

Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Agribusiness Managed Investment Schemes.

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PREAMBLE.

This submission will include the last two submissions to Treasury re Managed Investment Schemes {MIS} from ourselves [attached]. As with other submissions; the recent events vindicate the arguments previously advanced by us in our opposition to MIS in agriculture and silviculture. Unfortunately the wider community including the Government and Opposition, just could not see the reality behind a tsunami of tax avoidance ,some outrageous profit margins,“ unrealistic “claimed future outcomes and the inevitable cycle [bust] that follows boom times.

The culpability for what is unfolding goes to several sectors but all must acknowledge that this nation cannot go forward allowing such damage to our economic wealth, communities, and standards, both civil and legal. We recommend that this issue be the subject of judicial investigation as matters of serious concern will exhaust this Committee’s time and resources. The fact that patently obvious dishonesty, avarice and complicity continued unabated for more than ten years demands such attention. Governments should not confuse market mechanisms with overt favouritism and “picking winners” nor should they ignore the predictable result ; failure.

There is an inherent disconnect between the desire to avoid tax and sound profitable investment which is driven by market forces. When the Government decides to direct investment into areas by using tax avoidance as the incentive and at the same time gave very large guaranteed profits to the promoters, we should only be surprised if the outcome bears any resemblance to profitable enterprise. Industry in the vertical chain, with political clout, that manages to secure a below the cost of production resource [at investor loss] has satisfied their bottom line! Considerable attention needs to be given to the relationship of MIS lobbyists, their association with government in roles of public service and employment by peak industry lobby groups.

Because Australia has gone down the road of agricultural and silvicultural MIS, apart from the financial/legal quagmire, we know have extremely poor natural resource allocation. Land, water, soil, commodity and rural / regional negative outcomes. The fact that at no time since 1997 has Government done any opportunity costings or effective market analysis {relying on the beneficiaries to spin a positive view instead}, speaks volumes about why these sorts of policies should be avoided. If my advocacy along with others had been heeded over the last decade, and MIS had been removed as a agricultural/silvicultural corporate expansion model, we would not be facing probably the biggest financial scandal in Australia’s history.

As an economist, and a farmer for the last 30 years, I can attest to some very basic facts which seem to have been missed by the armchair experts on agriculture;

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1. There are no easy or large profit margins [for reasons which justify a really serious inquiry]

2. Very tight control of input costs is essential to have any chance of profitability.
3. Enterprise choice must satisfy your natural resource capability as that which your country does best. [Natural advantage]
4. The vagaries of markets, climate variability, and production problems mean returns are always subject to high risk.
5. A high level of multi skills and constant attention to production is essential. This includes the ability to change at minimum capital cost between commodity outputs. The owner operator model is superior in low cost, high quality output. Innovation and stability is their strength.

It seems a very large number of people have failed to realise these imperatives and have been sucked into what can only be described at best, as prospectus propositions as relevant and realistic as the existence of the tooth fairy!

The bi-partisan major party reluctance to face the obvious re MIS does no sector or group any favours in the long run. The Commonwealth Government must terminate MIS for both agricultural and plantation [silviculture] immediately. The Carbon Sink legislation must also be abandoned in its current form as it really constitutes nothing more than a turbo charged MIS.

PARTICULAR REFERENCE AREAS RE COMMITTEE INQUIRY:

1. business models and scheme structures of MIS;

Performance and outcomes always tell a story. When MIS claimed blue ribbon enterprises are described by the administrator as "having never made a profit" and being "hopelessly insolvent", there is a core problem. It seems the biggest almond and olive state of the art developments are a financial failure. No matter what input costs are, or claims of economies of scale, revenue is determined by a market price which is based on demand and supply. Anyone with excessive funds can spend millions on their business but they will still receive the market price. For example, the rest of the domestic and international olive producers do not use irrigation, MIS looked good but couldn't compete! The cost of irrigation actually exceeded the return from olives. The core problem with the business model is due to the nature of MIS, there is not a common driving bond between the promoter, investor, shareholder and management. Multi corporate structures within the MIS identity give rise to the reality that the core source of revenue and profit is derived from the investor not the agricultural or forestry returns. Product rulings with huge margins for the promoter have allowed resource developments to cost many times the real price. Plantations costing investors \$10,000 per hectare when real establishment costs are closer to \$2,000 or vineyards at \$80,000 when real market costs are \$35 to \$40,000. Returns on capital become academic. Loan books eventually bought by the banks from MIS, to finance this farce again drain the investor. The inflated, leveraged and unviable pack of cards collapses when the pyramid selling falters. That is the supply of investors dries up. The shareholders also abandon their optimistic expectations especially when the ponzi nature of product returns is exposed. All of this has happened, and it will continue to happen because the real business is to make upfront profit from investors. The risk and losses will be borne by them, as well as the shareholders, creditors, rural communities and the taxpayer. The

complexity of corporate structure and contractual arrangements have nothing to do with viable management of investment in agriculture and forestry, rather it's all about wealth transfer. Perhaps the final problem which clearly exposes this disconnect is the total paucity of practical agricultural/silvicultural experience from the promoters. Accountancy and Law, whilst handy for tax purposes do not substitute for agricultural and forestry practical experience and related business skill.

2. the impact of past and present taxation treatments and rulings related to MIS:

Investment in MIS is highly sensitive to changes to taxation arrangements. The cessation of rulings such as the 13 month rule caused a very sharp decline in investor activity. Similarly the Federal Court case involving the ATO put a large decline in any interest. Decisions to invest do not dominate in July, but rather May/June when in the accountants office facing tax liability problems. Suggestions to go for trees or almonds come from that office or one nearby where financial advice is given. There is no doubt that tax avoidance drives the MIS industry. No tax advantage, no MIS. Thus agriculture and forestry are being driven by nothing more sophisticated than the urgent desire to avoid tax. The normal conditions and considerations for investment are absent to a large extent. To date there has been a \$10 billion urgency.

3. any conflicts of interest for the board members and other directors:

The MIS entity including all its offshoots does not have the same self interest as those of the investors. The board is primarily concerned with the growth [leading to oversupply in chosen commodities] and this occurs by an ever increasing investor base. The investor on the other hand is dependent upon a profitable MIS activity resulting in good prices. That is, the board makes most of its revenue directly from the investor whilst the investor must sell the results of the investment for more than it has cost him. Also in many cases the assets apart from the actual crop are owned by the MIS entity. The investor has been a means to achieve this end, together with more recent finance from institutions. The fact that MIS has aggressively pursued wine grape and winery investments in a climate of disastrous oversupply with huge retail margins to investors [all approved by product rulings] belies their profit motive rather than their intention to manage investor interests. Again the constant expansion of wood chip plantation with long periods before harvest, does not really meet investor interests given we are now facing a wood chip glut of historical proportions. Members might find the purchase of an existing winery for \$6million and its reselling via a MIS for \$60 million something of a guide on this issue. {Palandari Wines}

4. commissions, fees and other remuneration paid to marketers, distributors, related entities and sellers of MIS to investors [including accountants and financial advisers]:

We have publically condemned the behaviour of accepting commissions from MIS, of 10% or more to "advise investors". There is a litany of recent examples of inappropriate advice with these sorts of commissions associated and the ultimate, perhaps predictable financial collapse. Professional ethics require advice to be given to the client in the client's best interests, not in the disgraceful manner the financial advisory sector has with MIS. SACA conducted a trial whereby we played the role of a potential investor. When we were introduced to the idea of MIS woodlots, we asked what the MAI was [i.e. the metric annual increment was, or growth rate]. The financial advisor had no idea what a MAI was! If you don't know the growth rate you cannot estimate return. The knowledge base of all

participants other than peak industry bodies, happy to see lemmings pay for a future loss making resource, for their gain], is woeful. An industry [MIS] bathed in copious funds from Government policy seems to have managed to find the combination that unlocks respectable behaviour and turns it into irresponsible at best.

5. the accuracy of promotional material for MIS, particularly information relating to claimed benefits and returns [including carbon offsets]:

You could say that with the benefit of hindsight the promotion of MIS has led to some very disappointed people. The spin has been staggering, attempts to point out obvious flaws, hard work. From prospectus to media propaganda financed by mainly the forestry industry, the claims have been carefully crafted to market the re-allocation of natural resource to them at taxpayers' expense and agricultural communities cost. The use of "green marketing" an obvious strategy, never let a fact get in the way of a good story. We think that even though timber harvest can be many years away it is not difficult to accurately assess prospectus claims. Soil type, rainfall, growth rates and market trends together with supply are all quite possible. Similarly horticultural business parameters again, all economically assessable. Political and bureaucratic institutions, media, and business sectors have all provided cover for what should have been easily seen as a scam. It is apparent that apart from outright prejudice there is a very ignorant society out there, when it comes to the natural resource and wealth creation.

6. the range of individuals and organisations involved with the schemes, including the holders of the relevant Australian Financial Services Licence:

There needs to be a thorough investigation of the linkages and relationships here. As with all financial scandals judicial inquiry is required.

7. the level of consumer education and understanding of these schemes:

The score so far, consumer zero, promoter 100%. They have been like bunny rabbits under the spotlight. Australians do not understand how the natural resource is managed to feed them. They certainly do not understand MIS but they are learning the hard way.

8. the performance of the schemes:

I don't think the committee needs us to comment on Timbercorp or Great Southern, but more failure will come. The whole sector is flawed. Could we say, score so far, rhetoric and promotion 100%, performance -80%, next round about to start. The real issue however, is the damage done to valuable resources [land, water, infrastructure, communities and businesses]. These schemes represent huge damage to our viable agricultural and forestry industries. The irrational over supply of commodities [unless the intention was to undercut viable operators and gain market control] and consumption of water has cost this nation. An opportunity costing would horrify Australia.

9. the factors underlying the recent scheme collapses:

a) micro economic fundamentals for projects totally flawed. The product rulings began the process, the businesses are unsustainable.

b] a loss of investor recruits allowing cash flow to service unsustainable debt. That is, allowing the inevitable to happen.

c] a chronic lack of knowledge in the financial sector about primary production economic realities.

10. the projected returns and supporting information, including assumptions on product price and demand:

A Judicial Inquiry must investigate these glaring failures. This information is so wrong as to be deliberate.

11. the impact of MIS on other related markets:

Agriculture and Forestry will struggle to regain credibility in future investment markets. Superannuation funds have been burnt and equity markets will exhibit undue caution in these industry areas due to the fallout of MIS. Impacts on the water market are of national concern, urgent Government action is required to stabilise irrigation industries and areas that have been severely affected by MIS actions. Oversupplied commodities must be assessed to stabilise the viable producers and communities. The “social engineering” exercise must now be put right in rural and regional Australia. The land price distortion and all the problems that follow from this must also be dealt with by government. The banks must be made to carry finance that now suffers a fall in asset value due to MIS price inflation, they are as usual up to their armpits in the MIS rip-off, and must be held accountable.

12. the need for any legislative or regulatory change:

The answer to this question forms also this submissions core recommendation. Legislate MIS as a identity out of existence. Further review the carbon sink legislation and remove the tax arrangements contained before we have turbo MIS debacle number two. Review the regulatory arrangements with a view to discovering why the train crash had to happen irrespective of plenty of warning.

No other OECD country employs MIS structures in natural resource industries. Why do we always have to learn the hard way?