Chapter 4

Key issues

4.1 The previous chapter considered evidence the committee received about the challenges facing many communities in regional Australia. While there were differing views on the seriousness and extent of the rural debt and access to finance, there is no doubt a major problem exists in rural Australia that requires government intervention. In this chapter, the committee considers whether the proposed ARDB is the most appropriate solution to the current debt situation in rural Australia and, longer term, to the ability of farmers to access finance that would allow them to withstand poor seasons. As part of its consideration, the committee also looks at the detail contained in the bill on the proposed ARDB, the general understanding of how the proposed ARDB would work, how the ARDB would fit within the RBA and the implications for the RBA's role as a central bank.

The ARDB and the RBA's 'rural reconstruction and development policy'

4.2 As noted in Chapter 2, the ARDB would be 'a specific entity tasked with examining, reconstructing and improving the financial status of the Australian agricultural sector and its associated industries and infrastructures'. The bill seeks to empower the ARDB to do this by determining and giving effect to the RBA's 'rural reconstruction and development policy'.[1]

4.3 For many submitters, the establishment of the ARDB would alleviate the distress suffered by farmers struggling to keep their business viable. The first priority would be to address crippling debt and stabilise the sector.[2] Some saw the current debt burden as 'a chronic problem' and attributed the situation to 'overlending and overborrowing' that warranted 'an adjustment'.[3] For example, Mr Walton argued that the situation in rural Australia was a serious problem, which needed to be rectified and could not be stabilised by holding it on course. According to Mr Walton an important early-stage action was reconstruction—'"fix the problem, stop it in its tracks, and get it sorted"; then we need to fix the problem'.[4] One of the principal problems stemmed from the falling capital values as Mr Rowell Walton explained:

> …when I wrote all my loans, and when everybody else who is in trouble wrote their loans, it was based on net equity. Net equity could include profit, but it did not necessarily include profit. A lot of the net equity was on the back of capital growth.

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1 Explanatory Memorandum, p. [1].

2 See Mr Ben Rees, *Proof Committee Hansard*, 18 March 2015, p. 39.

3 Mr Rowell Walton, *Proof Committee Hansard*, 18 March 2015, p. 3.

4 *Proof Committee Hansard*, 18 March 2015, p. 3.

> …
>
> So what we have now is a system where capital values are falling and nobody knows where the bottom is.[5]

4.4 Mr Walton noted further that he knew of operators who had not missed a solitary payment but their loan to value ratios (LVRs) got 'out of whack' and they were called in by the lender for discussions.[6] In his view:

> The operation of the ARDB will remove the severe pain, the write-downs will be less than otherwise and a modicum of confidence will begin to establish itself in the various areas most disrupted, dignity will return to the adjustment process, losses limited, viability and sustainability enhanced.[7]

4.5 Mr Rees similarly explained the devaluation of assets:

> When the capital markets started to look closely at the quality of the assets that were being presented, they decided some were toxic and some were okay. They did not want the toxic ones. Those ones became devalued in the eyes of the capital markets, and that flowed back to the real asset, which was the farm—rural lending. So farm values collapsed. And they are down about 40 per cent.[8]

4.6 According to Mr Rees a recent sale in the Condamine district was sold for $680 an acre, which a few years ago could have commanded between $1,000 to $1,200 an acre. He noted that people who had been secure and solvent were suddenly faced with that sale and questions asked about their solvency and their level of debt. He referred to a young man from Western Australia who had the same problem—had met all his payments and had not had a problem:

> The bank called in and started to ask questions about his solvency because the rural lands in that area had been devalued and his level of debt suddenly posed him a risk under these new valuations.[9]

4.7 Dr McGovern agreed with this view that 'even farms that meet all commitments can be caught as equity (or LVRs) fall across a sector'.[10] In his words, the main trouble was:

> …you have lots of farmers who are up for sale and asset prices are still falling. If we look at where they have fallen, 50 per cent would be an average across a number of areas—some are up higher, some are less, some are lucky…Now can you imagine what that does to your LVRs—it

5 *Proof Committee Hansard*, 18 March 2015, p. 5.

6 *Proof Committee Hansard*, 18 March 2015, p. 5.

7 *Proof Committee Hansard*, 18 March 2015, p. 2 and *Submission 128*, p. 14.

8 *Proof Committee Hansard*, 18 March 2015, p. 36.

9 *Proof Committee Hansard*, 18 March 2015, p. 37.

10 *Submission 129*, p. 1.

> completely stuffs up the security of the banks. It then imperils the banks themselves because on their own assets they have problems.[11]

4.8 With assets declining in value, Dr McGovern explained further that the banks have 'covenants which they have to enforce…We have a system which is going to drive this crisis until something effective changes'.[12] According to Dr McGovern, the source of the debt problem stemmed from the early 2000s when lending from about 2003 on was suspect, because of the way lending was structured—'the inferior products now in today's market'.[13] In his assessment, the ARDB would provide a way to actually tackle this problem of inappropriately issued funds.[14]

4.9 The Queensland Murray-Darling Committee (QMDC) advised that it 'supports the intent' of the bill 'based on the recognition that some sections of the agricultural industry are currently operating on an unsustainable basis':

> In QMDC's opinion, these sectors are facing a systemic failure. QMDC therefore supports the reconstruction of the industry by collaboration with the industry, government, [natural resource management] bodies and other key stakeholders.[15]

4.10 Wayne and Sandra Birchmore believed that the proposed ARDB was the only way to stabilise the situation, 'while policies are formulated & implemented to enable a return to profitability'. They explained:

> Current returns can no longer sustain the industry & without some government intervention, it will surely collapse, with massive repercussions for all the businesses that depend on it. The current drought is simply the final nail in the coffin, following years of poor returns exacerbated by the live cattle export ban imposed by the Federal Labor Government. While we all pray for rain to save our cattle, if returns do not improve, there will be no saving of the northern cattle industry.[16]

4.11 Another farmer burdened with debt, Mr Robert Walton, stated that should the ARDB get started, 'we would be adjusted to make a profit again'.[17] And yet another informed the committee that the ARDB would make a huge difference to his business. He stated, 'without it I fear we will be caught in a downward spiral unable to break out of debt that is crippling us'.[18] Mr Pete Mailler, a grain and cattle farmer, saw the

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11 *Proof Committee Hansard*, 18 March 2015, p. 7.

12 *Proof Committee Hansard*, 18 March 2015, p. 5.

13 *Proof Committee Hansard*, 18 March 2015, p. 6.

14 *Proof Committee Hansard*, 18 March 2015, p. 6.

15 Queensland Murray-Darling Committee Inc, *Submission 89*, p. 1.

16 *Submission 4*, p. 1.

17 *Submission 7*, p. [2].

18 *Submission 67*, p. [2].

establishment of the ARDB as 'a key opportunity to provide a relatively independent stabilising agent in the current financial turmoil in the agricultural sector'.[19]

4.12 While the purpose of the bill garnered strong support, the actual mechanics of how the ARDB would achieve this objective of debt relief was unclear, prompting a number of submitters to speculate on how the ARDB would carry out its functions. Most submitters, however, as noted earlier, did not question the details of how the ARDB would perform its tasks and were prepared to endorse the intention of the proposed legislation without requiring detail on its implementation. Mr Rowell Walton, however, provided the following explanation on the proposed ARDB's operation:

> The Board would receive applications from potential customers for acceptance into the facilities of the reconstruction board, by way of an application form signed off by the financial advisor, accountant or banker of the customer. It will be necessary to fit the guidelines set by the board to be accepted as a client.
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> If the customer is in default with its funder a conversation will be had between the banker or his representative and the ARDB as to a buyout of the mortgage, a discount may apply in the event there is no expectation of full recoupment of the outstanding funds. However it should be clear that the likely settlement would be greater than achievable through the regular sell down process. The result that the bank will have its capital loss minimised, while the customer will be far more able to repay the new mortgage at appropriately priced money, commensurate with anticipated and historically received profits.
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> Of upmost importance is the agreement on a viable or sustainable level of debt, the ARDB will not under any circumstances accept a level of debt which may make a customer unviable or unsustainable.[20]

4.13 Mr Rees was another proponent of the ARDB who offered an explanation on how the ARDB would work in practice. He envisaged that the ARDB would purchase low quality financial assets from private sector financial institutions at a current market valuation:

> The current market valuation effectively provides what is commonly called a 'haircut' to the nominal value of the mortgages issued in more robust times. The 'haircut', provides debt relief to the mortgagor and enhances credit worthiness. The haircut also becomes the penalty of shareholders and their financial institutions that practised imprudent rural lending.
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> Once ownership of the mortgage is transferred from the financial institution to the public entity, the once low quality asset/mortgage takes on the characteristic of a public security. As such, it can form the basis of an asset pool from which derivative securities can be sold into the capital market

19 *Submission 139*, p. [6].

20 *Submission 128*, p. 13.

> thereby generating a self-funding program. It is the process of ownership transfer from the retail financier to the public entity where asset enhancement occurs as the low quality asset transforms to a higher quality public sector asset. Interest rates on the mortgage should then reflect the interest rates of government paper as opposed to commercial penalty rates of the private sector.[21]

4.14 As noted in the quote, Mr Rees argued that the ARDB's activities could become self-funding through the sale of derivatives backed by the pool of assets the ARDB would acquire. Mr Rees also envisaged that the ARDB would provide development finance.[22]

4.15 While the proponents of the ARDB argued that the immediate task facing the proposed new RBA Board was to rectify the debt burden, they also recognised the need for the board to take on the longer term role of a development bank.

Longer term—Reserve Bank as lender

4.16 Many individuals pointed to the need for long-term adjustments to support their argument that some form of government intervention was warranted. For example, the Boothulla Pastoral Company argued that the ARDB was required not only to solve the current problem but 'to ensure long term stability'.[23] Mr Rees argued that agriculture was 'an industry facing imperfect markets' with 'farm businesses operating under decreasing returns to scale'. Mr Rees concluded:

> Decreasing returns to scale imply that an optimum production level will be reached beyond which profit levels decline until continued production generates losses. It follows that rural adjustment policy under a deregulated industry structure, could never be successful over the long term under decreasing returns to scale and the withdrawal of government intervention.[24]

4.17 Dr McGovern argued that the 'systemic failures' in the financing of Australian agriculture can only be rectified by 'prudent government intervention':

> Structural defects, market failures and policy oversights have impoverished rural Australia needlessly. Without reserves or realistic possibilities of building them, agricultural enterprises will remain at the mercy of the seasons, speculations and imperfect markets.[25]

4.18 In his view, the Reserve Bank has the ability to change the nature of products. Mr Rowell Walton suggested that the appropriate response was to have 'a public

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21 *Submission 2*, p. 21.

22 Mr Ben Rees, *Submission 2*, p. 21.

23 *Submission 136*, p. 1.

24 Mr Ben Rees, *Submission 2*, p. 6.

25 Dr Mark McGovern, *Submission 129*, cover page.

institution that provides competitive finance and provides effective arrangements so that the other banks need necessarily to compete with better arrangements'.[26] Dr McGovern explained that the ARDB would provide an institutional rejuvenation. He stated:

> If we look at what happened once upon a time, the RBA used to arrange export funding. From reading the RBA's submission, there seems to be almost an assumption we are going back to that sort of thing, but no; we are not. We are basically talking about the Reserve Bank acting as a lender of last resort in its proper, full sense, not as a party which favours a banking crisis. It should favour the welfare of the Australian people and its prosperity; that is in its charter. It should look at this across the whole financial arrangement so it can bring balance to the equation, and that is the sort of thing that I cannot do—a commercial banker cannot do—and the government is not well placed to do it. But the charter responsibility of the Reserve Bank is to do exactly those sorts of things, and it has not been doing it.[27]

4.19 It should be noted, as mentioned in chapter 2, the RBA is chartered with ensuring that its statutory powers are exercised in a manner as will best contribute to, inter alia, the economic prosperity and welfare of the people of Australia.[28]

4.20 According to Dr McGovern:

> The problem with the farm loan arrangement is that government is basically getting funds at retail rates to cover a debt, so it is actually acting a bit like a banker through its intermediary like QRAA. It would be far better, and this is the whole point of the ARDB, to get wholesale funds through a bank—and the Reserve Bank is a bank, even though it needs a few bankers in there—and to actually operate it as a financial arrangement separate from the Commonwealth budget.[29]

4.21 Mr Pete Mailler considered it would be essential for the ARDB to provide 'structural support' that is 'long term and focussed on chronic issues around viability and economic resilience'. Mr Mailler added that effective structural support often mitigated the need for short term direct support such as disaster relief.[30] He concluded:

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26 *Proof Committee Hansard*, 18 March 2015, p. 10.

27 *Proof Committee Hansard*, 18 March 2015, pp. 5–6.

28 *Reserve Bank Act 1959*, s. 10(2).

29 *Proof Committee Hansard*, 18 March 2015, p. 5. The QRAA was established under the *Rural and Regional Adjustment Act 1994* (Qld) 'primarily to administer assistance schemes that foster the development of a more productive and sustainable rural and regional sector in Queensland'.

30 Mr Pete Mailler, *Submission 139*, p. [4].

> …it is imperative that ARDB does not drift into welfare provision and/or dealing with treating short term symptoms in lieu of the longer term and more structural issues that underpin the sector.[31]

4.22 The Government of South Australia expressed support for the proposed ARDB, although it emphasised that the ARDB should not duplicate existing programs and services.[32] AgForce Queensland similarly observed there was a need to avoid 'duplication and inconsistent policy' after it noted that the National Rural Advisory Council already existed and several other government agencies collected rural data. However, AgForce informed the committee of its 'in principle and qualified support' for a board within the RBA focused on rural policy. It suggested that such a board would assist in highlighting issues affecting the agricultural sector within broader RBA policy settings.[33]

4.23 Furthermore, a number of witnesses referred to overseas practices whereby some countries subsidise agriculture. Dr McGovern thought that there was an average of three or four development banks per nation—but Australia had none. In his view, the ARDB could include a development bank and that was 'the way you would manage the banking in a responsible way—as a development bank in its own right'.[34]

Concerns regarding the bill in its current form or opposition to the bill

4.24 The submitters unconvinced of the merits of establishing the ARDB included the Australian Bankers' Association (ABA), which questioned the need for an ARDB. The ABA took the view that Australia did not have 'a national or even widespread debt crisis and saw no need for the proposed ARDB.[35] Furthermore, the ABA:

- maintained that the *Rural Adjustment Act 1992* currently existed for the specific purposes of enabling the Australian Government to provide directly or indirectly, grants and loans to farmers, for purposes related to rural adjustment.[36]
- was uncertain from commentary from the proponents of the Bill whether the purpose of the Board was for dealing with rural assistance issues in the rural sector today or providing a vision, direction and helping with policy on the future of the sector.[37]
- noted that while the bill did not identify a policy to be implemented, proponents had advocated that the proposed Board would implement a policy

31 Mr Pete Mailler, *Submission 139*, p. [6].

32 Government of South Australia, *Submission 70*, p. 2.

33 AgForce Queensland Industrial Union of Employers, *Submission 24*, p. 2.

34 *Proof Committee Hansard*, 18 March 2015, p. 11.

35 Mr Steven Münchenberg, *Proof Committee Hansard*, 18 March 2015, p. 21.

36 *Submission 109*, p. 2.

37 *Submission 109*, p. 2.

that aims to reduce the debt levels of farmers to sustainable levels, at subsidised interest rates—the ABA thought there appeared to be an expectation that banks would forgo debt owing to them, on problem loans, to a level that would achieve this.[38] If that were the expectation, the ABA suggested there were a number of problems, including that lending to farmers was generally well secured and a bank would be unlikely to forgo debt when there was security available to cover the debt owing.[39]

- suggested that if this requirement to forgo debt were to become a practice then it would 'likely be factored into the pricing of debt, potentially affecting all producers irrespective of the resilience and management capability within their operations. It would be difficult to avoid penalising the better operators at the expense of those struggling to run viable businesses'.[40]
- indicated that to avoid consequences such as the banks having to forgo debt and hence penalising the better operators at the expense of those struggling to run viable businesses, 'the proposed Board would have to buy out the debt from the bank, in effect refinancing the customer at a lower level of debt'. In doing so, the Board would take a loss upfront in providing the refinance. In addition to this loss, the Board would also incur costs relating to the raising of funds and meeting prudential capital and loss requirements. Assuming that the interest rates charged by the Board were subsidised, this policy appeared to be unsustainable.[41]

4.25 Indeed one of ABA's principal concerns was that the ARDB would force the banks to write off debt. Thus, according to Mr Münchenberg, 'we have to assume that the risk of all customers has increased, and that is potentially going to increase the capital that we have to carry for those loans'.[42] He explained in detail:

> …for every loan that we write in Australia to any farmer we will have to factor in the risk that at some point in the life of that loan, whether it is in a year, five years or 15 years, that farmer may get into a situation such that, without the agreement of the bank, the board will come in and force us to write down 25 per cent of that loan. So, we would have to factor that in to every loan we write. There is no other way of doing it. If we could predict in advance which customers are going to go bad, we would be making even more profits.[43]

38 *Submission 109,* p. 6.

39 *Submission 109,* p. 6.

40 *Submission 109,* p. 6.

41 *Submission 109,* p. 6.

42 *Proof Committee Hansard*, 18 March 2015, p. 25.

43 *Proof Committee Hansard*, 18 March 2015, p. 27.

4.26 Mr Münchenberg emphasised his view that the proposed legislation as it currently stood was 'incredibly vague as to what it does, so we can only take the evidence that is available to us'.[44]

4.27 Treasury was not in favour of the bill. As the proposed ARDB would have 'similar characteristics to a state-owned bank', Treasury argued that the proposal raised 'substantial concerns for businesses, individuals and the government':

> Direct lending via a government-owned Development Board is likely to reduce competition and innovation across the economy by crowding out private providers of credit.[45]

4.28 According to Treasury, other jurisdictions with state-owned banks generally find the presence of such banks 'hampers economic growth and distorts the financial system'.[46] Treasury added in order to achieve ARDB's objectives, the RBA would be involved in providing financial assistance to a wide range of businesses facing financial difficulty. It suggested that:

> Doing so would likely result in the RBA making large losses on the credit it provides, which could ultimately have negative impacts on government's fiscal position.[47]

4.29 Furthermore, Treasury suggested that the proposal placed 'the prospect of receiving dividends from the RBA at jeopardy'.[48] Noting that the proposed ARDB would have the task of 'reducing or eliminating the debilitating impact of financial arrangements', Treasury then indicated that the effect of this proposal depended on how the Board would achieve this objective. It surmised:

> If financial institutions are required to cancel loans and incur a loss, financial institutions will be unwilling to lend to businesses in the scope of the proposed board’s remit. This could result in reduced competition in credit provision and encourage industries to become dependent on the government for finance.
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> If the RBA cancels loans and compensates lenders to ensure there is no loss to financial institutions, then lenders could be encouraged to relax lending standards and borrowers would be encouraged to take on excessive debt.[49]

4.30 According to Treasury:

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44 *Proof Committee Hansard*, 18 March 2015, p. 27.

45 Treasury, *Submission 133*, p. 2.

46 Treasury, *Submission 133*, p. 10.

47 *Submission 133*, p. 8.

48 *Submission 133*, p. 8.

49 *Submission 133*, p. 9.

- an extension of credit to sectors that are indebted and poorly performing is likely to increase that sector's leverage without any necessary improvements in their operation and business conditions; and
- the misallocation of capital directs funding away from other more sustainable businesses, even within the agriculture sector, that have better prospects for contributing to Australia's long-term economic growth.[50]

4.31 The RBA also found flaws with the proposed ARDB. In its submission, the RBA stated that the addition of a third Board to the RBA's governance structure would risk blurring responsibilities and creating confusion over the RBA's policy objectives.[51] Furthermore, the RBA did 'not possess the requisite expertise in regular commercial lending'.[52] Overall, the RBA concluded that Australia has a mature financial system and capital markets and that the Australian banking system had:

> …sufficient capacity and expertise to service the financing needs of rural producers at a price that is appropriately adjusted for the risks that the lenders assume. Thus, the RBA's assessment is that…a commercial lending function is not appropriate for a central bank…The private financial system can satisfy the normal commercial demand for finance by the rural sector, and the provision of finance from this source dwarfs any public provision under current arrangements.[53]

4.32 The RBA advised the committee that it already monitors conditions and developments in the rural sector as part of its analysis of economic trends. The RBA argued, however, that any official financial support for a particular industry should be part of the government's budget process:

> To the extent that there is a market failure, or that subsidies are deemed to be appropriate, or that there is a case for financing at concessional rates for a particular purpose, the RBA respectfully submits that best practice would be for these issues to be addressed through an appropriately resourced and governed process, and transparently costed as part of the Commonwealth Budget. This promotes effectiveness, equity and accountability.[54]

4.33 Mr Christopher Aylmer, RBA, restated the RBA's position that if there were market failure or a need for a subsidy or concession that such measures should be taken through the appropriate vehicle, which was the Commonwealth budget.[55]

4.34 The Western Australian (WA) Government did not support the bill. In its submission, the WA Government argued that establishing the RBA as a lender of

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50 *Submission 133*, p. 9.

51 *Submission 93*, p. 5.

52 *Submission 93*, p. 5.

53 *Submission 93*, p. 5.

54 Reserve Bank of Australia, *Submission 93*, p. 5.

55 *Proof Committee Hansard*, 18 March 2015, p. 32.

last resort 'with limited grounds for prudent economic decisions' would be inconsistent with policies it has pursued and an intergovernmental agreement on national drought program reform agreed to by all states in May 2013. Furthermore, it advised that in 2011 it decided not to provide a loan scheme where it would act as a lender of last resort. The reasons for this decision followed concerns that:

- government 'would be required to assume risk that commercial lenders have rejected, with financiers referring risky clients so as to both limit their own exposure and avoid adverse publicity of debt recovery';
- the 'level of arrears and bad debts are often substantial and can be exacerbated if future seasons are also adverse'; and
- lender of last-resort schemes 'are distortionary and encourage unviable activity, artificially holding up land prices and delaying orderly restructure and adjustment'.[56]

4.35 WAFarmers stated its belief that the proposed legislation in its entirety was not the solution, 'but only a short-term safety-net to a greater, more complex issue around insufficient profitability within the industry'.[57]

4.36 The NFF was of the view that there was 'an ongoing need to investigate options for the farm sector to continue to access affordable capital, improve global competitiveness and innovation'. It suggested that transparency in the banking sector, tax-based mechanisms for investing in regional Australia, and education and awareness among farmers of risk-management tools should be considered.[58] Moreover, the NFF advised that it had 'only an equivocal and broad understanding' of the implications of establishing an ARDB and argued that the proposal:

> …requires considerable investigation and analysis particularly in relation to the impact any such entity might have on the broader financial markets, farm sector financial instruments and risk management strategies.[59]

4.37 Farmers NSW also highlighted the need for the role of the ARDB to be 'publically clear and well understood to avoid confusion'. For example, it stated that it was unclear how the ARDB would interact with the broader agricultural policy areas that affect the profitability of the industry and what consultative process and communication would operate between the board and the general public.[60]

4.38 The Australian Dairy Farmers similarly indicated that the bill and Explanatory Memorandum required more detail on the exact nature of the financial structures that

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56 The Hon Ken Baston MLC, WA Minister for Agriculture and Food, *Submission 8*, p. 1.

57 *Submission 127*, p. 2.

58 National Farmers' Federation, *Submission 124*, p. 7.

59 National Farmers' Federation, *Submission 124*, p. 6.

60 *Submission 125*, p. [2].

would be used to achieve the bill's aims.[61] It also suggested that ABARES and the Australian Farm Institute could undertake the facilitative task to be assigned to the proposed ARDB.[62]

4.39 Finally, the recent Financial System Inquiry report similarly noted the call on government to establish a government-owned bank to direct funding to particular causes, such as rural business. It stated clearly that it did not support this approach, indicating that 'to maximise the efficiency of the financial system, policy makers should not set out to favour one particular funding destination over another'.[63]

4.40 As noted above a number of submitters saw no need for the proposed ARDB and referred to existing measures designed to assist farmers manage their debt and to gain access to necessary funding to develop their business. In the following section, the committee considers views on the adequacy of Commonwealth assistance to the rural sector.

Current rural assistance and development policies

4.41 The RBA noted that various government agencies 'provide eligible farmers with access to a range of assistance packages, including concessional loans for productivity enhancements and disaster recovery'. On 30 June 2013, according to the RBA, lending by government agencies amounted to around $2.2 billion'.[64]

4.42 A useful starting point when considering how government rural assistance and development policies have evolved is the 1992 National Drought Policy (NDP) agreed to by Commonwealth and state ministers. The objectives of the NDP were to:

- encourage primary producers and other sections of rural Australia to adopt self-reliant approaches to managing climatic variability;
- maintain and protect Australia's agricultural and environmental resource base during periods of extreme climate stress; and
- ensure early recovery of agricultural and rural industries, consistent with long-term sustainable levels.[65]

4.43 The NDP stated that:

> During severe downturns, governments will act to preserve the social and physical resource base of rural Australia, and will provide adjustment

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61 *Submission 126,* p. 2.

62 *Submission 126,* p. 2.

63 *Financial System Inquiry,* Final Report, November 2014, pp. 14–15.

64 *Submission 93*, p. 3.

65 *National Drought Policy*, 1992, www.daff.gov.au/__data/assets/pdf_file/0006/924306/national-drought.pdf (accessed 8 July 2014), p. 1.

> assistance in the recovery phase. Support will be available to those with sound prospects who are temporarily in financial difficulty.[66]

4.44 In 2008, a national review of drought policy was undertaken[67] and through the Council of Australian Governments' Standing Council on Primary Industries, work on a new National Drought Policy commenced.[68] In 2013, the *Intergovernmental Agreement on National Drought Program Reform* was signed.[69] Under the agreement, the Commonwealth's role was described in the following terms:

> The Commonwealth is responsible for:
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> (a) funding and delivering a time-limited farm household support payment based on individual need, including
>
> (i) reciprocal obligations aimed at driving behavioural change
>
> (ii) case management to support reciprocal obligations
>
> (b) providing continued access to primary producer taxation concessions that support farmer risk management, including the [Farm Management Deposits] Scheme
>
> (c) delivering Commonwealth programs under this agreement
>
> (d) developing a Commonwealth implementation plan in consultation with the states and territories
>
> (e) monitoring and assessing the delivery and performance of Commonwealth programs under this agreement
>
> (f) reporting on the delivery of Commonwealth programs and the contribution of these programs to the achievement of outcomes as set out in this agreement.[70]

4.45 The Department of Agriculture has published the following advice about changes to drought assistance that commenced from 1 July 2014:

> The new approach, which will replace the existing Exceptional Circumstances arrangements, will help farmers prepare for and manage the effects of drought and other challenges, rather than waiting until they are in crisis to offer assistance, as well as supporting viable farms during prolonged or severe droughts. It is designed to deliver a more productive

66 *National Drought Policy*, 1992, (accessed 8 July 2014), p. 1.

67 Department of Agriculture, 'National Review of Drought Policy', www.daff.gov.au/agriculture-food/drought/drought-policy/history/national_review_of_drought_policy (accessed 8 July 2014).

68 NSW Department of Primary Industries, 'A new approach to drought management', www.dpi.nsw.gov.au/agriculture/emergency/seasonal-conditions (accessed 30 June 2014).

69 Department of Agriculture, 'National Drought Program Reform', www.daff.gov.au/agriculture-food/drought/drought-policy/drought-program-reform (accessed 9 July 2014).

70 *Intergovernmental Agreement on National Drought Program Reform*, 3 May 2013, www.daff.gov.au/__data/assets/pdf_file/0010/2288440/iga.pdf (accessed 9 July 2014).

> agriculture sector by helping farm businesses to make informed decisions and capture future opportunities.[71]

4.46 In response to the prolonged drought affecting Queensland and New South Wales, on 26 February 2014[72] the Australian government announced additional assistance to support farming families, farm businesses and rural communities.[73] In particular, the government supplemented the existing Farm Finance program with an additional $280 million for concessional loans to eligible drought-affected farm businesses. The loans could be used for debt restructuring, operating expenses and drought recovery activities.[74]

4.47 In addition to the Drought Concessional Loans Scheme and Farm Finance Concessional Loans Scheme, assistance programs currently available include:

- the Farm Household Allowance;
- Farm Management Deposits; and
- the Rural Finance Counselling Service.[75]

Concessional loans

4.48 The *Agricultural Competitiveness Green Paper* noted the government's concern about rural debt levels and the farm debt servicing difficulties that some farmers were experiencing. In response, according to the Green Paper, the government has introduced farm finance at concessional interest rates through the Farm Finance Concessional Loans Scheme to facilitate the restructuring of debt for long-term viable farms. It explained that under this scheme, eligible farm businesses could apply 'to refinance up to half of their existing commercial borrowings in the form of a loan with a reduced interest, or concessional, rate for a maximum of five years'.[76]

4.49 For example, the Drought Recovery Concessional Loans Scheme recently opened in Queensland and New South Wales to provide financial assistance to farm business to help businesses recover from unprecedented drought conditions.[77] This loan scheme together with two other concessional loan packages—the farm finance

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71 Department of Agriculture, 'Drought and Rural Assistance', www.daff.gov.au/agriculture-food/drought (accessed 30 June 2014).

72 Submissions to this inquiry closed on 10 February 2014.

73 See the Hon Tony Abbott MP (Prime Minister) and the Hon Barnaby Joyce MP (Minister for Agriculture), 'Supporting drought affected farmers', *Media Release*, 26 February 2014.

74 Treasury, *Submission 133*, p. 6.

75 Treasury, *Submission 133*, pp. 6–7.

76 *Agricultural Competitiveness Green Paper*, p. 36, https://agriculturalcompetitiveness.dpmc.gov.au/sites/default/files/green_paper.pdf (accessed 16 March 2015).

77 *Proof Committee Hansard*, 18 March 2015, p. 13.

and the drought concessional loans—provide funding of $700 million for farmers to restructure their debt or undertake productivity enhancements'.[78] Ms Anna Willock, Department of Agriculture, informed the committee of the following current variable interest rates:

- Farm Finance Concessional Loan Scheme 4.34 per cent;
- Drought Concessional Loan Scheme 3.84 per cent; and
- Drought Recovery Concessional Loan Scheme 3.21 per cent.[79]

4.50 While recognising the value of assistance through additional government funding, such as concessional loans, a number of witnesses thought that the loans were 'too slow and too small and some of them were to be repaid in too short a time'.[80] Dr McGovern was of the view that the *Rural Adjustment Act 1992* was expensive and limited compared to other measures that Australia could adopt. In his words, 'it may have been relevant in 1992 but not anymore'.[81] One farmer with no debt, but no income for multiple years because of drought, argued that recent government policies such as the exceptional circumstances program were not effective:

> Historically we have been drought declared a number of times and have received minimal assistance due to the structure of drought relief and exceptional circumstances (EC). My observations of EC in the past, especially the interest subsidy, is that it hasn't helped many genuine farmers who have gotten into difficulty due to drought. It has mainly gone to those who have structured it into their business plans as a safety net or simply used the provisions to borrow more heavily than otherwise would have been prudent. These businesses, often quite large ones, who can attract publicity, are usually the first able to seek assistance. The current call for interest subsidies or the transfer of debt to the Commonwealth would do little to assist most land holders without many other issues being considered. In fact this is a type of smoke screen or shield from the serious underlying problems of sustainability.[82]

4.51 In addition, Mr Rowell Walton suggested that the recent Farm Finance Package demonstrated that some states 'do not have effective machinery for delivery; many have lost the ability or simply refuse to participate'.[83]

78 *Proof Committee Hansard*, 18 March 2015, p. 13.

79 *Proof Committee Hansard*, 18 March 2015, p. 15.

80 *Proof Committee Hansard*, 18 March 2015, p. 4.

81 *Proof Committee Hansard*, 18 March 2015, pp. 11 and 12.

82 Mr Richard Knights, *Submission 49*, pp. 1–2.

83 *Submission 128*, p. 12.

Alternatives

4.52 When asked about overseas institutions that provide finance to their rural sector, such as Farm Credits Canada and Farmer Mac in the United States of America, Mr Nico Padovan, Department of Agriculture, informed the committee that the department was aware of these models when setting up the concessional loan and other schemes.[84] He explained further:

> There are key areas of difference, so the work that we do around things like the Drought Recovery Concessional Loans Scheme, as I understand it, is unique to the Australian context. They are special-purpose loans for those in a particular circumstance, whereas farm finance is probably more akin to the Canadian and US models, where it is a much more generic loan for debt restructure and productivity enhancement. That is very much by negotiation with the states in terms of what is available in each of the states. One of the challenges we have in answering some of your questions is that the individual agreements we have with the states, the level of admin costs and some of the other attributes of those loans are tailored to those particular states.[85]

4.53 The Department of Agriculture provided additional information on Farm Credit Canada; on the US Farm Credit System (FCS); and the US Federal Agricultural Mortgage Corporation, commonly known as 'Farmer Mac' which is part of the FSC. This information is at Appendix 4.

4.54 According to the RBA, the substantial variability of rural debt and rural asset values across the country and sectors raised the question whether this was 'a problem for which you would look for an insurance solution'.[86] Mr Aylmer explained:

> It is the volatility in cash flow that is the issue here, and the way you would normally look at that…'suggests maybe it is an insurance solution rather than a concessional loan solution.' And then there is the question: would the private sector actually be prepared to provide that? I do not know. In risk-adjusted terms, the premiums may well just be so high that you could not get an effective private solution.[87]

4.55 Treasury indicated that it was aware of new products being available to the rural sector to manage various risks:

> We are aware of multi-peril insurance products and, indeed, some other innovative forms of lending. There are some new lenders in the peer-to-peer market that we are aware have started to think about the agriculture sector. If those innovations moved into the agriculture sector, in our view that

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84 *Proof Committee Hansard*, 18 March 2015, p. 18.

85 *Proof Committee Hansard*, 18 March 2015, p. 19.

86 *Proof Committee Hansard*, 18 March 2015, p. 33.

87 *Proof Committee Hansard*, 18 March 2015, p. 33.

> would be a good way to provide different sources of funding and ways of managing risk.[88]

4.56 Mr Rees also noted the many options available under the WTO Agreement on Agriculture that allows rural assistance 'lay untapped', including crop insurance, which, according to Mr Rees, many countries use. He noted however, that such insurance would have to be subsidised because it was unprofitable due to the risk level. Mr Rees also mentioned payments that could be made for 'stewardship of the land'.[89]

Conclusion

4.57 There is no doubt that sectors of Australia's farming communities are under financial stress and require Commonwealth assistance to help them return to a sustainable and financially viable position. For many submitters the proposed ARDB would enable struggling rural communities to build the resilience, capabilities and financial viability required to sustain profitable farming and withstand the effects of natural disasters, market failures and inadequate commercial arrangements. There were others, however, who expressed concerns that the proposed ARDB was not the appropriate solution.

4.58 One of the principal concerns about the proposed ARDB was the lack of detail on how it would operate. For example, the NFF had 'only an equivocal and broad understanding' of the implications of establishing an ARDB and Farmers NSW spoke of the need for the role of the ARDB to be 'publically clear and well understood to avoid confusion'. The Australian Dairy Farmers wanted more detail on the exact nature of the financial structures to be used to achieve the bill's intentions, while, based on the available evidence, the ABA described the proposed legislation as 'incredibly vague'.

4.59 This lack of detail and certainty in the drafting of the proposal to establish an ARDB prompted a number of government agencies, rural organisations and the ABA to surmise on possible outcomes should the entity be established. The ABA referred to concerns that banks would be compelled to forgo debt or that the ARDB would buy out debt from the bank to refinance the customer at a lower level of debt. Treasury expressed concerns about reduced competition and innovation by crowding out private providers of credit. It referred to the possibility of ARDB making large losses on the credit it would provide. Treasury suggested that if the ARDB cancelled loans and compensated lenders then lenders could be encouraged to relax lending standards and borrowers to take on excessive debt. Moreover, the RBA formed the view that the current banking system had 'sufficient capacity and expertise to service the financing needs of rural producers at a price that is appropriately adjusted for the risks that the lenders assume'.

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88 *Proof Committee Hansard*, 18 March 2015, p. 31.

89 *Proof Committee Hansard*, 18 March 2015, p. 38.

4.60 In light of the lack of detail and confusion about how the ARDB would function in practice and the likely adverse consequences should it be established, the committee cannot support the passage of the bill.