1990 A.A.E.S. ANNUAL CONFERENCE

ABSTRACT

"FACTORS INFLUENCING THE FINANCIAL VIABILITY OF THE AUSTRALIAN FAMILY FARM IN THE 1980'S"

Over the past decade the continuation of a falling terms of trade and periods of extreme low farm income have placed considerable stress upon the viability of the Australian family farm. Throughout the 1980's average farm incomes fell to very low levels during the national drought of 1982/83 and again in 1985/86 because of weak commodity prices. The Federal Government's current high interest rate regimen has also placed substantial pressure on farm incomes in 1989.

During the 1980's successful Australian family farms have been those which have been able to ride out the troughs and reap the benefit of the better years by following an on-going farm investment strategy and maintaining an acceptable equity position. These farmers have expanded their asset base in terms of either land, fixed assets, livestock and machinery, and have typically maintained at least a 75% equity position over the period. This has allowed them to achieve productivity gains necessary to maintain farm incomes without jeopardising their financial security.

4/12/89

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A feature of Australian agriculture has been its tremendous ability to overcome adversity, and this has again been borne out in the 1980's. Increasingly in order to maintain living standards farmers are being forced by a falling terms of trade and often diminishing market access into managing their operations more efficiently. When one then considers the vagaries of seasonal conditions, floating exchange rates and a frequent tightening of monetary policy it is then clearly apparent that the Australian farmer is a resilient species.

It is therefore not surprising that Australian agriculture remains based on the family farm structure. It is the family farm that can most adequately cope with;

A) The large fluctuations in farm incomes on a year to year basis. 1. (Refer graph No 1.) There is no need to maintain a dividend stream as a corporate operation requires.
B) The variable labour needs of the farm operation.
C) The generally low annual return on capital relative to other sector's of the economy.

Evidence from the past decade reinforces that the family farm will continue to be the backbone of Australian agriculture, despite a growing corporate presence.

The key features of successful Australian family farms over the period has been that they have followed an on-going strategy of farm investment and asset growth. The farm asset base can be segmented into three major components;

(i) Land
(ii) Fixed assets
(iii) Livestock

Those farmers who have made on-going capital injections into their farm have typically embraced new technology or adopted new management practices to best suit their conditions. This has lead to the rural sector achieving significant productivity gains. For example, over the period 1965/66 to 1985/86 the rural sector achieved an average rise in productivity of 2.80% a year, compared with only 1.10% for the total economy over the same period. 2.

By achieving strong productivity gains successful farms have been able to generate improved cashflows, which in unfavourable years has allowed these farmers to largely maintain their equity position and ensure their financial survival. In favourable years productivity gains have enabled farmers to either consolidate their debt load, undertake further on-farm investment or ideally a combination of both. Those farmers who have not been in a position to undertake a strategy of on-farm investment or have been unwilling to do so will in all probability eventually become financially unviable.

It is very difficult to obtain accurate time series data on the financial position of Australia farmers. There are three sources of such data, farmers, government agencies (eg ABS) and financial institutions. However financial data collected from farmers directly or by government agencies is often deliberately misrepresented because of the rural community's mistrust of the end use of such data. Details from the other secondary source of financial data, financial institutions, is also difficult to obtain due to confidentiality restrictions.

1/ A.B.A.R.E., 1989
2/ A.B.A.R.E., 1988

.../2

One of the few sources of recent financial data is from the Joint Rural Debt Mediation Programme (1987). 3 The programme was set up jointly by the National Farmers' Federation and the Australia Banker's Association in response to public concern about the hardships farmers were facing following a period from 1985 to 1986 of a weak terms of trade, rising costs and relatively high interest rates. The programme initially covered a six month period, and farmers who were facing financial difficulties were invited to contact debt mediators who would act as independent assessor of the farmer's financial viability. The debt mediators were all well respected farm management consultants with many years of experience.

The programme was focused on areas of known difficulty in N.S.W., Victoria, S.A. and W.A., and was mainly centred on the wheat belts of the participating states. Over the six month period the mediators handled in excess of 500 enquiries, of which approximately 440 cases were dealt with involving total borrowings from financial institutions of $150M. The industry composition of the cases assessed by the mediator are as follows

- primarily grains	:	321
- primarily livestock	:	105
- horticulture	:	14
		440 cases

From the cases under mediation and from previously existing clients the debt mediators were able to obtain time series data for;

(i) Those farmers who were operating successfully and/or had long-term prospects of survival. (Graph No 2).
(ii) Those farmers who were experiencing difficulties but had prospects of survival. (Graph No 3).
(iii) Those farmers who had failed or are likely to fail. (Graph No 4).

Graph two illustrates that those farmers assessed by the debt mediator as operating successfully are typically producers who have consistently grown their on-farm capital base over the period 1984-87. It is also important to recognise that successful producers used their strong equity position to fund capital expenditure and to improve the value of their capital assets. For successful farmers their improved productivity (from on-going asset growth) and strong equity position (and hence low interest burden) has enabled them to be largely insulated from the severe drop of average farm income in 1982/83 and 1985/86.

You will note that throughout this period the average level of farm debt of the sample set rose only marginally from 1984 to 1987, from $112,000 to $159,000. This rise in the level of debt from 1984/87 can be attributed to the low level of farm incomes in 1985/86 and probably a flow-on from a period of property expansion following the 1982 drought. Importantly, whilst debt levels modestly increased from 1984/87 farm assets appreciated by a corresponding amount and equity levels were retained. Be maintaining equity levels over the period these farmers are ensuring the continued operation of their farms in a successful manner.

3. A.B.A.R.E., 1989

Graph three illustrates the plight of farmers who were under debt mediation because they were experiencing financial difficulties but in the mediator's view had prospects of survival. You will note that in 1984 these farmers relative to successful farmers had a lower level of farm assets, a higher debt level and consequently a weaker equity position, (75% equity compared to 89%). However most rural lenders and consultants would consider that in 1984 these farmers were in a relatively strong equity position. It can be concluded that in the subsequent three years these farmers increased their borrowings but failed to undertake asset growth in a manner that lead to farm asset appreciation. Most likely it was a small number of significant decisions, (eg purchase of additional land) that were incorrectly taken that lead to their uncertain financial position in 1987. From a lender's perspective and on the evidence of the farmers who were assessed a likely to fail, it is doubtful that many of the farmers assessed as having prospects of survival will in fact will be still operating into the 1990's.

The plight of farms under mediation that were assessed a having failed or likely to fail is illustrated in graph four. These farmers in 1984 had a high debt load relative to total assets and hence a poor equity position (43%). This poor equity position meant that for these farmers their land's productive capacity was insufficient to adequately service the debt load. Accordingly when farm incomes again fell in 1985/86 there was little scope on these farms to boost production to maintain cashflow, and inevitably debt level rose further and equity levels were eroded at an alarming rate. Furthermore farmers in this situation were not in a position to obtain additional finance to enable them to meet working capital requirements and the majority of the farmers would be forced to realise their assets.

It can therefore be concluded that throughout the period (1984-87) successful Australian family farms (wheat/sheep belt) typically entered the decade in a very strong equity position and were able to more than double their asset base whilst maintaining their equity level. It is proposed that these farmers were able to achieve such results because their on-going commitment to expand their farm asset base lead to strong productivity growth and a proportional increase in the generation of cashflow.

In contrast those farmers assessed as having failed or likely to do so through the period (1984-87) saw their low equity positions rapidly fall to an average level of 13%. This resulted from a fall in farm assets over the period, where high debt levels in excess of what the farm's productive capacity could service resulted in an escalation of the debt to an unviable level. Typically these farmers were significantly less diversified in their farm operations than the representative sample of successful farmers. Further, from 1984 to 1987 the level of debt increased from $422/ha to $723/ha, which compares with the increase in the level of debt for the successful farmers over the same period from $39/ha to $40/ha.

I therefore suggest that the data obtained by the programme highlights the importance of a sound equity position and maintaining a growing farm asset base in operating a successful Australian family farm. If a farmer can operate with these two principles in mind then they should be able to achieve the productivity gains necessary to generate sufficient cashflow maintain living standards. Further, when the inevitable adverse seasonal conditions do occur, the farmer will be in a position to ride out these periods and successfully reap the benefits of future favourable conditions.

As a postscript to the Joint Rural Debt Mediation Programme it is interesting to note that the number of cases assessed under the programme represents approximately 1.16% of establishments involved in wheat production, and only 0.3% of total farm establishments. This was at a time of intense public agitation over the financial difficulties that faced farmers, which saw the emergence of a number of high profile, reactionary lobby groups.

Again in 1989/90 we saw a number of these interest groups re-emerge into the (rural) public stage to castigate the government and financial institutions over the "widespread" difficulties now facing farmers. Data collected by NAB's internal sources strongly indicates that whilst a number of farmers are in severe financial and personal difficulties, it is not accurate to suggest that this situation is widespread. The NAB time series data indicates that in any year there is likely to be a core of borrowers (approximately 2-3%) who will be in severe financial difficulties. This represents only approximately 0.5% of the total number of NAB rural customer connections.

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5/1/90.

BIBLIOGRAPHY

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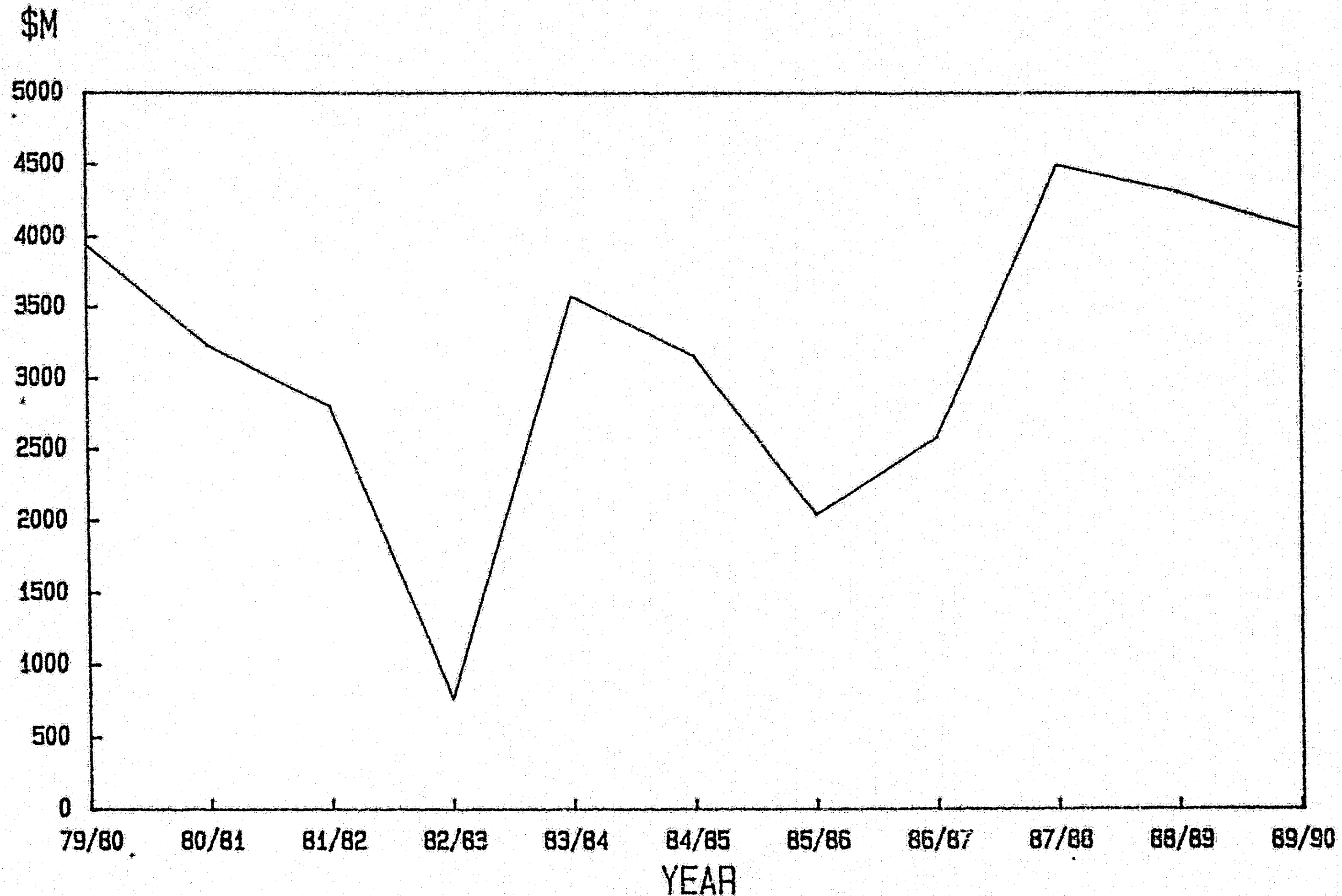
2. "Some Major Issues Affecting the Future of Australian Agriculture", Quarterly Review of the Rural Economy, Australian Bureau of Agricultural and Resource Economics, 1988 Canberra.

3. Joint Rural Debt Mediation Programme, 1987, Melbourne, (Unpublished).

CHART No 1

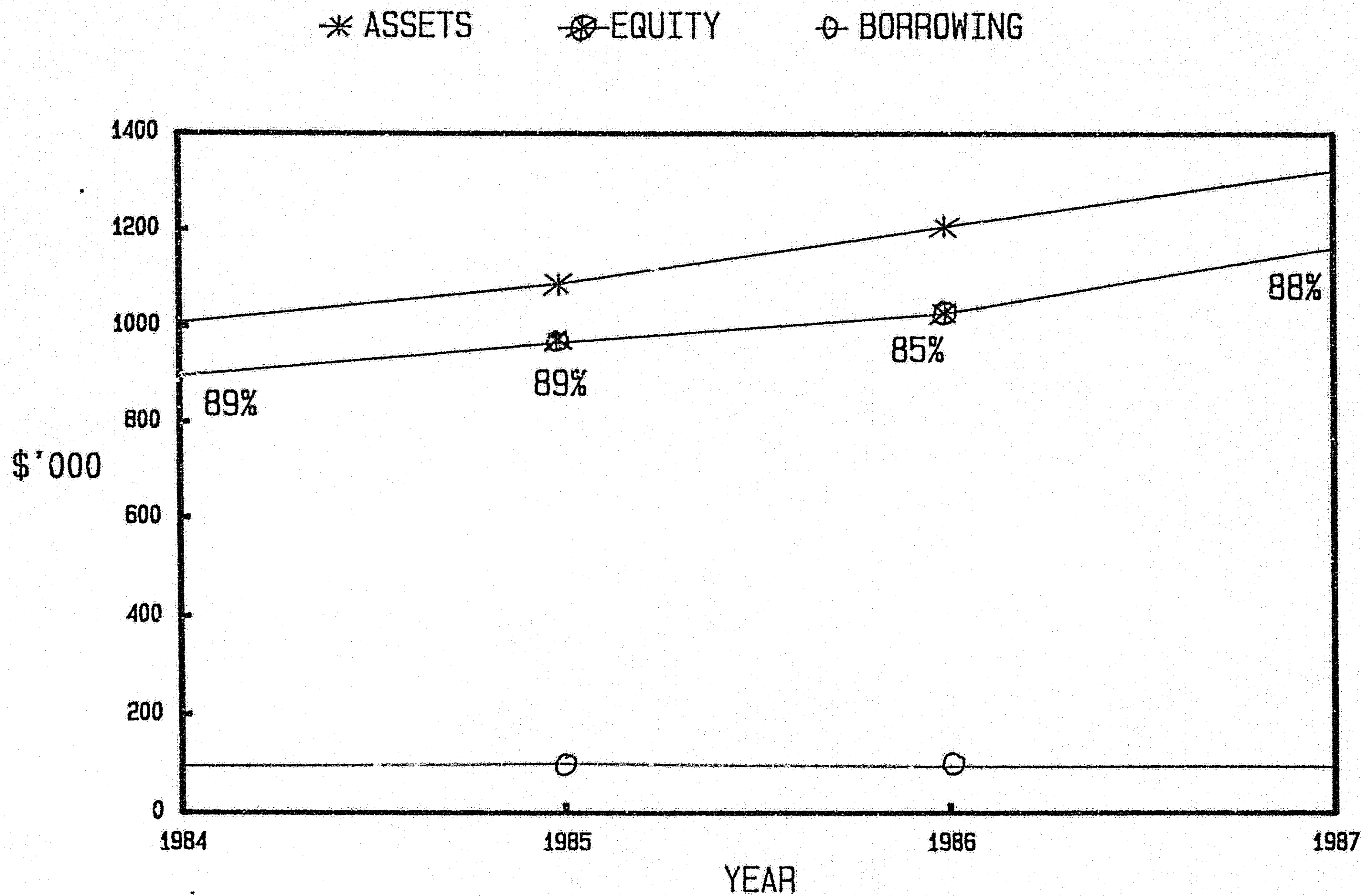
NET FARM INCOME - AUSTRALIA



SOURCE; ABARE 1989

CHART No 2

AV. TREND OF FARMERS OPERATING SUCCESSFULLY &/OR WITH LONG TERM PROSPECTS



Av. farm area: 1567 Ha (82/83), 2377 Ha (84/87)

SOURCE: JOINT RURAL DEBT MEDIATION PROGRAMME

CHART No 3

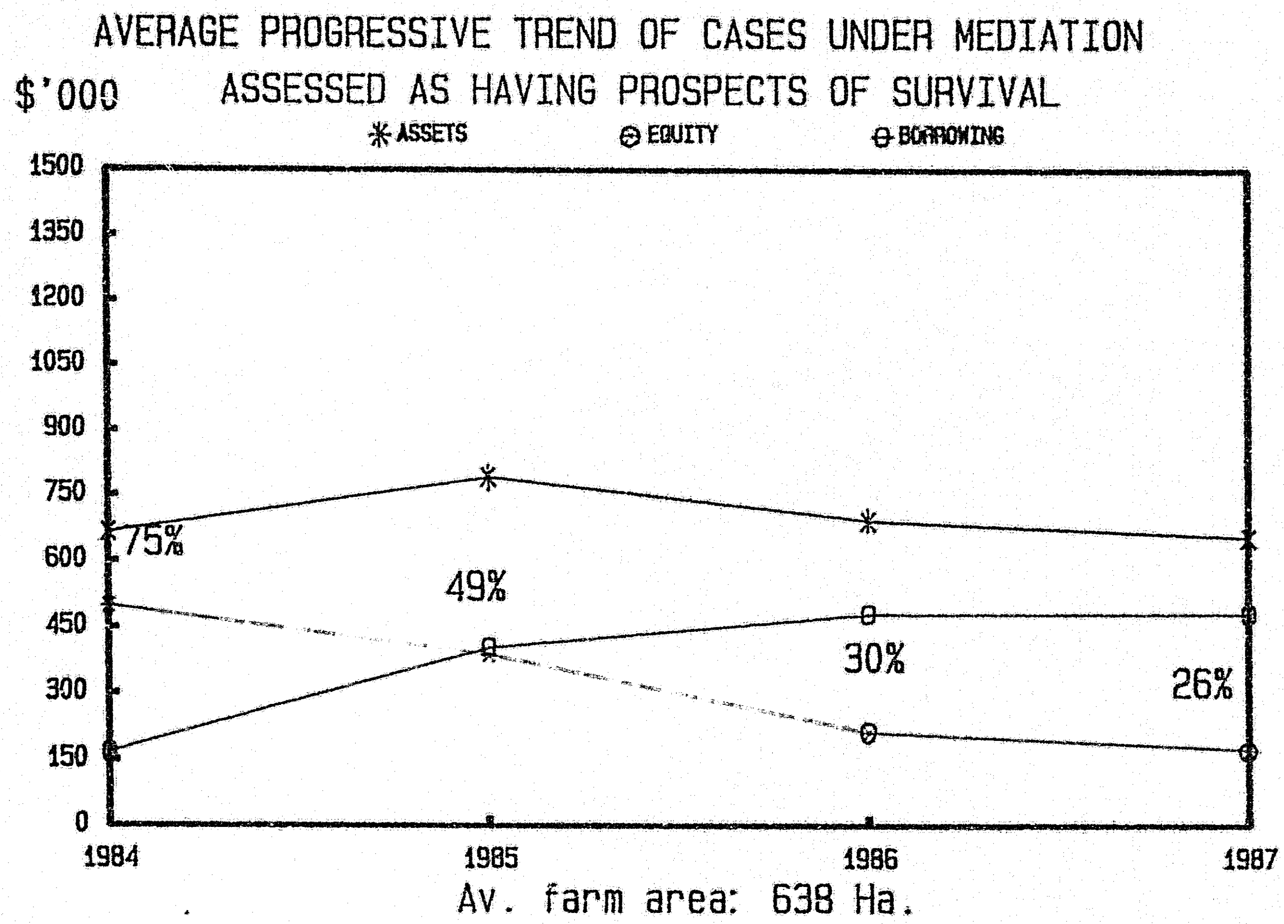
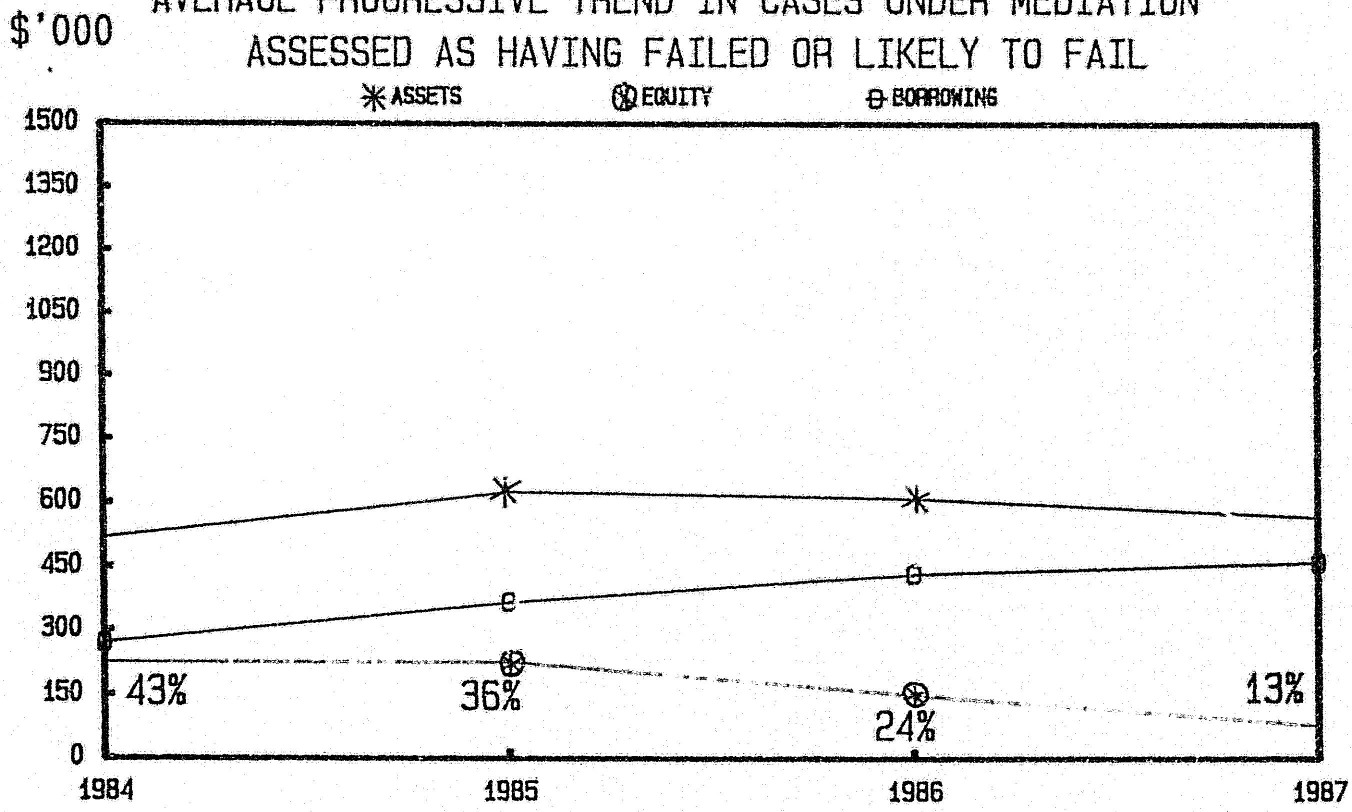

AVERAGE PROGRESSIVE TREND OF CASES UNDER MEDIATION
ASSESSED AS HAVING PROSPECTS OF SURVIVAL
$'000
ASSETS
EQUITY
BORROWING
1500
1350
1200
1050
900
750
600
450
300
150
0
75%
49%
30%
26%
1984
1985
1986
1987
Av. farm area: 638 Ha.

CHART No 4

AVERAGE PROGRESSIVE TREND IN CASES UNDER MEDIATION
ASSESSED AS HAVING FAILED OR LIKELY TO FAIL



SOURCE: JOINT RURAL DEBT MEDIATION PROGRAMME

Av. farm area: 638 Ha.