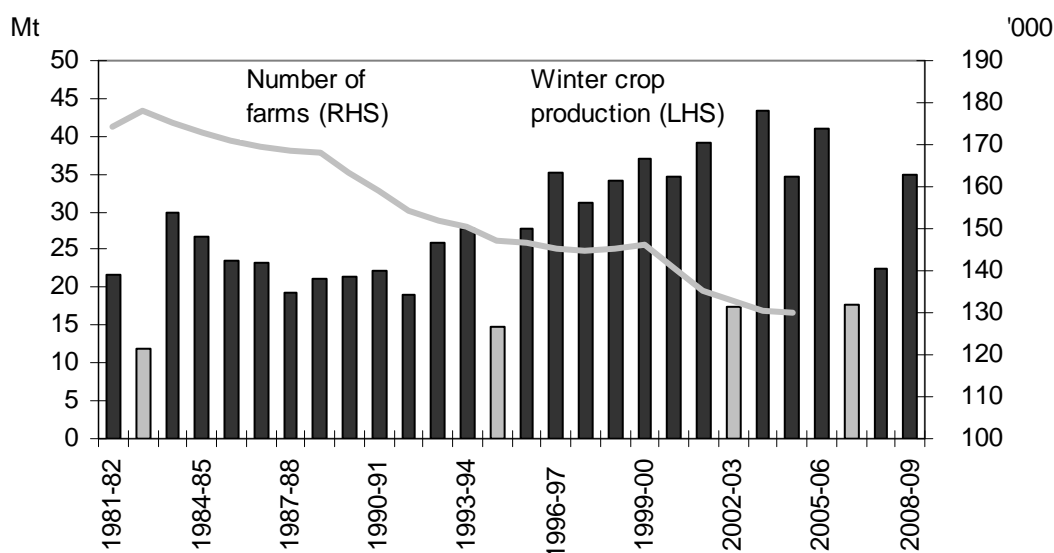
The Exceptional circumstances (EC) declaration process should be terminated. No new areas, full or interim, should be 'declared' and current declarations should cease by 30 June 2010. In areas that remain declared, recipients of EC assistance should continue to receive assistance until declarations terminate, but not beyond 30 June 2010.

A future policy framework

The rural sector has always adjusted to changing circumstances. In the main this adjustment occurs autonomously by the decisions of the myriad of farmers and others within the broader market framework. For example, the impact of the droughts of 1982, 1994, 2002 and 2006 on winter crop production in the broadacre sector are demonstrated in figure 7. But that figure also shows an increasing, but variable, winter crop output over time as influenced by natural climate variability, improving farm productivity and responses to commodity markets. This has been achieved at the same time as farm sizes have increased and the overall number of farms has declined. Other agricultural industries are going through similar short and longer term changes.

Figure 7 **Drought policy and adjustment in agriculture**

Broadacre production 1981–82 to 2008–09



Comparable time series data on farm numbers are not available after 2004-05. 2008-09 data are an ABARE forecast.

Economic activity and industry fortunes will continue to wax and wane, and the pattern of settlement will continue to change. Adding to this, climate projections indicate that current agricultural practices in some regions may not be sustainable.

Some participants have argued that payments made through the current NDP programs can reduce the rate of change (or avoid it altogether) by enabling all farmers to remain on the land and keeping local communities intact. While droughts can, at times, create greater pressure for change, the underlying economic and social forces remain.

For the last 100 years, small rural towns have felt the impact of farm amalgamations, bigger and better machinery and less need for on-farm labour. Better roads and vehicles have made it easier for farmers to conduct their commerce in larger regional centres. Reliance on agriculture is waning in many rural areas relative to other economic activities and, in some cases, growth from ‘sea change’ and ‘tree change’ demands.

The Expert Social Panel was of the view that:

... state and territory governments must consider the unintended consequences of withdrawing services and infrastructure during periods of stress, such as dryness. The Panel is supportive of any Australian Government initiatives which will provide incentives to consider the social impact of decisions regarding the provision of rural services and infrastructure (for example, schools, school bus services and local hospitals). (Kenny 2008, p. 27)

The Commission considers that it is not appropriate to seek to prevent or mitigate rural change that is the result of long term forces through periodic programs that only operate during drought. If governments are committed to supporting small towns per se, then different and more enduring regional development initiatives would be appropriate.

Objectives for Australia’s Farming Future

The Commission has argued against the retention of the EC declaration process and the various programs constructed in its name. Yet, the rationale underlying the NDP’s objectives remains basically sound. Accordingly, the Commission considers that there is a case for expanding the Australian Government’s *Australia’s Farming Future* initiative to embrace issues of drought and climate variability more broadly with recast objectives.

The objectives of the Australia’s Farming Future initiative should be revised and expanded to the following:

- *assist primary producers to adapt and adjust to the impacts of climate variability and climate change*
- *encourage primary producers to adopt self-reliant approaches to managing risks*
- *ensure that farm families in hardship have temporary access to a modified version of income support that recognises the special circumstances of farmers.*

Measures to facilitate self-reliance and preparedness

Self-reliance, and farm preparedness for climate variability, require a sound level of capital to be built up by farmers and their farm businesses. As noted above, the majority of farmers in drought declared areas cope without support from EC programs. Evidence points to farmers having stronger natural and physical capital on their farms and greater financial and human capital to draw on. The capital embodied in farmers' social networks is also important.

Governments have a role to play where there are market failures which impede farmers building that capital, or where current policy settings and programs inhibit its growth. Funding for warranted programs that assist farmers to grow capacity to become more self-reliant needs to be sufficient to achieve appropriate, effective and efficient outcomes.

Research, development and extension

Research, development and extension are fundamental elements of innovation, which is critical to Australia's future prosperity. While the Commission has found the governance structures of the rural research and development corporations to be soundly based, improving ways of doing things and ensuring that researchers, businesses and governments come together and disseminate information is in the national interest.

Public extension and its delivery has changed markedly from the era of linear, top-down, technology transfer where state departmental officers provided advice on how to improve yields and apply fertiliser and pesticides. Progressively there has been a move to more private sector delivery, the introduction of fee for service models and more emphasis on adult learning principles, information flows and participation by stakeholders.

There are sound and well-established market-failure rationales for governments to assist farmers to build their capacity through funding for research, development and extension services.

Given the climate outlook projected in the BoM-CSIRO report, there is a need to ensure that sufficient funding is directed to agricultural research, seasonal climate forecasting, and development and extension activities designed to improve risk management for climate variation and change, in addition to those aimed at improving agricultural production more generally.

The Commission considers that the following principles for public investment in agricultural research and development to manage climate variability and climate change should be adhered to:

- funds should be expended in areas where there are public benefits
- there should be safeguards against funds being directed into areas that deliver benefits appropriable by narrow industry groups
- where research provides clear private benefits, contributions from relevant organisations should be required
- there should be integration with extension services to ensure appropriate dissemination
- there should be strong linkages between RRDCs, CRCs and programs such as the Climate Change Research Program.

Significant public funding should be directed to research, development and extension to assist farmers prepare for, manage, and recover from the impacts of climate variability and change.

Grants for business training and professional advice that are well targeted and have an educational outcome are likely to provide private and broader community benefits.

The FarmReady (and former FarmBis) programs provide financial assistance to primary producers and rural land managers to undertake business and natural resource management training and education activities. FarmBis was strongly endorsed across the agricultural community on the basis that the financial and business training had led to improved drought preparedness. The most successful elements of FarmBis should be brought within FarmReady in a strengthened new program.

These programs provide a mix of public and private benefits. Where training leads to changed farm practices and outcomes which benefits the wider community, or where there are barriers to farmers accessing information, there is a case for public funding.

Significant public funding should be directed to a continuous learning program, incorporating the successful elements of the former FarmBis within the Farm Ready platform. The revised program should encompass advice and training for managing climate variability and for farm business management. Funding should be provided in the form of a subsidy which covers a proportion of the cost of training, with the recipient contributing the balance.

Rural financial counsellors can meet a need for objective advice in some areas that might not otherwise attract a commercial service provider. The Commission notes that the Expert Social Panel also examined the role played by the rural financial counsellors and recommended that their role be reviewed.

The contribution of rural financial counsellors to greater farmer self-reliance should be reviewed to assess:

- *the institutional barriers to the provision of private sector financial advice services in rural and remote regions*
- *the extent to which the scheme's case-management provides for referrals to other relevant services in a timely manner*
- *how services might be better targeted to instances where alternatives are not available.*

Farm management deposits

The Farm Management Deposits (FMD) scheme enables farmers to deposit up to \$400 000 of pre-tax income into an FMD for later withdrawal. The scheme plays a positive role in encouraging self-reliance and preparedness.

Some of the criticisms of FMDs revolve around their evident use for tax deferral, particularly given that an appropriate income tax averaging scheme for farmers already exists. Nonetheless, the evidence also points to FMDs encouraging farmers to save for periods of low income (such as drought) and for recovery (such as replanting and restocking). The restructured farm specific income support scheme, as proposed by the Commission, would require FMDs to be drawn down to below the cap for all liquid assets as a first resort during drought or other hardship, prior to being eligible for income support.

The FMD scheme does not generate significant perverse incentives and is a more efficient means of assisting self-reliance than alternatives.

The Farm Management Deposits scheme should be retained with its current cap of \$400 000 and no widening of its eligibility criteria.

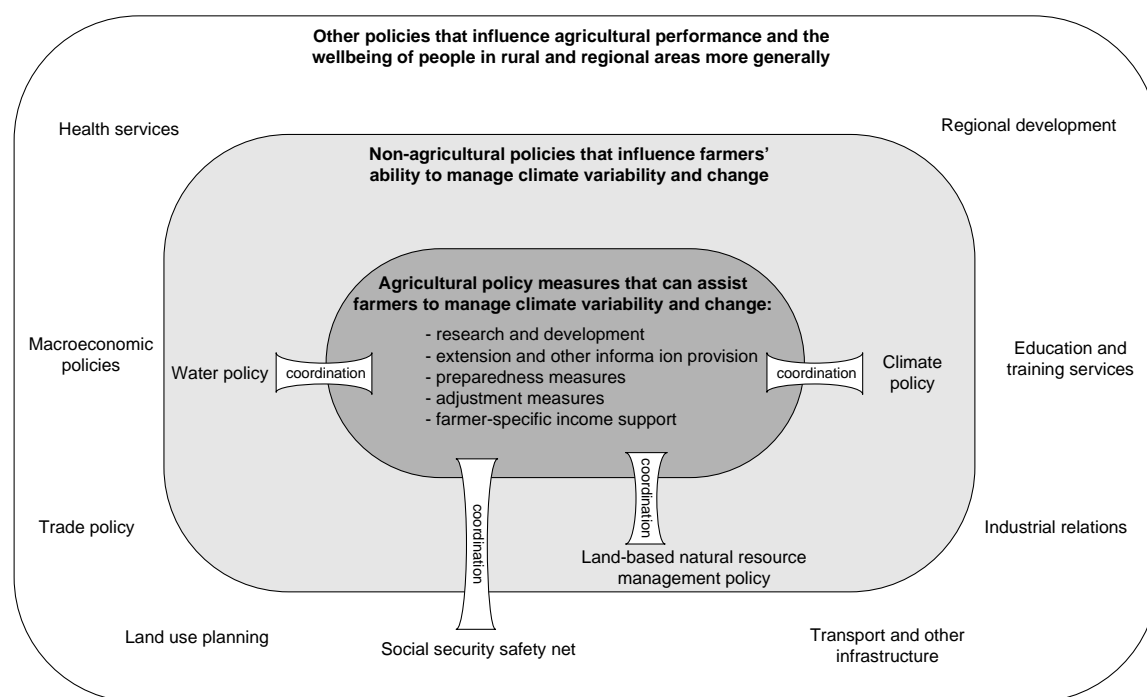
The broader policy context

It is critical that agricultural policy be developed and managed within the context of economy-wide policy frameworks (figure 8). The new objectives which the Commission has proposed for *Australia's Farming Future* relate solely to the centre

ring of the figure. But, as many participants made abundantly clear, there are wide ranging concerns about the multiple and sometimes uncoordinated impacts of government policy ‘silos’.

Irrigators, in particular, stressed the need to be cognisant of the interactions and potential tensions between water policy and drought policy. For example, water trading has presented some farmers with greater financial and production options, while allowing water to move to higher value uses. Also, appropriate natural resource management policies can help create the conditions to reduce environmental damage from drought. To this policy mix must be added the potential impacts on farmers of the impending carbon pollution reduction scheme.

Figure 8 Governance elements of a new approach



While it would not be appropriate to redefine other policies in the context of this inquiry, the Commission notes that disparate policy areas including water, natural resource management, and climate change all impact on the agricultural sector. Better coordination, and in some cases integration, between policy areas is needed, from the perspective of farmers, farm businesses and rural communities.

Making the transition

The Commission is proposing to refocus the national drought policy to reflect the broader issue of climate variability and the new imperative of climate change. The central tenet remains — that farmers should be responsible for self-reliance and preparedness. Within this revised policy framework, the Commission is proposing a significant redesign of programs.

Transitioning from the current arrangements to the new approach needs to be fair and not unnecessarily protracted. There should be no sudden change to the arrangements in EC declared areas that would leave people worse off. Nor should programs be run in parallel for longer than is necessary.

There is a clear need to address all farm household hardship, not just the needs of farmers in drought, and there should be equitable treatment with all others in the community. However, for a period of up to three years, the asset cap should recognise the issue of farm viability. The EC relief payments and the transitional income support scheme should be replaced with a farm-wide temporary income support scheme designed for farming circumstances.

The suite of business support programs involving interest rate subsidies, transport subsidies and small business income support should be terminated — they are inequitable, ineffective and inhibit the adoption of self-reliance and preparedness measures. And with their termination, together with the introduction of a broad-based income support scheme, the divisive EC declaration process has no further relevance and should also cease. A concluding date of June 2010 would allow farm businesses to plan for the transition.

The Commission supports, instead, substantial funding to be directed to self-reliance and preparedness measures where there is a clear rationale for government involvement. This includes research, development and extension services. A strengthened new farm business management program should bring together the successful elements of FarmReady and FarmBis. The current farm management deposit scheme should be retained.

These are practical measures which focus on supporting the achievement of the policy objectives. They will be available to all farmers, to give them the skills and confidence to adapt to the prevailing and likely climatic circumstances. The removal of the constraining influence of subsidies to stressed businesses will enable the more viable to grow and to be even more productive.

Figure 9 below summarises the nature and timing of the changes proposed in this report.

Figure 9 Current and proposed arrangements

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

Proposed								
ECIRS & ECRP								
Small Business Income Support								
EC exit grants								
Transaction-based subsidies								
Irrigation Management Grants								
Transitional Income Scheme								
Income support program for farmers (proposed) Counselling and Grants for training (proposed) Grants for financial planning and advice (proposed)								
CCAP grants for exit & advice								
Farm Ready (with increased scope similar to FarmBis)								
Rural Financial Counsellors (pending review)								
Farm Management Deposits (retained as is)								
Research, development and extension (enhanced)								
<i>Jun 2008</i>		<i>Jun 2009</i>		<i>Jun 2010</i>		<i>Jun 2011</i>		<i>Jun 2012</i>

