National Farmers' Federation

Submission to the

Senate Economics Committee Inquiry into Access of Small Business to Finance

16 April 2010

Contents

The National Farmers' Federation

The National Farmers' Federation (NFF) was established in 1979 and is the peak national body representing farmers, and more broadly, agriculture across Australia. The NFF's membership comprises of all Australia's major agricultural commodities. Operating under a federated structure, individual farmers join their respective state farm organisation and/or national commodity council. These organisations form the NFF.

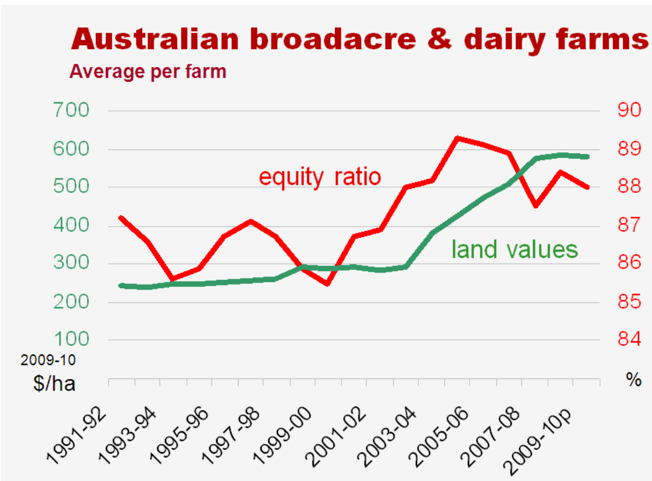
The NFF has recently implemented a re-structure of the organisation. Through an associate category this has enabled a broader cross section of the agricultural sector to become members of the NFF, including the breadth and the length of the supply chain.

Each of NFF's members deal with state-based "grass roots" issues or commodity specific issues, respectively, while the NFF represents the agreed imperatives of all at the national and international level.

The costs, terms and conditions of finance and changes to lending policies and practices affecting small businesses

By and large, Australian banks have been very supportive of Australian farmers in the last 10 years while drought has ravaged large stretches of the continent. Bank practices are now more balanced and considered and foreclosures are now the exception rather than the norm. The same could not be said 20-30 years ago when it seemed to be commonplace for banks to liquidate problematic loans at the drop of a hat.

While banks' understanding of the importance of reputational risk and the benefits of having a clear Corporate Social Responsibility have made enormous advances since those times, there is no doubting a key reason behind this change in mentality relates to increasing land values since 2003. These have provided banks with some comfort that debt to equity ratios are being maintained regardless of seasonal conditions. As the below chart shows, land values now sit above equity ratio's[1].



[1] ABARE presentation for Outlook 2010 Conference

Rural debt has escalated by over 85% since 2002-03 due to drought conditions, placing the agriculture sector at considerable exposure to increasing credit cost. For this reason, the NFF is cognoscente of the potential for regional land prices to fall, should the banking sector withdraw its support of the agricultural sector and aggressively foreclose on rural debt.

The NFF has received information from members that credit access has tightened. There have been cases where the global financial crisis (GFC) has had a noticeable impact on banks treatment of loan security requirements, with a clear increased sensitivity by the banks to their financial exposure. Some loans that would be offered prior to the GFC are no longer readily available. As stated by the Reserve Bank of Australia (RBA) "*Small businesses in most industries have been able to access funding throughout the financial crisis, albeit on less favourable terms than previously.......... Small business borrowers have faced lower loan-to-valuation ratios, stricter collateral requirements and higher interest coverage ratios*[2].

This issue has been heightened for those farmers with finance provided by non-bank lenders, which have been ineligible for the Government deposit underwriting guarantee. These non-banks have seen significant amounts of liquidity leave their institutions as customers seek the security provided by Government backed, banking institution deposits. The result has been a lower capacity by the non-bank lenders to offer credit to customers, including farmers. This issue has been exacerbated in Tasmania, where the non-bank lenders have, until recently, held a greater share of the farming customer base.

The impact of tightening monetary policies is also having an increasing impact on Australian farmers and posing challenges for the agricultural sector.

The reality is that monetary policy is an economy wide instrument, and RBA decisions on interest rates are based on the Australian economy in total. However, the state of the general economy may not reflect the circumstances felt by Australian farmers and indeed the rural economy as a whole. As a result, the blunt monetary policy instrument can be challenging for a sector such as agriculture and the regional communities it supports, whose fortunes are to a large degree dictated by the seasons.

Contractionary policies can often be seen being enforced by the RBA during the height of drought, exacerbating the pressure on regional communities through increased costs of debt financing and reduced competitiveness for the output they produce. The NFF accepts that this is the reality of how the RBA works but that does not mean that it isn't a challenge for Australian farmers.

The importance of reasonable access to funding to support small business expansion and the sector's contribution to employment growth and economic recovery

There are approximately 140,000 farm businesses in Australia (99% of which are family owned and operated), utilising approximately 54% of Australia's landmass. The agricultural sector, at farm-gate, contributes approximately 3% of Australia's total Gross Domestic Product (GDP).

[2] Reserve Bank of Australia Submission to the Senate Inquiry into Access of Small Business to Finance, 24 March 2010

However, when factoring in the vital value-adding activities that occur to farm outputs post farm-gate, and the value of all the economic activities supporting farm production in the farm-input sector, agriculture has averaged a contribution of 12.1% of GDP (approximately $103 billion in 2004-05 dollar terms) in the six years ending 2003-04[3].

In 2007-08, Australian agricultural exports were valued at $27.5 billion. These exports account for approximately 60% of Australia's agricultural production volume and 75% of value. In 2007-08, agricultural products accounted for 14.9% of Australian merchandise exports[4].

The future of Australian agriculture depends largely on conditions in overseas markets. However, with declining terms of trade in agricultural commodities, Australian agriculture has been challenged to maintain a low cost base in order to remain competitive. Indeed, Australia's balance of payments is strongly dependent on this being the case.

Despite declining terms of trade, Australian farmers have been able to remain internationally competitive and sustain their businesses largely through productivity growth. The productivity growth in Australian agriculture has average 2.8% over the past 20 years, consistently out-performing other sectors[5].

In 2008 there were 317, 730 people directly employed in Australian agriculture. This number has decreased from 385,000 (20%) in 2001-02[6]. The complete agricultural supply chain, including affiliated industries, provides over 1.6 million jobs to the Australian economy (1-in-6 of all jobs). For every million dollars of Agricultural Sector GDP, there are 22 jobs in the Agricultural Sector and an additional 65 jobs in the rest of the value chain[7].

As reported earlier, rural debt levels have increased significantly in the last decade. According to ABARE[8], this debt is increasingly due to investments in on-farm capital works, as farmers look to improve productivity. While these investments in capital works should hold those farmers in good stead into the future, recent interest rate rises have hit hard for those looking to recover from the drought.

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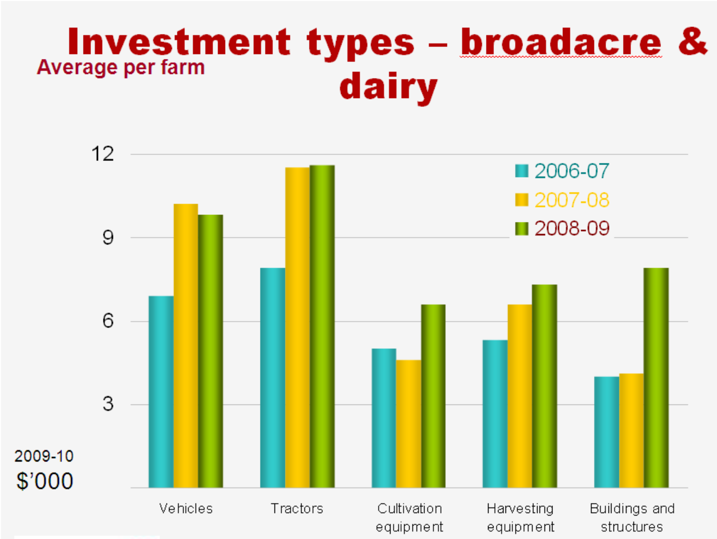
[3] Australian Farm Institute, March 2005, *Australia's Farm Dependent Economy*
[4] ABARE, 2008Australian Commodity Statistics, Canberra
[5] Australian Farm Institute, March 2005, *Australia's Farm Dependent Economy*
[6] Australian Bureau of Statistics, *Labour Force Australia, Detailed Quarterly, Nov 2008, Catalogue No.6291.0.55.003*. & ABARE, 2008 Commodity Statistics, Canberra
[7] Australian Farm Institute, March 2005, *Australia's Farm Dependent Economy*
[8] ABARE presentation for Outlook 2010 Conference



The state of competition in small business lending and the impact of the Government's banking guarantees

On 12 October 2008, the Government announced it would guarantee deposits in Australian owned banks, locally incorporated subsidiaries of foreign banks, credit unions and building societies for a period of three years. The Government also announced a guarantee on wholesale debt securities issued by these same institutions, on application, and for a fee.[9] This decision has resulted in a significant outflow of funds from the non-bank financial institutions, severely restricting their capacity to extend credit to new or existing customers.

The NFF believes that the non-bank sector has made a valuable contribution to the financial markets in adding a healthy level of competition within the sector and that recent policy developments have jeopardised this competition.

Concerning for the NFF is that it now appears that Australian banks are wearing very little of the risk they face in sourcing finance. Increases in bank financing costs, whether they be a result of official cash rate movements, or as a result of other finance sourcing issues, are too easily passed on to the end consumer - whether they be farmers or others within the general community.

Opportunities and obstacles to other forms of financing, for example, equity to support small business 'start ups', liquidity, growth and expansion

Much has been said on the issue of Managed Investment Schemes (MIS) and the issues that they have created in distorting resource allocation in regional Australia. It is widely accepted that in most cases, this mechanism will not be appropriate to finance agricultural enterprise.

[9] Press Release (The Hon Wayne Swan MP), 24 October 2008, Government Announces Details of Deposit and Wholesale Funding Guarantees

But that is not to say that we should not look at alternative investment mechanisms that draw in investment through the taxation system or by other means that retain some link to the output generated by the operation – a factor sorely lacking by MIS. The NFF has consistently asked that alternative investment mechanisms that draw finance to the farm sector be further examined.

Policies, practices and strategies to enhance access to small business finance that exist in other countries

The negative impact and extent of trade distorting measures in the trade of agricultural commodities is widespread and extremely destructive for farmers everywhere. The level of distortions in agricultural markets is clearly outlined by the producer support estimates (PSE) derived by the OECD. The PSE expresses the gross monetary transfers from consumers and taxpayers to agricultural producers as a percentage of gross farm receipts. Although the average of such subsidies to OECD producers has fallen from 37% in 1986–88 to 22% in 2008, levels remain high in many countries. Australian farmers receive only around 4% of their gross earnings from transfers, the second lowest (behind New Zealand) in the OECD. Australia's PSE is also below many developing countries as well, including, Brazil (6%), China (10%) and South Africa (5%).

As another demonstration of the level of distortion within the trade in agricultural goods, agriculture remains the only sector where export subsidies are still permitted under international trade law. Despite agreement during the Hong Kong WTO Ministerial Conference in 2005 to eliminate agricultural export subsidies by 2013, farmers continue to see the effects of these destructive policies, with both the EU and United States of America implementing export subsidies for their diary sectors during 2009.

The NFF does not support the use of trade distorting domestic support measures and has been a vocal opponent to the international utilization of farm protection that depresses global agriculture prices. Reverting to protectionist measures is not the way forward for Australian farmers.

Yet it cannot be denied that such Government intervention in farm production systems around the globe has had a significant impact on the risk profile of those farming enterprises and in doing so, affected their farmer's access to finance.

Other related matters

Credit access for Australian farmers' major international buyers has been restricted as a result of the GFC, seeing difficulties emerging in buyers accessing Letters of Credit (a letter of credit is a formal document guaranteeing payment by an issuing bank on behalf of a buyer [an importer] to a third party [the producer of the goods being produced] for a specific amount of money, provided certain conditions are met), and in some cases, even reneging on existing contracts.

For an industry such as agriculture that relies on overseas markets to consume approximately two thirds of its total output, such uncertainty in the international trading environment is generating major problems and lowering returns.

What should be done to improve farmers' access to affordable finance/investment?

Building competition and transparency in the banking sector

Unfortunately it is extremely difficult for consumers of credit to keep financial institutions to account for their decisions regarding interest rates. It is all too difficult, particularly for farm businesses, to monitor how much of the official cash rate cut is being passed on by their own financial institution, or indeed to monitor the actions by competing financial institutions.
The NFF believes that, in the interests of enhancing competition within the banking sector, that a mechanism should be created whereby rate change decisions by financial institutions are lodged and publically reported. Transparency in this area (particularly for small business loan rates) is sadly lacking, and therefore detracting from the urgency for financial institutions to pass on rate cuts. In turn, this is subduing the intended market response to monetary policy changes through the RBA.

Competition within the finance sector must come into question, particularly since non-bank lenders have increasingly struggled since the big banks received the Government's deposit underwriting guarantee.

As a result of this policy decision, the non-banks have seen significant amounts of liquidity leave their institutions as customers seek the security provided by Government backed, banking institution deposits. The result has been a lower capacity by the non-bank lenders to offer credit to customers, including farmers, and greater power to the big four.

The NFF encourages Government, and particularly the ACCC, to look closely at this issue of competition and transparency in the banking sector.

Improved understanding by the RBA of regional economic conditions

The NFF is eager to ensure that the Reserve Bank of Australia (RBA) has a full and accurate understanding about agriculture and regional Australian conditions when setting monetary policy. The NFF encourages the RBA to intensify its dialogue with the agricultural sector to ensure that it understands the dynamics faced by our sector and the communities in which we operate. The NFF also encourages the Government to ensure that an appropriate representation of agricultural interests is maintained on the Board of the RBA.

Revisit tax based investment mechanisms for regional Australia

The NFF believes that there is an urgent need for Governments to revisit tax based investment mechanisms and to look at alternative investment mechanisms that draw in investment through the taxation system or by other means that retain some link to the output generated by the operation. These investment mechanisms have the potential to revitalise regional Australia.

Risk Management

The NFF notes that responsibility also rests with farmers themselves to ensure that they manage their risks effectively and in doing so, give confidence to lenders in providing them with credit.

Effective risk management strategies can help to provide some insulation to interest rate and currency fluctuations.

Farmers are increasingly adopting a range of risk management tools to provide some insulation from the variables they face. National Farmers' Federation (NFF) Vice-President Charles Burke stated, "*The NFF often quotes the figure that every one percent appreciation in the Australian dollar deflates farm incomes by approximately $190 million in raw terms. However, we hope that through the adoption of risk management tools such as price hedging, on-farm grain and feed storage, that farmers have some insulation from the full impact of fluctuations in variables such as the dollar*."

The NFF encourages farmers to continue to consider their suite of risk management tools in order to reduce the effect of commodity, interest rate, and exchange rate fluctuations in their business. The broad suit of public and private risk management tools needs to be more effectively promoted by to Australian farmers. Both Government and industry can play an important role in this education process.

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