FMDs a vital tool in Government's farm financial risk management kit

Farming in Australia is often not easy even at the best of times. At the worst of times, government assistance is sometimes necessary. As evidenced by the fluctuations in farm income subsequent to recent droughts and natural disaster events, even the most financially resilient farm businesses can be put under severe pressure and require government intervention.

In 2020, the AFI participated in a multi-organisation project coordinated by the National Farmers' Federation investigating different aspects of risk management in Australian agriculture; i.e. insurance markets, hedging options, the place of mutuals and cooperatives, education and awareness, off-farm income and government policy.

The Institute's research identified and described Australian Government farm financial risk management measures to make recommendations on how policy measures could be improved.

Government-provided programs in Australia remain important in helping at an individual enterprise level; for example, the **Farm Management Deposit (FMD) scheme** increases effective management of financial risks by providing a tax effective mechanism to build up cash reserves to cope with cash flow fluctuations.

However, the role of Government in provision of risk management options is fraught. Questions consistently arose throughout this and previous AFI research (Laurie et al., 2019) around the role for Government in stimulating the risk management product market where there is now market failure or immaturity.

Project findings

Awareness and consistency

A comprehensive survey was conducted by the project coordinators which included questions on policy interactions with agricultural risk management.

The project survey questioned farmers about their awareness and participation in a range of government programs that address farm financial risk management. Around two-thirds of participants answered one or more of these questions. Those who responded to specific questions about awareness of options indicated that there is a **high level of awareness of FMDs** (100%) and accelerated depreciation for fencing fodder and water facilities (91%) There was also a strong awareness of Farm Household Support (78%) and Rural Financial Counselling (91%). It is notable that FMDs and other taxation measures have been in place for several decades, as have the government emergency support measures, which have been widely promoted during several droughts and other extreme events.

The more recently introduced measures, or where administrative arrangements have been recently altered (including concessional loans and support for education about risk management), are less widely understood. The awareness of loans available from the RIC and the Emergency Water Infrastructure Grants was 67-70%. There was a low awareness in the educational rebate for the Managing Farm Risk Program (37%).

The participation rates in those programs that are subject to eligibility criteria was generally low (less than 10%); 32% of respondents indicated they had held FMDs in the past five years and 43% indicated that had used the accelerated depreciation measures in the past five years[1].

Barriers to awareness of government programs seems mostly to be associated with recently introduced or transitory programs, such as the educational rebate for the Managing Farm Risk Program. **Longstanding measures, such as FMDs and accelerated depreciation, are well understood.** It is uncertain whether uptake is limited by other than eligibility as a large proportion of respondents indicated they had not applied for most of the programs in the last five years[2].

Priority policy areas

Government policies aimed at addressing risk in Australian agriculture have a long and chequered history. While a range of government programs intended to improve management of financial risks are available to Australian farmers, there is little evidence to indicate that the majority of past policies can be considered successful in smoothing the volatility inherent in the sector.

The continuance of ad hoc policy responses to periods of adverse climatic conditions (particularly drought) is an indication that policy settings are still not delivering a predictable, stable operating environment for agriculture, in which Government intervention delivers the most efficient and fair distribution of taxpayer funds. In many cases, these ad hoc and often politically-motivated responses cause perverse and distortionary results within the sector.

Australian governments are already spending billions of dollars on ad-hoc risk mitigation through drought payments and other emergency measures. If Government is to consistently address risk in the broadest sense across the greatest number of subsectors, a better approach would be to investigate and **support measures which enable and extend best-practice farm business management** as widely as possible. It is the Institute's opinion that **FMDs** are an important weapon in the farm business management arsenal.

Australian governments are already investing significantly in alleviating the consequences of production, market and institutional shocks in Australian agriculture. A thorough examination of the cost-benefit of that investment, compared to a more **proactive approach** which prioritises the stimulation of financially resilient and prepared farm businesses (which have access to cash reserves, income-smoothing measures and mature insurance markets as risk management levers) will enable a more efficient spend of the public dollar.

Investing in RD&E to improve productivity and profitability in a changing climate, negotiating and maintaining beneficial trade arrangements and creating efficient infrastructure for supply chains, results in a profitable, resilient farm sector – thus enhancing the ability of the businesses that make up that sector to use profit/equity to mitigate risk (e.g. via FMD-type arrangements).

The research project also investigated the agricultural risk policy frameworks of other countries to provide insight about alternative policy response options. It is important to recognise that the interventions aimed at redressing agricultural risks which are by most foreign governments largely fail to do so. These interventions have altered the structure and efficiency of their agricultural industries for the worse and are completely inappropriate to agriculture in Australia.

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[1] NB: No conclusions can be drawn from these responses as the respondents were not randomly selected.

[2] This may be because they judged they were ineligible, or were discouraged from applying for other reasons such as complexity of the application process or awareness of specifics of the applicability to their circumstances.

Report recommendations

The research presented for the project report was analysed under the principle that Australian agriculture operates within the socioeconomic context of a democratic, open-market economy. This implies that the role of a government working to maintain such an economy is to:

- promote and maintain social equity,
- allow competitive markets to be the primary driver of the distribution of land, labour and capital for the production of goods and services,
- maintain regulations that deliver efficient markets for goods and services, and
- push against forces that contribute to social and economic instability.

This principle was applied to both international and Australian learnings, resulting in four major themes for recommendations:

1. **Focus on families:** The preferred government policy regime addressing risk in Australian agriculture should focus on assisting individuals and families who are engaged in farm businesses.
2. **Incentivise preparation:** Policies directed towards farm businesses need to focus on incentives for preparation, innovation in risk mitigation, and an ability to **smooth variability in income generation (e.g. via FMDs).**
3. **Remove distortionary outcomes:** Increased investment in Government programs which assist individuals and families and incentivise preparedness can be achieved through the removal of measures that create perverse and distortionary outcomes.
4. **Improve data collection:** A rational analysis of the success or otherwise of existing measures would be aided by a commitment from State and Commonwealth Governments to collect appropriate data for the purpose of evaluating the impact of risk management and drought support programs.

The many iterations of drought and disaster relief policies in Australia have perpetuated a chasm of uncertainty for farmers regarding how they are expected to address the most severe weather risks. The central philosophical proposition - that there is a severity of weather events which is beyond what a well-managed business can reasonably expected to provide for - is impossible to use as a basis for policy action. Reliance on this policy philosophy continues to discourage action to mitigate the risks, rewards management inaction by farmers, crowds out any potential commercial products that may assist farmers, and creates gross inequities between various cohorts of farmers and between farmers and other taxpayers.

Long-term viability of Government risk measures

The AFI considers that the key requirement for long-term viability of Government farm financial risk management measures is **clarity of the policy and consistency in its delivery** across all levels of Government. They must also not violate reasonable standards of economic efficiency and equity across agriculture and the Australian community.

The Government measures that directly address financial risk management – i.e. **FMDs** and various investment incentives – have for the most part demonstrated long-term viability because they meet all these criteria.

Drought policy has seemingly failed the test of long-term viability to date, having been revised every 10-15 years over the past half century. Historic policies have been vague in how they would apply in individual circumstances, eligibility criteria have not been transparent, and many measures have been criticised for their inequitable treatment of farmers facing similar circumstances.

In contrast to the uncertainty generated by ad hoc subsidies and various concessional finance arrangements, the existing **income averaging arrangements for farm businesses** are longstanding, sustainable and are available to all primary producers, and should be maintained. These taxation provisions are essential to redress an inequity that would otherwise exist between farmer taxpayers (and some other occupations) who have fluctuating incomes, and the majority of taxpayers who have more stable annual incomes.

The AFI considers that the Farm Management Deposit (FMD) scheme should be maintained as a mechanism that also facilitates smoothing of income and tax liabilities. However, it has been noted that the flows of FMDs appear to be unresponsive to serious droughts and other events which would be expected to trigger withdrawal of deposits in order to smooth income flows within farm businesses. Further analysis of how FMDs are being utilised is required to determine whether the scheme is fulfilling its original intentions or whether modifications are required to improve its effectiveness.

The complete report encompassing a synthesis of all six sub-projects prepared by Pottinger will be released in 2021.

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