National Farmers' Federation

Submission to the Department of Agriculture, Water and the Environment on the review of the Farm Management Deposit Scheme

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30 April 2021

NFF Member Organisations

AGFORCE

ACGC Australian Chicken Growers' Council

Australian Dairy Farmers

Australian Forest Products Association

ALEC Australian Livestock Exporters Council

ALPA

Australian Organic

Australian Pork

AVA Australian Veterinary Association

Beechworth Honey

Canegrowers

Cattle Council of Australia

Cotton Australia

farmers for climate action

GICA Goat Industry Council of Australia

GrainCorp

Grain Growers

National Farmers Federation Horticulture Council

KIAA

NSWIC New South Wales Irrigators' Council

NSW Farmers

Northern Territory Cattlemen's Association N.T.C.A

PET Primary Employers Tasmania

ppsa Primary Producers SA

Ricegrowers' Association of Australia Inc

Sheep Producers Australia

SoilsForLife

Tasmanian Farmers and Graziers Association TFGA

Victorian Farmers Federation

WAFarmers

WoolProducers Australia

National Farmers Federation

The National Farmers' Federation (NFF) is the voice of Australian farmers.

The NFF was established in 1979 as the national peak body representing farmers and more broadly, agriculture across Australia. The NFF's membership comprises all of Australia's major agricultural commodities across the breadth and the length of the supply chain.

Operating under a federated structure, individual farmers join their respective state farm organisation and/or national commodity council. These organisations form the NFF.

The NFF represents Australian agriculture on national and foreign policy issues including workplace relations, trade and natural resource management. Our members complement this work through the delivery of direct 'grass roots' member services as well as state-based policy and commodity-specific interests.

Statistics on Australian Agriculture

Australian agriculture makes an important contribution to Australia's social, economic and environmental fabric.

Social >

There are approximately 85,000 farm businesses in Australia, 99 per cent of which are wholly Australian owned and operated.

Economic >

In 2018-19, the agricultural sector, at farm-gate, contributed 1.9 per cent to Australia's total Gross Domestic Product (GDP). The gross value of Australian farm production in 2018-19 is estimated to have reached $62.2 billion.

Workplace >

The agriculture, forestry and fishing sector employs approximately 318,600 people, including full time (239,100) and part time employees (79,500).

Seasonal conditions affect the sector's capacity to employ. Permanent employment is the main form of employment in the sector, but more than 26 per cent of the employed workforce is casual.

Environmental >

Australian farmers are environmental stewards, owning, managing and caring for 51 per cent of Australia's land mass. Farmers are at the frontline of delivering environmental outcomes on behalf of the Australian community, with 7.4 million hectares of agricultural land set aside by Australian farmers purely for conservation/protection purposes.

In 1989, the National Farmers' Federation together with the Australian Conservation Foundation was pivotal in ensuring that the emerging Landcare movement became a national programme with bipartisan support.

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Introduction

The National Farmers' Federation (NFF) welcomes the opportunity to provide comment on the Department of Agriculture, Water and the Environment's (DAWE) review of the Farm Management Deposit Scheme (FMDS). The NFF and its members believe that the FMDS has made significant contribution to improving farm business resilience and preparedness and recommend that the scheme continue and be expanded.

In reviewing the FMDS, the NFF seeks that the review provide:

- greater analysis and availability of data and metrics on FMDS by commodity and geography;
- analysis on the interplay between the effectiveness of FMDS and utilisation by farmers; and
- analysis of the effectiveness of the FMDS as part of the portfolio of drought measures available to farmers at a federal and state government level.

More public analysis and reporting on the FMDS is required to ensure adequate engagement with the review of the scheme.

With respect to substantive issues, the NFF seeks that:

- FMDS eligibility be explicitly extended to other business structures, such as trusts and partnerships;
- limits on off-farm income be reviewed;
- the FMDS allow the drawdown of FMD accounts over three years for unforeseen circumstances, such as death;
- the cap on deposits be regularly reviewed every three years for its appropriateness given climate and market conditions;
- increased education and awareness on the benefits and implications of various drought measures, including the FMDS; and
- ensuring other government settings promote the use of FMDS, such as prudential regulations.

FMDS an essential risk management tool

The NFF believes that the FMDS has significantly aided primary producers in becoming more financially self-reliant and resilient. Recent drawdown trends show that the scheme is being used by primary producers to get through tough times caused by drought and other perils, and to fund farm businesses through the recovery phase.

It should be noted that aggregate deposit and drawdowns of FMD accounts do not track weather conditions with absolute fidelity, noting that the on-farm and financial impact of drought do not always coincide. As an example, livestock at a beginning of a severe drought are sold off, potentially increasing balances with an FMD account. Conversely, the first years of better conditions could see a drawdown of FMD accounts, as farmers restock.

The NFF refutes suggestions that stated reasons for the utilisation of the FMDS by farmers, other than for risk management, invalidates the effectiveness of the scheme. A 2018 ABARES survey suggests that 63% of farmers use the scheme as a tax management strategy. The 2019 Auditor-General's audit of the FMDS responds to this assertion:

"the relatively high reported use of FMDs for tax management purposes is consistent with the objectives of the scheme... the tax concession encourages a change in behaviour and results in improved self-reliance..."

Recent changes to the FMDS scheme including increasing the deposit cap to $800,000, the ability to withdraw a deposit within twelve-months in severe drought conditions without losing tax concession benefits, and the ability to use FMD accounts as an offset to a loan are most welcome.

Of the changes outlined, the increasing of the deposit cap has been most scrutinised The Auditor General review notes little policy reason for the increase of the cap, noting the minimal number of primary producers having deposits exceeding the original $400,000 cap. This should not be an argument to limit or reduce the cap but remove caps altogether. Farmers have clearly demonstrated the appropriate use of the FMDS that is tailored to their business and are not simply 'maxing' out caps for tax concession reasons.

The agriculture industry and farmers view the FMDS as a key tool in preparedness and resilience and recommend that the program continue and be expanded.

The review process

The NFF would welcome further analysis to be made publicly available by the DAWE as a part of any review of the Farm Management Deposit Scheme and its effectiveness. Specifically, the NFF seeks:

- greater analysis and availability of data and metrics on FMDS by commodity and geography; and
- analysis on the interplay between the effectiveness of FMDS and utilisation by farmers.

Similarly discrete reviews of drought measures, including the FMDS, does not provide industry with an opportunity to assess the effectiveness of drought measures as a portfolio of solutions, and shape each measure to work in conjunction to provide optimal resilience and preparedness outcomes.

This further analysis would allow industry and the public to engage with the question of effectiveness in a more informed manner.

<u>Availability of data and analysis on the FMDS</u>

The 2021 Farm Management Deposits Scheme Evaluation does not provide enough data and analysis for industry to provide a considered view on the effectiveness of the FMDS. While data made available on the DAWE website on FMDS provides aggregated details on accounts and amounts held by commodity and geography, it does not provide sufficient granularity to assess overall FMDS performance. Data and analysis required, include (but not limited to):

- Utilisation of FMD accounts as a % of total farmers eligible by state jurisdiction, commodity type, and turnover;
- Changes in number of farmers eligible to make deposits into an FMD account over time; and
- The variation in the account balance of FMD holders within each commodity stream and any correlation with turnover (not just averages).

Without further analysis it is very hard to provide a considered position on the overall effectiveness of the FMDS, the relative effectiveness within commodity groups or in farm businesses of differing sizes.

The last holistic review and analysis of the FMDS was in October 2012 by the National Rural Advisory Council (NARC), while the 2019 review by the Auditor General only focussed on establishing whether the FMDS as a tax measure was being effectively administered.

<u>Utilisation v effectiveness</u>

The terms of reference for the 2021 FMDS review notes that there are some 49,000 FMD accounts held by farmers, well short of the total number of farmers who are eligible to hold an FMD account. The NFF cautions equating utilisation and effectiveness of the FMDS without making further analysis and information available on the matter.

The FMDS is one risk management tool available to farmers, with a myriad of risk management tools available to farmers including insurances, financial derivatives, securing of high security water rights, on-farm infrastructure, debt, and income diversification through off-farm income. The FMDS may not be the most appropriate or cost-effective risk management tool for all farmers.

As an example, a farm-business in its start-up phase would likely reinvest all profits into investments on-farm and secure more access to finance, instead of locking away financial capital in an FMD account.

Similarly, different farming businesses have differing access and costs for risk management tools available. Intensive horticulture and dairy farming are likely to rely less heavily on FMDS as extensive farming operations, given that irrigation and the purchasing of high security water rights is more readily available to them. In the absence of publicly available information on utilisation numbers by commodity, the 2018 ABARES survey on FMD accounts suggests balances held by dairy farmers are significantly lower than those held by extensive farming enterprises.

There has not been the required analysis provided to draw conclusions on the FMDS' effectiveness based on utilisation, or what an appropriate rate of utilisation may or may not be.

<u>Review of FMDS in the context of the portfolio of drought measures</u>

The NFF seeks that the review of drought measures, such as the FMDS, not be held discretely in isolation of the portfolio of drought measures provide by the Federal Government and by the state jurisdictions.

The efficacy of the FMDS must be assessed with reference to its interaction with other measures such as state and federal government including other tax incentives, concessional loan schemes, the Future Drought Fund, grants for on-farm infrastructure, and hardship payments. Discretely optimising individual drought measures leads to a situation akin to a Nash equilibrium, where individual optimisation leads to a sub-optimal portfolio outcome.

The FMDS and its review suffer from this tunnel vision. As an example, eligibility criteria around off-farm income disincentivises farmers from utilising off-farm income as a risk management tool. At the same time governments are attempting to incentivise farmers to provide environmental services (carbon and biodiversity offsets etc.) as income that is uncorrelated to climatic conditions, which would significantly increase off-farm income.

Recommended improvements to the FMDS

Exclusion of various business structures from the FMDS

The NFF and its members oppose the effective exclusion of business structures, such as partnerships and trusts from the FMDS, noting that the main purpose of the FMDS is to create resilient and prepared farm businesses regardless of their structure. FMD accounts should be vested in the business operation not the individual.

There is an inconsistency with the vesting of FMD accounts with the individual. The FMDS purports to build resilient primary production businesses and excludes individuals who might derive too much of their income from off-farm sources, on the basis that they are no longer predominantly in primary production. At the same time business structures that are set up for the sole purpose of advancing a primary production endeavour is excluded. This could explain the limited utilisation of the FMDS.

The exclusion of these business structures is counterproductive to building resilience and preparedness, and is based on antiquated notions of unsophisticated family farmers with little business acumen. The establishment of these business structures are often to improve the risk management capabilities of the farm business, to then exclude these farm businesses from measures that will improve resilience and preparedness is illogical.

There are practical implications for resilience and preparedness. The untimely death of an individual holding an FMD account, and the tax liability that drawing down the account in one year creates, can severely dent the viability of a farm business.

Non-primary production income limits a barrier to the effective use of FMDS

The FMDS eligibility criteria limiting off-farm income to $100,000 p.a. is at odds with incentivising farmer to use all risk management tools to promote resilience and preparedness. Off-farm income is a key risk management measure for farmers in dealing with the cyclical nature of primary production income, and penalising farmers who utilise off-farm income by restricting their use of the FMDS does not promote good resilience and preparedness outcomes.

The interplay of off-farm income and the FMDS will become even more critical as other industry and government measures promote the expansion of off-farm income opportunities. The creation of markets for environmental services, such as carbon and biodiversity offsets, and the increased incidence of farmers hosting renewable energy generation will likely make more farmers ineligible for the FMDS due to off-farm income exceeding the $100,000 limit.

While the NFF understands the Government's intent on limiting the FMDS to those individuals who predominantly derive income from primary production, this eligibility criterion is a blunt instrument that creates more cost than benefit in terms of preparedness and resilience.

This selection criterion implicitly suggests that excluding farmers who would otherwise be eligible for the FMDS is justified from the benefit of excluding those who are not predominantly primary producers. The NFF does not believe that these farmers should be treated as collateral damage because there is an absence of more appropriate eligibility criteria.

The NFF recommends this criterion is changed in recognition of the significant benefits of off-farm income as a risk management tool. Further analysis is required as to how this change would be made (whether it be changes to off-farm income limits, changes to definitions of primary production, or other measures).

Triggers for the enforced withdrawal of FMDS

The NFF believes that requirement to withdraw the balance of an FMD account within twelve-months due to unforeseen circumstances, such as death, is counterintuitive to improving farm business resilience, creating a significant tax liability for the farm business in that year. In these circumstances, the farm business is being penalised by paying more tax (at a higher marginal rate) than had they not participated in the FMDS. This is a counterintuitive outcome.

The NFF recommends that in these circumstances accounts be allowed to be drawn down over three years to ensure a more appropriate and just tax liability.

Regular review of FMDS cap

The NFF recommends that the FMD account cap be reviewed on regular basis to ascertain its appropriateness in promoting resilience and preparedness in farm businesses.

Changes in climate, financial and trade conditions may or may not necessitate changes to the cap. A myriad of factors beyond climate volatility need to be taken into account in determining the appropriateness of the cap, noting that the impact and severity of drought is a combination of weather and climatic events and market conditions leading up to a drought, and condition thereafter.

Drought measures, policies and eligibility criteria should not be an exercise in 'setting and forgetting'. A review could be held every three years to determine the appropriateness of the cap.

Increased education and awareness

NFF members, including those with accounting and financial planning expertise, have suggested that farm advisor (accountants, financial planners etc.) education would benefit from a holistic overview of drought measures (including the FMDS), their operation and their typical use.

The NFF has highlighted the need for the development of a national curriculum on risk management for the network of farm advisors and is awaiting response from the Future Drought Fund.

Other policy and regulatory settings comprising the efficacy of the FMDS

The review must look outside drought policy to identify and tackle barriers to the more effective operation of the FMDS. As an example, banks are not incentivised to promote the use and expansion of FMD accounts as funds held are not recognised as tier-1 capital that would go towards fulfilling their capital adequacy requirements.

The recognition by APRA of FMD funds as tier-1 capital would increase the utility for banks of funds held in FMDs, and banks would actively promote their use and benefits to customers.

Should you have any questions regarding this submission, please contact Mr Ash Salardini, Chief Economist and General Manager Trade on 0490 785 390 or at asalardini@nff.org.au.

Yours sincerely

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