DEVELOPMENTS IN ADJUSTMENT POLICY

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Abstract

Despite the broader agenda of microeconomic reform and the accepted role of markets in this process, government continues to intervene in agricultural markets through the provision of adjustment assistance. Recent developments such as the so-called productivity focus of the new Rural Adjustment Scheme are seriously at odds with contemporary policy theory linking government intervention with market failure.

A further concern in the area of adjustment policy are recent initiatives, presumably based on equity considerations, such as regional development. An interpretation of this shift in policy focus is that it represents a form of rent seeking behaviour on the part of government faced with the prospect of downsizing in concert with deregulation of agricultural marketing arrangements and the declining importance of agriculture as a sector of the Australian economy.

Note: The authors are employed by NSW Agriculture in the Economic Services Unit. The views expressed in this paper are those of the authors, rather than those of NSW Agriculture or the NSW Government.

Introduction

The most recent developments in agricultural adjustment policy can be summarised by reference to the Commonwealth's recently announced Rural Structural Adjustment Strategy. Components of the strategy include:

- the National Drought Policy
- the revised Income Equalisation Deposit Scheme
- Farm Management Bonds
- the revised Rural Adjustment Scheme
- Landcare; and
- the Commonwealth Economic Development Strategy for Rural Australia.

The Commonwealth proposed the Rural Structural Adjustment Strategy on the basis that it is an "integrated approach" and will provide a "framework and consistent direction" to government policy. As well, it aims to address "long term structural adjustment and increase self-reliance among farm managers". The extent to which these policies are truly integrated, particularly drought policy, IED's and RAS and the appropriateness of the direction they provide, are the subject of this paper.

Despite recent reviews, IED's, RAS and to a lesser extent drought policy have remained largely unchanged for a considerable period of time. There has been little applied analysis of their effects and interrelationships. With the announcement of the Structural Adjustment Strategy, it could therefore be argued that emphasis has simply been on repackaging these products, rather than seriously questioning the need for government to intervene in market processes in this way.

It is therefore questionable that this policy package should be seen as providing a framework and consistent direction. A particular concern is the failure of government to withdraw distortionary forms of adjustment assistance and the associated shift in policy emphasis from efficiency to equity (social justice) as reflected in the recent move by government into the area of regional development. This changed policy focus could alternatively be viewed as rent seeking behaviour by government, faced with the prospect of downsizing in line with deregulation of agricultural markets and the declining importance of agriculture as a sector of the economy.

A further symptom of rent seeking behaviour is the development of 'visions' with which government endeavours to justify new forms of government activity. The Rural Structural Adjustment Strategy has for example been put forward as being consistent with the Commonwealth 'vision' for agriculture. This vision, with its social engineering connotations, is outlined below.

The Commonwealth Vision for Rural Areas

The Commonwealth's vision for agriculture is an industry which is internationally competitive, operates on the principles of sustainable development, self reliance and responsible risk management, has strong linkages with efficient businesses and is part of a community of people who aspire to live in economically viable and socially just rural areas.

This vision requires strong regionalised industries which are based on a high level of value adding and further processing of locally produced primary products, using leading edge technologies and management, and are effective marketers of rural products in international markets.

Such a vision must also include a concept of rural communities as centres with a strong and diverse economic base which can generate internationally competitive products, and where people have ready access to modern technology and management, transport and communications, education and social and cultural opportunities.

Within this framework there is still a major role for governments to ensure the economic and institutional environment is conducive to sound decision making. Governments can lead the way in promoting attitudinal change, can provide advice and guidance through education and extension and can improve the operation of markets such as for information (Kingma and Grant 1993).

Drought Policy

The National Drought Policy, based on work of the Drought Policy Review Taskforce (Drought Policy Review Taskforce 1990), involved transferring drought provisions from the National Disaster Relief Arrangements to the 'exceptional circumstances' provisions within the new Rural Adjustment Scheme. With the Commonwealth reserving its right to provide assistance in times of extreme drought, 1991 and 1992 saw extended debate between the Commonwealth and States on the finer points of the policy, such as when does a drought become a severe drought, and who pays.

The final outcome was:

- increased funding for training in risk management;
- increased funding for drought related research;
- allowance for severe drought in the 'exceptional circumstances' provisions of the new RAS; and
- phasing out State transaction subsidies.

In a general sense, by only underwriting severe drought and endeavouring to replace subsidies with training and research, government saw itself in the favourable light of transferring a proportion of the cost of drought to farmers, thus making them more 'self-reliant'.

The exceptional circumstances provisions, representing part of the Commonwealth's drought policy, provide for interest rate subsidies up to 100 percent. To date the provisions have been invoked for unseasonally wet weather in southern Australia resulting in rain damage to crops, low prices in the wool industry and drought in NSW and Queensland.

The exceptional circumstances criteria are an attempt to describe those 'severe' circumstances relating to prolonged drought, unseasonal rain, extreme temperature, disease, pests and low commodity prices, and the point at which assistance will be provided (see Attachment). One can liken them to a series of 'if statements', that while providing administrative ease, translate into fundamental inequities and inefficiencies upon implementation. By defining events that qualify for assistance rather than using needs based criteria, the provisions have the effect of rewarding inefficient producers at the expense of the efficient. If government assistance for short term problems such as drought was assessed purely on a needs basis, rather than also requiring events to be defined, the exceptional circumstances provisions could be removed and short term assistance addressed through normal RAS provisions.

Following recent activation of the provisions in response to low wool prices, in conjunction with some somewhat arbitrary rationing rules, a paper highlighting the inefficiencies associated with this form of assistance was submitted to the Standing Committee for Agriculture and Resource Management by NSW and Victoria. A key problem raised was that an inappropriate instrument, ie interest rate subsidies, were being used to address what was essentially a welfare problem, ie periods of temporary financial difficulty (for a discussion of resource use distortions associated with the provision of interest rate subsidies for drought and a critique of commonly used arguments to justify short term assistance for events such as commodity price downturns and drought, see Freebairn 1978 and 1983, respectively). The exceptional circumstances criteria have subsequently been referred to a working party where the likely outcome will be a redefinition of events that qualify for assistance.

Given the broad ranging nature of events that may potentially qualify for EC assistance and the advisory role to the Federal Minister for Primary Industries and Energy played by the new Rural Adjustment Scheme Advisory Council in relation to drought, a further concern is the extent to which the criteria and the role of RASAC lend themselves to increased lobbying by interest groups. On the basis of these concerns, it seems likely that the farm sectors newly gained responsibility for drought management, will be more imagined than real.

IED Scheme

Developments in drought policy lead to a Commonwealth review of IED's in 1992, with a revised scheme being introduced at the beginning of this year. While the scheme could not be justified on market failure grounds, a case was presented in the review whereby the scheme could be viewed as a transitionary measure to encourage contingency planning, in the process of winding back assistance in areas such as RAS. The following statement summarises the position:

> As well as partially addressing period inequity, the IED Scheme can therefore be used as a vehicle to encourage the strategic use of surplus funds over time, thus reducing reliance on current assistance arrangements, notably drought and structural adjustment assistance provided through the Rural Adjustment Scheme. In this context, the IED Scheme is potentially a mechanism to encourage a greater level of contingency planning within the farm sector, thereby providing government with an opportunity to strategically realign assistance policy in a way that is more likely to achieve the Government's efficiency goals. The extent to which such an objective for the IED Scheme can be embraced, however, is dependent upon the extent to which government policy is likely to change from one of politically expedient financial assistance, to one of truly encouraging financial self-reliance (Douglas and Davenport 1993).

It is interesting to note that a new deposit scheme, farm management bonds (FMB's), were not a recommendation from the review, yet they were introduced, bringing into question the policy formation process and the extent to which political imperative overrides considerations of efficiency.

The obvious confusion associated with parallel deposit schemes and the difficulties that could be anticipated in legislating for those 'difficult times' at which FMB's could be withdrawn, again reflect poorly on the current process of policy development. Because of this problem, the onus of proof with respect to when FMB's can be withdrawn has been placed on the depositor, opening the way for subjectivity and abuse.

Apart from the obvious policy inconsistency between the self help nature of IED's and the concessions available under RAS, a further inconsistency is the similarity between the criteria under which FMB's can be withdrawn and the criteria under which the exceptional circumstances provisions can be invoked. It would seem the latter would act as a disincentive to use of the former.

The Rural Adjustment Scheme

The Rural Adjustment Scheme was recently reviewed by consultants (Synapse Consulting Pty Ltd 1992) who were asked to report on 'the efficiency and effectiveness with which the scheme was meeting its objectives.' Legislation was passed late in 1992 and the new scheme was introduced at the beginning of 1993.

Operational changes to RAS included:

- amalgamating Parts A, B and C;
- Farm Household Support administered by the Department of Social Security;
- more generous exit provisions ($45,000);
- introducing the EC provisions;
- changing the cost sharing arrangements between the Commonwealth and states; and
- proposed review of the scheme in 4 years (1996) and termination in eight years (2000).

Superficially there was little change between RAS88 and the new scheme. Interest subsidies remain available, but with a changed productivity focus, carry-on assistance previously available under Part B is now available under the EC provisions, and household support and exit assistance remain.

RAS88	RAS92
Part A 50% subsidy	new RAS productivity provisions 50% int. subsidy to $20,000 p.a.
Part B carry-on finance	Exceptional Circumstances up to 100% int. rate subsidy.
Part C household support & re-establishment	Farm Household Support (DSS) & re-establishment

Of major significance however, was the fundamental shift in the delivery of interest rate subsidies (the primary form of assistance provided through RAS), from targeting farmers that were marginally viable, typically with debt reconstruction assistance, to targeting those already supported by financial markets in undertaking productivity improvements. A direct quote from the assessment criteria for productivity based interest rate subsidies under the new scheme, is that:

"farmers must be able to access commercial finance"

While previously government was viewed as a guarantor for the marginally viable, it now fills the role of good samaritan bearing gifts to the viable. Given the obvious need under this boundless productivity focus for RAS funds to be rationed, RAS authorities would now be forced into the difficult position of developing alternative criteria to those of commercial lenders.

Concern about the new productivity focus was also recently expressed by the Chairman of the Board of the NSW Rural Assistance Authority who stated that "even at this early stage of implementation of the new guidelines, the Board has a concern that these guidelines may deny needed and justifiable support to a very important group of previously proven viable farmers who have the potential to be viable again" (New South Wales Rural Assistance Authority 1993).

One can only surmise at what might have lead to broadening the target group in this way. The consultants raised concerns about maximising the return to the public's investment in farm adjustment – as if that investment was justified in the first place.

Perhaps, given the schemes structural adjustment objectives, and recognising the limited impact that targeting the marginally viable had on overall adjustment, it was suggested assistance be provided to all. Alternatively, it may have been recognised that market failure, regardless of existence or nature, was unlikely to be limited in effect to the marginally viable, and therefore again a natural progression was to provide assistance to all.

While one can only hope that such arguments were not the basis of the change to a boundless productivity focus, the reviewers should perhaps be given the benefit of the doubt, insofar as they may have proposed the productivity focus appreciating that its shortcomings would lead to an earlier termination of the scheme than otherwise.

Whatever the case, the current version of the scheme will undoubtable go down as one of the more significant government failures of recent times.

Previous RAS Reviews

This recent derailment of the RAS may also in part be explained by the irregular and inconsistent review process to which the scheme has been exposed (for a detailed overview see Musgrave 1990). Originally introduced on 1 January 1977 under the States Grants Act, the objectives of the scheme have since remained confused in relation to efficiency and welfare, presumably due to the schemes political underpinnings.

The RAS has been reviewed by the Industry Commission twice, in 1976 and 1984. The fact that subsequent reviews in 1987 and 1991 were by consultants (see Coopers and Lybrand WD Scott 1988 and Synapse Consulting Pty Ltd 1992), raises concerns about the rigour of the review process. These later reviews had a more narrow sectoral focus, concentrating on how well the scheme meets its objectives, rather than questioning the objectives within a broader economy-wide framework. Furthermore, few of the recommendations from these inquiries relating to accountability of the scheme, have been adopted.

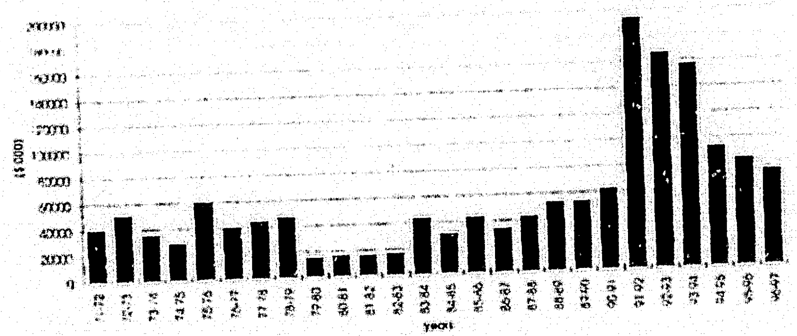
The 1976 review by the Industries Assistance Commission (IAC 1976) is remembered for highlighting the inequities and inefficiencies associated with the individual commodity based assistance schemes that existed under the Rural Reconstruction Scheme. Unfortunately however, rather than recommend that such measures be withdrawn to overcome the problem, the Commission recommended that commodity based schemes be replaced by a more broadly based scheme provided on a continuing basis. Furthermore, recognising that measures other than increasing property size would facilitate adjustment, the Commission recommended farm development measures be introduced. Unusually, the Commission focused on inconsistencies in application of the scheme, rather than on considerations of efficiency.

In the 1985 review (IAC 1985), the Commission focused more on the efficiency implications of government involvement in adjustment. While at that time a case could not be established on the basis of capital market failure to support the scheme, it is interesting to note that the Commission endeavoured to justify its 1976 decision to continue the scheme on the basis of capital market failure. In the 1976 report, however, there is no reference to capital market failure underpinning the recommendations. While the Commission appeared to have second thoughts about what was proposed in the previous review, it was the classic case of once a vote winner is in place, it is almost impossible to withdraw, unless of course budgetary considerations dictate otherwise.

For many the RAS debate is often confined to the effects of concessional credit on land values and its potential to slow adjustment through the retention of non-viable farms, however lack of analysis has largely relegated these concerns to popular conversation. Alternatively, such concerns have been dismissed due to what is considered to be a relatively small amount of funds being directed through RAS.

While it can be seen from Figure 1 that this assumption about outlays has and will become less valid, direct budgetary outlays are nevertheless likely to be a poor measure of the real cost of the scheme.

Figure 1. RAS Outlays



Given the increased debt that can be supported through interest subsidies versus concessional loans, more important will be the supply response effects of subsidised debt and the subsequent price and income penalties imposed on the efficient, by the inefficient.

Rural Adjustment Scheme Advisory Council

Under the Rural Adjustment Act 1992 the Rural Adjustment Scheme Advisory Council (RASAC) was appointed by the Minister for Primary Industries and Energy for a term of three years from 1 January 1993 to 31 December 1995. RASAC has responsibility for recommending to the Minister a strategic plan, budget and annual program for RAS (RASAC 1993a).

RASAC recently published its first strategic plan for the RAS (RASAC 1993b) which apart from its brevity is notable for the following statement by the Federal Minister of the time, Simon Crean:

> "while RAS is not the principal force driving structural adjustment, which will continue regardless of RAS, it is an important one".

The statement is interesting because it clearly positions government as consciously intervening in markets. The lack of justification for government intervention, in both this statement and the RAS Strategic Plan, places government in the position of accepting an ongoing role in structural adjustment. Such a position is difficult to defend against the proposed termination of the scheme in the year 2000 given the inference that from then on structural adjustment will no longer be a problem. Alternatively, the year 2000 may be viewed as being sufficiently far away as to enable alternative justifications to be developed.

RASAC Sub-Committees

In order to ensure RAS is achieving its objectives in relation to the three RAS themes of productivity, profitability and sustainability, various sub-committees to RASAC have been formed. While the work of the sub-committees provides a useful insight into potential new directions in adjustment policy, one needs to be mindful of the expansionary implications of much of this work, and therefore its possible inconsistency with the proposed winding back of RAS.

A further concern is the extent to which councils and committees, dominated by sectoral representation result in a certain maintenance of sectorally based policy outcomes. A relevant digression is to consider the extent to which the overall agricultural policy formation process, comprising State and Commonwealth representation on the Standing Committee for Agricultural and Resource Management, and subsequently ARMCANZ, leads to policy outcomes more aligned with sectoral rather than national objectives.

Performance Indicators Sub-Committee

In order to assess the effectiveness of RAS, the concept of performance indicators is currently being addressed by a RASAC Performance Indicators Sub-Committee. The thrust of the Committee's work has been to first redefine what RAS authorities should be doing to overcome adjustment impediments, so that appropriate indicators can then be considered.

For most impediments, information, training and counselling are identified as the appropriate RAS measures, providing an indication of possible future direction of the Scheme.

In identifying the extent to which such measures overcome impediments however, obviously it would be difficult to construct performance indicators that net out the contribution of RAS to farm productivity, profitability and sustainability from other factors such as seasonal influences and commodity price movements. The Sub-committee is therefore likely to recommend that rather than measure outcomes, diagnostic procedures be put in place to more closely align the form of assistance provided with the particular adjustment impediments being encountered by individual farmers. Under this approach, accountability reduces to being functionally correct, but as with many government services will not extend to an actual understanding of the benefit and costs of government expenditure in this area.

The Sub-committee will also look at how consistently RAS authorities deliver adjustment assistance. Significant inconsistencies can be expected, which while to some extent may reflect differences in local conditions, will also reflect inefficiencies in the delivery of public funds. In some states where farm diagnostics are undertaken prior to giving assistance, such as in Western Australia, assistance measures are more closely matched to adjustment impediments. But in other states, interest subsidies are universally used to treat adjustment problems, despite the cost of capital not being an impediment.

Regional Adjustment Sub-Committee

A second sub-committee, the Regional Adjustment Sub-Committee was formed:

> *'to develop a national overview of regional adjustment needs from a rural industry perspective, in order to facilitate prioritisation of resource commitment.'*

The Sub-Committee invited RAS authorities to identify 'areas that may require a regional approach to achieve adjustment goals', consistent with new provisions in the Act. The Bureau of Resource Sciences on behalf of the Committee then produced a report identifying adjustment issues across Australia (BRS 1993). The loose use of terms, ie adjustment 'needs', 'goals' and 'issues', ultimately lead to a report of limited use that recommended more work was required to identify, not surprisingly, adjustment impediments.

Lack of economic input to the BRS report was also reflected in regional adjustment issues then being classified into three groups:

- those regions requiring development to improve industry efficiency and international competitiveness;

- those requiring development to improve farm viability; and

- those with major resource degradation issues to be addressed to improve the long term viability of farming.

The classification is of questionable use from a policy perspective due to its focus on outcomes (visions) rather than causes. More generally however, the regional approach to the provision of adjustment assistance suffers from efficiency and equity problems associated with boundary definitions and the additional administrative arrangements that would be required.

Land Trading Sub-committee

Provisions were included in the new RAS Act for trading in land by RAS authorities and a Land-Trading Sub-Committee was formed. This was despite low levels of land trading previously, as reflected in the fact that in 1992-93 there was only four cases in Australia (see RASAC 1993a).

The perceived problem is the situation where low and negative equity farmers are unable to sell their properties due to a depressed land market and banks are unwilling to foreclose for the same reason. This stand-off situation is thought to slow farmer exit and therefore adjustment and is considered by some as a form of market failure. A paper by Edwards (1976) on the price gap between what sellers are willing to sell for and what buyers are willing to offer, considers this to be a normal part of market processes.

In relation to the point of slowing adjustment, it is difficult to imagine why government would be any better at selling properties than farmers or banks. Hence, while a farmer may be able to exit sooner than otherwise, there is unlikely to be any efficiency gains in terms of resource re-allocation. If government were to offer, to pay 15 percent of secured debt to a maximum amount of $45,000 consistent with the Western Australian scheme, such intervention simply represents a financial transfer from government to financiers, a form of government underwriting, encouraging less judicious decision making and flexibility by lenders.

Farm Human Resource Development Sub-Committee

The last RAS review stressed the need to provide resources for increased farmer education and training. It was found that in 1991-92 only 3 per cent of the RAS budget, on average across states, was spent on training. A farm human resources sub-committee was formed, concerned with how best to use RAS to facilitate the development of farm human resources.

At this stage some broad strategies are being developed involving research into issues such as why farmers don't attend training programs, sponsoring the development of case study material and reviewing institutional settings.

Conclusions

Components of the Commonwealth's Rural Structural Adjustment Strategy, namely drought policy, IED's and RAS, represent remnant policy constructs which owe their survival more to political merit than considerations of the efficiency and competitiveness of Australian agriculture. While there has been some attempts to justify components of the strategy, these have had little to do with market failure and perhaps more to do with either a directionless policy agenda or conscious rent seeking.

Drought policy, as defined within the exceptional circumstances criteria, represents an unnecessary continuation of the need on the part of industry and bureaucrats to define events that qualify for assistance, rather than directing short term assistance solely at those with legitimate welfare needs. One of the interesting contradictions of agriculture and those governing it, is on the one hand the acceptance of a free enterprise philosophy, but on the other, acceptance of government assistance, whereby the efficient effectively subsidise the inefficient.

While the IED Scheme was recently reviewed, the failure of government to ensure complementarity with drought policy and RAS, and the uncertainty introduced as a result of parallel deposit schemes now being in place, will likely render these schemes as unpopular as they have been in the past.

In relation to the RAS, the recently introduced productivity focus and the introduction of various councils and committees to provide advice and determine future direction are indicative of a program entering an expansionary phase rather than contracting in a manner consistent with reforms occurring in other sectors of the economy. Given the forthcoming review of RAS in 1996, and assuming budgetary implications don't force an earlier termination of interest rate subsidies, the next two years will be a timely period for closer examination of the scheme. An early indication of political intention in relation to RAS will be provided by the extent of adoption of sub-committees' recommendations and the extent to which a truly economy-wide investigation is undertaken in 1996.

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ATTACHMENT - EXCEPTIONAL CIRCUMSTANCES PROVISIONS (DRAFT)

eneral Guidelines For Exceptional Circumstances

(i)	(ii)	(iii)	(iv)	(v)	(vi)	(vii)	(viii)	(ix)
Event/Cause	Significant of Event (indicators as appropriate)	Damage	Magnitude (Extent) of Damage By State and/or Region and/or Industry	Effect	On-going Support (eg existing C'wealth and/or State Schemes)	Appropriate Type of Support of the Event/Cause	Duration of Support and Application Time Limits	Farm Performance and Strategies
Natural								
Climatic eg prolonged drought - unseasonal and prolonged rain - extreme temperature Environmental Disease eg crop disease - livestock disease Pest eg grasshoppers	When during crucial stages of the production cycles (eg planting and harvesting) Frequency of Event 1 in 25 years 1 in 50 years or more and/or Duration 2 consecutive production cycles or more and associated factors*	decrease in output and/or lower quality thus lower prices resulting in lower return	- number of farmers (eg 30%) affected - decrease in production (eg 30%) - percentage of production downgraded (eg 30%)	- negative/reduced farm cash income - negative/reduced farm profit increase in debt servicing ratio affecting farmers carry-on capacity - farm incomes for the application year should be lower than the average for the total period of the previous 5 years (eg 30%) - thus impeding ability to continue farm business	eg NDRA, Insurance, Transactions-based-subsistence	Interest subsidies to a maximum of 100% on existing or new debt for - carry-on - debt/capital restructuring - productivity improvement Support for farmers to continue farm operation and undertake essential farm investment but not to compensate for the damage.	Event: initially one production cycle and then to be reviewed Application: - to be submitted within a given time limit	- positive farm performance record - sustainability productivity/ profitability potential - adequacy of business planning including risk management strategy

(i)	(ii)	(iii)	(iv)	(v)	(vi)	(vii)	(viii)	(ix)
Event/Cause	Significant of Event (indicators as appropriate)	Damage	Magnitude (Extent) of Damage By State and/or Region and/or Industry	Effect	On-going Support (eg existing C'wealth and/or State Schemes)	Appropriate Type of Support of the Event/Cause	Duration of Support and Application Time Limits	Farm Performance and Strategies
Economic								
- commodity price downturn (ie below the long term trend line eg 10 years)	Sharpness of Decline dramatic decrease from the average of previous 10 years, within one production cycle (eg 30%) and Period of Low Prices (eg 3 years of more)		- number of farmers (eg 30%) affected	- negative/reduced farm cash income - negative/reduced farm profit increase in debt servicing ratio to affecting farmers carry-on capacity - farm incomes for the application year should be lower than the average for the total period of the previous 5 years (eg 30%) - thus Impeding ability to continue farm business	eg NDRA, Insurance, Transaction-based-subsistence	Interest subsidies to a maximum of 100% on existing or new debt for. - carry-on - debt/capital restructuring - productivity improvement Support for farmers to continue farm operation and undertake essential farm investment but not to compensate for the downturn	Event initially one production cycle and then to be reviewed Application: - to be submitted within a given time limit	- positive farm performance record - sustainability productivity/ profitability potential - adequacy of business planning including risk management strategy

* Other Associated Factors	One of the above events or a combination of occurrences: eg drought two years followed by low commodity prices and/or low incomes because of grasshoppers followed by drought, then low commodity prices again could also be considered in consistency with the above considerations
N.B.	The Assessment Criteria in the Guidelines are only an indicator. It is probably necessary to treat the circumstances on a case by case basis.