

AGRICULTURE ISSUES PAPER

Farm Risk Management – the need for a new approach

Rodney Hamilton¹, Peter Thompson², Jean-Francois Rochecouste³ & Julie Cotter⁴

Australian agriculture is facing a crisis from volatile market demand and increasing input costs resulting in profit uncertainties, rising debt and a risk to farm assets. The financial stress condition is exacerbated by extreme weather events creating an increased likelihood of production loss. Rising input costs results in ever higher stakes gamble for producers in the event of a catastrophic loss (e.g. from frost or flood).

Current drought relief arrangements are welcome, but they do not deliver relief for the majority of farmers. In fact, they can cause unforeseen disadvantage to viable farm businesses and the current drought policy has unintended adverse consequences.

Farmers want to be self reliant, but achieving full self reliance will require improved risk management strategies, particularly for those rare and unexpected events such as extraordinary drought, flood, hail, frost and cyclones.

A change in Government policy is required. While welfare payments should be afforded to all Australians in genuine need of welfare, regardless of asset ownership, Government policies should enable businesses to prosper and effectively manage risk. For this reason, we advocate a farm insurance scheme which can be used to cover input costs in the event of a very unusual catastrophic weather event.

The key issues are:

1. The impact of drought and other severe weather events on farm profitability and cash flows – farmer's inability to effectively manage these risks and the losses arising from them under the current policy framework and in the **absence of suitable and affordable agricultural insurance products**.
2. **High debt levels and increased risk** that have resulted from crop losses arising from drought and other severe weather events. This has led to problems accessing investment finance and supplier credit.

¹ Farmer, Condamine,

² Farmer, Roma district

³ Executive Officer, Conservation Agriculture Australia Inc (CAAI) & Industry Research Fellow University of Southern Qld

⁴ Professor of Finance, University of Southern Queensland

3. Many farmers **struggling to maintain profitability, manage cash flows and make sound investment decisions** in the context of extreme climate variability, changing market demand, increased input costs and changing biophysical pressures.

As a result of these pressures research outcomes of the past may not always be appropriate to current conditions. New farming systems need to be evaluated and considered taking account of the economic conditions currently facing farmers. A range of business risk management tools to deal with the crisis of viability facing farm businesses is urgently needed.

Agricultural operations require significant machinery and other investments to remain globally competitive. Increasing investment coupled with higher risk of production loss is also creating a credit squeeze to finance farm investment. This is having a flow-on affect to rural suppliers who are increasingly carrying a greater risk burden on behalf of their client.

Conclusion:

Farming needs a transition to a more business-oriented model and a degree of support in investment analysis and risk management. This is likely to come with generational change but can be facilitated by government policy.

The sector needs to take immediate steps to manage the associated business risk. Research integrating bio-physical and climate risk into business risk management is limited for the agricultural sector. Climate is the most significant risk issue for agriculture and understanding the risk probabilities is necessary to improved management decision that reduce asset and investment risk. The available research is not being fully utilised to provide systematic climate risk information for business decision.

A broader range of insurance tools is needed to assist farmers manage risk from catastrophic loss. The private sector suppliers of insurance are looking for policy certainty and independent ongoing climate risk data for global reinsurance purposes. Previous reports on agricultural insurance identified that reinsurers (e.g. Lloyds, Swiss re) require government substantiated data for reinsurance purposes^{5,6}.

The cost of premiums for insuring the value of an agricultural commodity against a range of climate risks is considered to be unaffordable in Australia⁷. Options looking at protecting a degree of investment cost needs to be considered to extend available reserves and rein in rural debt burdens.

⁵ Government of Western Australia, Department of Agriculture & Food, 2009, *Discussion Paper – Multi Peril Crop Insurance in Western Australia*.

⁶ National Rural Advisory Council, 2012, *Feasibility of agricultural insurance products in Australia for weather-related production risks*.

⁷ Australian Government – ABARES report, 2012, *Options for insuring Australian agriculture*. Report for Department of Agriculture

Recommendations:

1. The government supports research into the framework for a functional private insurance market to allow farmers to help themselves in managing risk.
2. The Government supports the provision of a broader range of decision support tools and interpretation that can provide
 - Situated financial outcomes for decision scenarios that consider risk and long term sustainability
 - Farm level financial benchmarking data
 - Farm business planning capability
 - Linkages with bio-physical and climate risk

Insurers have available products that can potentially manage a portion of the production risk to allow farmers to replant without resorting to further debt. The premiums for these products could be more competitive with better risk data availability verified by the government. The government could additionally look into the suitability of legislation relating to the terms of the contracts to better protect both the insurer against moral hazard and the farmer against uncompetitive conduct.

Insurance products alone will not fix all the issues, but must be supported by better farm business management tools and education, well contextualized to current Australian farming conditions. New business ideas must be generated to make agriculture work successfully