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**DROUGHT POLICY REVISITED :
A CRITIQUE OF THE
DROUGHT POLICY REVIEW TASK FORCE REPORT**

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"Many economists have argued.. ..that droughts, of themselves, do not justify specific drought subsidies for resource efficiency reasons and that welfare support is more directly and effectively achieved by direct income grants than by product and input subsidies" (Freebairn 1983).

1. BACKGROUND

Until recently, drought assistance in the form of concessional loans, subsidies and rebates has been provided to Australian farmers under the Natural Disaster Relief Arrangements (NDRA).¹ Under the NDRA, the Commonwealth provides financial assistance when a State's total outlays in a financial year exceed a predetermined base. Although there is considerable autonomy in determining the specific measures under which assistance is disbursed, the States/Territory are required to ensure that: assistance does not operate as a disincentive to self-help; assistance is designed to achieve an efficient allocation of resources; and, for other than personal hardship relief, concessional loans are preferable to non-repayable grants.²

In an Economic Statement delivered in April 1989, the Commonwealth Government announced that as from 1 July 1989 drought assistance would no longer be available under the NDRA. Assistance for other forms of natural disasters would, however, remain under the NDRA.

Also in April 1989, the Minister for Primary Industries and Energy, John Kerin, MP, announced the establishment of an independent Task Force to conduct "a comprehensive review of drought policy" (Kerin 1989). The Drought Policy Review Task Force (hereafter the Task Force) was required to:

- * *Identify policy options to encourage primary producers and other segments of rural Australia to adopt self-reliant approaches to the management of drought;*
- * *Consider the integration of drought policy with other relevant policies including structural adjustment, social welfare, land management, conservation of breeding stock and animal welfare.*

The Final Report of the Task Force was publicly released on 15 August 1990. The Task Force supported the decision to separate drought from the NDRA, and recommended significant modifications to drought assistance arrangements. On

¹Natural disaster assistance covers mainly weather-related events such as bushfires, cyclones, earthquakes, floods and storms.

²Whether natural disaster assistance satisfies these criteria is a moot point. As with drought assistance, a thorough review of the NDRA may be warranted.

policy issues relating to financial assistance arrangements the Task Force recommended:

- * Against the provision of transaction-based subsidies or rebates under a national drought policy.
- * State/Territory assistance for drought purposes provided by way of concessional loans; transaction-based and other specific subsidies should be discontinued, or if retained, they should be subject to specific performance criteria.
- * The provision of grants or interest-free loans should be limited to extreme situations.
- * The income support needs of rural families should be addressed through the Rural Adjustment Scheme (RAS).

A further set of recommendations which have a direct bearing on the level of assistance to farmers relates to taxation policy. Specifically, the Task Force recommended that:

- * A review of income and other taxation arrangements for capital intensive industries be undertaken in the context of sustainable development.
- * Structural improvements for the storage of grain, hay or fodder be entitled to immediate tax deduction in the year in which expenditure is incurred.
- * Expenditures on plant or structural improvements for the purposes of conserving or conveying water be restored to full tax deductibility in the year in which expenditure is incurred.

The Task Force also recommended reviews of policies and programs which affect the implementation of drought policy, including:

- * A review of drought declaration procedures.

- * A review of the scope of Income Equalisation Deposits (IEDs) and the desirability of a rural bond scheme (for drought and other purposes).
- * Additional research funding to improve the capacity for climate prediction.
- * Improvement in the monitoring of kangaroo populations.
- * Advisory and research programs which take an integrated approach to the provision of farm management advice.

In this paper, the recommendations of the Task Force for drought assistance are examined with a view to establishing whether they are likely to be in the national interest.³ The arguments put forward for an enhanced Rural Adjustment Scheme are examined and some potential problems in the administration of the proposed national drought policy are highlighted.

2. AN OVERVIEW OF EXISTING DROUGHT ASSISTANCE ARRANGEMENTS

What is drought?

A universally acceptable and useful definition of drought remains elusive, although it is generally accepted that drought occurs when there is a period of prolonged rainfall deficiency (Task Force 1990a, p.9). One problem of this concept is the difficulty in distinguishing drought from aridity. Furthermore, the concept fails to include other agronomic and management factors which affect the consequences of drought for farm businesses. For example, in many areas of Australia, prolonged dry periods are not unusual, and farming practices, pasture species and livestock are selected to suit the climate. Under these circumstances, a period of prolonged rainfall deficiency would not necessarily imply that farmers are suffering the effects of a drought.

In New South Wales, drought is declared within Rural Lands Protection Districts (RLPDs), on the basis of pasture condition. Drought is declared in a RLPD when at least 50 per cent of the district is considered by the relevant authority, (either a member of a Rural Lands Protection Board, or an officer from NSW Agriculture &

³The question of what constitutes the national interest is discussed in Section 5.

Fisheries), to be sufficiently drought affected to require survival hand feeding (Smith, 1989).⁴

The use of pasture condition as an indicator of drought allows a number of variables which affect plant growth to be included in drought assessment. However, this definition also allows the management practices of the farmer to influence drought declaration. Decisions made by a farmer with respect to pasture management and livestock stocking rates affect the ability of the pasture to support livestock. Heavier stocking rates exert a greater pressure on pastures, possibly requiring an earlier resort to hand feeding and consequently an earlier drought declaration.

Attempts to define drought may seem bewildering to those not fully conversant with drought relief arrangements. Formal declaration of drought is clearly not required before farmers can implement drought management strategies. However, the purpose of drought declaration in NSW, and in most other States, is to define the circumstances under which drought relief arrangements come into effect. If not for farm management purposes, drought declaration is required for the administration of drought policy, in particular, for establishing conditions upon which assistance becomes available.

One danger of underwriting the risks of particular events is that individuals have a reduced incentive to undertake preventative activities. This problem arises when the insured party can influence the outcome of the insured event. Typically, insurance schemes aim to avoid such problems of 'moral hazard' by dealing with catastrophic events which are fortuitous, i.e., outside the control of the individuals concerned. Otherwise, the insurer is faced with the dilemma of either acting as 'moral policeman' or adjusting its premium rates to take account of the losses induced by the availability of insurance (IAC 1986). The problem of management practices being influenced by partial insurance is likely to be exacerbated by declaration procedures which link the probability of drought declaration with farm management strategies.

Moral hazard due to drought relief may take the form of a reduced incentive to conserve fodder and water in the expectation that the costs of these activities will be underwritten, or an increase in the stocking rate under the expectation that the

⁴Details of the drought declaration procedures which apply in each State/Territory are provided in the Final Report of the Task Force (1990c).

consequences of increasing one's exposure to drought risk will be ameliorated by assistance.

A corollary of the problem of moral hazard is that the provision of relief has tended to discriminate against those who have adopted conservative management strategies.

Drought Declarations

In view of the relatively subjective nature of drought assessment, combined with the financial incentives which encourage farmers to seek drought declarations, it may not be surprising to find that drought declarations have been relatively frequent. In New South Wales, for the 20 year period 1967 to 1986, drought was declared for the following percentages of time⁵:

| | |
|------------------|-----|
| Western Division | 32% |
| Central Division | 25% |
| Eastern Division | 18% |

In some individual Rural Lands Protection districts the proportion of time under drought declaration was even higher. In the Western Division of NSW, for example, some districts have been drought declared for three months or longer in 20 out of the last 30 years (Task Force 1989).

The relative frequency of drought declarations which has occurred in New South Wales is also evident in Queensland and Western Australia. At the other end of the scale, there have been no recent declarations of drought in South Australia. One interesting feature of these comparisons is that South Australia does not have a set of formal drought declaration and assistance procedures similar to those which operate in New South Wales, Queensland and Western Australia. One possible interpretation of these comparisons is that rather than act as a constraint on claims for assistance, the formalised procedures for drought declaration which apply in some States provide an effective vehicle for interest groups to lobby for drought relief. This opportunity for effective lobbying is reflected in the higher rates of drought declaration and the commensurately higher rates of drought assistance in these States.

⁵Source: NSW Agriculture & Fisheries (1989).

It is apparent that drought relief arrangements offer an incentive for farmers to seek declarations yet an equal, but opposite incentive to resist declaration is not vested in any group, including groups within the bureaucracy.⁶ Under these circumstances, the system favours frequent rather than infrequent drought declarations.

Drought as a Management Risk

The Task Force was no more successful than previous attempts to define drought. However, for the purposes of the review the Task Force adopted the following working definition:

"drought represents the risk that existing agricultural activity may not be sustainable, given spatial and temporal variations in rainfall and other climatic conditions" (1990a, p.19).

This working definition recognises drought as a risk involved in agricultural production but fails to overcome the nexus between drought risk and the management strategies of individual farmers. The risk definition of drought is useful, however, in highlighting the role of government "...to remove impediments to effective operation of the marketplace and to ensure producers have an opportunity to manage the risks involved" (Task Force 1990a, p.21).

The Nature of Existing Drought Assistance Arrangements

Once a district is drought declared, individual landowners in the district become eligible for relief. Drought relief measures have historically taken the form of concessional loans for "carry-on purposes" and "specific purposes", and subsidies and rebates on transport costs of fodder, livestock and water (Table 1). Not all of the mechanisms listed in Table 1 have been available in each State. In South Australia, for example, the Rural Adjustment Scheme is used to target assistance to drought affected producers, whereas Queensland producers can seek an Individual Drought Property (IDP) declaration for their properties (Task Force 1989, p.22).

⁶Perhaps some public servants are concerned by the frequent declaration of drought, but the involvement of the responsible Minister in each State/Territory may over-rule such concerns.

Table 1: Drought Assistance Measures^a

| Concessional Loans | Subsidies/Rebates |
|--|--|
| Carry-on Purposes | Transport subsidies for: |
| <ul style="list-style-type: none">- purchase of fodder- replacement of stock- inputs for sowing and harvesting crops- household items | <ul style="list-style-type: none">- stock- fodder- water cartage |
| Specific Purposes | |
| <ul style="list-style-type: none">- restocking- development of water supplies- emergency soil conservation measures | <ul style="list-style-type: none">- agistment^b- fodder purchase^b<ul style="list-style-type: none">- slaughter- droving- scrub cutting or lopping- erosion control- bulk molasses storage- interest subsidy |

^a Not necessarily used or available in all States/Territories.

^b Commonwealth only in 1982-3.

Source : Drought Policy Review Task Force (1989).

Until 1 July 1989 Commonwealth involvement in drought relief had been provided by way of the NDRA. Payments made to the States/Territory under NDRA, and payments for drought assistance, for the period 1984-5 to 1987-9 are listed in Table 2. The data indicate that in recent years Queensland has been a significant recipient of NDRA payments. Data for New South Wales indicates that for the period 1980-81 to 1987-88, approximately \$23 million was spent annually on drought assistance (Table 3).

Table 2: Commonwealth Payments to States/Territory under NDRA

| | 1984-84 | 1985-86 | 1986-87 | 1987-88 |
|-----------------------------|---------|---------|---------|---------|
| New South Wales | 402 | 73 | 2 984 | 2 219 |
| Victoria | 386 | 28 | 4 | 3 |
| Queensland | 11 851 | 23 693 | 33 989 | 15 764 |
| Western Australia | 0.5 | 1 183 | 0 | 28 |
| South Australia | 0.5 | 0 | 0 | 0 |
| Tasmania | 0 | 0 | 0 | 0 |
| Northern Territory | 14 | 0 | 0 | 29 |
| Drought Assistance * | | | | |
| Queensland | 3 672 | 9 210 | 17 474 | 13 679 |
| Western Australia | 0 | 892 | 0 | 0 |

*Based on pro rata analysis of State expenditure and details of disasters in those years. Other States received no assistance for drought purposes.

Source: Task Force (1989).

Table 3: Natural Disaster Relief and Drought Payments in NSW

| | (\$'000) | | |
|--------------|----------------|----------------|-----------------------------|
| | NDRA | Drought | Drought as % of Total |
| 1980-81 | 64 544 | 62 595 | 97 |
| 1981-82 | 31 302 | 30 993 | 99 |
| 1982-83 | 53 667 | 53 655 | 99 |
| 1983-84 | 36 510 | 20 690 | 57 |
| 1984-85 | 10 695 | 1 078 | 10 |
| 1985-86 | 6 498 | 1 749 | 27 |
| 1986-87 | 24 364 | 8 678 | 33 |
| 1987-88 | 39 120 | 4 426 | 12 |
| Total | 226 700 | 183 664 | 69 |

Source: NSW Agriculture & Fisheries

3. THE TASK FORCE'S VIEW ON PREVIOUS DROUGHT RELIEF ARRANGEMENTS

The basic philosophy of the Task Force's Review is that drought policy should encourage primary producers and other segments of rural Australia to adopt self-reliant approaches to the management of drought. Managing for drought was considered by the Task Force to involve managing for the risks associated with agricultural production in a variable and unpredictable climate. The role of government, according to the Task Force, is to ensure a range of policy instruments are in place to allow individuals to adequately address the risks associated with periods of climate stress.

The Task Force interpret this role of government as improving the operation of the marketplace, removing disincentives to invest in capital intensive industries, and "providing incentives to managers when community expectations for resource management differ from commercial decision-making" (Task Force 1990b, p.33). Although the view of the Task Force is that the marketplace is the most effective means of ensuring the efficient allocation of the nation's resources, the Task Force reserve a role for government assistance "when the risks involved are beyond the capacity of individual producers to address on a commercial basis" (Task Force 1990b, p.34).

The Task Force review arguments for drought relief under four headings:

- (a) Incentives for effective farm management;
- (b) Incentives to land care;
- (c) A form of general industry support, given the unique characteristics of agriculture;
- (d) A measure of last resort for extreme situations.

(a) Management Incentives

The Task Force reject the argument that drought relief is required to foster effective farm management practices. The Task Force point out that producers should be interested in the stewardship of their properties, and therefore seek to minimise land degradation pressures which are associated with drought. The Task Force noted that although some submissions claimed the rationale for drought declaration procedures and the relief arrangements was to minimise land degradation, there was a significant body of evidence to suggest that drought subsidies encourage exploitation and land degradation. The Task Force argue that the term incentive is often used as a euphemism for positive assistance. "At the same time, there is a genuine concern that existing assistance policies have acted as a disincentive to good farm management" (Task Force 1990b, p.50).

The Task Force conclude that if a national drought policy is to provide appropriate management incentives to primary producers, previous drought relief arrangements fall well short of the mark (Task Force 1990b, p.51).

(b) Incentives to Land Care

The Task Force believe that the consequences for land care of drought relief arrangements are not clear, with a strong view that relief arrangements have exacerbated degradation. The Task Force also express the view that incentives to control soil erosion and improve land management practices should be provided through existing soil conservation programs in each State and Territory. This conclusion is consistent with that of another review of drought relief and land degradation, wherein it was concluded that management practices, encouraged by relief arrangements, contributed to land degradation problems (Department of Primary Industries/Australian Soil Conservation Council 1988).

(c) General Industry Assistance

Drought relief has been seen by some as compensation for distortions elsewhere in the economy, or in recognition of the "unique" features of agriculture. The Task Force reject the notion that drought relief is justified as a form of tariff compensation. While the Task Force believe that much needs to be done to improve intersectoral neutrality, tariff compensation "... is not a legitimate purpose for drought relief" (p.53).

(d) A Measure of Last Resort

The Task Force suggest that a possible area of general agreement is that drought policy should provide assistance to producers where government action is required as a measure of last resort. However, the Task Force argue that the frequency of declarations belies the suggestion that drought relief is used as a measure of last resort. The Task Force recommend that these deficiencies should be rectified under a national drought policy.

To summarise their review of previous drought relief arrangements, the Task Force believe past drought relief measures have failed to provide appropriate incentive for management to protect the viability of the farm or the resource base during drought. The Task Force argued the past drought relief measures are more likely to act as a disincentive to appropriate management by delaying necessary farm management

decisions. The Task Force also reject the view that drought relief is justified as a form of general industry support. On the other hand, the Task Force have suggested that assistance may be justified in "calamitous circumstances", but suggest that the current drought relief arrangements have not been administered in a manner consistent with a measure of last resort.

Based on their review of the failures of previous drought assistance arrangements the Task Force recommend a new direction in drought policy. The Task Force recommendations are outlined in the following section.

4 THE TASK FORCE'S RECOMMENDATIONS FOR A NEW DROUGHT POLICY

Justification for Assistance

Although the Task Force argue that the responsibility for drought management resides with the individual producer, a role for government assistance is identified "when the risks involved begin to exceed those that can be reasonably addressed on a commercial basis" (Task Force 1990b, p.82). The case for assistance under these circumstances was provided to the Task Force by "an expert review of the economic, social and environmental justifications of government action" (Task Force 1990b, p.85).⁷

The Task Force conclude that three objectives are relevant to the issue of government action in managing for periods of climate stress:

- (a) to ensure the efficient allocation of the nation's economic and environmental resources;
- (b) to facilitate the process of industry adjustment within a dynamic market environment;
- (c) to meet welfare and personal hardship considerations in more extreme situations to protect the national interest.

⁷A summary of the case for government assistance, based on the report commissioned by the Task Force is in Annex 2 of the Final Report (Task Force 1990c, pp.9-19).

(a) Market efficiency

The Task Force argue that efficiency considerations may arise when the market place is unable to deliver economically and environmentally preferred outcomes. However, the Task Force argue that these concerns are not unique to drought and should be addressed directly through, for example, taxation policies, advisory services, and income smoothing, rather than through the provision of drought assistance. In most cases, the Task Force believe, alleged instances of market failure represent an unwillingness or inability on the part of individual producers to manage for the risks involved (Task Force 1990b, p.86).

(b) Industry Adjustment

The Task Force argue that the process of structural change does not of itself provide the basis for government intervention. However, the Task Force believe that under conditions of uncertainty, "the market may give outcomes that are not consistent with long term adjustment trends" (Task Force 1990b, p.86). Government assistance, the Task Force argue, may be required "to ensure the adjustment process is consistent with longer term trends" (Task Force 1990b, p.87).

The Task Force distinguish adjustment assistance from other forms of industry assistance on the argument that adjustment assistance places an onus for responding to change with the producer. "Industry assistance, on the other hand, is intended to reduce the costs or improve the competitive position of the recipients. It is rarely tied to particular adjustment objectives and continues more or less regardless of market situation" (Task Force 1990c, p.18).

(c) Welfare Considerations

The Task Force argue that freight and other subsidies have failed to effectively target welfare needs of producers. For producers who may not have made adequate contingency plans for drought, the Task Force believe welfare assistance should be provided by the existing social security system under the same conditions which apply to other members of the community.

Households which are unable to maintain adequate subsistence levels during periods of financial difficulty "normally leave the industry and take advantage of other employment opportunities or assistance under the social security system" Task Force 1990b, p.87). However, the Task Force argue for special assistance arrangements to maintain producers in agriculture in extreme drought. *"It is only when the rate at which resources are leaving the industry becomes excessive, and may threaten the national interest, that the provision of welfare assistance to rural households is compatible with producers continuing to stay in farming"* (Task Force 1990b, p.87).

Welfare assistance under these circumstances, when according to the Task Force the national interest is threatened, should not be provided through the social security system, but through the RAS.⁸

In short, the Task Force isolate industry adjustment and welfare support as possible justifications for government assistance. The case for intervention on market efficiency grounds is, by comparison, limited to policies which improve the operation of the market.

The case for welfare assistance outside the existing social security arrangements is based on the belief that severe drought may lead to an excessive rate of adjustment of resources out of an industry. Existing social security arrangements, the Task Force argue, are generally only available to individuals seeking employment, and farmers who remain in agriculture are likely to be denied assistance on these grounds.

Adjustment assistance is required, the Task Force argue, because outcomes in the short term are often not consistent with long-term adjustment trends. Adjustment assistance would allow individuals within the market "take a considered view about desirable long-term outcomes" (Task Force 1990b, p.86).

⁸An outline of the Rural Adjustment Scheme is provided in an annexure to this paper.

Preferred Policy Instruments

Income Support Measures

The Task Force argued that whilst the integrity of the social security system should be respected, that the Rural Adjustment Scheme (RAS) is the preferred vehicle of welfare assistance for primary producers while they remain in farming. This view is based on the observation that rural families generally experience difficulty in qualifying for unemployment benefits while they retain an interest in the family farm. In forming this opinion, the Task Force agree with the findings of the 1977 Myer Report that the RAS provides the most appropriate vehicle for welfare support.

The Task Force believe that in extreme situations the national interest may be threatened by an excessive loss of resources from agriculture. The Task Force considered that a new Part D of RAS should be established to provide household maintenance to rural producers in those regions facing extreme situations. It is recommended that two threshold criteria need apply:

- (1) The situation be of such an extreme and widespread nature that at least 15 per cent (or such other figures as may be agreed between the Commonwealth and the States and Territories) of all primary producers in that State or Territory are receiving RAS assistance (under Parts A, B or C).
- (2) assistance under Part D would be available only to those regions where financial difficulties are particularly acute, such as at least 25 per cent (or such other figure may be agreed) of producers in the region or regions are in receipt of assistance under RAS (Task Force 1990b, p172).

Under the suggested guidelines, household maintenance under a new Part D would provide income support as an interest free loan at an amount equivalent to household support under Part C of the scheme.

Although the Task Force believe there exists a need for welfare support to retain resources in agriculture, this necessity, the Task Force believe is limited to extreme

circumstances, defined by the two threshold criteria. Welfare assistance for less extreme droughts should be accommodated by existing social security provisions.

Adjustment Assistance

The Task Force recommend the RAS form the basis for Commonwealth involvement in providing assistance under a national drought policy. In the Task Force's view, assistance available under Part A of the RAS, which provides assistance for debt restructuring, farm build-up, and capital purchasing, has an important role to play in drought management. The Task Force recommend that governments remove any doubt about the availability of RAS Part A for assisting eligible producers to cope with variable climatic conditions.

In contrast to the structural adjustment implied by Part A assistance, Part B of the RAS provides for concessional 'carry-on' funding. Part B assistance is available as a contingency measure for those situations when producers are thought to be experiencing shortages of funds due to circumstances beyond their control.

Although the Task Force believe Part B funding should be available to drought affected farmers, it was recommended that this assistance would be invoked only in severe cases. As a guide, the Task Force believe such severe circumstances which warrant assistance would occur once every 10 to 20 years. More frequent occurrences, the Task Force argue, should be dealt with under RAS Part A.

5 A CRITIQUE OF THE TASK FORCE RECOMMENDATIONS

Criteria for Assessing Governments Role in Drought

The framework chosen here for assessment of policy alternatives derives from the notion of scarcity and the desire to maximise economic benefit to society through the most efficient use of resources. A second aim of policy is taken to be to efficiently allocate society's wealth "fairly". Put another way, the approach to micro-economic policy is taken to be to maximise the size of society's "cake", and then to distribute

portions of the "cake" as efficiently as possible in accordance with the social welfare objectives expressed by society.

In societies such as our own, the operation of markets and the price mechanism plays an important role in determining the efficient allocation of resources. Specifically, in economies characterised by well-functioning markets it is possible to show that resources will be allocated efficiently and, furthermore, allocations will be Pareto optimal. Under these circumstances, governments cannot increase the size of the "economic cake" through intervention in markets.

Notwithstanding the outcomes of ideal markets, there are a number of well-documented examples where markets fail to yield efficient allocations. In these situations, the role of government in markets may be seen as strengthening or supplanting market forces to improve the efficiency of resource use.

In practice, government intervention is neither costless nor infallible. It does not follow, therefore, that evidence of market failure warrants government intervention. Policy formulation properly requires the perceived inadequacies of market outcomes to be compared with the expected costs of intervention and the anticipated improvements in economic welfare.

The second role for government involvement in micro-economic policy involves the transfer of wealth in accordance with society's views on fairness or equity. Ideally, welfare payments should be lump sum payments to individuals in need, and thereby neutral with respect to resource allocation (Varian 1987)⁹.

To summarise, the view taken in this paper is that the national interest is served by government intervention when it has first been established that the operation of markets has failed to maximise community welfare, and second, the expected benefits of intervention outweigh the estimated costs of government action. Furthermore, maximisation of the national interest requires the action taken by government be the most effective option available. This latter condition would require, for example,

⁹In practice it is extremely difficult to design and implement a non-distortionary transfer scheme, nevertheless some principles should be adhered to. The approach taken in this analysis is that to avoid significant deadweight losses, transfer payments should be made directly to those in need, and every attempt should be made to avoid the association of welfare payments with the rate of resource use.

assistance on social welfare grounds to be delivered through direct measures (such as those available through the social security system) rather than assistance tied to specific events such as drought.

The Task Force identify two main arguments for the provision of financial assistance measures. First, the Task Force recommends enhancements to welfare support available to the rural sector. In particular, the Task Force recommends that income support be provided to rural families in severe financial difficulties. Second, the Task Force recommend the availability of "general purpose concessional loans" as a form of adjustment assistance. Finally, the Task Force concluded that the appropriate vehicle for drought assistance is the Rural Adjustment Scheme. An assessment of the claims by the Task Force for drought assistance, both in the form of adjustment assistance and welfare support is provided below.

Income Support Measures

There is no doubt that agriculture is a risky business. Moreover, unanticipated events, such as crop damage, a downturn in commodity demand, or a drought can cause substantial falls in farm income. However, this unpredictable and variable nature of farm incomes should not in itself create a welfare problem. As Leach (1983) pointed out, rational decisions to enter an industry, including agriculture, require returns to be generated, on average, to meet satisfactory income levels including an allowance for the risks involved.

The Task Force did not furnish evidence to suggest that farm families are either irrational or held in agriculture in a "poverty trap". Even if either of these propositions were true, it is unlikely that income support would be a better policy than attempts to improve the decision making environment or remove impediments to resource mobility. In other words, if the problem confronting farm families is the difficulty in coping with the stochastic nature of agriculture, then preferred policy options involve ensuring that private risk management strategies operate as efficiently as possible. One of the dangers of providing income support to producers who experience difficulties is the possibility that assistance underwrites poor management.

Although most farm families cope successfully with fluctuating incomes, inevitably some individuals will not be able to meet their household consumption needs. Even if we accept the social goal of ensuring that all members of the community receive at

least a minimum income, it is not certain that an industry-specific policy to meet the needs of farm families adversely affected by drought is either required or desirable.

The difficulties associated with providing welfare support to farmers and the inevitable gaps which must exist within the social security system, does not imply the answer lies in creating institutions outside existing the welfare system. The payment of unemployment benefits or similar forms of income support to persons who continued to operate an unprofitable business would be equivalent to a subsidy for the activity. The removal of the work test for farmers either within the social security system, or implicitly by introducing special assistance to the rural sector, provides a guaranteed minimum income to a select group in the community (IAC 1984). Furthermore, there are strong doubts that the RAS, the purpose of which is to maintain and improve the efficiency of Australian agriculture, is an appropriate vehicle for administering welfare payments.

Although it is the intention of the Task Force to provide income support in a manner which does not discourage self-reliance, in practice, the provision of income support subject to the occurrence of a specific event has inevitable resource implications. The Task Force contend that the provision of household support should be based on (among other factors), the possibility that an excessive number of producers would otherwise be forced to leave farming which would not be in the long-term interests of the industry. This pre-condition assures that income support is tied to issues of resource adjustment, and contradicts the desired objective of leaving the rates of adjustment to be determined in the marketplace. The added difficulty of identifying the situation when an "excessive number of producers are leaving farming" is taken up in the next section.

Adjustment Assistance

The case made by the Task Force for adjustment assistance rests on the proposition that due to market imperfections, resources may, in the short-term, adjust inappropriately. According to the Task Force, in the longer-term, markets allocate resources according to nationally preferred outcomes.

The argument that drought can lead to costly resource movements has been challenged by Freebairn (1978, 1983). While a drought causes a temporary fall in returns to agricultural resources, "the fall, of itself, does not necessarily lead to a

misallocation of society's resources" (Freebairn 1983, p192). Freebairn argues that given longer-term prospects of a return to normal seasons, most quasi-fixed resources stay in drought affected industries. Transferable resources might be sold, but in general these are likely to be intra-industry transfers and not losses to the industry. Assistance to preserve resources in drought affected farms also penalises farmers who, by good management or good fortune, are in a position to purchase resources at reduced prices.

The Task Force do not produce evidence to suggest that "short term factors can result in significant resource movements that later need to be reversed" (Task Force 1990b, p159). There is the danger, however, that the Task Force misconstrue evidence that decisions made during a drought appear later, with the benefit of hindsight, to be inappropriate. As Anderson, Dillon and Hardaker (1977) point out, a good risky decision does not guarantee a good result. "A good decision is a considered choice based on a rational interpretation of the available information. Whether such a decision turns out to be right or wrong is partly a matter of luck *and in any case can never be determined until after the event, and often not even then*" (Anderson, Dillon and Hardaker 1977, p.3).¹⁰

The fact that decisions are later reversed does not imply a failure by private decision makers. Rather, the new decision may be a rational response to information which was unavailable at the time the original decision was made. Although we would all benefit from hindsight, the lack of it is not a case for government intervention.

If a policy of adjustment assistance was implemented, the difficulties in distinguishing between short-term phenomena and longer-term trends present significant problems for policy makers. The Task Force appear to be claiming that farmers generally over-react to climatic variability, yet they do not present any evidence to suggest that any other group in the economy, including those in government, would be better able to judge industry prospects. Indeed the Task Force claim it is unnecessary for the Government to have better knowledge or information than the marketplace to implement a policy of adjustment assistance. "Instead, it recognises that short-term combinations of factors, beyond an individual's control, can result in significant resource movements that later need to be reversed" (Task Force 1990b, p.151).

¹⁰Emphasis added.

The justification for government assistance based on this proposition is difficult to grasp. If the phenomenon of "over-adjustment" is widely recognised and the costs of readjustment are significant, it is uncertain why the commercial financial sector would be unwilling to meet the carry-on requirements of farmers. Furthermore, it is unclear why this apparent irrationality would persist, unless of course, farmers are in some way protected from the consequences of their actions. If that was the case, then the most efficient policy for overcoming the 'collective myopia' of farmers would be to remove the support protecting farmers from certain outcomes.

The Task Force failed to establish how concessional finance guarantees short-term resource use which conforms to the optimal allocation revealed in the longer term. There seems to be no guarantee for example, that concessional loans would not retain resources in enterprises which were revealed in the longer term to be inappropriate. Assistance provided to meet short-term difficulties runs the risk of allowing farm-firms to avoid or defer indefinitely the restructuring which is necessary to make the firm more resilient in the future.

7. CONCLUSIONS

The Drought Policy Review Task Force recommend an attenuated form of drought relief. Income support, under the arrangements recommended by the Task Force, would be limited to extreme droughts. Adjustment assistance to enable farmers to overcome financial difficulties associated with climatic variability would be available under Parts A, B and C of the Rural Adjustment Scheme.

The Task Force argue that previous drought assistance arrangements did not encourage efficient management practices, nor did assistance encourage self-reliance. Drought, in the Task Force's view, should be treated as part of the normal commercial risks faced by Australian farmers, and should not, except in extreme cases, be underwritten by government assistance.

Many of the conclusions of the Task Force, especially in their review of the deficiencies of previous arrangements, are consistent with reviews of drought policy by economists (e.g. Freebairn 1983, Kraft and Piggott 1989). Moreover, it might be argued that the Task Force have effectively defused arguments made for undertaking only minor modifications to previous drought relief arrangements (e.g. Goucher 1989). However, it is argued in this paper that the case made by the Task Force for

new drought assistance arrangements, either in the form of income support arrangements or adjustment assistance, cannot be supported in the national interest.

The Task Force are wrong to recommend income support measures outside the social security system. Welfare assistance, rightfully remains the province of the social security system, and should not be administered by a scheme purportedly designed to improve the efficiency of Australian agriculture.

The recommendation for adjustment assistance is also rejected. Although it is acknowledged that risky choices are often revealed to be 'wrong', this phenomena is not a justification for special industry support. An added danger is that industry support would prevent adjustment which would otherwise make the firm more resilient to climatic variability.

Decision making under uncertainty requires that individuals are well equipped with information about the probabilities of uncertain events and the costs and benefits of alternative strategies. The Task Force recognise that the public good nature of information means that some of this data will be under-supplied by the private market. Recommendations by the Task Force to improve climate prediction and farm management are in keeping with the desire to maximise the public interest. In contrast, recommendations to maintain drought relief arrangements, albeit in a significantly modified form, are unjustifiable concessions to the rural sector and are inconsistent with the national interest.

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ANNEXURE

Rural Adjustment Scheme

The purpose of the Rural Adjustment Scheme is to improve the efficiency of Australian rural industry through the provision of financial assistance to farmers. The Scheme is divided into three parts (Parts A, B and C).

Part A

Part A of the RAS provides concessional finance in the form of interest subsidies, loans or grants with the objectives of "enabling farmers to overcome financial difficulties arising from causes beyond their control" and "assisting farmers to improve their technical and financial performance".

The assessment criteria for Part A assistance require that the farmer:

- . be suffering, or likely to suffer, unless financial assistance is provided, financial difficulties beyond his/her control such that the continuing operation of the farm enterprise is in doubt;
- . have the capacity to become financially independent of assistance under the Scheme within a reasonable period.

Part B

Part B of the RAS provides carry-on assistance to farmers in industries or regions which are experiencing a short-term downturn.

There is now no prohibition on the use of Part B to provide carry-on assistance to enable farmers to overcome the effects of drought.

Part C

Part C of the RAS provides household support and re-establishment assistance to:

- . alleviate the personal hardship of farm families;
- . assist farmers to realise farm assets in an orderly manner;
- . assist farmers to re-establish themselves post-farming.