

## **How Profitable is Farm Business in Australia?**

Farm Performance Data and Some Implications from ABARE Broadacre and Dairy Industries Farm Surveys

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### **ABSTRACT**

Time series data on farm profitability for Australia and South Australia from ABARE's farm surveys, shows a minority of businesses consistently profitable and a majority not. The paper finds evidence of prevalent and persistent negative farm profit in both available long-run data (1990-2007) and more recent data (2006-09). Trends in several structural change elements, productivity, farm size and age of operators, are also examined to aid the interpretation of farm economic performance in agri-food.

The paper concludes with several contemporary examples of public policy distorting the structure and performance of the farm sector and spoiling the usefulness of profitability as an indicator of sectoral performance. Policies on hobby farming tax benefits, drought, and agribusiness managed investment schemes policy are discussed in this context

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<sup>3</sup> All responsibility for the content of this paper remains with the authors. The views expressed in this paper are the author's and should not be taken to represent the views of the South Australian government.

## 1. Introduction

This paper has been developed in response to a request by Professor Andrew Fearn, 2008-09 Adelaide Thinker in Residence on *Food and Wine Value Chains: Prosperity through Collaboration*<sup>4</sup> for evidence on the profitability of agri-food and wine sectors. The request has been cast into the question: How profitable is farm business in Australia?

In address of this question the first section of the paper reviews profit and related data for Australian and South Australian broadacre and dairy farms in ABARE Farm Survey data from 1990 to 2007. ABARE's online portal, AGsurf, provides three online farm financial performance databases: broadacre, broadacre by size and dairy, covering the period 1990 to 2007. All financial data are expressed in 2006-07 dollars, thus removing the impact of inflation. ABARE's definitions and data on farm business profit and farm family income are important to gaining economic and social policy perspectives in an environment where most business remains family based, but income is increasingly diversified, on and off-farm. Reference is also made to ABARE analysis of recent farm performance, 2006-2009, as reported at Outlook 2009 (ABARE 2009). So, the paper aims to provide both a long (1990-2007) and a current (2006-09) perspective on farm profitability.

Agri-food industries are constantly changing in their technologies, productivity and productivity possibilities and their structures. Outcome measures of farm financial performance are interesting and important, but not sufficient to interpreting the status of industries or the well-being of their stakeholders. The second section of the paper joins some structural change elements, productivity, farm size and age of operators, to the mix to aid interpretation of farming in agri-food.

Agri-food industry structure and performance is influenced by public policies. Policy reform in Australia during the past decade, such as national competition policy, has seen the removal of some government involvement in agri-food, such as single export marketing legislation. Other policies continue to impact structure and performance. The paper concludes with several examples where recent reports and events suggest that public policy has been a factor in the prevalence and persistence of negative farm profits. Tax policy on hobby farming, drought assistance policy and managed investment scheme policy are discussed in this context.

## 2. Key Indicators of Farm Financial Performance<sup>5</sup>

This section spans several key indicators of farm profitability to gain a long view of both farm business and farm family financial performance. Data on rate of return on capital, costs to cash ratio and income is drawn from broadacre and dairy industries for Australia and South Australia (SA).

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<sup>4</sup> Professor Fearn is the 14<sup>th</sup> Thinker in the Adelaide Thinkers in Residence (ATIR) program. Additional information about ATIR and the Fearn residency is available on the website: [www.thinkers.sa.gov.au](http://www.thinkers.sa.gov.au)

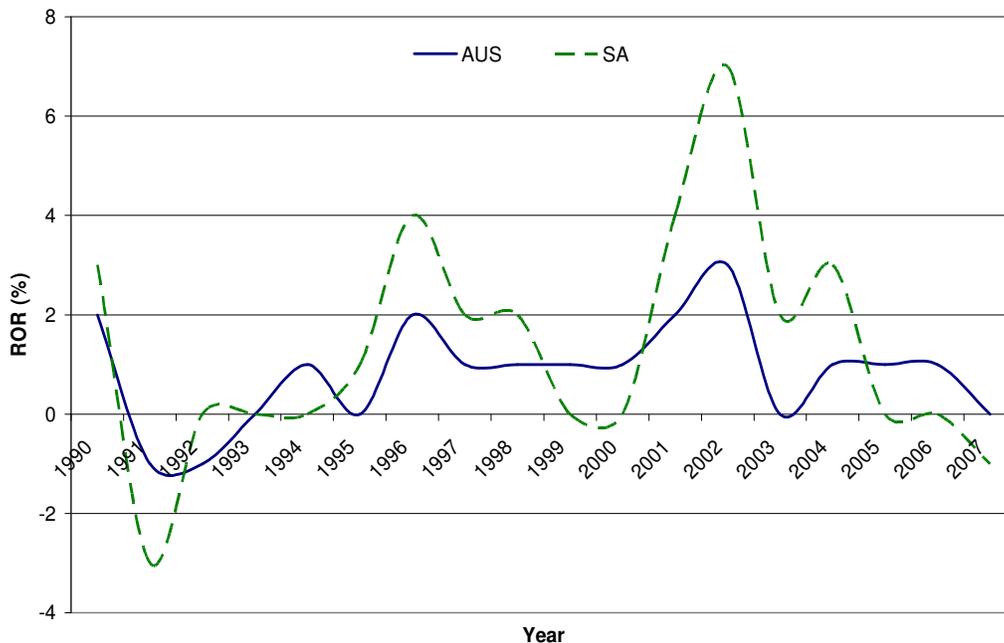
<sup>5</sup> The source of data for this paper is the ABARE Farm Survey Reports which are available online through <http://www.abareconomics.com/ame/agsurf/agsurf.asp>. All estimates are *per farm* averages. The latest available data from AGSurf is for 2007.

## 2.1 Rate of Return on Capital - Broadacre Industries

This section refers to rate of return excluding capital appreciation (ROR)<sup>6</sup> as an indicator of farm profitability. ROR is defined as profit at full equity expressed as a percentage of total opening capital (excluding capital appreciation). There is also a brief discussion on other selected data for broadacre farms. From 1990 to 2007, Australia and SA broadacre farms had zero or negative ROR (rate of return on capital) for six and nine years, respectively. SA farms' ROR is higher than the national average. Figure 2.1 shows an increasing though variable trend in farm profitability from 1990 to 2002. In recent years, from 2002 to 2007, average farm business profitability has been declining in an erratic manner. In 2001-2002, Australian and SA farmers posted the highest farm profits in recent years. High commodity prices and good seasonal conditions were the factors cited for profitability at that time.<sup>7</sup>

Figure 1 shows a steeper decline in ROR for SA farms, especially during the period 2005-07. In fact, ROR for SA farms during that period was -0.33, lower than the national average of 0.66. Drought and other conditions such as low water storage levels and soil moisture depletion were some of the factors affecting financial performance of farms in Australia and SA.<sup>8</sup>

**Figure 1: Rate of Return Excluding Capital Appreciation, All Broadacre Farms, Australia and South Australia, 1990-2007**



Source: ABARE

Table 1 shows the average farm profitability of broadacre farms in Australia and South Australia from 2005-2006 to 2007-2008. Notable information includes the following:

<sup>6</sup>Profit at full equity expressed as a percentage of total opening capital (excluding capital appreciation).

<sup>7</sup> [http://www.abareconomics.com/publications\\_html/conference/conference\\_02/OL02\\_12.pdf](http://www.abareconomics.com/publications_html/conference/conference_02/OL02_12.pdf)

<sup>8</sup> [http://www.abareconomics.com/publications\\_html/economy/economy\\_08/fsr\\_08.pdf](http://www.abareconomics.com/publications_html/economy/economy_08/fsr_08.pdf)

- Less than 50% of broadacre farms in SA and Australia were profitable from 2005-2006 to 2007-2008.
- In 2007-2008, 46% of broadacre farms in SA were profitable (average profit ranging from \$0-25,000 to greater than \$50,000), an increase from both the 2005-06 and 2006-07 figure of 35% and 22%, respectively.
- Only 38% of Australian farms were profitable in 2007-08, compared with 35% and 20% in 2005-06 and 2006-07, respectively.
- Most of the profitable Australian and SA broadacre farms have an average profit greater than \$50,000.

**Table 1: Average Broadacre Farm Profitability, by Profit Range, Australia and South Australia, 2005-2008**

Profit Range	Australia			South Australia		
	2005-06	2006-07	2007-08	2005-06	2006-07	2007-08
Less than -\$50,000	33%	52%	40%	33%	56%	28%
-\$50,000 to -\$25,000	18%	17%	11%	23%	10%	8%
-\$25,000 to 0	14%	11%	11%	9%	12%	17%
0 to \$25,000	10%	5%	8%	13%	7%	5%
\$25,000 to 50,000	7%	3%	6%	5%	6%	8%
Greater than \$50,000	18%	12%	25%	17%	9%	33%
Total	100%	100%	100%	100%	100%	100%

Source: ABARE

Figures 2 and 3 shows the ROR by farm size for Australia and SA, excluding (Fig 2) and including capital appreciation (Fig 3). Analysis of this information is an important complement to interpreting farm business performance.

As expected, the rate of return on capital performance indicator is strongly correlated with farm size. When looking at the ROR for all broadacre farms by farm size, Australian and SA farms in the size category less than \$100,000 gross turnover have not, on average, been profitable for the past 18 years. In contrast, Australia and SA broadacre farms with a size greater than \$400,000 have, on average, been profitable in all years. Australia and SA broadacre farms in the size range \$100,000-\$200,000 turnover have only had a positive ROR for 1 and 4 out of 18 years, respectively.

## 2.2 Rate of Return on Capital – Dairy Industry

In contrast to broadacre farms, Australia and SA average dairyfarm ROR has been positive for 16 and 17 out of the past 18 years. There was a marked increase in profitability in 2002 for Australian and South Australian dairyfarms, followed by a steep downturn in 2003. Compared with the 2002-2007 period, the trend in farm business profit was relatively stable from 1990 to 2001. As with broadacre farms, profitability of Australia and SA dairy farms was highest in 2002. Higher export prices for dairy products as well as higher beef cattle prices are some of the factors contributing to the high profitability observed in 2002.<sup>9</sup>

Table 2 shows average dairy farm profitability of Australia and SA dairyfarms from 2005-06 to 2007-08. Notable trends include:

<sup>9</sup> [http://www.abareconomics.com/publications\\_html/conference/conference\\_02/OL02\\_12.pdf](http://www.abareconomics.com/publications_html/conference/conference_02/OL02_12.pdf)

- More SA dairyfarms were profitable in 2008 (54%), than Australian dairy farms (49%).
- The number of profitable SA dairyfarms in 2007-08 increased compared with the previous year.
- Of the profitable SA and Australia dairyfarms, a majority had a profit greater than \$50,000.
- For SA, only in 2008 did the number of profitable dairyfarms exceed the number that were unprofitable.
- For Australia, there were more unprofitable dairyfarms than profitable.

**Table 2: Average Dairy Farm Profitability, by Profit Range, Australia and South Australia , 2005-2008**

Profit Range	Australia			South Australia		
	2005-06	2006-07	2007-08	2005-06	2006-07	2007-08
Less than -\$50,000	16%	45%	29%	40%	43%	40%
-\$50,000 to -\$25,000	18%	13%	11%	7%	9%	2%
-\$25,000 to 0	16%	14%	10%	13%	8%	4%
0 to \$25,000	15%	7%	16%	1%	16%	9%
\$25,000 to 50,000	6%	3%	7%	13%	0%	0%
Greater than \$50,000	30%	17%	26%	27%	23%	45%
Total	100%	100%	100%	100%	100%	100%

Source: ABARE

Figures 4 and 5 show the rate of return excluding capital appreciation and profit, including change in capital value. Surveyed average Australian and South Australian dairy farm capital value in 2007 was 13 times the value that it was in 1992. The annual average growth rate of capital appreciation for SA Dairy farms was three times the national dairy farm business average.

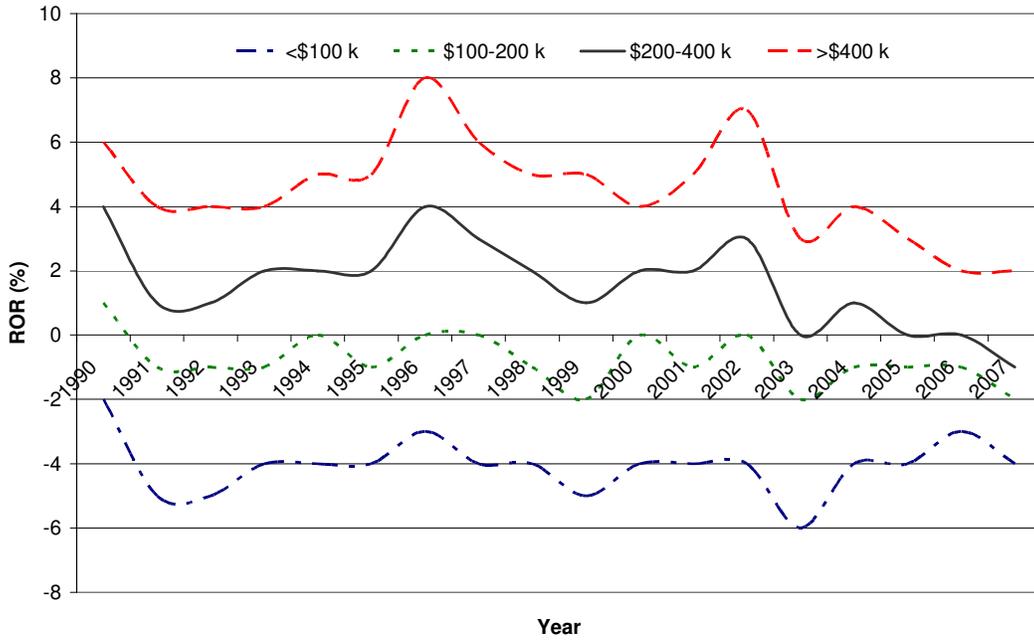
Figure 5 merits more detailed consideration. It is likely that that the high rates of capital appreciation are directly related to the industry structural adjustment program earlier in the decade, either in decoupling land and water assets or in boosting the potential profitability of those assets. Interestingly, the latter is not reflected in the Rate of Return data shown in Figure 2.1. This is likely to be the result of the overriding influence of drought in Australia's main dairy regions.

### 2.3 Farm Profit - Broadacre and Dairy Industries, 2006-09

Most recent data from ABARE indicates that 81% (SA 79%) of all broadacre industry farms posted negative farm business profit; the preliminary figure for 2007-08 is 70% (SA 64%) and the provisional estimate for 2008-09 is 69% (SA 76%) (Martin et al; 2009).

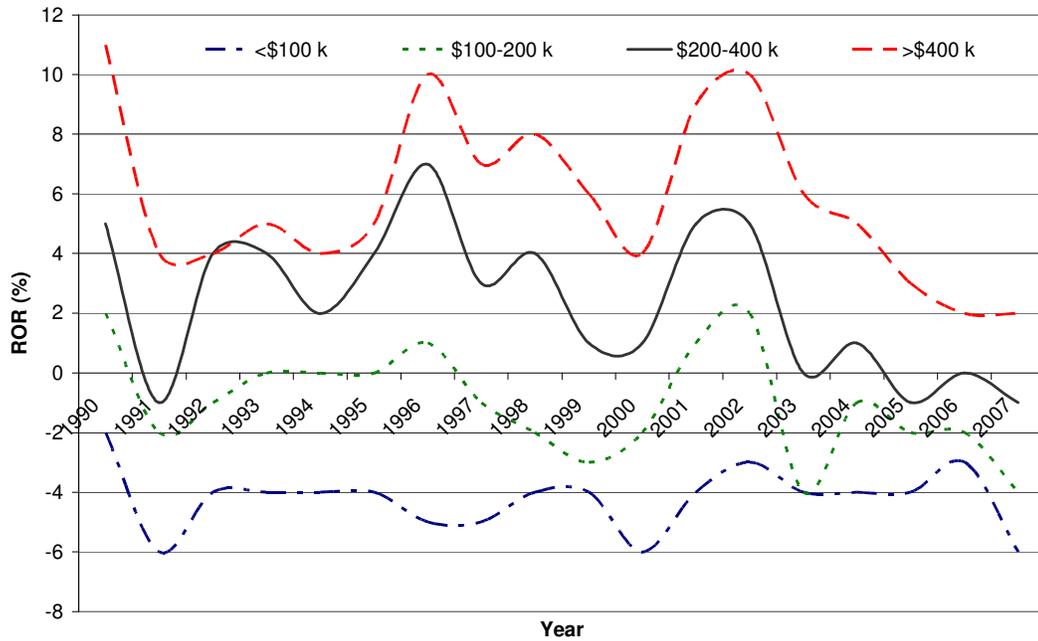
The ABARE national dairy survey reports 73% of businesses with negative farm business profit in 2006-07; 38% negative in 2007-08 (preliminary) and 62% negative in 2008-09 (provisional estimate) (Martin et al; 2009).

**Figure 2: Rate of Return Excluding Capital Appreciation, Broadacre Farms by Size, Australia, 1990-2007**



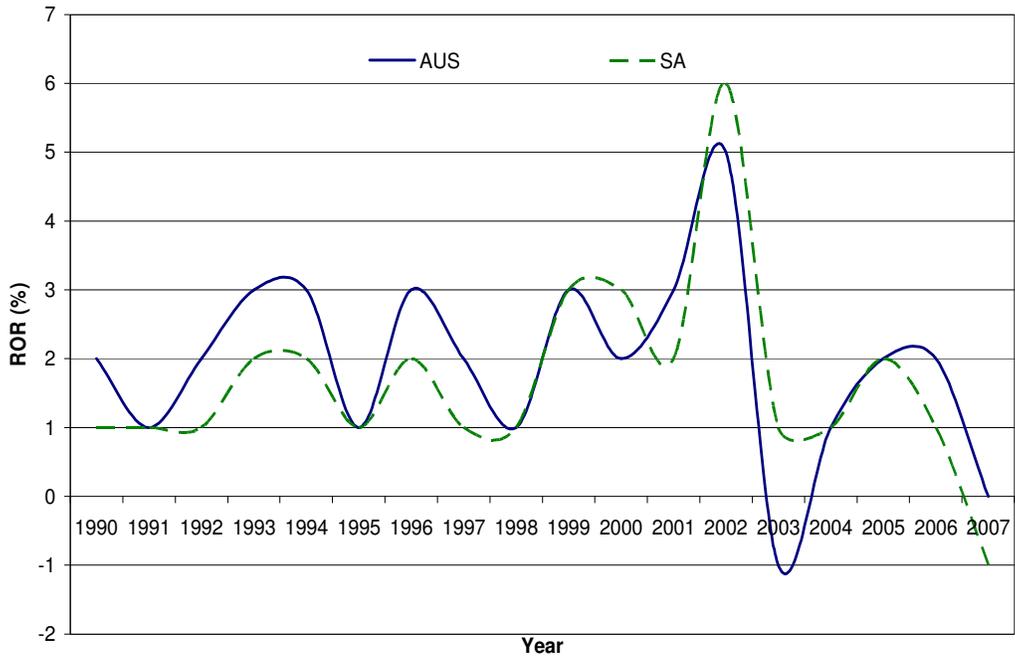
Source: ABARE

**Figure 3: Rate of Return Excluding Capital Appreciation, Broadacre Farms by Size, South Australia, 1990-2007**



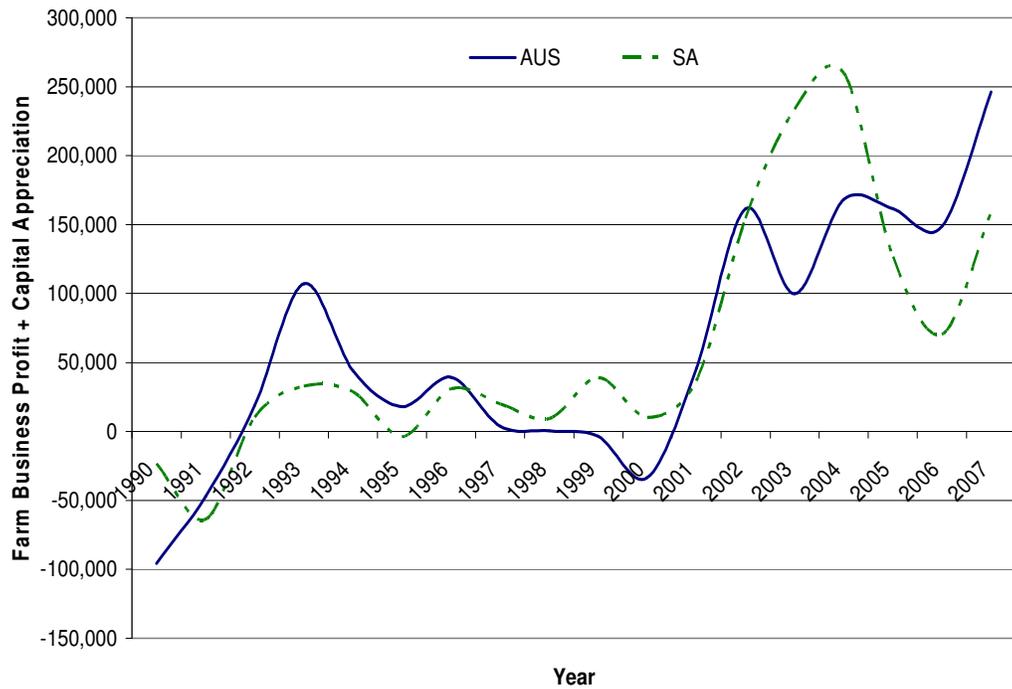
Source: ABARE

**Figure 4: Rate of Return Excluding Capital Appreciation, Australia and South Australian Dairy Farms, 1990 - 2007**



Source: ABARE

**Figure 5: Farm Business Profit, Including Capital Appreciation, Australia and South Australian Dairy Farms, 1990 - 2007**



Source: ABARE

## 2.4 Farm Income Profile of Broadacre and Dairy Farms, Australia

Examining the average farm income profile for both broadacre and dairyfarms in Australia gives an insight to the overall average farm performance and is an interesting complementary analysis to that of farm profitability.<sup>10</sup> ABARE defines family income as operator-manager's family share of net farm income plus off farm income of farm operator-manager and spouse. Farm income is defined as Operator-manager family's share of net farm income and is Calculated as family share of (farm cash income - depreciation + build-up in trading stocks - wages paid to family) plus wages paid to family.

Figure 6 shows the average family income<sup>11</sup> in terms of share of farm income<sup>12</sup> and off-farm income for both broadacre and dairyfarms across four time periods: 1988-89 to 1992-93, 1993-94 to 1997-98, 1998-99-2002-03 and 2003-04 to 2007-08. The average family share of farm income from 2003-04 to 2007-08 was \$21,000, up slightly from the 1988-89 to 1992-93 average of \$19,000. However, off-farm income expanded considerably, from an average of \$20,000 in 1988-89 to 1992-93 to \$29,000 for 2003-04 to 2007-08. Off-farm income accounted for 58% of total family income from 2003-04 to 2007-08, up from 50% share in 1988-89 to 1992-93.

Figure 7 shows the yearly data on average family income. Trend in off-farm income has remained relatively stable compared with the family share of farm income. Of interest is the data for 2006-07, showing family share of farm income at -\$21,000 the first recorded negative farm family income in this series for the past twenty years.

Off-farm income has the following components: wage and salary income, investment income and government sourced payments.<sup>13</sup> Figure 8 and 9 gives the estimates of off-farm income for broadacre and dairyfarms. The three sources of off farm income are wage and salary income, investment income and government sourced payments. For both broadacre and dairyfarms, the percentage share of government support payments to average off farm income has increased. In 2007-08, government sourced payments comprised 16% of the average off-farm income, up from the 1977-78 share of 4%. Government support (in terms of government sourced payments) is even more significant for dairy farms. In 2007-08, percentage share of government payments was 44%, up from 9% in 1979-80.

## 3. Farm Structural Change in Broadacre and Dairy Industries

Many factors drive structural change, including productivity and profitability. Previous sections have examined the best available information on farm profitability in Australia.

This section of the paper briefly looks at trends in productivity trends before presenting the outcomes of all change drivers, as evident in structural changes

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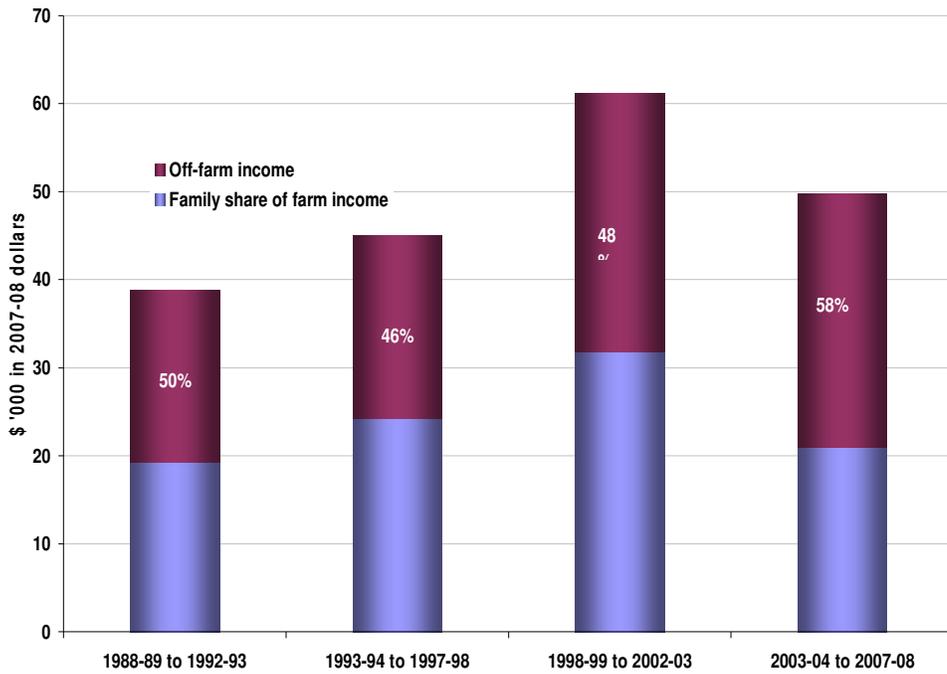
<sup>10</sup> There is little difference between states on average farm income profile. (Personal Communication, Peter Martin, 29 April 2009).

<sup>11</sup> Operator-manager's family share of net farm income plus off farm income of farm operator-manager and spouse.

<sup>12</sup> Operator-manager family's share of net farm income. Calculated as family share of (farm cash income - depreciation + build-up in trading stocks - wages paid to family) plus wages paid to family.

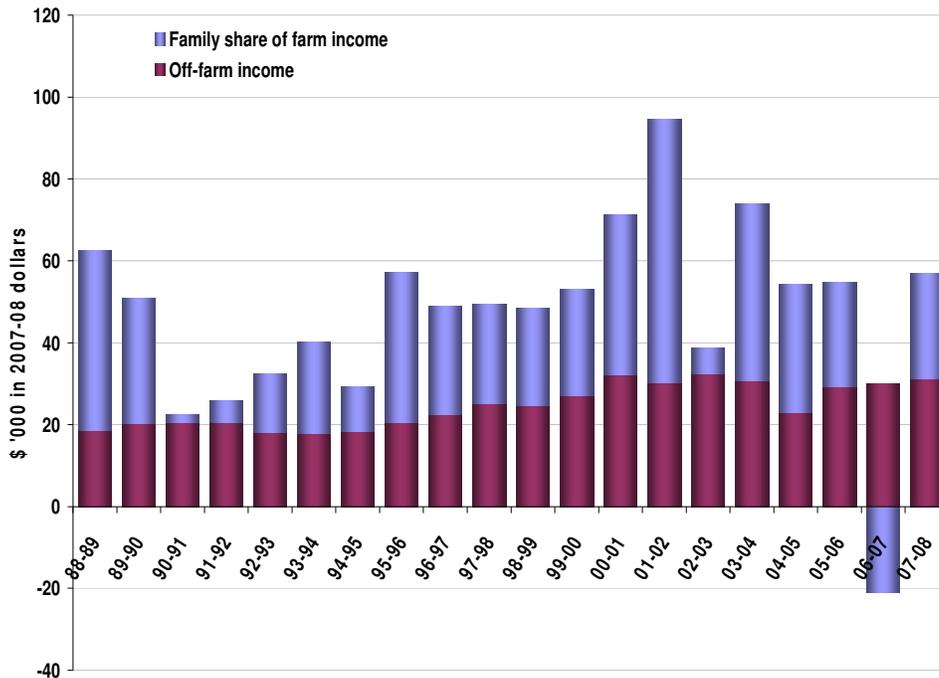
<sup>13</sup> Government sourced payments include ERCP payments (2001-02 onwards) and all government payments to families, allowances, pensions etc and does not include fuel rebates or Structural Adjustment Payments.

**Figure 6: Comparison of Average Family Income, Five Year Brackets, 1988-89 to 1992-93/ 1993-94 to 1997-98/ 1998-99 to 2002-03 and 2003-04 to 2007-08**



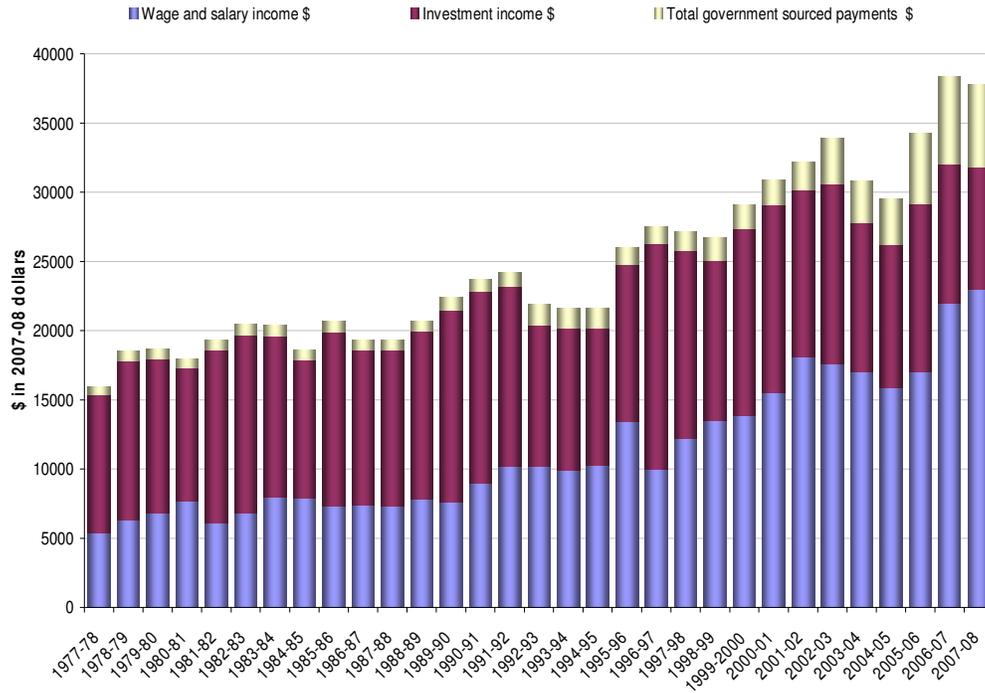
Source: ABARE

**Figure 7: Average Family Income, Broadacre and Dairy Farms, Australia, 1988-89 to 2007-08**



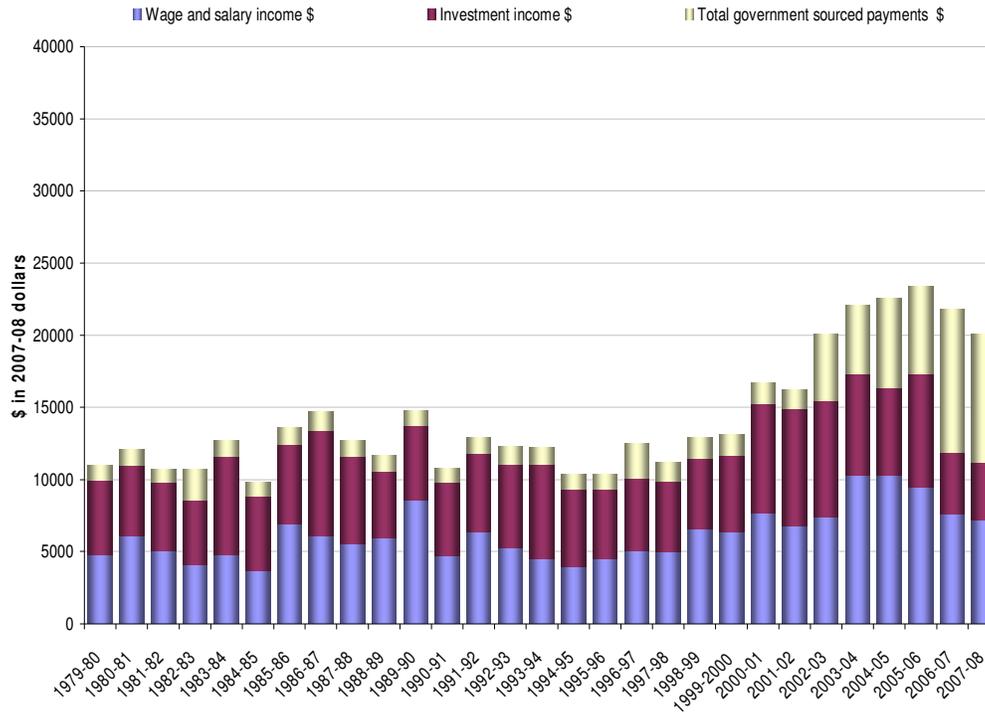
Source: ABARE

**Figure 8: Estimates of Average Off-Farm Income for operator-manager and spouse, Broadacre Farms, Australia, 1977-78 to 2007-08**



Source: ABARE

**Figure 9: Estimates of Off-Farm Income for operator-manager and spouse, Dairy Farms, Australia, 1979-80 to 2007-08**

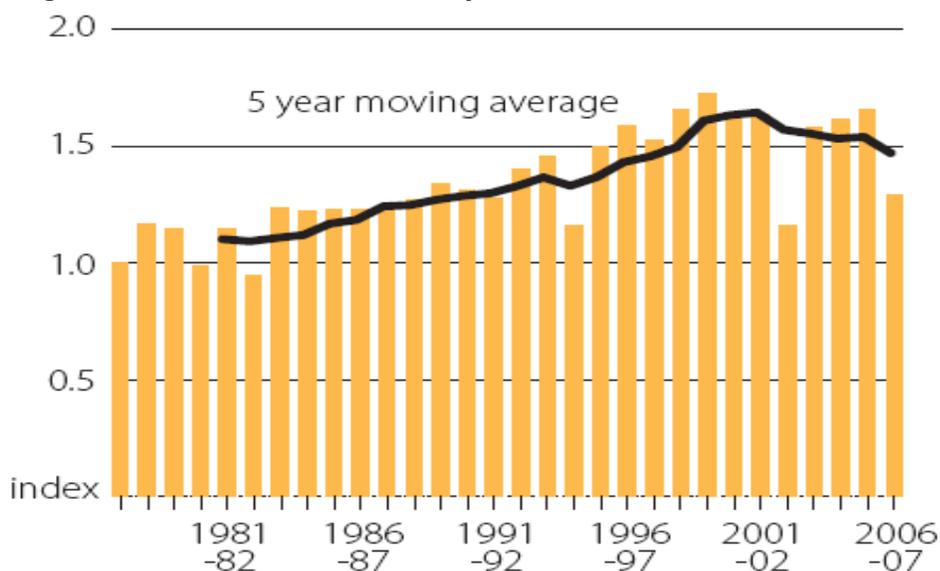


Source: ABARE

occurring within the broadacre and dairyfarms in Australia and South Australia. These trends are important as they provide context to the question of farm profitability and insight to the future state of the agricultural sector.

### 3.1 Productivity Trends

**Figure 10: Total Factor Productivity, Broadacre, 1981/82 – 2006/07**



Source: Nossal et al, 2009, ABARE

ABARE researchers (Nossal et al; 2009) have recently analysed productivity in Australian agriculture, noting the following trends:

- Productivity growth in broadacre agriculture has been highly volatile, but positive over the long term, averaging 1.5 per cent a year between 1977-78 and 2006-07. Dairy productivity growth has averaged 1.2 per cent a year between 1988-89 and 2006-07.
- Cropping specialists continue to outperform livestock industries over the long term with 2.1 per cent annual average productivity growth. However, productivity growth in crop and mixed crop-livestock industries is showing signs of slowing down.
- Regional disparities influence productivity growth rates, while seasonal conditions and access to markets are among other factors affecting overall performance in the farm sector. Recent drought conditions across Australia have diminished some regional advantages, with high performing regions more difficult to distinguish.
- Productivity gains in broadacre agriculture are partly influenced by farms changing their input mix. In particular, inputs of materials and services have increased by 2.4 per cent a year, while there has been a long-term decline in the use of other inputs.

The authors note that broadacre productivity growth began to show a negative trend between 1997-98 and 2006-07, falling at an average rate of 1.4% per year. Droughts have influenced productivity growth, with severe downturns in output and productivity occurring during drought years 1994-95, 2002-03 and 2006-07. However, slowdown

in productivity growth has been largely restricted to cropping industries, with the beef and sheep industry showing improved productivity performance.<sup>14</sup>

## **3.2 Fewer and Bigger Farms**

### **3.2.1 Broadacre**

The number of broadacre farms in Australia and South Australia has been declining over the past 18 years. The annual average rate of decline is -1.72% and -1.78% for Australia and SA, respectively. There are 61,160 and 7,349 Australia and SA broadacre farms, down from the 1990 figures of 83,618 and 9,828. SA's share of the national broadacre farm population has remained stable at 12%. While average Australia broadacre farm area decreased in 2007, average SA broadacre farm area increased from 7,217 hectares in 2006 to 7,672 hectares in 2007.

Looking at the number of farms by turnover gives a better picture of the broadacre farm industry as a whole. A notable trend is the increasing number of farms with a size greater than \$400,000 turnover. Figure 11 and 12 shows the broadacre farm classification by size in 2007 for Australia and South Australia. In 2007, 19% and 20% of Australian and SA farms have a turnover that is greater than \$400,000, up from the 1990 figures of 8% and 6%, respectively. SA outpaces the rest of the country in growth of farms greater than \$400,000 turnover, with an annual average growth rate of 4.9% compared with 2.76% for the rest of the country. All other farm size categories have negative annual average growth from 1990 to 2007.

In 2007, 45% and 37% respectively of Australian and SA broadacre farms were in the less than \$100,000 turnover, little different to the 1990 figures of 46% and 36%.

### **3.2.2 Dairy**

The number of dairyfarms in Australia and South Australia has declined over the past 18 years. In 1990, there were 14,453 and 905 dairy farms in Australia and SA, respectively. As of 2007, there are only 9,081 and 418 Australia and SA dairyfarms, a 37% and 54% drop, respectively. SA dairy farms now account for only 4.6% of total dairy farms in Australia, down from its 1990 share of 6.3%.

### **3.2.3 Production Concentration**

The trend towards consolidation of broadacre and dairyfarms has resulted in the increase in share of industry output by the largest producers. Table 3 shows the shift in share of industry output by the top 30 percent (in terms of value of output) of farms in Australia.<sup>15</sup>

According to the 2008 draft Productivity Commission review of Government Drought Support, for all Australian farms with an estimated value of operations greater than \$5 000 (in constant 2007-08 dollars), it is estimated that:

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<sup>14</sup> Nossal, K., Zhao, S., Sheng, Y. and Gunasekera, D. (2009), Productivity movements in Australian agriculture. ABARE, Australian Commodities, vol 16, No. 1 March Quarter, pp 206-216

[http://www.abare.gov.au/publications\\_html/ac/ac\\_09/ac09\\_March.pdf](http://www.abare.gov.au/publications_html/ac/ac_09/ac09_March.pdf)

<sup>15</sup> Review of Government Drought Support, Inquiry Report, Productivity Commission Melbourne, 2009, <http://www.pc.gov.au/projects/inquiry/drought/report>

- in 1996-97, the largest 30 per cent of farms generated 76.5 per cent of the total value of agricultural operations, while the smallest 50 per cent generated 9.8 per cent of the total value of agricultural operations; and
- by 2005-06, the largest 30 per cent of farms generated 82 per cent of the total value of agricultural operations, while the smallest 50 per cent of farms generated 7.2 per cent.

**Table 3: Share of Industry Output by the largest 30 per cent of Farms**

Type	1983-84	2003-04
Beef specialists	77%	81%
Sheep specialists	67%	70%
Grain businesses	59%	62%
Dairy specialists	54%	59%

Source: Department of Agriculture, Forestry and Fisheries (2005)

### 3.3 Ageing Farmers

By 2007 the average age of the farm owner/managers for Australia and SA broadacre farms was 57 and 64 years, respectively. This is higher than the national and state average in 1990 of 53 and 52 years, pointing to an ageing ownership/management profile. The average age of the farm owner/manager tends to be lower for larger sized farms. As with broadacre farms, the average age of the farm owner/manager for Australian and SA dairyfarms has increased in the ABARE Dairy farm Survey, from 48 and 53 years in 1990, to 54 and 57 years in 2007, respectively.

**Table 4: Average Age\* of Farm Owner/Manager, Australia and South Australia Dairyfarms**

Year	Australia	South Australia
1990	48	53
1998	51	52
2007	54	57

\*Age by years  
Source: ABARE

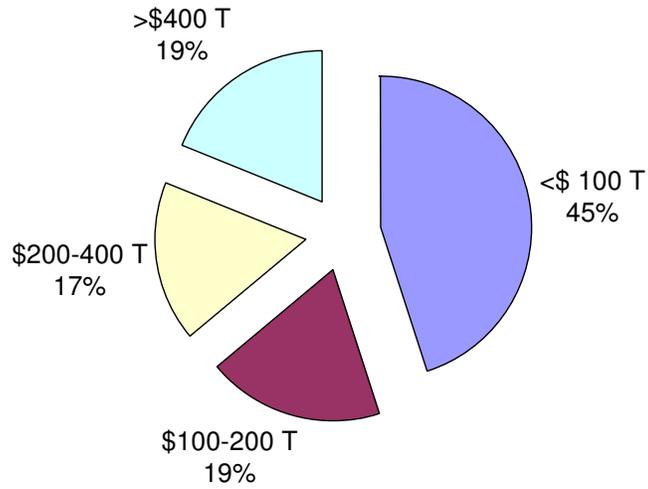
### 3.4 Social Forces Shaping Rural Landscapes

Research by Dr Neil Barr and others at Victorian Department of Primary Industries, Bendigo, has emphasised the importance of social factors as forces in rural landscape change (Barr, 2002a; Barr, 2002b; Barr, 2005a; Barr 2005b). These papers have pointed to demographic changes, ecosystem and water policy changes and the social capacity of communities to absorb and adapt to change from all directions (economic, social and environmental)<sup>16</sup>. Dr Barr spoke at a PIRSA Friday Forum in 2008 where he referred to his work in the Victorian wool industry, where farm net worth was found to be more important than income in explaining business adjustment (Barr, 2002a):

For the many sheep farmers in their late career years, the farm is the asset that can provide income security in retirement. With limited prospects of improving incomes by quitting farming, any decision to sell the farm during a period of low demand for farmland would threaten retirement security. Many older farmers sensibly delay plans to sell land during periods of poor commodity prices.

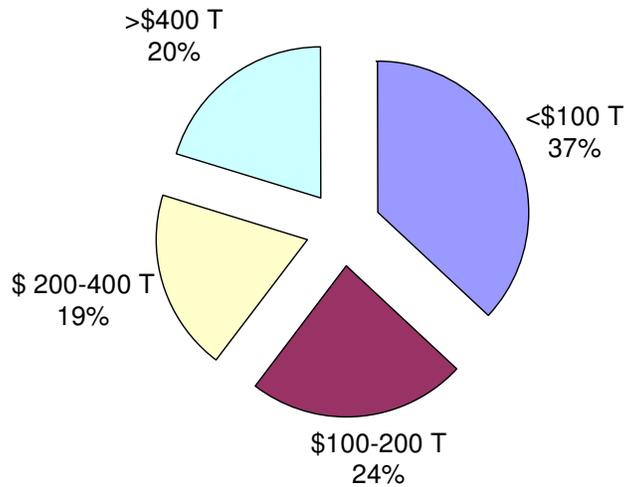
<sup>16</sup> Barr, Neil (2002), Social Trajectories for Rural Landscaping, Connections, [http://www.agrifood.info/connections/autumn\\_2002/Barr.html](http://www.agrifood.info/connections/autumn_2002/Barr.html)

**Figure 11: Broadacre Farm Size by Gross Turnover Category, Australia, 2007  
(in \$'000)**



Source: ABARE

**Figure 12: Broadacre Farm Size by Gross Turnover Category, South Australia, 2007 (in \$'000)**



Source: ABARE

#### **4. Some Public Policies Influencing Farm Profitability**

The prevalence and persistency of negative farm profitability indicated in this paper in the only industries consistently measured, broadacre and dairy, is not entirely an outcome of market forces, seasonal climatic variation or climate change. Public policy has also been a consistent contributor in recent decades. This section of the paper identifies three public policies that have been a negative influence on farm profitability; hobby farming tax status, drought assistance policy and managed investment scheme policy. None of the three examples are new policy areas; all have been contentious during the past decade. Two policies: hobby farm tax status and drought, have been contentious for decades.

Other public policies may be boosting farm performance. Notwithstanding, the presence and negative influence of those that are not needs to be factored into any consideration of the structure and performance, financial and physical, of agribusiness in the agri-food sector.

##### **4.1 Taxation Status of Hobby/Lifestyle Farms**

Previous sections of this paper showed that relatively few small and medium sized farms surface to economic profitability, based on ABARE's definition of profit, which includes the imputed value of farm family labour. It is also well recognised that not all owners of rural land and operators of enterprises on rural land are profit oriented. The income tax interface between farming for profit and farming as a hobby or lifestyle has been contentious for decades. The tax breaks associated with primary production have been well recognised as a factor attracting and retaining investment in agribusiness.

The Australian Taxation Office (ATO) has responsibility to adjudicate tax policy, including the mixing of losses from unprofitable enterprises with profitable ones. Past policy has permitted some farm 'businesses' to transmit losses to profitable non-farm enterprises, encouraging entry to farming and persistence of farms with little or no profit performance and with little or no prospect of profitability.

The 2009 Federal Budget has introduced quarantining of the losses of businesses that are engaged in enterprises for hobby and lifestyle purposes, an attempt by Treasury and the ATO to reduce the leakage of taxation revenue from 'businesses', including agri-business. According to the Treasury website:

The Government will tighten the application of the rules on the use of non-commercial losses to prevent high income individuals from offsetting excess deductions from non-commercial business activities against salary and other income. The measure has effect from the 2009-10 income year. The measure will have an ongoing gain to revenue which is estimated to be \$700.0 million over the forward estimates period.<sup>17</sup>

These changes, though not peculiar to primary production, are likely to impact where the line will be drawn in future in assessing deductions and transmission of hobby and lifestyle farm losses.

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<sup>17</sup>Budget Paper No. 2 - Improving fairness and integrity in the tax system — tightening access to non-commercial business losses.  
[http://budget.australia.gov.au/2009-10/content/bp2/html/bp2\\_revenue-05.htm](http://budget.australia.gov.au/2009-10/content/bp2/html/bp2_revenue-05.htm)

## 4.2 Drought Policy and Exceptional Circumstances Assistance

Productivity Commission and other recent reporting to government are recommending rationalisation of drought assistance and reform of drought policy. The report recognises that the level of drought assistance has crept from a one in twenty five exceptional event to become more frequent in the presence of a long dry and changing climate. In this circumstance, the general observation emerges that too many farm businesses in too many regions have been receiving Exceptional Circumstances (EC) and other related assistance more frequently than the original definition and policy intent. The level of assistance is now deemed inappropriate and an unsustainable distortion of the farm business sector, particularly in the context of climate change.<sup>18</sup>

According to the report<sup>19</sup>:

Most farmers are sufficiently self-reliant to manage climate variability. In 2007-08, 23 per cent of Australia's 143,000 farms received drought assistance, totalling over \$ 1 billion, with some on income support continuously since 2002. In drought declared areas, most farmers manage without assistance. From 2002-03 to 2007-08, on average, about 70 per cent of dairy and broadacre farms in drought areas received no drought assistance. Governments need to commit to a long term reform path that recognises that the primary responsibility for managing risks, including from climate variability and change, rests with farmers.

The report includes the following recommendations:

- Exceptional Circumstances interest rate subsidies should be terminated, subject to transition arrangements;
- The Exceptional Circumstances exit package should be terminated, subject to transition arrangements;
- The appropriateness, effectiveness and efficiency of the Small Block Irrigators Exit Grant package should be evaluated following its conclusion;
- States and territories should, as previously agreed, terminate transactions-based subsidies;
- The Murray-Darling Basin Irrigation Management Grants program should conclude, as scheduled, on 30 June 2009, and
- Exceptional Circumstances relief payments should be replaced, subject to transition arrangements.<sup>20</sup>

Backgrounding a House of Representatives Primary Industries Committee inquiry into Agriculture and Climate Change Oakeshott and Maslen (2009, p) quote the Chair of the inquiry, Dick Adams (Member for Lyons, Tasmania), on the importance of agricultural public policy to be more strategic in future with respect to assistance to farm businesses:

Putting our resources into black holes is not where the future is and not a good way to spend the public dollar. I think the Australian people would rather be assisting enterprises that have a business plan looking to the future; that will adapt to climate

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<sup>18</sup> Alan Mitchell's article in the Australian Financial Review (Farm welfare's poor crop, May 27, 2009) provides a thorough explanation of the effect of drought assistance to the agriculture sector.

<sup>19</sup> Review of Government Drought Support, Inquiry Report, Productivity Commission Melbourne, 2009, <http://www.pc.gov.au/projects/inquiry/drought/report>

<sup>20</sup> [http://www.pc.gov.au/\\_\\_data/assets/pdf\\_file/0005/86279/03-recommendations.pdf](http://www.pc.gov.au/__data/assets/pdf_file/0005/86279/03-recommendations.pdf)

change and the issues that confront us in the next 20 to 30 years. We've also got to look at the opportunities at the enterprise level and look at where we're going in a world sense. I think farmers will get left behind if they don't adapt and look for opportunities.

### 4.3 Agribusiness Managed Investment Scheme (MIS) Policy

The Federal Government's change in non-forestry managed investment scheme (MIS) policy in 2007 was an acknowledgement that previous policy was attracting investment from non-farming in anticipation of taxation benefits not available to mainstream non-MIS agribusinesses. One of the impacts of positively skewed tax benefits for MIS investors in agribusiness was local upward impact on land values where MIS business investments occurred, adversely affecting the competitiveness of the local non-MIS landowner in land and water markets<sup>21</sup>.

Government policy on MIS has accelerated unsustainable investment and development in agri-food. The business models of some MIS agribusinesses have not been sustainable in circumstances where the tax benefits were withdrawn and the industry simultaneously encountered drought, high irrigation water costs, global financial crisis and high refinancing costs and/or an inability to refinance loans in the context of policy and economic turmoil.

Mackarness and Malcolm (2006) drew attention to public policy flaws that have led to recurring business failures and losses for investors and advisors not wit to the risks involved:

The chief cause of problems stems from the abolition of the Trustee introduced by the Managed Investments Act 1998. This has had a pernicious effect on specialised investments such as agribusiness where there is limited information in the public domain. To a limited extent, the lack of power afforded to ASIC by the MIA and the simplistic optimism of Plantation for Australia: the 2020 Vision, have contributed to this state of affairs.

Stephens (2009) diagnoses that serious policy failure over a long period has preceded the recent spectacular failures of Timbercorp, Great Southern and other MIS businesses:

Federal governments and regulators have knowingly allowed businesses and investors to live with false expectations about the performance of many of the businesses operating under the managed investment scheme rules.

Governments allowed tax concessions, trailing commissions and the issuing of prospectuses which made unrealistic claims. These activities continued for long after governments were warned of the consequences.<sup>22</sup>

Stephens also refers to the private and public costs of MIS policy:

Government MIS policy has delivered a misallocation of scarce resources and a smaller economic pie. The combination of factors above and has ensured that, as a general rule, MIS industries are inherently doomed to fail both from an investment and a social good perspective.

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<sup>21</sup> Peter Small's paper 'From Sam Wadham to Blue Gums' gives an analysis of how the MIS Schemes work within the forestry sector.

<http://www.agrifood.info/connections/2006/Small.html>

<sup>22</sup> Mike Stephens, Concerns were logged a long time ago. Australian Financial Review, 4 June, 2009, p59

A Senate Parliamentary Joint Committee is now conducting an inquiry into agribusiness MIS and is due to report in September, 2009. This inquiry follows a string of previous reports:

- Rural Industries Research and Development Corporation (RIRDC) in 2000 and 2004;
- Australian Securities and Investments Commission (ASIC) in 2003, and
- Senate Reference Committee Inquiry (2002) into mass-marketed tax effective schemes.

Following Stephens article, an editorial in the Australian Financial Review referred to three current inquiries with opportunity to recommend policy reform on (MIS and other investment) advisor remuneration:

- A Senate parliamentary joint committee inquiry into MIS;<sup>23</sup>
- A general review of financial products and services, and
- The Cooper review of superannuation.

The editorial summed the scale of recent losses:

The collapse of two of the biggest MIS operators, Timbercorp and Great Southern, has left 55,000 grower-investors high and dry. Banks have \$1.8 billion at risk, \$4.7 billion of taxpayers' money may have gone up in smoke and many rural communities are in the doldrums.

The editorial concluded that:

Commissioning various inquiries after the mishap is all very well but the government also needs to take a long, hard look at its tax policies. The failed managed investment schemes highlight the folly of governments trying to pick winners. Tilting agricultural production in favour of one class of producer at the expense of the another – in this case in favour of corporate investors at the expense of traditional farmers – is particularly poor policy. From a consumer's point of view, purely tax driven investments rarely stack up in the long term. The MIS tax concessions are one of many distortions that should be consigned to the compost bin of history by the Henry review of taxation.<sup>24</sup>

Given the recurrence of gyrations of agribusiness based on the prevailing MIS model and the ramifications for the farming and regional communities as well as investors many will be hoping for policy reform from any direction.

## 5. Summary/Conclusions

1. Broadacre and dairyfarm business profits for Australian and South Australian farms declined from 2002 to 2007. Prior to 2002, farm business profit exhibited an increasing trend, albeit in an erratic manner. Drought and other conditions such as low water storage levels and soil moisture depletion were some of the factors affecting the financial performance of farms in Australia and South Australia. Bigger sized broadacre farms have been more profitable than smaller farms, irrespective of the long dry. SA broadacre farms have been more profitable than the national average. In contrast, SA dairyfarms have been less profitable through the period than the national sample.

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<sup>23</sup> The Senate Parliamentary Joint Committee of Corporations and Financial Services is conducting an inquiry into MIS.

[http://www.aph.gov.au/Senate/committee/corporations\\_ctte/MIS/tor.htm](http://www.aph.gov.au/Senate/committee/corporations_ctte/MIS/tor.htm)

<sup>24</sup> Anon; MIS tax breaks don't stack up. Australian Financial Review, 11 June, 2009, p62

2. During the longer period of review (1990-2007), farm profitability, including capital appreciation, lifted significantly for both broadacre and dairy farms. The growth in capital value has been driven primarily by the increase in land prices. Farm land prices are a function of many variables including general inflation in asset values across the economy, credit availability, inflated expectations about longer-term commodity prices and outcomes<sup>25</sup>, expansion of urbanisation and the proliferation of 'lifestyle investors/hobby farmers,' among others.
3. The decline in the number of farms in Australia and South Australia during the past two decades indicates substantial on-going adjustment. For broadacre farms, the trend points to consolidation of farms toward the bigger size category (greater than \$400,000 gross turnover) in a quest for economies of scale and better profit performance.
4. Other significant structural changes in broadacre and dairy farm management are the ageing management profiles and the increasing concentration of farm output to the largest farms (in terms of the estimated value of operations).
5. Movements in rate of return on capital invested in farming point to the influence of seasonal conditions. The effect of drought and other climactic conditions are most likely compounded for both South Australia and Australia farms, hence the cyclical trend. An expanded data set is needed to shed further light on this.
6. There is no size category breakdown for dairy farms in the AgSurf online portal, which would have been useful in the analysis. Additional analysis on South Australian broadacre farms by zone (pastoral, wheat-sheep and high rainfall) or by region (North Pastoral, Eyre Peninsula, Murray Lands and Yorke Peninsula and South East) would also provide additional insights to the state of broadacre farm industries in South Australia. Both improvements would involve the extra cost of larger sample sizes.
7. ABARE's Outlook 2009 reporting of recent farm performance, 2006-09, showed negative farm business profit for about 60 to 80 percent of broadacre and dairyfarm businesses nationally and in South Australia. Changing industry market and seasonal conditions and change in sample composition and size create interpretation challenges in answering the farm profitability question at an industry, state and national level. Surveys at this level are not business or chain case studies, so generalisations are hazardous. Nonetheless, there appears little reason for satisfaction with profit performance for most broadacre and dairy farm business stakeholders for most of the period reviewed. There may have been more satisfaction with asset capital appreciation, reflected in rate of return excluding and including capital.
8. The answer to the lead question that the authors arrive at is that ABARE farm survey data, as evidenced in this paper, suggests farming for most smaller scale broadacre and dairy stakeholders (where turnover is the basis for size categories) has been persistently missing profitability for the period reviewed. The medium sized business category has shown modest profitability. Only larger businesses, the top 20 to 25 percent, have been able to maintain profitability consistently, including through recent dry years.

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<sup>25</sup> Personal Communication, Peter Martin, Senior Economist, ABARE, 24 February, 2009

9. There is evidence from ABARE Broadacre and Dairy Farm surveys that average farm income has been supported or sustained from off-farm income and that the percentage share of government sourced payments to average off-farm income of both broadacre and dairy farms has been increasing.
10. While farm family income, including off-farm, has enabled 'survival' of stakeholders in small and medium turnover categories, where profit, by ABARE definition, has been modest, mediocre or missing for much or most of the time in recent decades in broadacre and dairy. At the industry level, this is simply more evidence of a familiar phenomenon in the farm stage of agri-food business: satisfactory business performance by an upper quartile that are unambiguously internationally competitive; less than sustainable competitiveness for small-medium categories, where stakeholders are open to diagnosis as farming for the lifestyle (since the standard business indicators of profit are perennially absent).
11. Inability or indifference by stakeholders in the bottom quartiles of farm businesses to achieve profit typically leads to diagnosis of under-adjustment of the sector, where many farm businesses persist without evidence of the profitability considered essential at other stages of agri-food chains or other non-farm business. Many businesses in this category are operating to objectives other than profit, including capital gain, off-farm income and an ability to decrease income taxation by shifting losses to non-farm, profitable enterprises.
12. There are other factors that help to explain low farm exit rates within the broadacre and dairy industries given the low level of profitability. There is evidence that farmers base their adjustment decisions more on balance sheet indicators than profitability indicators.
13. The policy environment that has prevailed for farm and agribusiness for the two decade period of this review has included policies which have contributed to the prevalence and persistence of negative farm profits. The three policies exemplified – the tax status of hobby and lifestyle enterprises; drought policy and Managed Investment Scheme policy – have all made contributions. The tax status of hobby farms has been addressed in the recent Federal Budget. Three drought policy reports have been tabled with government in 2009, all pointing to the need for reform. MIS policy has become a national issue in recent months, with several inquiries having the opportunity to recommend reform. The presence of these farm sector performance distorting policies has to be factored into interpretations of profitability. Additional research would be required to cost the adverse effects of these policies. While recent reports on drought and current inquiries into managed investment schemes add to many before them, the best opportunity in decades for policy change may have arrived in current reporting to a government with an appetite for overdue reform.

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