

Submission to the Inquiry into the Reserve Bank Amendment (Australian Reconstruction and Development Board) Bill 2013

Senate Economics Legislation Committee

February 2014

The Reserve Bank Amendment (Australian Reconstruction and Development Board) Bill 2013 proposes the establishment of an Australian Reconstruction and Development Board (ARDB) within the Reserve Bank of Australia (RBA). The ARDB would have the task of forming and implementing rural reconstruction and development policy. The proposed responsibilities of the ARDB would include:

- offering funding arrangements which contribute to the development of the Australian agricultural sector, associated industries and infrastructure
- reporting on, and helping to develop, the financial viability of the rural sector
- addressing situations which have resulted in debilitating financial arrangements in the agricultural sector or associated industries.

The *Reserve Bank Act 1959* would be amended to establish the ARDB.

This submission provides an overview of the rural sector, in particular how it is financed, the official assistance it currently receives and the previous role that the RBA has had in the area of financing the rural sector. It concludes with some comments on the proposed arrangements.

1. Rural Sector Funding

1.1 The provision of finance

The rural sector accounts for around 2 per cent of domestic output, and currently employs over 335 000 workers.¹ The Australian banking system currently provides the bulk of the rural sector's debt financing, with bank lending accounting for around 94 per cent of outstanding rural credit.² Rural debt outstanding totalled \$64.5 billion as at June 2013.³ Much of the broadacre farm debt is fairly concentrated, with around 70 per cent of total broad-acre sector debt on 30 June 2012 being held by 12 per cent of farms, most of which were larger operations.⁴

¹ ABS (Australian Bureau of Statistics) (2013), '[Australian National Accounts: National Income, Expenditure and Product, Sep 2013](#)', ABS Cat No 5206.0, September; ABS (2013), '[Labour Force, Australia, Detailed, Quarterly, Nov 2013](#)', ABS Cat No 6291.0.55.003, November.

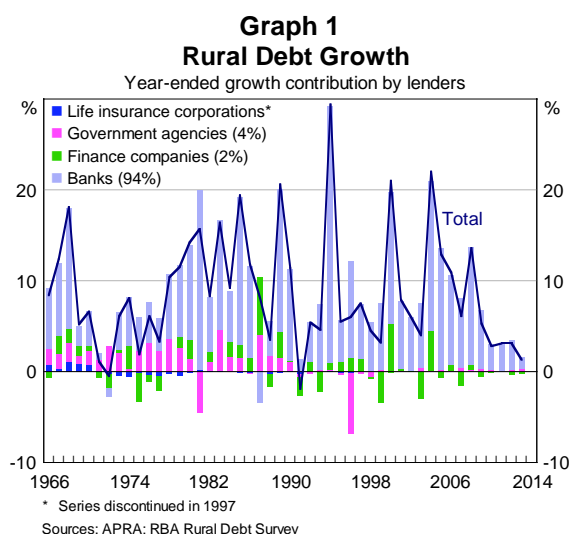
² See [RBA Statistical Table B1 – Assets of Financial Institutions](#), [RBA Statistical Table D2 – Lending and Credit Aggregates](#) and [RBA Statistical Table D9 – Rural Debt by Lender](#) for more information.

³ Includes debts owed to banks, finance companies and government agencies. See [RBA Statistical Table D9 – Rural Debt by Lender](#) for more information.

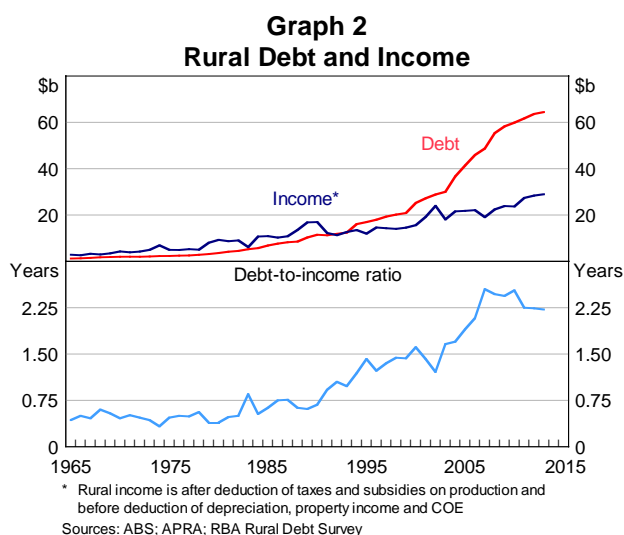
⁴ ABARES (2013), [Australian Farm Survey Results 2010–11 to 2012–13](#), March, Australian Bureau of Agricultural and Resource Economics and Sciences, Canberra.

Rural debt has more than doubled over the past decade. This increase was partly driven by borrowing for farm improvements and capital investments. The reduction in farm incomes resulting from the widespread drought in the 2000s also contributed, as farmers increased borrowing to meet their working capital requirements.⁵

More recently, annual growth in rural lending has slowed considerably (Graph 1). This is likely to reflect a number of factors, including growth in rural incomes, increased economic uncertainty and higher perceived risk from climate variability. Liaison conducted by the RBA suggests that farmers are increasingly recognising the importance of managing their balance sheets following previous episodes of drought. At the same time, financial intermediaries have reassessed the terms associated with the supply of credit, as part of a broader review of their loan performance and lending standards since the global financial crisis.⁶



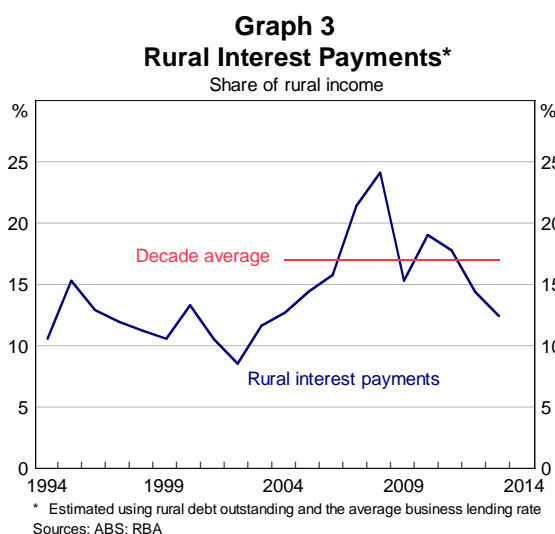
The relatively fast growth in debt in the 2000–2008 period caused the rural sector’s debt-to-income ratio to increase rapidly. (This was also true for the broader community, with the household debt-to-income ratio increasing markedly over the period.) While this ratio has fallen slightly over recent years, it remains elevated (Graph 2).



⁵ ABARES (2013), [Australian Farm Survey Results 2010–11 to 2012–13](#), March, Australian Bureau of Agricultural and Resource Economics and Sciences, Canberra.

⁶ ABARES (2013), [Australian Farm Survey Results 2010–11 to 2012–13](#), March, Australian Bureau of Agricultural and Resource Economics and Sciences, Canberra; RBA (2010), [‘Submission to the Inquiry into Access of Small Business to Finance’](#), Submission to the Senate Economics References Committee Inquiry into Access of Small Business to Finance, March.

Notwithstanding the high debt-to-income ratio, lower business lending rates and the slowdown in rural debt growth have led to a decline in the rural sector's interest payments as a share of income since 2008 (Graph 3). However, recent RBA liaison with agricultural businesses indicates that some individual farms may be finding it difficult to access additional funding due to their existing high debt levels.



Banks offer a range of products to rural borrowers, including overdraft and redraw facilities, and loans with repayment schedules that can be matched to farmers' expected cash flow cycles. The specific borrowing requirements and the volatility of agricultural income are risks that lenders take into account in providing loans to businesses in the rural sector. Rural loan arrangements generally include risk premiums that account for these risks and, similar to other loan arrangements, account for the financial position and operational viability of the individual borrower. (Little public data are available on the performance of rural loans.) The Productivity Commission has reported that farmers' access to capital is similar to that of other small businesses, with viable rural producers being able to acquire credit even after the risk premium adjustments made around the start of the financial crisis.⁷

Access to intermediated credit may become limited by the prospective ability of the business to service the debt. The ABARES *Australian Farm Survey Results 2010–11 to 2012–13* suggests that institutional lenders generally require farms to maintain their debt levels below 30 per cent of owned assets. The value of farm land – which is often used as the primary form of loan collateral – has reportedly declined since 2009 for broadacre and dairy farms in some areas, including the northern pastoral regions. The slowdown in rural land price appreciation is often cited as a factor that has been constraining the rural sector's access to finance over recent years. ABARES, however, estimates that 91 per cent of broadacre farms and 72 per cent of dairy farms had equity exceeding 70 per cent of assets on 30 June 2012.⁸

1.2 Government assistance

Various government agencies provide eligible farmers with access to a range of assistance packages, including concessional loans for productivity enhancements and disaster recovery. On 30 June 2013, lending by government agencies amounted to around \$2.2 billion.⁹

⁷ Productivity Commission (2009), '[Government Drought Support](#)', Report No 46, Final Inquiry Report, Melbourne, 27 February.

⁸ ABARES (2013), *Australian Farm Survey Results 2010–11 to 2012–13*, March, Australian Bureau of Agricultural and Resource Economics and Sciences, Canberra.

⁹ See [RBA Statistical Table D9 – Rural Debt by Lender](#) for more information.

The Australian Government also offers a number of measures to support the rural sector, including:

- the Farm Finance program, which will provide up to \$420 million of concessional loans through to 2015 to assist farmers with productivity improvements and debt restructuring
- the Farm Management Deposits scheme, which smooths farmers' incomes and reduces their tax burdens by allowing them to deposit pre-tax income and draw on these deposits in years of low income; the deposits are excluded from taxable income until they are drawn down¹⁰
- the National Drought Program Reform package, which will be implemented in July 2014 and will replace the existing Exceptional Circumstances policy; the new package will include a Farm Household Allowance, a national approach to farm business training and social support services, and tools to aid farmers' decision-making.

The total cost of Australian Government farm assistance programs between July 2001 and June 2009 was around \$5.9 billion.¹¹ The ABS estimates that in 2011/12, around 32 per cent of agriculture, forestry and fishing businesses received some government financial assistance.¹²

The government also helps fund investment in research, development and innovation to improve the productivity, sustainability and competitiveness of the rural sector through the Rural Research and Development Corporations.

In other countries, such as the United States and Canada, government assistance is provided to the rural sector through their government departments responsible for agriculture. The US Department of Agriculture, for example, provides rural development loan assistance, crop and livestock insurance, and farm loan programs through the federal Farm Service Agency. The *Canadian Agricultural Loans Act* is a financial loan guarantee program that allows farmers easier access to credit; these loans are guaranteed by the federal government.

1.3 Previous role of the RBA

In the past, the RBA (and prior to 1959, the Commonwealth Bank) has had a broader role in the rural sector. Between 1925 and 1988 the Rural Credits Department (RCD) provided seasonal credit for periods of up to one year to statutory marketing authorities and rural cooperative associations to facilitate the marketing, processing and manufacture of primary produce. It also extended research grants and fellowships for projects associated with the promotion of primary production.¹³

The RCD was created when the size of the rural sector meant that its demand for seasonal finance was very large relative to the capacity of private financial markets. By the 1980s, however, the commercial banking system had become the primary source of rural credit, and bank lending techniques had become well suited to the variable financing needs of rural producers.¹⁴ A major part of RCD advances had started moving to the financial markets in 1979, when the Australian Wheat Board began issuing commercial paper. Interest rates on RCD loans had also become more closely aligned with commercial rates and, by mid 1984, all were at fully commercial rates.

¹⁰ As at 30 November 2013, there were over 43 000 Farm Management Deposit accounts, totalling \$3.2 billion ([DAFF](#)).

¹¹ Productivity Commission (2009), '[Government Drought Support](#)', Report No 46, Final Inquiry Report, Melbourne, 27 February.

¹² See ABS (2013), [Selected Characteristics of Australian Business 2011-12](#), ABS Cat No 8167.0, September.

¹³ Between 1925 and December 1988, the RCD's Rural Credit Development Fund provided \$40.34 million of awards.

¹⁴ Australian Financial System Inquiry (1981), *Australian Financial System: Final Report of the Committee of Inquiry* (J Campbell, Chairman), Australian Government Publishing Service, Canberra.

The 1981 Committee of Inquiry into the Australian Financial System (the Campbell Committee) recommended that the RCD should be phased out.¹⁵ The Committee's view was that private markets had matured sufficiently to cope comfortably with rural financing needs. As for rural research and development, it saw the Budget as a more appropriate source of finance. It therefore recommended that 'the Rural Credits Department of the Reserve Bank should be phased out, with appropriate transition arrangements to enable existing customers to make alternative arrangements'. The 1983 Martin Report endorsed this recommendation.¹⁶

The legislation to wind up the RCD was passed by Parliament in 1986. The phasing-out process was completed in January 1988, when the last customer advance was repaid. The final research awards from the Rural Credits Development Fund were announced in December 1988.

2. Comments on the Proposed Arrangements

The rural sector plays an important role in Australia's economy. It is notable for the income-generating role it plays in rural communities and the seasonal variation in its output. Reflecting this, the RBA monitors conditions and developments in the rural sector as part of the RBA's analysis of economic trends. The RBA also maintains offices in various States, which conduct regular liaison with businesses in all regions throughout Australia.

Australia has a mature financial system and capital markets. The Australian banking system has sufficient capacity and expertise to service the financing needs of rural producers at a price that is appropriately adjusted for the risks that the lenders assume. Thus, the RBA's assessment is that the Campbell Committee's view that a commercial lending function is not appropriate for a central bank remains relevant. The private financial system can satisfy the normal commercial demand for finance by the rural sector, and the provision of finance from this source dwarfs any public provision under current arrangements.

To the extent that there is a market failure, or that subsidies are deemed to be appropriate, or that there is a case for financing at concessional rates for a particular purpose, the RBA respectfully submits that best practice would be for these issues to be addressed through an appropriately resourced and governed process, and transparently costed as part of the Commonwealth Budget. This promotes effectiveness, equity and accountability. That any official support for industry should be part of a budget process is also consistent with the approach taken in other countries. The RBA does not possess the requisite expertise in regular commercial lending. Moreover, the addition of a third Board to the RBA's governance structure would risk blurring of responsibilities and confusion over the RBA's policy objectives.

Reserve Bank of Australia
10 February 2014

¹⁵ Australian Financial System Inquiry (1981), *Australian Financial System: Final Report of the Committee of Inquiry* (J Campbell, Chairman), Australian Government Publishing Service, Canberra.

¹⁶ Australian Financial System Review Group (1984), *Australian Financial System: Report of the Review Group, December 1983* (VE Martin, Chairman), Australian Government Publishing Service, Canberra.