The Senate

Economics Legislation Committee

Reserve Bank Amendment (Australian Reconstruction and Development Board) Bill 2013

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Senate Economics Legislation Committee

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Introduction

1.1 On 12 December 2013, the Senate referred the Reserve Bank Amendment (Australian Reconstruction and Development Board) Bill 2013 to the Economics Legislation Committee for inquiry and report by 26 March 2014.[1] The Senate subsequently extended the reporting date on four occasions: first to 25 June 2014, then to 28 August and 4 December 2014 and finally to 31 March 2015.

1.2 The bill is a private senators' bill co-sponsored by Senators John Madigan and Nick Xenophon. It proposes to amend the *Reserve Bank Act 1959* to establish an Australian Reconstruction and Development Board (ARDB) of the Reserve Bank of Australia (RBA). The ARDB would have the task of forming and implementing a rural reconstruction and development policy.

1.3 Bills containing similar proposals were introduced into the House of Representatives and the Senate during the 43rd Parliament. They lapsed, however, as a result of the prorogation of the Parliament that occurred prior to the 2013 federal election.[2] The bill before this committee contains some drafting changes that differentiate it from its precursor bills.

Conduct of the inquiry

1.4 The committee advertised the inquiry on its website and in *The Australian*. It also wrote to relevant stakeholders and interested parties inviting submissions. The committee received 145 submissions, which are listed at Appendix 1. On 18 March 2015, the committee held a public hearing in Canberra. A list of witnesses is at Appendix 3.

1.5 The committee thanks all the individuals and organisations that provided a submission to this inquiry and who gave oral evidence.

Consideration of the bill by legislative scrutiny committees

1.6 When examining a bill or draft bill, the committee takes into account any relevant comments published by the Senate Standing Committee for the Scrutiny of Bills. The committee has also considered the comments on the bill made by the

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1 *Journals of the Senate*, 2013, no. 11 (12 December 2013), pp. 361–62.

2 The private member's bill was introduced by the Hon Bob Katter MP on 17 June 2013 and shares the same short title as this bill. The private senator's bill was introduced by Senator Xenophon on 27 June 2013 and has the short title: Reserve Bank Amendment (Australian Reconstruction and Development Board) Bill 2013 [No. 2]. Neither bill was referred to a committee for inquiry.

Parliamentary Joint Committee on Human Rights (PJCHR). The findings of the two legislative scrutiny committees are outlined briefly below.

Senate Scrutiny of Bills Committee

1.7 The Senate Standing Committee for the Scrutiny of Bills assesses legislative proposals against a set of accountability standards that focus on the effect of proposed legislation on individual rights, liberties and obligations, and on parliamentary propriety. The Scrutiny of Bills Committee considered the bill in its ninth *Alert Digest* of 2013. It made no comment on the bill.[3]

Parliamentary Joint Committee on Human Rights

1.8 One of the functions of the PJCHR is to examine bills for compatibility with human rights, and to report to both Houses of the Parliament on that issue.[4] The PJCHR considered the bill in its first report of the 44th Parliament. The PJCHR sought further information from Senators Madigan and Xenophon regarding how the power to terminate the appointment of the RBA's representative on the proposed ARDB would be compatible with the right to work.[5]

1.9 The bill provides that the RBA representative must be a member of the Reserve Bank Board or a staff member of the Reserve Bank Service.[6] Under the bill as currently drafted, the RBA Governor may terminate the appointment of the RBA's representative at any time. The removal of an individual which is the RBA representative on the proposed ARDB, however, would not appear to affect his or her service on the Reserve Bank Board or employment at the RBA, whichever is applicable.

Structure of this report

1.10 This report comprises five chapters including this introductory chapter and:

- Chapter 2—provides background information about the current role of the RBA and of the former Commonwealth Development Bank and an explanation of the proposed ARDB;
- Chapter 3—discusses the challenges facing regional Australia and how the proposed legislative changes are intended to meet these challenges;

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3 Senate Standing Committee for the Scrutiny of Bills, *Alert Digest*, no. 9 of 2013, p. 33.

4 *Human Rights (Parliamentary Scrutiny) Act 2011*, s. 7(a).

5 Parliamentary Joint Committee on Human Rights, *Examination of legislation in accordance with the Human Rights (Parliamentary Scrutiny) Act 2011: Bills introduced 12 November – 5 December 2013; Legislative Instruments received 8 June – 22 November 2013*, First Report of 44th Parliament, December 2013, pp. 49–50.

6 Schedule 1, item 19, proposed new section 25NB.

- Chapter 4—identifies the main issues that arose when considering the proposed ARDB, including the approach to rural development adopted by various governments and how the proposed ARDB relates to the RBA's current role; and
- Chapter 5—presents the committee's findings and recommendations.

Chapter 2

Background and overview of the bill

2.1 The bill proposes that an ARDB be established as a third board of the Reserve Bank of Australia (RBA). In this chapter, the committee outlines the current role and functions of the RBA and its two boards, before examining the role of the previous Commonwealth Development Bank and the proposed ARDB.

Current role of the Reserve Bank of Australia

2.2 The Explanatory Memorandum indicates that the RBA already has the necessary regulatory framework, powers and relevant duties legislatively assigned to be able to constitute the ARDB as a third Board within the Reserve Bank of Australia.[1] The RBA is Australia's central bank, and is responsible for:

- Australia's monetary policy;
- maintaining the stability of the financial system;
- ensuring the stability, efficiency and competitiveness of the payments system;
- providing certain banking services to the Australian government, overseas central banks and official institutions;
- designing and issuing Australia's banknotes;
- managing Australia's gold and foreign exchange reserves; and
- providing specialised banking services to the Australian government, various government agencies, and a number of overseas central banks and official institutions.[2]

2.3 The Reserve Bank Act provides that the RBA is to act as a central bank and, subject to that Act and the *Banking Act 1959*, the RBA 'shall not carry on business other than as a central bank'.[3] Section 8 of the Reserve Bank Act outlines the RBA's general powers, which are as follows:

> The Bank has such powers as are necessary for the purposes of this Act and any other Act conferring functions on the Bank and, in particular, and in addition to any other powers conferred on it by this Act and such other Acts, has power:
>
> (a) to receive money on deposit;
>
> (b) to borrow money;

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1 Explanatory Memorandum p. [1].

2 Reserve Bank of Australia, www.rba.gov.au (accessed 18 December 2013); *Annual Report 2013*, October 2013, pp. 3–4.

3 *Reserve Bank Act 1959*, s. 26.

(c) to lend money;

(d) to buy, sell, discount and re-discount bills of exchange, promissory notes and treasury bills;

(e) to buy and sell securities issued by the Commonwealth and other securities;

(f) to buy, sell and otherwise deal in foreign currency, specie, gold and other precious metals;

(g) to establish credits and give guarantees;

(h) to issue bills and drafts and effect transfers of money;

(i) to underwrite loans; and

(j) to do anything incidental to any of its powers.[4]

2.4 The RBA currently has two boards that, between them, are responsible for determining the RBA's policies on the matters entrusted to the bank. These boards are the Reserve Bank Board and the Payments System Board. The Reserve Bank Board is responsible for the RBA's monetary and banking policy and the RBA's policies on all other matters except for its payments system policy, which is the responsibility of the Payments System Board.[5]

2.5 The Reserve Bank Board is chartered with ensuring, within the limits of its powers, that the RBA's statutory powers, other than those that relate to the safety and stability of the payments system, are exercised in such a manner as will best contribute to:

- the stability of the currency of Australia;
- the maintenance of full employment in Australia; and
- the economic prosperity and welfare of the people of Australia.[6]

2.6 Within the limits of its powers, the Payments System Board is charged with ensuring that the RBA's payments system policy and the exercise of its statutory powers that relate to the payments system are exercised in a way that will best contribute to:

- controlling risk in the financial system;
- promoting the efficiency of the payments system; and
- promoting competition in the market for payment services, consistent with the overall stability of the financial system.

2.7 In relation to the RBA's powers and functions under Part 7.3 of the *Corporations Act 2001* that address the licensing of clearing and settlement facilities,

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4 *Reserve Bank Act 1959*, s. 8.

5 *Reserve Bank Act 1959*, ss. 8A(1)–(3).

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

the Payments System Board is required to exercise these in a way that will best contribute to the overall stability of the financial system.[7]

2.8 Both boards are required to ensure, again within the limits of their powers, that the policies they develop are 'directed to the greatest advantage of the people of Australia'.[8]

Commonwealth Development Bank and the RBA's former role in rural credit

2.9 In his second reading speech, Senator Xenophon stated that the proposed ARDB would, 'in a sense', be similar to the former Commonwealth Development Bank.[9] The following section provides a brief outline of the history of the Commonwealth Development Bank and the RBA's former role in rural credit.

History of the Commonwealth Development Bank

2.10 Between 1960 and 1974, the main function of the Commonwealth Development Bank was to provide finance related to primary production and industry undertakings (particularly small undertakings). In 1974, the bank was allowed to provide finance for tourism development projects. In 1978, the lending activities of the bank were widened further to cover business activities generally, with a focus on small business.[10] Lending would occur in cases where the provision of finance was desirable and the finance was not otherwise available, either in full or in part, on reasonable and suitable terms and conditions.[11] The legislation also provided that the Development Bank should have regard 'primarily to the prospects of the operations of that person becoming, or continuing to be, successful' and not necessarily 'the value of the security available in respect of that finance'.[12]

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7 *Reserve Bank Act 1959*, s. 10B(3)(b) and (c).

8 *Reserve Bank Act 1959*, ss. 10(2) and 10B(3)(a).

9 Senator Xenophon, *Senate Hansard*, 5 December 2013, p. 953.

10 Department of the Parliamentary Library, 'Commonwealth Banks Amendment Bill 1978', *Short Digest of Bill*, no. 78/28 (10 April 1978), http://parlinfo.aph.gov.au/parlInfo/download/legislation/billsdgs/3161177/upload_binary/3161177.pdf (accessed 2 July 2014), p. 1; *Commonwealth Banks Act 1959*, C1959A00005 (23 April 1959), ss. 72, 73; C2004C02847 (27 October 1993), ss. 72, 73.

11 *Commonwealth Banks Act 1959*, C2004C02847 (27 October 1993), s. 72.

12 *Commonwealth Banks Act 1959*, C2004C02847 (27 October 1993), s. 73.

2.11 Along with the Commonwealth Bank of Australia (CBA), the Commonwealth Development Bank was converted from a statutory authority into a public company in 1990.[13] The Development Bank was made a subsidiary of the CBA.[14] Following the sale of the Commonwealth of Australia's last holding in the CBA, in July 1996 the fully privatised CBA purchased the Commonwealth of Australia's remaining shares in the Development Bank. The Development Bank was absorbed into the CBA's business banking division.[15]

RBA's former role in rural credit

2.12 In addition to the role previously performed by the Commonwealth Development Bank, the RBA also had a former role in the provision of rural credit. The RBA provided the following history of this function:

> In the past, the RBA (and prior to 1959, the Commonwealth Bank) has had a broader role in the rural sector. Between 1925 and 1988 the Rural Credits Department (RCD) provided seasonal credit for periods of up to one year to statutory marketing authorities and rural cooperative associations to facilitate the marketing, processing and manufacture of primary produce. It also extended research grants and fellowships for projects associated with the promotion of primary production.
>
> The RCD was created when the size of the rural sector meant that its demand for seasonal finance was very large relative to the capacity of private financial markets. By the 1980s, however, the commercial banking system had become the primary source of rural credit, and bank lending techniques had become well suited to the variable financing needs of rural producers. A major part of RCD advances had started moving to the financial markets in 1979, when the Australian Wheat Board began issuing commercial paper. Interest rates on RCD loans had also become more closely aligned with commercial rates and, by mid-1984, all were at fully commercial rates.[16]

2.13 Treasury noted that the 1981 Campbell Committee inquiry into the financial system recommended the phasing out of the RBA's Rural Credits Department

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13 *Commonwealth Banks Restructuring Act 1990* and Commonwealth Bank of Australia, 'Privatisation (1991) and subsequent developments', www.commbank.com.au/about-us/our-company/history/privatisation.html (accessed 7 July 2014).

14 Department of the Parliamentary Library, 'Commonwealth Bank Sale Bill 1995', *Bills Digest*, 1995–96, no. 49, http://parlinfo.aph.gov.au/parlInfo/download/legislation/billsdgs/F5K20/upload_binary/F5K20.pdf, p. 3 (accessed 7 July 2014).

15 Commonwealth Bank of Australia, *Annual Report 1997*, www.commbank.com.au/about-us/shareholders/pdfs/annual-reports/1997_Annual_report.pdf (accessed 7 July 2014), pp. 13, 23.

16 Reserve Bank of Australia, *Submission 93*, p. 4.

'with the view that private markets were well equipped to meet rural financing needs'.[17]

The proposed ARDB

2.14 In his second reading speech, Senator Xenophon advised that the bill was intended to provide a means to 'overhaul' rural policy by establishing a body with 'the power to make a real, long term difference'. Senator Xenophon argued that 'government grants and programs were no longer enough':

> Rural and regional Australia is struggling. We have heard over and over again the challenges communities are facing, and how they are trying to survive. In recent years, they have borne the brunt of extreme weather events, a high Australian dollar, and a lack of support from State, Territory and Federal Governments…Rural and regional areas are, in many ways, the lifeblood of our country. Certainly, our farmers play an incredibly important role both in our economy and our food security. Without their produce, we are all vulnerable. People living in rural and regional areas face challenges on almost every front. In terms of healthcare, of education, of aged care, and of employment, they have to fight to be counted. If rural and regional communities do not receive the support they so desperately need, the impact on the rest of Australia will be significant, in both economic and cultural terms.[18]

2.15 Senator Xenophon concluded:

> We cannot ignore this problem any longer. Australians living in rural and regional communities deserve better. They deserve security, and they deserve to know the Government is taking meaningful steps to fix this problem. The measures in this bill will bring about real and long lasting change. And that change will not only benefit rural and regional communities, but the rest of Australia as those communities flourish.[19]

Purpose of the bill

2.16 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'.[20] According to the Explanatory Memorandum, the ARDB activities would relate to agriculture and associated industries and infrastructure and help to develop:

- the resilience, capabilities and ongoing financial viability of Australia's food and natural fibre systems;

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

18 Senator Xenophon, *Senate Hansard*, 5 December 2013, p. 953.

19 Senator Xenophon, *Senate Hansard*, 5 December 2013, p. 953.

20 Explanatory Memorandum, p. 1.

- a profitable farming sector exercising good stewardship of the resources associated with production;
- effective ways to mitigate the impacts of adverse events, particularly those associated with natural disasters, market failures and inadequate commercial financial arrangements; and
- the capability of agriculture to contribute more fully, responsibly and reliably to the economic prosperity and welfare of the people of Australia and the peoples of other nations.[21]

2.17 The bill seeks to empower the ARDB to do this by determining and giving effect to the RBA's 'rural reconstruction and development policy'. The rural reconstruction and development policy would relate to the following three tasks:

- The 'facilitative task'—to aid better financial decision making by businesses—involves researching, reporting on and helping to develop the resilience, capabilities and ongoing financial viability of Australia's food and natural fibre systems, as well as any other Australian industries or sectors that need, or may need, reconstructing or development. The bill would require that this task must be conducted in a 'timely' way.[22]
- The 'development task'—to help ensure that needed development funds are offered from appropriate sources in ways that support capital formation and reduce risk—involves developing and offering financial arrangements, and reviewing financial arrangements, to contribute to the development of Australian agriculture, associated industries and infrastructure.[23]
- The 'reconstruction task'—to assist financial transactions—involves 'fairly, reasonably and effectively' reducing or eliminating the debilitating effect of those financial arrangements related to financial arrangements that, because of certain specified circumstances, reduce or threaten the ongoing viability or sustainability of enterprises in Australian agriculture or associated industries.[24]

2.18 The ARDB would be required to ensure, within the limits of its powers, that the rural reconstruction and development policy was 'directed to the greatest

21 Explanatory Memorandum, pp. [1–2].

22 Dr Mark McGovern, *Submission 129,* p. 4 and See schedule 1, item 14, proposed paragraph 10BB(2)(c).The three tasks are outlined in schedule 1, item 14, proposed subsection 10BB(2).

23 Dr Mark McGovern, *Submission 129,* p. 4 and See schedule 1, item 14, proposed paragraph 10BB(2)(c).The three tasks are outlined in schedule 1, item 14, proposed subsection 10BB(2).

24 Examples of circumstances specified include: the design of the financial arrangements, market failure and natural disasters. See schedule 1, item 14, proposed paragraph 10BB(2)(c).The three tasks are outlined in schedule 1, item 14, proposed subsection 10BB(2).

advantage of the people and industries of Australia'.[25] The ARDB would also be required to ensure that the RBA's powers were exercised in a manner that best fulfilled the three set tasks in ways that were timely, equitable and transparent, and with due regard to economic responsibility.[26]

2.19 The bill proposes that to give effect to the policy, the ARDB would have the power to use the capital the RBA holds as Australia's central bank.[27] Section 28 of the Reserve Bank Act would be amended to allow the capital held by the RBA for its functions as a central bank to also be used for the RBA's rural reconstruction and development policy (a policy that the bill would, if passed, require the ARDB to establish).

Reserve Bank Reserve Fund

2.20 The RBA's capital includes the Reserve Bank Reserve Fund.[28] In its most recent annual report, the RBA described the primary purpose of the Reserve Fund as providing 'a capacity to absorb losses when it is necessary to do so'.[29] In October 2013, the government announced a grant of $8.8 billion to strengthen the position of the Reserve Fund. The *Mid-Year Economic and Fiscal Outlook* released in December 2013 provided the following information on the types of losses the Reserve Fund needed to absorb in recent times and the reasons for the government's decision to make a grant to the Fund:

> The strong and sustained appreciation of the Australian dollar from 2009 caused the RBA to record large financial losses in 2009–10 and 2010–11 as the value of its foreign currency assets declined in Australian dollar terms. This coincided with global interest rates declining to historical lows, reducing the RBA's underlying earnings.
>
> The resultant losses were absorbed by the Reserve Bank Reserve Fund (RBRF), reducing the balance to significantly below the level now considered prudent by the Reserve Bank Board based on its most recent assessment of the risks to the RBA's balance sheet…
>
> The low level of the RBRF has not posed an immediate risk to the solvency of the RBA and has not impaired its operations. Nevertheless, on current projections, it would take many years to build the RBRF to the level deemed prudent by the Board—15 per cent of assets at risk—through the

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25 Schedule 1, item 14, proposed paragraph 10BB(4)(a). The inclusion of the words 'and industries' distinguishes this requirement from the duties imposed on the Reserve Bank Board and the Payments System Board which only refer to the people of Australia: see paragraph 1.14–1.15.

26 Schedule 1, item 14, proposed paragraph 10BB(4)(b); Explanatory Memorandum, p. [4].

27 Schedule 1, item 14, proposed subsection 10BB(3), and item 20.

28 *Reserve Bank Act 1959*, s. 29.

29 Reserve Bank of Australia, *Annual Report 2013*, p. 71.

> usual channel of retaining profits, leaving the RBA financially exposed in an uncertain global environment.
>
> The Government has therefore decided, following consultation with the Reserve Bank Governor, to provide a one-off $8.8 billion grant to the RBA to strengthen its financial position. The grant safeguards the credibility and independence of the RBA, putting beyond doubt its ability to perform its key functions at the heart of Australia's financial system and to meet any challenges that may lie ahead in a volatile global economy.[30]

2.21 It should be noted that if a policy determined by the Reserve Bank Board and a policy determined by the ARDB are inconsistent, the Reserve Bank Board's policy prevails and the ARDB's policy has effect as if it were modified to remove the inconsistency. The Treasurer would resolve any disagreement between the Reserve Bank Board and the ARDB as to which of the Boards would be responsible for determining the Bank's policy on a matter.[31]

Financial statement

2.22 The bill does not contain a financial impact statement.

Membership

2.23 The membership of the ARDB would consist of nine members, including the RBA Governor, a member of the Reserve Bank Board or an RBA staff member (the RBA's representative), and seven other members appointed by the Treasurer.[32] Of the seven members, the Treasurer would appoint for a specified period not exceeding five years—an economist; an accountant; a banker; a representative of the States and Territories; and a farmer. They would be required to have rural and agricultural experience.[33]

Relationship with Parliament

2.24 Under proposed subsection 10BB(5), a House of the Parliament, a committee of a House, or a joint committee of both Houses may request the Board:

- to take a matter into account in performing the Board's functions; or
- to report to the House or committee on a matter relevant to the Board's functions.

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30 Australian Government, *Mid-Year Economic and Fiscal Outlook 2013–14,* December 2013, p. 37.

31 Schedule 1, Item 15.

32 The bill requires that the seven other members must include: an economist; an accountant; a banker; a representative of the states and territories; and a farmer. Schedule 1, item 19, proposed section 25NA.

33 Explanatory Memorandum, p. [5].

Committee view

2.25 While the provisions of the bill are straightforward in articulating the intention to establish the ARDB, the implications of establishing such an entity raised some concerns. In the following chapter, the committee examines the perceived need for the establishment of the proposed ARDB.

Chapter 3

Problems the bill seeks to address

3.1 The ARDB's tasks would relate to the financial viability of Australian agriculture and associated industries, and the financial arrangements entered into by these industries. This chapter examines the stated reasons for establishing the proposed ARDB and considers whether there are strong grounds for creating such a board within the RBA.

Challenges facing regional Australia

3.2 The committee received many submissions from farmers and people in rural communities that expressed support for the proposed ARDB. Submitters cited many of following challenges affecting regional Australia when arguing for the creation of an ARDB. These included:

- access to finance and changes in bank lending practices since the global financial crisis;
- declining farm profitability;
- farm debt levels and their sustainability;
- the flow on effects of challenging agricultural production and market conditions for small businesses reliant on farming businesses;
- market interruptions, such as the suspension of live cattle exports to Indonesia in 2011;
- recent natural disasters, such as drought and floods;[1] and
- the sustained high Australian dollar.

3.3 Many who participated in the inquiry drew attention to problems being experienced in parts of rural Australia. They spoke of excessive debt, unserviceable loans, foreclosures, insolvencies and rural suicides as evidence that the ARDB model was needed.[2] For example, Mr Rowell Walton stated:

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1 Rainfall for the 26-month period ending May 2014 was below-average across most of eastern Australia and the west coast of Western Australia. Queensland in particular was affected; in March 2014, 79 per cent of Queensland was declared to be in drought, the largest area of the state ever recorded. Farms and regional communities in Queensland have also been affected by various tropical cyclones and floods in recent years. See Bureau of Meteorology, www.bom.gov.au/climate/drought/archive/20140604.3.deciles.gif (accessed 30 June 2014); and the Hon John McVeigh MP (Queensland Minister for Agriculture, Fisheries and Forestry), 'The largest area of Queensland ever drought declared', *Media Release*, 7 March 2014, http://statements.qld.gov.au/Statement/2014/3/7/the-largest-area-of-queensland-ever-drought-declared (accessed 30 June 2014).

2 Mr Ben Rees, *Submission 2*, p. [12].

> Reports recently garnered from our community suggest some are now faced with no income, the banks are in retreat and unprepared to further lend, some people are said to be unable to feed themselves. As an Australian I am embarrassed to have come to this place. I imagine the bankers would feel no particular comfort; the solutions rightly belong in the public domain.[3]

3.4 Indeed, Mr Walton told the committee that many people were now saying that they had 'never seen it as difficult as this in their history or to their knowledge' with capital values falling while rates were 'in fact rising'.[4] In this context, a number of submitters gave their personal accounts of life in regional Australia. Mr John Whitehead, whose family had owned and operated Mentone Station in central Queensland since 1914, argued that the drought affecting beef producers was a major disaster because it followed other particularly unfavourable events and market conditions:

> Over the 100 years of our time here there have been plenty of droughts and hard times, but there has been nothing like the time we are experiencing at the moment. In the past they used to earn enough in the good times to ride them through the bad times and they would come out the other end knocked around a bit but they would get up and start off again. Now we earn enough in the good times to just cover costs and put a bit away, but nowhere enough to get us through a disaster like the one we are experiencing now. There have been plenty [of] times when we have had worst dry spells then this, but never the combination of negative forces against us. This drought has had the perfect lead up for a major disaster, the global financial crises, out of control expenses, the live export ban, low stock prices, high wages, higher than normal stock numbers and these are just the major issues. There are plenty of local issues affecting us as well.[5]

3.5 Mr Xavier McKinnon, a veterinarian from Cobden, Victoria, whose business relies on the local dairy industry, advised that at least a quarter of his clients have told him their bank is not lending any more money for feeding cows. Mr McKinnon provided the following outline of his views as to why his local dairy industry was under pressure:

> In the last 10 years we have had the boom and bust of the managed investment schemes that pushed the price of land up to an unaffordable level, they promised returns they could never produce and got tax breaks by doing this! This new supposed value of land lead to banks' lending against unrealistic valuations and leaving the farmer exposed to any downturn no matter how minor it may have been! Now that the price of land has dropped the banks are putting pressure on the farmers telling them that their debt levels are too high. We have also had the price of milk drop to unrealistic levels at the farm-gate, a high Australian dollar making it harder to compete

3 *Submission 128*, p. 11.

4 *Proof Committee Hansard*, 18 March 2015, p. 1.

5 Mr John Whitehead, *Submission 34*, p. 1.

> on the export front, one of the wettest seasons ever followed by one of the driest seasons ever! We also had a little thing called the Global Financial Crisis which has impacted the export market![6]

3.6 A 28 year-old farmer from the Western Darling Downs wrote that, after studying agribusiness at university, he decided not to return to his family's farm after concluding that the farm's income could not support him. He also highlighted the flow on effects that occur in regional communities when agriculture struggles:

> Agriculture has seen a perfect storm in that we have seen near a decade of drought to be finished off with floods while the GFC cause[d] the dollar to rise which reduced the value of commodities and has made it harder to obtain working capital. This poor decade has made it very difficult for farmers to operate as the level of debt has increased across the board.
>
> The flow on effect of such increased debt within the industry is that farmers have reduced their spending on inputs which is causing local companies that supply these inputs out of business while also making the agricultural industry increasingly inefficient. In my search for employment away from the farm I have seen that the level of positions available is reduced due to the reduced capital that farmers are spending.
>
> The agricultural industry is too large and affects too many people across the country for it to fail, the government must step in and restructure their polices to help this industry before it is too late. The Australian Reconstruction and Development Board is desperately needed to maintain efficiency and not lose our land to less efficient foreign investors.[7]

3.7 A Western Australian farmer submitted that changes to lending practices following the global financial crisis had made their financial position difficult:

> Up until the GFC and subsequent run of seasons we had received unwavering support from our bank. This gave us the confidence to invest in our industry and take on risk (which has not always been a Yilgarn farmer's desire or strength)…Since the GFC we have had to endure risk profile recording, increasing annually our risk margin, now seeing finance costs 2-3% above that of a housing loan for the general public, a re-evaluation of our land at our own cost ($8,500) and a cap on bank lending forcing us to seek out third tier lenders for short term deferred accounts at interest rates up to 18%.[8]

3.8 Debt dominated the concerns raised in submissions. Ms Erin Lawless wrote:

> We really only have one (1) sustainability issue: our costs of production will always increase, while there is no mechanism in the market for our prices to meet rising costs.

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6 Mr Xavier McKinnon, *Submission 97*, p. 1.

7 Mr Hugh Hamilton, *Submission 23*, p. 1.

8 Mr Clint Della Bosca, *Submission 68*, pp. 2–3. Other submissions also advised that banks were no longer lending as a result of changing risk assessments. See, for example, *Submission 123*.

> We are a 'book-end' in the market. Unlike other industries and other sectors of this industry, there is no one to whom we can pass on our costs. We absorb and absorb and innovate as best we can, but eventually we have haemorrhaged people from our industry and communities, and tried to patch this market-structure problem with unsustainable, treacherous levels of debt.[9]

3.9 Other submitters pointed to a range of other challenges they believe Australian agriculture faces. A citrus farmer from the Riverina region of New South Wales expressed discontent with numerous government policies:

> …Australia's blind following of the belief in free trade and deregulation has left farmers suffering and unable to compete with juice or fruit coming from countries which don't have the same environmental, social or quality standards. These are forced onto us but not onto imports. Social issues include minimum wage, [occupational health and safety] and super contribution. Quality include safe use of chemicals, product traceability and various accreditations and registrations. Environmental includes carbon tax, water reform and restricted farm practices. All of these come at a cost burden to the Australian producer and are not placed on the equivalent imported product.[10]

3.10 Another submitter argued that deregulation and the removal of tariffs meant that funds needed to be made available to rebalance the financial circumstances of many farmers, as well as industries dependant on farming:

> Producers who have as a result of a change in government opinion, and policy, had all risk amelioration removed from their industries, dairy, grain and every industry which has lost its protection, whether countervailing market power, import protection via tariffs, or simply drought and exceptional circumstance provisions. Government have effectively passed all the risks of production on to the producer, this has been both deliberate and profound. Unfortunately many have carried excess debt, in the circumstance, provided and based upon a system, which now simply does not exist. It may well be there is an argument for compensation to readjust debt levels more in line with risk now set by policy.[11]

3.11 The combination of numerous factors places the financial viability of many Australian farms at risk. Indeed, the majority of the 145 submissions were concerned about the level of debt in rural Australia and the struggles facing farmers trying to keep their businesses afloat. In the following section, the committee explores the extent of this problem and whether it provides a solid basis for government intervention.

9 Ms Erin Lawless, *Submission 36*, p. 1.

10 Mr Bart Brighenti, *Submission 113*, p. 2.

11 Mr Rowell Walton, *Submission 128*, p. 8.

Is there a rural debt crisis?

3.12 As noted earlier, rural debt was specifically cited as a problem that an ARDB would address. The Explanatory Memorandum drew attention to the fact that rural Australia was:

> …struggling under an insurmountable debt burden, characterised by low farm income and lending practices of financial institutions in deregulated financial markets. In 1980, debt in Gross Value Farm Production was at 32% and this has escalated to historically high levels of debt, reaching 135.4% in 2012. With escalating debts, many farmers and producers are facing foreclosures. Forced sales are widening loan-to-value ratios, leading to a risk of 'fire sales', which could precipitate a raging financial contagion that may not be contained to rural and regional Australia.
>
> In such circumstances of uncertainty and risk to nationally important agricultural and associated industries, reconstruction is critical to re-establish a sound financial basis, and development funds to maintain and sustainably develop capabilities.[12]

3.13 A number of submitters agreed with this view that parts of rural Australia faced a most serious situation with crippling debt—a situation worsened by the fear of contagion. Mr Ben Rees, an economist with the rural debt roundtable and retired farmer, argued that there was a 'long term policy failure characterized now as a rural debt crisis'. He indicated that prior to the global financial crisis, lending was based on debt-to-equity ratios dependant on asset inflation. The crisis, however, 'brought asset inflation to an abrupt end':[13]

> Suddenly, farmers were asked to repay loans from income. The difficulty was that debt to equity lending had never been designed to be repaid from incomes. Consequently, overvalued rural assets were written down to more realistic market levels. The effect of falling land prices undermined the solvency of farmers who had borrowed in the halcyon days of debt to equity lending and ever rising land values.[14]

3.14 Dr Mark McGovern argued that during 2013, farm funding became very difficult for many. He submitted that the use of standard mortgages and growth in debt funding since 2000 was a cause of the current illiquidity in farm finance. Dr McGovern argued that the mortgages 'by design assume stable incomes' despite 'changing production and market realities'. He added there was also a disconnect between income and servicing obligations, with expected performance not matching actual results.[15] According to Dr McGovern, the market response, asset deflation, would be damaging—'a crisis is triggered by income problems and changes in

12 Explanatory Memorandum, p. [1].

13 Mr Ben Rees, *Submission 2*, pp. 2 and 4.

14 Mr Ben Rees, *Submission 2*, p. 4.

15 Dr Mark McGovern, *Submission 129*, p. 1.

valuations leading to spreading concerns about equity levels and repayment prospects'. He stated:

> Contagion becomes a real risk as falling asset values affect all farms, even those with no debt. Liquidity dries up until the down slide is seen as complete only after the property overhang is liquidated.
>
> Markets typically overreact, with needless loss of wealth. With active assets, such as farms, capacity is also destroyed. Serious new entrants, having delayed until both prices had bottomed and income:asset ratios rectified, now face considerable restoration costs. A once productive farm becomes derelict if restoration is too difficult or expensive, not for production, environmental or like reasons but due to a fatal financial exposure.[16]

3.15 The Western Australian Farmers Federation also expressed concern about the current level of farm debt and the potential for property devaluation contagion:

> WAFarmers believes strongly that the current farm debt situation, which is believed to be in the vicinity of $64bn, is untenable.
>
> Aligned with a five-year average national agricultural gross production value of $42.24 billion (ABS 2014), this represents a debt to income ratio of exceeding 1.5, which at that level, is considered by the mainstream banking sector 'to be at significant risk' in terms of the industry's inability to service the existing debt.
>
> There are certainly sectors within the industry whose relative debt loading would be proportionally higher than the average, particularly grains, dairy and livestock systems dependant on the live export industry.[17]

3.16 The National Farmers' Federation (NFF) noted concerns about increasing rural debt levels. Despite capital investments, which 'ideally hold farmers in good stead into the future', the NFF argued that 'total farm debt levels at above $60 billion place the agricultural sector at considerable exposure to increasing credit costs and ongoing viability'.[18] The NSW Farmers submitted that the escalation of rural debt in Australia and the ability to finance this was 'a serious issue for the industry'.[19]

3.17 The committee sought evidence about farm debt and rural lending practices from relevant government bodies.

3.18 Treasury submitted that rural debt had trebled over the past 15 years.[20] It noted that rural debt had risen from around 100 per cent of rural output in the early

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16 Dr Mark McGovern, *Submission 129*, p. 2.

17 Western Australian Farmers Federation, *Submission 127*, p. 2.

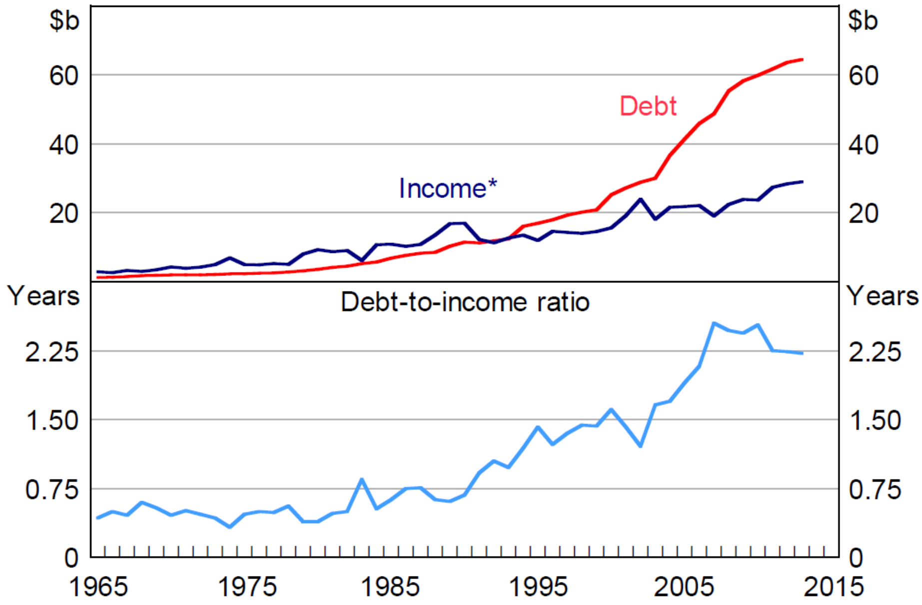
18 National Farmers' Federation, *Submission 124*, p. 7.

19 *Submission 125*, p. [1].

20 *Submission 133*, p. 5.

1990s to almost 200 per cent in 2012–13.[21] The growth in rural debt relative to income is depicted at Figure 3.1.

Figure 3.1: Rural debt and income



* Rural income is after deduction of taxes and subsidies on production and before deduction of depreciation, property income and cash operating expenses.

Source: Reserve Bank of Australia, *Submission 93*, p. 2; based on ABS, APRA and RBA Rural Debt Survey data.

3.19 According to Treasury, rising cost pressures, over the long term, had 'necessitated increases in productivity in order for farmers to remain profitable and keep operations viable'.[22] Land purchases have been a key cause of increased indebtedness, although Treasury noted that other sectors in the economy had also seen increased indebtedness since the 1990s. For example:

- between the early 1990s and 2012–13, the ratio of household debt to disposable income rose by almost 100 percentage points to 146 per cent; and
- over the same period, the aggregate credit-to-GDP ratio grew from around 80 per cent to approximately 140 per cent.[23]

3.20 Treasury added that much of the rural debt was 'held by a relatively small proportion of mostly large farms'.[24]

3.21 Ms Karen Schneider, Australian Bureau of Agricultural and Resources Economics and Sciences (ABARES), recognised that debt was an important source of

21 Treasury, *Submission 133*, p. 5.

22 Treasury, *Submission 133*, p. 3.

23 Treasury, *Submission 133*, p. 5.

24 Treasury, *Submission 133*, p. 5.

funds for farm investment and continuing working capital.[25] She also identified the many factors that have influenced the growth in farm debt over the past two decades which included:

> …lower interest rates, increased use of interest-only loans, structural adjustment—primarily the shift into cropping, which is relatively capital and input intensive—higher variability in incomes, increases in the size of farm enterprises, use of more intensive production technologies and the slowdown of loan repayments and increases in borrowing to meet working capital requirements during drought.[26]

3.22 The RBA acknowledged that rural debt had more than doubled over the past decade, explaining that the marked increase in debt over that period was:

> …partly driven by borrowing for farm improvements and capital investments. The reduction in farm incomes resulting from the widespread drought in the 2000s also contributed, as farmers increased borrowing to meet their working capital requirements.[27]

3.23 The RBA stated further that:

> Notwithstanding the high debt-to-income ratio, lower business lending rates and the slowdown in rural debt growth have led to a decline in the rural sector's interest payments as a share of income since 2008. However, recent RBA liaison with agricultural businesses indicates that some individual farms may be finding it difficult to access additional funding due to their existing high debt levels.[28]

3.24 According to the RBA, in recent years, there appeared to have been a slowdown in rural lending and debt growth, as well as a decline in the proportion of the rural sector's income allocated to interest payments (Figure 3.2).[29] The RBA attributed these developments to factors including:

- farmers increasingly recognising the importance of managing their balance sheets following previous episodes of drought;
- growth in rural incomes;
- higher perceived risk from climate variability;
- increased economic uncertainty;
- lower business lending rates; and

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

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

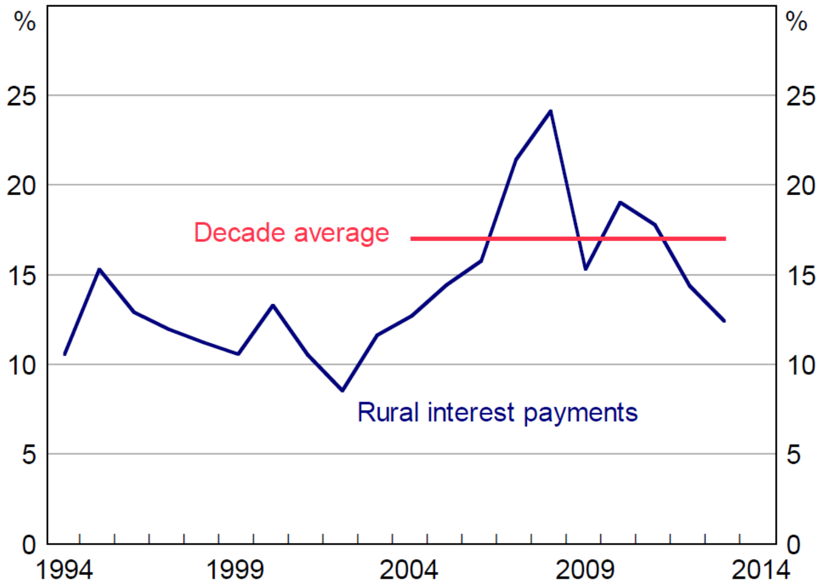
27 Reserve Bank of Australia, *Submission 93*, p. 2.

28 *Submission 93*, p. 3.

29 *Submission 93*, p. 3

- reassessments by financial intermediaries of the terms associated with the supply of credit, as part of a broader review of loan performance and lending standards since the global financial crisis.[30]

Figure 3.2: Rural interest payments* as a share of rural income



* Estimated using rural debt outstanding and the average business lending rate.

Source: Reserve Bank of Australia, *Submission 93*, p. 3; based on ABS and RBA data.

3.25 The Australian Bankers' Association (ABA) recognised that rural debt had 'grown significantly over the past 10 years'. It did not agree, however, with the contention that there was 'a rural debt crisis'. The ABA provided the following summary:

> The banking sector has a strong record in recent times of supporting the rural sector through the 'decade of drought' on the East Coast and more recently through a prolonged drought period in the West Coast grains industry. These areas have been recovering and rebuilding equity. Bank Pillar 32 Reporting indicates that less than 1.5% of loans to agriculture are more than 90 days in arrears. Bank losses on the portfolio of rural loans are less than 0.5%. Impaired loans, including 90 days plus in arrears are estimated by the ABA to be less than 3% of bank loans outstanding to agriculture.[31]

3.26 The ABA, however, was not disputing that there were people on the land struggling and that there were people being forced off the land, sometimes after multiple generations of working that land:

> We do acknowledge that there are farmers in specific areas and industries that are under financial pressure. In the case of Northern Beef Cattle

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30 Reserve Bank of Australia, *Submission 93*, pp. 2–3.

31 *Submission 109*, p. 6.

> producers their position has been obviously exacerbated by disruptive events such as the live export ban and more recent drought. In light of recent droughts in Western Australia and more recently in Northern Queensland it may be timely for Government to again review the effectiveness of changes made to drought programs and assistance provided. The impact of drought affects producers, at all levels, regardless of whether the[y] hold bank debt.[32]

3.27 Mr Steven Münchenberg, ABA, cited figures taken from the northern beef industry at the end of the 2014 financial year, where the banks had 1,258 customers in northern Queensland and of those, 43 were 90 days in arrears equivalent to 3.4 per cent.[33] Importantly, he acknowledged that there would be customers who were keeping up with their repayments 'through selling assets including stock'.[34] While not disputing that there were segments of the agricultural sector currently in severe difficulty, the ABA contended that:

> …the proposition of this bill is based on there being some form of nationwide problem. They may be solutions that are needed to be looked at in particular circumstances. But this bill, which would have serious implications for the risk assessment of lending to agriculture across Australia, is a systemic response to an issue that is not systemic.[35]

3.28 According to the ABA, government policy should be put in place to respond to rural debt.[36]

Particular sectors and rural debt

3.29 There is no doubt that rural debt levels have risen over the last decade. According to the *Agricultural Competitiveness Green Paper*:

> Most of the rise in gross debt over the last decade occurred prior to 2008 and debt has been relatively stable since then. Key drivers of the increase included lower interest rates, increasing farm scale, structural change towards more capital intensive operations, and the availability of interest-only loans…Higher debt in the 2000s was also supported by rising land values, with these often not backed up with higher returns that could be earned from that land.[37]

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32 Australian Bankers' Association, *Submission 109*, p. 6.

33 *Proof Committee Hansard*, 18 March 2015, p. 22.

34 *Proof Committee Hansard*, 18 March 2015, p. 23.

35 *Proof Committee Hansard*, 18 March 2015, p. 24.

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

37 *Agricultural Competitiveness Green Paper*, p. 35, https://agriculturalcompetitiveness.dpmc.gov.au/sites/default/files/green_paper.pdf (accessed 16 March 2015)

3.30 The Green Paper noted further that some farms were experiencing debt 'at unsustainable levels, at least during times of poor cash flow'. It indicated that impaired loans had risen over the last two years and accounted for around 3 per cent of loans nationally. This rate was slightly above levels experienced for other Australian businesses in 2010, following the Global Financial Crisis. Pointedly, however, it noted that:

> Impaired loans may be significantly higher than the national average in some parts of the sector and some geographical areas.
>
> …
>
> The northern Australian cattle industry has been particularly affected by financial stress—due to a combination of drought and the mid-2011 government-imposed disruption to live cattle exports to Indonesia, which resulted in lower cattle prices, falling pastoral property valuations and consequently higher debt-to-equity ratios.[38]

3.31 Indeed, the Australian Beef Association informed the committee that the cattle industry was 'severely damaged' and needed radical action if it were 'to be a productive, sustainable and Australian owned and operated industry'.[39] It indicated further that it was unlikely Queensland cattle producers would 'ever be able to repay the current debt out of income'.[40]

3.32 The Australian Beef Association drew on their members' experiences to highlight the size of the debt burden. It noted that in 2001 the average debt per head of cattle was $191, which had ballooned out to $727 per head in 2011.[41]

3.33 Mr Ben Rees, an economist with the rural debt roundtable, could not reconcile the evidence regarding rural debt given by the ABA and the various government departments and agencies with that of farmers with on-the-ground experience. He explained:

> I was a speaker, along with Dr McGovern, at the Winton crisis meeting on 5 December. The Catholic priest of Longreach…said there were at least 43 people in and around Longreach that he knew were either in receivership or at risk. On Monday, I took the opportunity of going into Miles to talk to our local government agent, who helps people when they become involved in difficulties. She identified 12 people either in receivership or close to it, and many more, she believed, were at threat.

38 *Agricultural Competitiveness Green Paper*, p. 35, https://agriculturalcompetitiveness.dpmc.gov.au/sites/default/files/green_paper.pdf (accessed 16 March 2015).

39 *Submission 55*, p. 11.

40 *Submission 55*, p. 6.

41 The Australian Beef Association explained that ' Debt per Head is derived by dividing the total Queensland Cattle Producers’ debt by the number of cattle in Queensland. Between 2001 and 2011 Queensland cattle numbers increased from 11.3 million and 12.6 million'.

> …Dr McGovern, Mr Walton and I have addressed a number of farmer meetings across Australia: a thousand people in Merredin, in Western Australia; 200 at Colac, in Victoria. I and Mr Walton addressed 70 at Hughenden in December 2013. Mr Walton was present. There were 500 members at Richmond, farmers, who attended. Dr McGovern and I addressed a meeting at Winton: 350 farmers. This idea that it is just confined to northern New South Wales and Queensland, to me, is pretty hard to believe.[42]

3.34 Clearly there is a mismatch in perceptions or understanding of the level and extent of rural debt. A major problem appears to stem from incomplete data on rural debt, and, while figures about aggregates are quoted, it would seem they mask the particular and serious difficulties facing certain sectors or regions in rural Australia.

Data on rural debt

3.35 In his submission, Dr McGovern stated that the overall rural financial condition was difficult to determine empirically due to the withholding or limited analysis of data.[43] Mr Walton stated simply that it was 'unclear how large the actual debt which is impaired or at risk'.[44] He stated:

> Full and accurate numbers seem very hard to acquire, reports by the banks that it is all ok flies in the face of ground truthed information. It is one of the shortcomings of the current information that clarity is not available. Whether the bankers are compelled to provide full reporting to the APRA [Australian Prudential Regulation Authority] is unclear, but for certain whatever data is available does not offer the requisite information for clarity around quantum.[45]

3.36 The RBA also observed that little public data were 'available on the performance of rural loans'.[46] In responding to the observations about the poor quality of data available on rural debt, the ABA noted that APRA's role in collecting data was 'very much focused on the stability of the banking system. It will only go to a level at which they are interested'.[47] Likewise, Treasury indicated that more data would be useful.[48]

3.37 Ms Schneider, ABARES, agreed that more information was 'always better than less information' and further that if ABARES had more information on levels of

42 *Proof Committee Hansard*, 18 March 2015, p. 35.

43 *Submission 129*, p. 1.

44 *Submission 128*, p. 14

45 *Submission 128*, p. 14.

46 *Submission 93*, p. 3.

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

48 *Proof Committee Hansard*, 18 March 2015, pp. 28 and 29.

debt, it would be able to analyse the situation better.[49] A recent concerted effort brought together ABARES, the Australian Bankers' Association, the Gulf Cattlemen's Association and the National Farmers' Federation to share data in order to gain 'a more accurate picture of rural debt, particularly for the Northern Queensland cattle industry'.[50] According to Mr Peter Gooday, ABARES:

> In terms of the region where the problem is most acute, it is those regions in the report we did with the ABA and the NFF: northern New South Wales, northern Queensland, south-west Queensland. It is obvious there that the proportion of farm receipts required to cover interest payments is substantially higher than the rest of the country. There is no doubt that there are issues there. In terms of industries that are most affected at the moment, the Beef industry stands out as one where, again, the proportion of receipts required to cover interest payments is higher than most other industries…[51]

3.38 Mr Steven Münchenberg agreed with the view that there was a gap in information and indicated that after the joint exercise in 2014, the ABA had approached the government and suggested that it would provide, on a regular basis, information on the state-by-state basis and on an industry-by-industry basis.[52]

3.39 Dr McGovern argued that the Reserve Bank was in a position where it could demand relevant information and 'not be fobbed off' and was also in contact with the bankers directly.[53]

Committee view

3.40 The committee notes the importance of having a sound understanding of the challenges confronting rural businesses and communities. The need to hold a meeting in 2014 when the rural debt situation in northern Queensland had already been well established indicates that Australia's decision makers have not been well prepared to make timely and informed decisions. Moreover, the RBA, ABA and ABARES recognised that more data on rural debt would be helpful.

Recommendation 1

3.41 The committee recommends that the Department of Agriculture and Treasury consult with the banking sector and the relevant bodies who have identified deficiencies in the current information available on rural debt. The purpose of the consultation would be to progress a suitable data collection method to ensure that the quality of data available to government on rural debt

49 *Proof Committee Hansard*, 18 March 2015, p. 16.

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

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

52 *Proof Committee Hansard*, 18 March 2015, p. 24.

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

would provide the information needed for decisions-makers to make timely and well-informed decisions.

Conclusion

3.42 The committee is grateful to the individuals who were willing to share their difficult experiences of managing businesses in regional Australia. While uncertainty and risk are shared by all businesses, the committee understands and appreciates the additional challenges agricultural enterprises and businesses reliant on them face.

3.43 The committee is mindful of the need for financial arrangements to be sustainable. It also notes that there was a divergence of views on the sustainability of Australia's rural debt. Based on the evidence before it, the committee observes that levels of debt and the ratio of rural debt-to-income clearly increased significantly between 2003 and 2008, and have remained high since then. However, increased indebtedness across other sectors in the economy has also occurred during this period. Annual growth in rural lending has slowed and rural interest payments as a share of rural income are currently significantly below the decade average. Even so, the committee understands that debt levels vary for different farm businesses, particularly for business that have encountered natural disasters and other challenges, and currently there are farming sectors under financial stress and in need of government assistance.

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.

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

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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.
>
> 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.
>
> 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.
>
> 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

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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.
>
> 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

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:
>
> (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

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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]

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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.

Chapter 5

Committee view

5.1 The level and sustainability of rural debt is a complex issue encompassing the absolute levels of debt that rural businesses are burdened with, the income and profitability of these businesses, and the lending practices of Australian financial institutions. It is clear that some owners of farming businesses and businesses reliant on farms are under severe stress due to financial hardship. The committee also acknowledges that the agriculture sector faces special challenges, such as natural disasters and market fluctuations. Operating conditions and debt-to-income ratios have, for a sustained period of time, been demanding for many rural businesses. Despite existing government assistance programs being based on an understanding of the circumstances rural Australia is experiencing, the committee is aware that consideration of a long-term plan addressing more fundamental problems is required. In this regard, the committee appreciates the overall objective of the bill.

5.2 Based on the evidence received during this inquiry, broad observations have been made in this report about the nature and state of rural debt in Australia. The committee wishes to express its gratitude to the individuals and organisations that took the time to make submissions on these issues. The committee also acknowledges there is some interest within the community in establishing an ARDB that would, among other things, be involved in financial arrangements entered into by enterprises in Australian agriculture or associated industries.

5.3 As a legislation committee tasked with examining the proposed ARDB, the committee must focus on the provisions of the bill. This restricts the committee to considering the merits of a very specific proposal—the establishment of an ARDB within the RBA. The committee has a number of concerns with the bill as outlined in the previous chapter. For example, it is not readily apparent why the RBA should be tasked with the role of facilitating or managing rural adjustment and financial reconstruction activities. The proposal outlined in the bill would, if implemented, represent a significant change to the role of the RBA. The nature of financial assistance provided to businesses by the Commonwealth would also fundamentally change. There is a clear need to ensure that capital is allocated efficiently to the most sustainable and productive businesses. The committee also notes the argument that the proposal has the potential to distort the market for rural finance and, depending on how it is implemented, to increase the cost of finance.

5.4 The funding arrangements proposed for the ARDB also raise important accountability issues. Assistance to industry should be provided transparently either through specific budgetary outlays or tax concessions. Rather than money for the ARDB being purposely appropriated, however, the bill seeks to use the RBA's existing capital. The RBA's reserves provide a capacity for the RBA to absorb losses when doing so is necessary to help ensure Australia's financial system remains strong. It is essential that the RBA has the reserves necessary for it to carry out these key operations.

5.5 The committee is certainly concerned about various challenges that parts of regional Australia now face. However, the committee is of the view that this bill is not an appropriate solution. Proposals such as this must be carefully developed and assessed, and should not be contemplated in isolation. The creation of a new Commonwealth entity could only be made following a comprehensive review of the nature and level of rural debt in Australia by a body expressly charged with such a task. A broader review would be able to receive evidence on and test various policy proposals for addressing problems and market failures that may exist. As outlined above, the committee is restricted to examining this particular bill.

5.6 Several comprehensive policy development processes that are considering matters relevant to this bill are currently underway. Of most direct relevance is the white paper on Australia's agricultural competitiveness that the government is currently developing. Among other things, the white paper will consider how market returns for farmers can be improved, as well as issues related to access to investment finance, farm debt levels and debt sustainability.[1] As part of the white paper process, on 20 October 2014 the government released a green paper. The green paper advised that the government has no plans to progress with a rural reconstruction bank that would provide concessional loans, such as an ARDB.[2] Rather, as the green paper explains, the government is seeking to develop an agriculture policy that will, among other things, increase returns at the farm gate.[3] The government invited submissions on the paper, including on policy ideas to improve access to finance.

5.7 Also, the Joint Select Committee into the Australia Fund Establishment was set up to consider whether a fund should be established to support rural and manufacturing industries. That committee will also consider issues relating to bankruptcy and insolvency laws. Clearly, this Select Committee has a much broader remit than inquiring into one specific mechanism intended to assist farmers gain access to affordable credit and to manage debt. While the evidence before the committee suggests that the establishment of the ARDB is not the most appropriate way to assist farmers, it highlighted the need for effective government intervention. Importantly, the inquiry opened up fruitful avenues that clearly warrant further and serious exploration. Indeed, rather than end the debate, this inquiry has enlivened the conversation about farming in Australia and how to provide finance more effectively

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1 Australian Government, 'Agricultural Competitiveness White Paper: Terms of Reference', https://agriculturalcompetitiveness.dpmc.gov.au/terms-of-reference (accessed 8 July 2014).

2 Australian Government, *Agricultural Competitiveness Green Paper*, 20 October 2014, https://agriculturalcompetitiveness.dpmc.gov.au/sites/default/files/green_paper.pdf (accessed 20 October 2014), p. 42.

3 Australian Government, *Agricultural Competitiveness Green Paper*, pp. vii–viii.

to farmers that would allow them to manage the feast and famine cycles that characterise the sector. This conversation needs to continue.

5.8 In addition to the white paper, this Joint Select Committee inquiry may also provide insights into rural reconstruction and development issues, and potential policy options that could provide an effective response. Consequently, the committee recommends that the Joint Select Committee on the Australian Fund consider the evidence presented during the inquiry into the Reserve Bank Amendment (Australian Reconstruction and Development Board) Bill 2013 and use it to inform its inquiry.

5.9 While the committee's position on the bill may disappoint those looking for immediate action, the committee cannot endorse a proposal such as the ARDB without being able to examine and assess alternative proposals. As noted in the previous chapter, the bill lacks detail. Other policy processes already underway are better placed to consider the issues that led to the bill being introduced. However, the committee would like the evidence it has gathered during this inquiry to contribute to policy discussions taking place elsewhere.

Recommendation 2

5.10 The committee requests that, during its deliberations on the establishment of a fund to support rural and manufacturing industries, the Joint Select Committee into the Australia Fund Establishment take into account the issues raised in the submissions received during this inquiry.

Recommendation 3

5.11 The committee recommends that the Senate not pass the bill.

Senator Sean Edwards
Chair

Dissenting Report by Senator Nick Xenophon

Rural debt: Crisis, what crisis?

1.1 Historically speaking Australia has had a proud tradition of agricultural production. It was not uncommon for families to own and operate farms for generation upon generation. However, a multitude of factors has contributed to the struggles of rural and regional Australia. The high Australian dollar, falling commodity prices, drought and extreme weather events, lack of support from State, Territory and Federal Governments and changes to lending practices following the Global Financial Crisis have all made participation and survival in the agricultural sector increasingly difficult to achieve. As a result, rural debt has skyrocketed. Indeed, Mr Ben Rees (an economist) described rural debt as 'taking on a life of its own' since 1993.[1]

1.2 At the outset I acknowledge the key role the Hon Bob Katter MP has played in instigating the concept of the ARDB, and the work of my co-sponsor of this bill, Senator John Madigan. Most importantly, I thank the submitters for sharing their powerful personal stories.

The need for the Australian Reconstruction and Development Board

1.3 The Reserve Bank Amendment (Australian Reconstruction and Development Board) Bill 2013 aims to address this debt crisis by creating a 'specific board under the umbrella of the Reserve Bank, with the aim of promoting reconstruction and development in rural and regional areas'.[2] This board would be called the Australian Reconstruction and Development Board ('ARDB'), and it would be tasked with developing and implementing rural reconstruction and development policy. As the Explanatory Memorandum to the bill explains:

> Rural Australia is struggling under an insurmountable debt burden, characterised by low farm income and lending practices of financial institutions in deregulated financial markets. In 1980, debt in Gross Value Farm Production was at 32% and this has escalated to historically high levels of debt, reaching 135.4% in 2012. With escalating debts, many farms and producers are facing foreclosures. Forced sales are widening loan-to-value ratios, leading to a risk of 'fire sales', which could precipitate a raging financial contagion that may not be contained to rural and regional Australia. In circumstances of uncertainty and risk to nationally important agriculture and associated industries, reconstruction is critical to re-establish a sound financial basis, and development funds to maintain and sustainably develop capabilities.[3]

1.4 The concept of an ARDB is not entirely new in Australia. The Commonwealth Development Bank ('CDB') provided finance to primary production

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1 Mr Ben Rees, *Submission 2*, p. 2.

2 Senator Xenophon, *Senate Hansard*, 5 December 2013, p. 952.

3 *Explanatory Memorandum*, p. 1.

and small industry undertakings between 1960 and 1974 where funding was desirable but not obtainable through other means on suitable or reasonable terms.[4]

1.5 Additionally, the former Rural Credits Department of the Reserve Bank of Australia previously provided seasonal credits to statutory marketing authorities and rural cooperative associations for projects associated with primary production.[5] The RCD was established at a time when 'the size of the rural sector meant that its demand for seasonal finance was very large relative to the capacity of private financial markets'.[6] However, the RCD was disbanded in 1988 as by that time the private banking sector had adjusted to seasonal rural demand for credit.

1.6 While the extent of this adjustment may have been satisfactory to cater to the needs of rural and regional Australia, the needs of borrowers in the agricultural sector are once again not being met by the private banking sector. During the committee's public hearing Mr Walton described this mismatch in more detail:

> …there is a heavy mismatch between the available capital arrangements between lenders and borrowers in agriculture. As these governments that we have had in Canberra for a number of years have removed various risk ameliorating systems—the single desk, drought relief and so on—agriculture has had to carry a higher level of risk and there has been no effective adjustment in the arrangements between financiers. So financiers are still lending the same product they would have been lending ages ago, years and years ago. They seem to be quite inappropriate to the risk taken today in agriculture. Mind you, I think that we have to find a new way of dealing with risk—and there are some people out there doing their very best in that line.[7]

1.7 In his submission, Dr Mark Govern described some of the reasons commercial banking arrangements have not been suitable for farmers:

> Farm funding has become very difficult for many in the last year. The use of standard mortgages primed the current illiquidity in farm financing. Debt funding grew rapidly since 2000 despite obvious misfits between:
>
> - mortgages that by design assume stable incomes and changing production and market realities;
> - a rising disconnect between incomes and servicing obligations;
> - expected and actually realized performances.[8]

1.8 The level and extent of rural debt is an issue on which several submitters disagreed. Despite evidence from Treasury that rural debt had trebled over the past 15 years,[9] and the RBA's acknowledgement that rural debt had more than doubled over

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4 Commonwealth Banks Act 1959, C2004C02847 (27 October 1993), ss. 72, 73.

5 Reserve Bank of Australia, *Submission 93*. p. 4.

6 Reserve Bank of Australia, *Submission 93*. p. 4.

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

8 Dr Mark McGovern, *Submission 129*, p. 1.

9 *Submission 133*, p. 5.

the past decade,[10] the Australian Bankers Association (ABA) refused to characterise the current situation as a 'rural debt crisis'.[11] Concerns about the lack of information on debt levels were described by Mr Walton in his submission:

> Full and accurate numbers seem very hard to acquire, reports by the banks that it is all ok flies in the face of ground truthed information. It is one of the shortcomings of the current information that clarity is not available.[12]

1.9 While it may not be possible to put an exact figure on the amount of families in financial crisis, the tragic consequences of rural debt and the lack of access to finance were described by Mr Walton:

> The phenomenon of suicide haunts our communities; this is often the end game of economic failure. We hear with disturbing regularity that one or more of these events have occurred in this district or that. The national Rural Health Alliance (May 2009) suggested men in regional and remote Australia are '1.3 to 2.6 times more likely to end their lives by suicide than urban counterparts'. They went on to list the first two factors relevant as financial insecurity and stress caused by drought, flood and bushfires. That authorities publicly spin the need for councillors to resolve this problem is a terrible insult, when must of this is a result of failed industry policy leading to empirically demonstrated low profits and finally overbearing debts and a feeling of complete abandonment. We can do better; we must do better…[13]

1.10 NOTE: If anyone reading this report who is affected by rural debt believes they or someone they know may be at risk of self-harm, it is important to seek advice from beyondblue on 1300 22 4636 (www.beyondblue.org.au) or Lifeline on 13 11 14 (www.lifeline.org.au).

The functions of the ARDB

1.11 The ARDB's reconstruction and development policy will be determined by the ARDB's three tasks: the facilitative task, the development task and the reconstructive task which are described in the bill's Explanatory Memorandum:

- The facilitative tasks consists of researching, reporting on and helping to develop the resilience, capabilities and ongoing financial viability of Australia's food and natural fibre systems, and any other Australian industries or sectors that the (ARDB) has identified as being at risk. The Bill also provides that this task must be undertaken in a timely way.
- The development task consists of contributing to the development of Australian agriculture, associated industries and infrastructure by developing and offering financial arrangements and reviewing financial arrangements.

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10 *Submission 93*, p. 2.

11 *Submission 109*, p. 6.

12 *Submission 128*, p. 14.

13 *Submission 128*, pp. 4–5.

- The reconstruction task requires the (ARDB) to fairly, reasonably and effectively reduce or eliminate the debilitating impact of certain financial arrangements. This relates to financial arrangements which, because of certain conditions or circumstances, threaten or reduce the ongoing viability or sustainability of Australian agricultural enterprises or associated entities. These conditions or circumstances…include design, inadequate evaluation, market or organisational failures, seasonal conditions, or any other adverse circumstances.[14]

1.12 An analogy for the proposed ARDB could be drawn with South Australia's HomeStart Finance. Since its establishment in 1989, HomeStart Finance has helped 63,500 South Australian households into home ownership, the overwhelming majority of whom would not have been able to obtain finance through traditional lenders. HomeStart Finance demonstrates how targeted assistance to a specific customer group benefits not only individuals and families, but the economy as a whole. Just as HomeStart's functions and policies help to achieve long term housing strategies in South Australia, filling a market void, the ARDB will identify what needs of farmers and producers are not currently being met by the private banking sector and will develop meaningful and effective responses to those needs in a timely manner.

Major lenders are not responding to this crisis

1.13 The conduct of Australia's big banks must also be brought into question, particularly in relation to their responses to customers who are in financial distress. Journalist Colin Bettles recently reported on Bruce Dixon, a Western Australian sheep and grain producer who was confronted by receivers appointed by the ANZ a day after defaulting on his multimillion dollar loan with the bank. By this time the ANZ had already taken steps to obtain possession of the property, and the receivers had been instructed to speak with Mr Dixon about a timeline for his exit. Mr Dixon also alleges the receivers made veiled threats, stating that they were entitled to call the Tactical Response Unit if he refused to leave.[15]

1.14 Mr Dixon stated he defaulted on his loan (following an agreement made with the ANZ in August 2014) as his debt levels rose by $500,000 in the space of 8 months due to the high interest rate applied to his account.[16]

1.15 In response to the actions of the receivers, the Rural Action Movement allegedly 'impounded' the receivers' vehicle by surrounding it with haystacks. Such a measure is clearly reflective of the desperation and frustration many farmers are feeling about the heavy handedness of banks in appointing receivers.

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14 *Explanatory Memorandum*, p. 4.

15 Farm Online, Receivers defend foreclosure procedures, 30 March 2015, available at http://www.farmonline.com.au/news/agriculture/general/news/receivers-defend-foreclosure-procedure/2727742.aspx?storypage=0 (accessed 30 March 2015).

16 Farm Online, Receivers defend foreclosure procedures, 30 March 2015, available at http://www.farmonline.com.au/news/agriculture/general/news/receivers-defend-foreclosure-procedure/2727742.aspx?storypage=0 (accessed 30 March 2015).

Conclusion

1.16 Whether the banking industry wants to admit it or not, Australia is in the midst of a rural financial crisis. The Reserve Bank Amendment (Australian Reconstruction and Development Board) Bill 2013 would go some way to responding to this crisis by providing a framework through which the RBA can address the needs of farmers and producers to ensure the long term survival of our agricultural industry.

1.17 We cannot rely on broad measures such as those contained in Basel III to remedy this situation. As Dr McGovern told the committee at its public hearing:

> Basel III will worsen the situation potentially, because it is saying that, if the banks get it right, we can manage the banks, but they are not saying what happens to the economies. What you have to remember is we have got an introverted banking system which looks after the solvency of the banks and not the prosperity of the people—the Reserve Bank has both as a joint responsibility.[17]

1.18 Dr McGovern continued:

> The legislation is already there; it needs an amendment so we can deal with today's problems and look forward. We have an opportunity to free up things and avoid needless loss of wealth and capacity. The one that really worries me is: classically what happens in these situations is that you lose critical, productive capacity. The country cannot export what it once did; it cannot feed itself as well as it once did; it then becomes less viable as a nation. That is the sort of thing that Basel III does not go anywhere near. Problems are systemic.[18]

1.19 Without appropriate Federal Government support we are at risk of jeopardising not only our ability to feed ourselves, but Australia's economy as a whole.

Recommendation 1

1.20 That the Reserve Bank Amendment (Australian Reconstruction and Development Board) Bill 2013 be passed.

Senator Nick Xenophon
Independent Senator for South Australia

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

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

APPENDIX 1

Submissions received

Submission Number	Submitter
1	Mr Charles Nason
2	Mr Ben Rees
3	Mr W R Loughnan
4	Mr and Mrs Wayne and Sandra Birchmore
5	Mr Ron Wadforth
6	Mr Shantanu Rastrapal
7	Mr Robert Walton
8	Hon Ken Baston MLC, WA Minister for Agriculture and Food
9	Mr Rob Atkinson
10	Ms Carol Mackee
11	Mr Simon Kensit
12	Ms Heather Allen
13	Mr and Mrs Allen and Barbara Clark
14	Mr and Mrs Benn and Robyn Brown
15	Mr and Mrs Bill and Gillian Mott
16	Ms Sue Brighenti
17	Ms Kate Harrington
18	Ms Rosemary Coggan
19	Mr Geoff Birchnell
20	Ms Tricia Fea
21	Mr David Wells

22	Ms Caroline Ferris
23	Mr Hugh Hamilton
24	AgForce Queensland
25	Name Withheld
26	Mr Andrew Butler
27	Mr and Mrs Kevin and Emma Greensill
28	Mr Matt Welsh
29	Ms Belinda Duncan
30	Mr and Mrs Roger and Briony Hoare
31	Mr and Mrs David and Sarah Birchmore
32	Ms Susan Allan
33	Ms Sherrill Stivano
34	Mr John Whitehead
35	Ms Helen Roth
36	Ms Erin Lawless
37	Ms Cherie Fenwick
38	Name Withheld
39	Mr Sam Hamilton
40	Ms Lyndal Hamilton
41	Mr and Mrs Rodney and Margaret Hamilton
42	Mr John Carter
43	Name Withheld
44	Mr Graham Hitchener
45	Mr Mark Brown
47	Mr Peter Randall

48	Not allocated
49	Mr Richard Knights
50	Mr and Mrs Matt and Fiona Brown
51	Ms Roma Britnell
52	Mr James O'Keefe
53	Mr Steve Hossen
54	Mr Ian Tincknell
55	Australian Beef Association
56	Mr Roger Crook
57	Ms Alison Murphy
58	Muntadgin Farming Alliance of Western Australia
59	Ms Jacqueline Curley
60	Wheatbelt Country Supplies
61	Mr and Mrs Robbie and Jo-Anne Bloomfield
62	Ms Frances Hamblin
63	Mr Greg McNamara
64	Mr and Mrs Pat and Diane O'Keefe
65	Ms Kathryn Baxter
66	Mr and Mrs Annette and Ronald Baxter
67	Mr and Mrs Christopher and Michelle Walton
68	Mr Clint Della Bosca
69	Mr Val Cormack
70	Government of South Australia
71	Mr Greg Darcy
72	Mr and Mrs Mark and Kathryn Liddle

73	Mr Philip and Tania Curr
74	Mr Leighton Hamlin
75	Mr Gregory Kenney
76	Mr Frank Battistel
77	Name Withheld
78	Mr and Mrs Harold and Sally Harris
79	Ms Pamela Kensit
80	Mr John Kerlin
81	Ms Shelly Bird
82	Mr Peter Ryrie
83	Mr Stephen Jellie
84	Mr Robert Lethbridge
85	Mr William Bensted
86	Mr and Mrs Elwyn and Joanne Rea
87	Mr and Mrs Michael and Louise McCosker
88	Ms Marion Jarratt
89	Queensland Murray-Darling Committee Inc
90	Mr Des McKinnon
91	Griffith City Council
92	Mr Gerard Shadbolt
93	Reserve Bank of Australia
94	Ms Sophia Tomkins
95	Mr Tom Harris
96	Hon Bob Katter MP
97	Mr Xavier McKinnon

98	Regional Infrastructure
99	Ms Bernadette McKinnon
100	Mr Ken Wilson
101	Mrs Anita Lethbridge
102	Mr Peter Honnef
103	NT Buffalo Industry Inc.
104	Mr Norman Hunt
105	Name Withheld
106	Ms Jane McPhee
107	Name Withheld
108	Mr Rob Katter MP
109	Australian Bankers' Association Inc.
110	Mr Gary Smith
111	Mr Alistair Hamblin
112	Australian Canefarmers
113	Mr Bart Brighenti
114	Mr Geoffrey Morrow
115	Mr and Mrs Robert and Michelle Devine
116	Mr Mike Hamblin
117	Mr and Mrs Russell and Mandy Bishop
118	Empirical Capital Pty Ltd
119	Ms Rhonda Smith
120	Mr Karrinjeet Singh-Mahil and Brian Schuler
121	Daydawn (Nashdale) Pty Ltd
122	Ms Wendy Bell

123	Mr Timothy Cashmore
124	National Farmers' Federation
125	NSW Farmers Association
126	Australian Dairy Farmers
127	The Western Australian Farmers Federation Inc. (WAFarmers)
128	Mr Rowell Walton
129	Dr Mark McGovern • Additional Information
130	Barossa Mid-North Co-operative Dairymen Limited
131	CT Healthcare Pty Ltd
132	Mr Grant Bird • Supplementary submission
133	The Treasury • Updated version received on 4 March 2014
134	Name Withheld
135	Mr Leonard Clampett
136	Mr and Mrs Michael and Judy Treloar
137	Ms Jeanine McRae
138	Mr Chris O’Keefe
139	Mr Pete Mailler
140	Mr Leighton Hamblin
141	Mr Chris O'Keefe
142	Mr Garth Power
143	Confidential
144	Confidential
145	Confidential

APPENDIX 2

Additional information received

1. Documents provided by Mr Mark McGovern following the public hearing held in Canberra on 18 March 2015.

2. Additional information received from Ernst and Young on 24 March 2014.

3. Additional information received from the Australian Bankers' Association Inc. on 30 March 2014.

Tabled documents

4. Document tabled by Mr Rowell Walton at a public hearing held in Canberra on 18 March 2015.

5. Document tabled by Mr Ben Rees at a public hearing held in Canberra on 18 March 2015.

6. Document tabled by the Department of Agriculture at a public hearing held in Canberra on 18 March 2015.

7. Document tabled by the Department of Agriculture at a public hearing held in Canberra on 18 March 2015.

Answers to questions on notice

1. Answers to questions on notice from a public hearing held in Canberra on 18 March 2015, received from the Reserve Bank of Australia on 20 March 2015.

2. Answers to questions on notice from a public hearing held in Canberra on 18 March 2015, received from Mr Ben Rees on 23 March 2015.

3. Answers to questions on notice from a public hearing held in Canberra on 18 March 2015, received from the Department of Agriculture on 26 March 2015.

APPENDIX 3

Public hearings and witnesses

CANBERRA, 18 MARCH 2015

AYLMER, Mr Christopher Patrick, Head of Domestic Markets Department, Financial Markets Group, Reserve Bank of Australia

GOODAY, Mr Peter, Assistant Secretary, Farm Analysis and Biosecurity Branch, Australia Bureau of Agricultural and Resource Economics Sciences, Department of Agriculture

HOCKEY, Mr Kurt, Manager, Financial System Assessment Unit, Treasury

McGOVERN, Dr Mark Francis, Senior Lecturer, Economics and Finance, QUT Business School

MÜNCHENBERG, Mr Steven, Chief Executive Officer, Australian Bankers' Association Inc.

PADOVAN, Mr Nico, Acting Deputy Secretary, Department of Agriculture

POWER, Mr Trevor, Principal Adviser, Financial System and Services Division, Treasury

REES, Mr Ben, Economist, Rural Finance Roundtable Working Group

SCHNEIDER, Ms Karen, Executive Director, Australian Bureau of Agricultural and Resource Economics and Sciences, Department of Agriculture

WALTON, Mr Rowell, Chair, Rural Finance Roundtable Working Group

WILLOCK, Ms Anna, Acting First Assistant Secretary, Agricultural Adaptation and Forestry Division, Department of Agriculture

APPENDIX 4

Answers to questions on notice received from the Department of Agriculture

Department of Agriculture

Committee inquiry: Senate Economics Legislation Committee inquiry into the Reserve Bank Amendment (Australian Reconstruction and Development Board) Bill 2013

Date Held: 18 March 2015

Question Taken on Notice

Question:

Senator XENOPHON: Firstly, why didn't we get a submission on this earlier? Can you explain that to me?

Mr Padovan: I cannot answer that one.

Senator XENOPHON: Who can? Maybe you can get back to me as to why there was a decision made not to provide a submission to this inquiry. That would be useful. Dr McGovern says that there is very little public data that is available on the performance of rural loans. Ms Schneider, do you disagree with that? Do you believe that there can be a more comprehensive picture of rural loans other than has been provided to date?

Answer:

The department does not routinely submit to all inquiries and takes into consideration; whether the department is the lead agency, information currently available and its capacity to contribute.

Department of Agriculture

Committee inquiry: Senate Economics Legislation Committee inquiry into the Reserve Bank Amendment (Australian Reconstruction and Development Board) Bill 2013

Date Held: 18 March 2015

Question Taken on Notice

Question:

Mr Padovan: I would have to go back and look at the timings around Basel III.

Senator XENOPHON: Could you take that on notice as to when Treasury and your department will be having discussions about Basel III and the impact on rural debt.

Answer:

The current prudential framework is based on the principle that banks are required to hold more capital against riskier lending. Overall compared with residential mortgages, business loans may have higher risk weightings because of the additional risks present.

The Basel III capital framework sets out internationally-agreed minimum requirements for higher and better quality capital for banks globally. The Australian Prudential Regulatory Authority's application of Basel III came into effect in Australia in January 2013 and has been largely implemented.

Treasury is continuing to monitor global developments in capital rules and is consulting with industry on the recommendations in the Financial System Inquiry. Treasury has indicated that it will engage with the Department of Agriculture as regulatory standards are progressed.

Department of Agriculture

Committee inquiry: Senate Economics Legislation Committee inquiry into the Reserve Bank Amendment (Australian Reconstruction and Development Board) Bill 2013

Date Held: 18 March 2015

Question Taken on Notice

Question:

CHAIR: But you really do not know whether you are replicating what other countries like Canada and the US are doing in this space. Can you have a look at that? Can you have a look at where you are at variance with those models that operate in those two bodies and perhaps give us a one-page brief, on notice?

Answer:

The Department of Agriculture has worked with Treasury to provide the following high-level summary based on publicly available information of the current farm credit systems in the United States of America and Canada.

US Farm Credit System (FCS) and Farm Credit Canada (FCC): comparisons with Australian Government Concessional Loans

- **US Farm Credit System (FCS)**
- The FCS was established in 1916 to provide below market-cost loans and credit to the US agriculture sector. It operates as a nationwide network of cooperative borrower/farmer owned, government-sponsored lending institutions. The cooperatives were created to spread risk and ensure the FCS was only partially underwritten by the US government.
- The US Federal Agricultural Mortgage Corporation, commonly known as 'Farmer Mac', was established in 1987 as part of the FCS, as the 1980s farm recession sent the government-backed FCS into crisis. It operates as a secondary credit market of cheap liquidity and lending capacity for FCS lenders, so it can meet demand from the agriculture sector for credit and long-term loans at stable interest rates and terms.
- Farmer Mac conducts its business primarily through two programs:
    - Farmer Mac I, in which Farmer Mac purchases, or commits to purchase, qualified agricultural or rural housing mortgage loans, or obligations backed by qualified loans
    - Farmer Mac II, in which Farmer Mac purchases the portions of qualified loans that are guaranteed by the U.S. Department of Agriculture

- Farmer Mac guarantees the timely payment of principal and interest on securities backed by qualified loans or guaranteed portions, and either retains those securities in its portfolio or sells them in the secondary capital markets.
- Farmer Mac also purchases non-performing loans from stressed lenders and provides US Government guarantees on those loans to prevent the cost of credit rising in the FCS and the system becoming unsustainable as it did in the 1980s.
- Farmer Mac does not lend directly to farmers, but effectively acts as a 'lender of last resort' given it can purchase non-performing loans from other lenders.
- There is risk that, as a holder and guarantor of non-performing loans, ongoing cheap credit creates an artificial market of low cost loans that are not viable in the long term.

- **Farm Credit Canada (FCC)**
- Farm Credit Canada (FCC) is Canada's largest provider of business and financial services (including loans) to farms and agribusinesses. FCC is financially self-sustaining, raising funds on public markets, as well as borrowing from the Canadian Government.
- It is argued that FCC operates on a semi-commercial basis, as it borrows from the Canadian Government at preferential rates or issues debt backed by it. It is therefore able to fund riskier loans as the expected return, minus funding costs, is higher than for private competitors, and provides loan products which have higher risks of default (i.e. those with long amortization periods, higher loan-to-value ratios, and interest-only periods).
- FCC argues it is not a lender of last resort as it charges a premium on its lending, assesses credit history, past/projected financial performance, off-farm income and security. It argues it should not become a lender of last resort as it would expose taxpayers to more risk; its current practice of lending to varying sized customers and sectors spreads risk.
- FCC provides specialised and personalised business and financial services and products to farming operations, including family farms, and to those businesses in rural Canada, including small and medium-sized businesses, that are businesses related to farming and that provide the inputs to and outputs from primary production and young farmers (below the age of 40).
- The FCC product portfolio includes: lines of credit, crop input finance, livestock purchases, equipment finance, farm transfer finance, land and building purchase, environmental solution finance to assist in switching to more environmentally sound practices and renewable energy resources. There are various intermediate and long-term loans, with lending periods as long as 29 years

- **Australian Government Concessional Loans Schemes**
- The Australian Government's concessional loans provide short-term, targeted assistance to farm businesses suffering financial hardship but which have sound prospects of returning to commercial viability.

- The two drought-related concessional loans schemes are targeted at those farm businesses experiencing significant financial impacts due to circumstances that are outside the ability of a farm business to reasonably prepare for, manage through and recover from.
- The loan can be for no more than 50 per cent of a farm business’s debt; is limited to debt restructuring and/or productivity enhancements; is for a maximum of five (Farm Finance and Drought Concessional Loans Schemes) or ten years (Drought Recovery Concessional Loans Scheme); must be repaid in full at the end of the loan term.

Department of Agriculture

Committee inquiry: Senate Economics Legislation Committee inquiry into the Reserve Bank Amendment (Australian Reconstruction and Development Board) Bill 2013

Date Held: 18 March 2015

Question Taken on Notice

Question:

CHAIR: I would extend on that, Senator Madigan. Australian people regard the security of their food as a very high priority. In the context of berries recently, they would be somewhat shocked if they felt that the Australian government was not supportive of continuing a vibrant industry. We are going to have to wrap up shortly, but can you tell me the cost of the concessional loan scheme to the Australian taxpayer?

Answer:

Answer: The net cost of the concessional loans schemes (Farm Finance, Drought and Drought Recovery) to the Australian taxpayer over financial years 2013-14 and 2014-15 is $22.105 million. The actual cost in the out years of the programmes will be determined by the level of uptake under each scheme and levels of default and/or write-off.