

AFI submission on the operation of the Regional Investment Corporation Act

Addressing the need for the RIC as a mechanism to deliver nationally consistent concessional finance to support the long-term strength, resilience and profitability of Australian farm businesses.

Summary

As an organisation dedicated to promoting policy solutions which maximise the economic and social wellbeing of farmers, the Australian Farm Institute (AFI) supports the RIC's *intended function* to provide consistent financial support to regional Australia. Economic resilience is a key pillar in ensuring a sustainable future for Australian agriculture (McRobert et al., 2023).

Government-provided programs in Australia such as concessional loans are important tools in helping the agricultural industry manage financial risk at an *individual enterprise level*, by providing farm businesses with a mechanism to build up reserves to cope with cash flow fluctuations. The utility of these loans has been displayed in recent times of significant environmental challenges.

However, the role of Government in the provision of risk management options for agriculture is fraught, and concessional loans are not excluded from this.

Research conducted by the AFI has concluded that concessional lending and interest rate subsidies for agriculture do not result in overall socioeconomic benefits. As noted in Tune's Independent Review of the RIC:

'This perpetuation of lending at concessional rates is a major risk, as it is likely to impede appropriate structural adjustment in the agriculture sector and undermine the government's policy objective of fostering self-reliance and long-term drought resilience. In addition, it suggests that the ability to repay the loans is at risk 'down the track', thereby increasing financial risk for the RIC and the government.' (Tune, 2021)

Instead, the Commonwealth would better serve farmers in managing risk – and more effectively deploy its resources – by investing more in farm business management education and extension, strongly supporting RD&E to improve ag productivity and profitability in a changing climate, negotiating beneficial trade arrangements and creating efficient infrastructure for supply chains. These actions will enhance the ability of farm businesses to utilise profit/equity to mitigate risk and smooth income, without hindering structural adjustment.

The RIC aims to “have a positive impact on Regional Australia and the agriculture industry by providing capital to stimulate the growth, resilience, and sustainability of Australia's agricultural economy” (RIC, 2023). Indeed, the fundamental functions of government in a democratic, open-market economy are to provide social equity and promote both economic growth and efficient use of productive resources. However, the question must be asked: **is concessional lending the right tool to achieve these outcomes?**

The following excerpts from AFI reports on *The Definition of a Farming Business* (unpublished, 2022) and *Government Farm Financial Risk Management Measures* (2020) clearly speak to these issues.

EXCERPT 1: Government Farm Financial Risk Management Measures

Source: Australian Farm Institute, 2020

While there may be justification for RIC to provide loans to State and regional authorities to accelerate regional development, it is more problematic to justify concessional lending to commercial farm businesses. Concessional lending and interest rate subsidies for agriculture have been reviewed on numerous occasions, with findings **consistently advising against** such forms of assistance.

The findings have been:

- that there is no evidence to support the theory that commercial finance sources do not provide adequate financial accommodation to viable farm businesses,
- recipients of the assistance often have broader structural problems, and
- that there are **adverse impacts in providing concessional finance to farm businesses**.

For example, the 2004 Drought Review Panel stated:

'... there is no strong case for the provision of such assistance [i.e. long-term low interest loans] by Government. The Panel considers that any involvement of the Australian and State/Territory Governments in providing long-term low interest loans would require consideration of whether there is a problem in the commercial finance sector, of possible effects on the future operation of commercial finance sources, and the possible distortion of markets by such measures.' (Drought Review Panel 2004, p.69)

One of the more detailed reviews of assistance measures provided to agriculture in the context of risk management is the Productivity Commission's inquiry into Government drought support (Productivity Commission, 2009). In reviewing the Exceptional Circumstances Interest Rate Subsidies, the Commission stated that:

Interest rate subsidies are inappropriate, ineffective and inefficient. They focus support onto those farms and businesses in EC areas that, on average, have high levels of debt, low levels of liquid assets and low off-farm income (p. 154), and ... the Commission does not support offering concessional finance to a group of borrowers to induce them to borrow at a higher level than their own risk preferences would allow. A greater sensitivity to a loss of the farm due to the high nonmonetary value placed on farming is rational and does not provide an efficiency case for measures to encourage farmers to take on more debt (p. 204).

The Commission also considered the adverse consequences of government assistance and found:

Having farmers dependent on government support for their businesses not only has implications for the way in which they operate, but also results in a less productive agricultural sector in the longer term (p. 153); that overall, the incentives inadvertently created ... may mean farm businesses adopt less self-reliant strategies (p. 153), and ... removing these measures would increase the incentive for the development of private arrangements to allocate risk to those best able to bear it (p. 283).

Australia has a sophisticated commercial banking industry which is strongly competitive and has extensive experience in lending to farm businesses across all sectors of agriculture. There is no evidence that the availability of loans, the terms or the interest rates applied to agriculture are inconsistent with lending available to other sectors of the economy. Nor is there evidence that commercial banking sources are not competent in assessing the viability of farm businesses or are



withdrawing finance to businesses that would otherwise have sound prospects of long-term profitability.

Given the long history of findings against successive incarnations of concessional financing arrangements aimed at drought and risk management for Australian farm businesses, and the likelihood of adverse incentives and perverse outcomes for the agricultural industry, the authors are unable to support continuation of this facility.

The capacity to overturn the findings against the provision of concessional finance facilities, or demonstrate whether there may be instances where a clear public benefit can be demonstrated, is constrained by ongoing **failure to gather comprehensive data** on how these facilities have been deployed in the past. There is a compelling case for all government assistance programs to rigorously gather quantitative data on delivery of the programs to **facilitate careful, ex-post impact assessment**.

The central philosophical proposition – that there is a severity of weather [and market] events which are beyond what a well-managed business can be 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.

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.

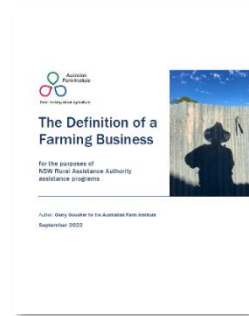
This principle was applied to both international and Australian learnings, resulting in four major themes for recommendations:

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**.
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.

EXCERPT 2: The Definition of a Farming Business

Source: Goucher, 2022

Developed market economies acknowledge that allowing competitive market forces to drive the allocation of private capital and productive resources produces greater aggregate returns than relying on government-driven industrial policy preferences. It is also accepted that in areas where a competitive market does not exist – so-called market failure – **government should intervene only if it can show that by doing so will deliver a better outcome for the society.**



This shift in policy-making philosophy has caused changes in the policies governing farming. The industry has witnessed **farmers being required to take greater responsibility for managing the effects of seasonal variability on their farming businesses.** The proliferation of statutory marketing arrangements that were intended to protect farmers from the effects of fluctuating markets have been removed so that farmers have both a wider array of marketing options as well as the responsibility for managing market risk. Governments can be expected to continue to be aware of the matters around risk and commercial incentives, around public and private benefits arising from government expenditures, and around getting the most effective outcome from public expenditures.

Differences in the definitions adopted by various administrations contribute to inconsistency in policy impact, as well as confusion and uncertainty among recipients of policy programs and risks of unintended consequences. Beyond the needs of particular agencies¹, there are potential benefits for the economy as a whole if a clear and fundamentally sound definition of farming is widely adopted across agencies and policy programs.

Revision of the definition of farming can contribute to economic and fiscal responsibility in a number of ways. By defining as a group activities or business types that have greater similarity in their operations capital structure and risk profiles, there is less potential for assistance payments to spill into activities where they are not needed or not intended. In turn this reduces the potential for unintended incentives and adverse outcomes from policy programs.

The proposed definitions [presented in this report] are broader in ways that **avoid conflict with other policy directions and expectations of farming and land use.** Inclusion of income from ancillary sources such as carbon credits, biodiversity credits or rental from third-party energy production avoids the need to quarantine this income and related costs, does not disadvantage those who embrace the policy goals behind these activities and provides for a greater degree of income diversity and self-reliance within farming.

The proposed definitions link to **the fundamental functions of government of providing social equity while promoting economic growth and efficient use of productive resources...** [and] also seek to minimise inequities arising from certain activities being inadvertently excluded from access to assistance or support.

¹ E.g., in reducing administrative costs in assessing applications, as well as minimising the uncertainty and evidentiary burden on applicants trying to understand their eligibility.

Conclusions

The questions asked in the current review focus primarily on operating function of the RIC itself, seeking information on the RIC's functions, activities, governance, legislative framework, eligibility criteria, funding arrangements, products and services. In our assessment, only three of the 34 questions posed in the Discussion Paper directly ask stakeholders to **consider the purpose and value** of the RIC:

- 10) *Are publicly-funded farm business concessional loans a useful policy tool?*
- 11) *Are there any unintended consequences from the use of concessional loans as a policy tool? If so, how could these be addressed?*
- 12) *Would a different form of Commonwealth-funded financial support be more effective? If so, what and why?*

An additional two questions indirectly address the core issue of purpose:

- 18) *Is this the right cohort the Australian Government should be seeking to assist with concessional loans?*
- 19) *Should public resources be spent assisting this cohort?*

The AFI's view on these five questions is:

1. There is little to no evidence supporting the view that farm business concessional loans are a useful policy tool for the objectives of providing social equity and promoting economic growth; although they may indeed be a useful means of *demonstrating the Commonwealth's sentiment* of support for the farm sector.
2. Unintended consequences of concessional loans include the perverse outcome of supporting risk management inaction and hindering structural adjustments.
3. Commonwealth-funded financial support should be directed to focus on *assisting individuals and families* who are engaged in farm businesses and living regional Australia, not businesses. Policies directed towards *businesses* need to focus on incentives for preparation, innovation in risk mitigation, and an ability to smooth variability in income generation.
4. It is difficult to assess whether the 'right cohort' is accessing assistance when definitions of farmers, farming businesses and eligibility criteria differ across programs and jurisdictions, and when the intended cohort is so loosely identified.
5. Public resources are best directed to programs which incentivise preparation, remove distortionary outcomes, improve data collection and enable the market to operate freely.

The RIC's annual report (perhaps unintentionally) puts function well ahead of purpose, with five pages of operational reporting preceding the one-line purpose statement provided (RIC, 2023). This is symptomatic of an approach that focuses on *what* is being done (outputs), rather than a continuous interrogation of *how* and *why* resources are deployed (outcomes).

We recommend a **full cost/benefit analysis of concessional lending for agriculture** be undertaken, to ensure future policy decisions are based on evidence of impact.

We also recommend the **adoption of nationally consistent definitions of farmers and farm businesses**, to better allocate funds fairly to those recipients intended by policy and program designers.

References

Australian Farm Institute. (2020). *Government Farm Financial Risk Management Measures* [Research Report]. https://www.farminstitute.org.au/wp-content/uploads/2021/08/Government-Farm-Financial-Risk-Management-Measures_AFI-web.pdf

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Productivity Commission. (2009). *Government Drought Support*. Productivity Commission.

RIC. (2023). *Regional Investment Corporation Annual Report 2022/23*.

Tune, D. (2021). *Independent Review of the Regional Investment Corporation*. Department of Agriculture, Water and the Environment.

Links:

- [Government-Farm-Financial-Risk-Management-Measures_AFI-web.pdf \(farminstitute.org.au\)](https://www.farminstitute.org.au/wp-content/uploads/2021/08/Government-Farm-Financial-Risk-Management-Measures_AFI-web.pdf)
- [REPORT Definition-of-a-Farm-Business_AFI_2022.pdf \(farminstitute.org.au\)](#)