Discussion Paper

Resulting from the Rural debt Roundtable Process

Initiated by the Hon Wayne Swan MP and Hon Bob Katter MP

Proposing a Path forward

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Introduction...

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This paper is intended to stimulate consideration and discussion about the alternatives and motives for the intervention of government in the economic life of stressed primary producers in the second decade of the 21st century.

Some have a view that there is an opportunity in Asia which is rather more than the illusion deregulation and privatisation have provided farmers the past couple decades. As Treasurer Swan said on the 17th of October 2012 in Brisbane ***" it looks like we may need to find new ways of doing things so we are still standing for the future"***

It is incumbent upon those who attended this day to recognise the opportunity provided and assist to find new ways.

It should also be noted that this paper is directed at prioritising the agenda, as we did at QUT the following day, stop the forced sales, rearrange the debt, then look to see what can be done to manage the realities we all confront to see that primary production returns equitable profits for those who engage in it. It is not to say that profit belongs to all, but to recognise the comparative competition in the world around us, both overseas and domestically to recognise the very high risks to the art of production in the Australian context and the very debilitating effects of both changes in social attitude to our industries and very normal maturation of our economy.

This paper does not deal with the changes needed in industry policy which would alter the market power of domestic and international marketing arrangements which themselves contribute to undermining the capacity of many producers to receive reasonable returns for their work, nor the apparent concentration by the machinery of government on the removal of our photo sanitary protections at the very real expense of imported disease and hence domestic industry.

We simply want to begin at the beginning and have a win, build and move on for our people and for our communities.

Background.

A number of primary industries and their producers are encountering debilitating debts, accumulated as a result of a number of issues directly attributable to the policy direction adopted post 1980's : removal of various industry protections, based upon the view that market solutions better allocate resources. The WA pilot program is a classic example of a market driven drought solution which sets up the foundations for a national roll out of a system with no safety net what-ever.

Particular financial arrangements have prevailed which have encouraged financial institutions to develop strong and in some cases aggressive lending practices. This has created a situation in which primary producers, advisors and bankers across the economy would re-evaluate risk profiles and for lenders to accept risk based on constant rising asset values. This situation changed dramatically in 2008 with the onset of the GFC. Indeed it is unlikely that the pre 2008 will return.

All this in the face of an unrelenting phenomenon best described by Ben Rees in his various papers as "terms of trade decline" and in reality the effects of changes in maturing economies properly described as "Engle's Law". This pervading law describes how consumer budget preferences change as incomes rise in advanced growing economies. Consequently we are left with the fundamentals of a modern economic system which will need constant management and ongoing adjustment to maintain relative incomes and living standards of the farm sector. Removal of intervention has exasperated not ameliorated relative rural decline.

Upon reflection, there has been a long term transfer of income from producers to consumers, and Engle's law properly describes this pattern. For the uninitiated the price of many inputs into agriculture have kept pace with prices in the wider economy, eg. Wages, fuel, fertilizers, chemicals etc. However, primary producer's real income has long since been left behind and more often reflects nominal values of several decades. This confirms the disadvantage of a competitive market in the primary production sector purchasing inputs from monopoly structured input markets; and selling products to monopolized output markets.

This transfer of income from primary producers to secondary and tertiary industries lies at the root of problems of adjustment faced by primary producers. Relative decline in primary sector incomes can be seen as failure of policy to adequately address the question of income distribution as it pertains to primary producers.

The transfer of the full gamut of risk down the production chain to producers has left them seriously exposed and for many the challenges no longer offer any reward.

In many areas our system is on the brink of collapse. The Northern cattle industry is estimated to have 30% of operators in default. Some areas of WA are said to have every property in the district for sale, my own district has an unprecedented number of operators in difficulty.

Consideration must be given to two propositions which can be run in conjunction or as alternatives. It seems that some problems are of higher concentration in certain areas like the Eastern Wheat-belt in Western Australia where descriptions like "every property in our district is for sale" describe an area specific need to particular adjustment, while the description of the Northern cattle industry as having 30% of the operators in default describes an industry situation. As a result of these descriptors it would be proposed that the guidelines for entry to the program be as broad as possible to allow the "authority" as much flexibility as required to carry out the program design.

To intervene or not.

Government has a choice, to activate a policy response to a definite need in the rural community or to allow the invisible hand to sort the problem. To some extent the banking industry, the other partner in this difficulty has at its discretion a remedial system intended to tidy up failure. We contend that the machinery available is intended to be utilised for a small percentage of defaulters, while, at least anecdotally, the numbers suggested point to policy failure and therefore require remedial activity at the level of government.

In the current circumstance with the particular political powers in the states and the lack of adjustment machinery available in some states a Federal initiative may be the best path forward.

A failure to intervene will certainly lead to the funding institutions moving to make their own "adjustments" and there lies some risk of a sub optimal outcome and even suggestions of wholesale overseas capital taking up entire districts. There is little doubt the wider public would be less than comfortable with this outcome. I have little doubt those we sent to war to fight for our freedoms and rights would turn in their graves at this prospect.

No intervention may lead to;

- Wholesale exit from some farming districts.
- Loss of specialist knowledge.
- Pressure on banking industry portfolios as losses crystallise.
- Overseas ownership of large tracts of agricultural land.
- Deeper and greater business losses follow in support industries.
- Further business failure.
- Rising unemployment.
- Slowed reconstruction.
- Social fabric decline in rural communities.

The Purpose of a Program.

This program should have at its central plank -

- Provide economic stability to rural industry.
- Retain technical skills in agricultural production.
- Address policy failure.
- Reconstruct debt to viable level.
- Initiate and facilitate reconstruction.
- Maintain property values.
- Stabilise rural finance.
- Provide social stability.
- Provide the confidence to producers to continue.

A Path Forward

Discussions have occurred about the possibility of utilising accumulated tax losses as transferable tax credits to form part of an adjustment package. Accumulated tax losses come about by the effective loss of profit either by trading below the cost of production and or the addition of available claimable benefits like depreciation, investment allowances and so on. In their current form accumulated tax losses are a retained right of a particular producer and are non-transferable.

In some tax systems in other jurisdictions these rights or similar rights are transferable by sale on a secondary financial market. In Australia they are an unfunded liability to the Commonwealth Taxation Department and can be utilised at any time the tax payer makes sufficient profit to provide taxable income. As profit offsets they reduce or remove the payment of taxation revenue to the Commonwealth.

In many perhaps most asset sell downs producers are left bankrupt and the losses are thus extinguished... a benefit to the Commonwealth.

It is accumulated tax losses which are proposed to become part of an adjustment program. There are two scenarios in which this might be structured. Firstly, accumulated tax losses could be surrendered directly to the Commonwealth as part of debt reconstruction thereby extinguishing the unfunded liability of the Taxation Department. Alternatively, they could be surrendered to the lender, offsetting debt to a negotiated level. The second option would save the Commonwealth Reconstruction Institution an offsetting level of debt refinance.

It seems simple to make it one part of an adjustment program which could be traded with the primary lender or reclaimed by the government in the process, so long as certain other adjustments are made.

Debt reconstruction should be structured through a Government Institution which could be an integrated department in a public banking system, or, a specialist type financial institution. If a specialist type institution is accepted as the way forward, there are many examples in economic literature of how this can be achieved. Firstly, there is the US Great Depression Federal Farm Mortgage Corporation. More recent examples applied during the GFC are simply variations on a theme: TARP, ESM, "Bad bank " models in Spain and Ireland. In all cases, an institution relieves a bank of troublesome assets at a market discount. It is in this type of arrangement that accumulated tax losses could be used to benefit both a troubled producer whilst at the same time extinguishing the unfunded liability of the Commonwealth Government through the taxation Department.

A failure to do this job effectively will simply slow the exit from the bush rather than inhibit or stabilise.

For instance, if insufficient debt was removed from the client, or the rate of interest lowered to a certain level, it may well be that the client can never adjust to levels "sustainable" as at the very instance a profit is made sufficient to repay debt, taxation becomes the priority...if losses are off loaded then tax will be paid rather than debt unwound.

At various forums the example quoted was a customer who held debts to 4 million and losses to 2 million, at that ratio a transfer of 1 for 1 losses against debt will bring the customer to 50% of the earlier debt, but it may be insufficient to bring the debt to levels sustainable and require a further write down by the funder. This proportion may not well reflect real situations, when insufficient losses exist to obtain sustainable adjustment, that is the business is predominately at risk as a result of adjustment of capital value of property. There is said to be up to 50% reduction in property valuation's since the GFC, it takes not too much imagination to see the danger here as a loan secured at an equity ratio of 50% net equity is now under water, and further that some funders may begin pre-emptive sell downs to recoup at risk money from loans secured in most conservative ratios pre GFC. Certainly they will focus on profit and any sign of a series of seasonal or price anomalies will see quick remedial action.

A further problem exists when no bank will retain "adjusted" accounts and thus it seems a necessity to provide a lender of last resort to facilitate this process, it would be that such a lender with Commonwealth legislation may be much more able to negotiate with large banking organisation who will certainly compare the return from wind up against net through adjustment. Market power would thus be balanced in this negotiation and the goals of the program protected and achieved.

The suggestion that a Development Bank or specialist Rural Bank be the machine seems to begin a path toward resolving the delivery of this program, perhaps though the extension of a trading bank to allow the Commonwealth to maintain reasonable margins through effective competition in the wider Australian banking market could be a very popular and eminently sensible outcome.

Clearly the seed capital would be provided by the Commonwealth and the credit for the reconstruction program provided via treasury credit while government would sit behind the trading bank retaining effective control, using it as an instrument of the state.

Lending to the reconstruction program would be at concessional rates, allowing a greater portion of the 'at risk' capital to be retained by the primary lender.

Eligible primary producers would make application and be considered by a board with a goal of completing its work over a period, perhaps two years.

The opportunity is to take charge of this situation and provide the funders with an advantage of an improved outcome upon adjustment rather than the whole-sale sell downs which constitute their obvious alternative.

The wider rural communities receive benefit as business stability is achieved and public benefit as well, with stabilisation of rural values and rural business, thus the benefit afforded extends from farm businesses adjusted to bankers and their shareholders and the wider community.

There will be a need to "review" the activity of the program to test against stated goals.

There is no choice but to act.

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