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A submission to the inquiry into agribusiness managed investment schemes (MIS)

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In 2006 as the author of MS&As submission into the MIS industry I hoped that, based on the facts presented, the Government of the day would make the appropriate policy decisions.

The problems with the MIS industry have been known and documented for some time. Contrary to industry spin, the fact that the majority of MIS operators, not just Timbercorp and Great Southern, have now fallen over will not be a shock to any one who took a truly independent (a term that has been used very loosely in this industry) view. A RIDRC report in 2000 found “that the overall performance of MIS was mediocre with the poor quality of management and high commissions to promoters limiting returns to investors’. Another RIDRC report in 2004 stated that ‘one independent assessment of schemes offered to the public in 2002-03 found that less than ten percent were sufficiently sound investments to warrant their recommendation. Even ASIC in 2003 made the following points about agricultural MIS schemes:

1. The questionable commerciality of the schemes.
2. At times, the poor quality and absence of disclosure.
3. Occasional inappropriate or misleading advice.
4. Payment of high commissions in excess of norms for retail investment schemes.

Yet in 2006 when the politicians had an opportunity to do something about these systemic issues they chose to make changes which where ineffectual at best. The resultant outcome is now history.

One of the most concerning facts that was highlighted in the 2006 report was the lack of credible economic modeling that had gone into the 2020 vision. Yet this 2020 vision is continuously used for the justification of the MIS policy. To quote from the report:

‘I find it incomprehensible that protectionist rhetoric should be driving this debate. The 2020 forestry vision would seem lightweight in its economic analysis. There is a significant body of evidence from eminent academics such as Professor Gordon MacAulay and Dr Judy Clark that shows we have enough plantation wood to meet our Pulp chips requirements without the need to subsidise its growth.

Current Federal Government Plantation Taxation policy is wedded to the need to achieve the so-called ‘2020 Vision’. Unfortunately, there does not seem to have been any independent and robust analysis to the cost benefits of achieving this vision.

Firstly, the original document needs to be put in context, as the title states it’s ‘a plan to achieve the plantations 2020 vision’, this was never a document published to analyse the cost benefits of achieving this plan. Personal communication with the authors, Centre for International Economics, reinforces the fact that they were never asked to analyse the economic net benefits of the plan, just to provide a strategic plan to achieve the set goal. Justifiably, it is not surprising therefore that they have delivered a ‘whatever it takes to achieve this strategy’ attitude in framing the required outcomes of the report.

The fundamental driver of the vision is the target. This was set in the original document to treble the effective area of Australia’s plantation between 1996 and 2020[1]. The obvious question that then arises is why treble and why 2020? The benefits of the 2020 vision were made as follows:

1. *More than $3 billion will be invested.*
2. *20% increase in farm incomes.*

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The current $2 billion wood and wood product trade deficit would be converted into a surplus.
4. Up to 40,000 jobs will be created.

There is no economic modeling to support these statements. Interestingly, as I have already discussed, the forestry industry focuses on the benefits and disregards the costs. For example, how many jobs will be lost in those industries that currently support existing agricultural pursuits?

The most important statement of the whole vision document is made on page 19, ***'Care would need to be taken to ensure that any incentive offered would not distort investment decision'***[2] *Clearly, as we have identified, the current taxation policy is distorting investment decision.*

It is our concern that government policy, which is based purely on a production target at the expense of profitability and long term sustainability, can have disastrous consequences. (Refer to the wine industry)

To put this in context, currently in New Zealand significant areas of plantation forestry are being killed (sprayed out) due to the lack of profitability in plantation forestry. It is interesting to note that New Zealand is held up as the role model within the report.

The costs have been estimated to me to be around $2,200 per hectare to renovate timber country back to profitable pasture country. Given this, there is a strong likelihood that where growth rates have been uneconomical this land will become redundant, as it will be too expensive to revert back to pasture, unless the government provides assistance! Why do we as a nation, wish to go down this road, and in doing so destroy the current social and economic infrastructure that currently supports viable and profitable agricultural pursuits?'(D.Cornish 2006)

Yet billions of dollars of tax payer money has been wasted to support a policy that has never been substantiated as being of net benefit to Australia.

Another disconcerting fact is the lack of action by ASIC to protect shareholders and investors from unscrupulous behaviour by promoters. In the 2006 submission I indentified the unusual business practices of Great Southern Plantations.

"As the first schemes come to fruition it is becoming obvious that the actual returns are well below market expectation. To cover up this fact Great Southern as, highlighted in their notes to financial statement 2005 note 33 point 5, have internally purchased the wood at considerably inflated prices. The intelligent investor newsletter picks up on this point up and highlights that this considerable act of generosity, totaling $3 million after tax, would shelter current income stream from coming under investor scrutiny. It is estimated that they will generate a profit of $124 million from project sales this year. $3 million is a small investment in keeping investors quiet for another few years."(D.Cornish 2006)

Given this was public knowledge at the time the question must be asked why did ASIC turn a blind eye to these facts when it was first raised. It is concerning that ASIC waited until the company had fallen over and shareholder and investor had lost substantial amounts of money before investigating these issues.
Since writing the submission several other factors must now be considered:

Food scarcity. It could be argued that the need for food security now far out weights the need for

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wood chip security. Government policy must now ensure that the continued removal of prime western district of Victoria food producing country is reversed.

The very public implosion of both Timbercorp and Great Southern adds further weight to my other arguments made in the 2006 submission regarding the unsuitability of the MIS structure for direct investment in agriculture. The inability to unwind the schemes in an orderly fashion insures, accept for administrators and lawyers, that everyone loses.

The greatest myth that is continually thrown up to support these schemes is that agriculture needs more capital. Nothing could be further from the truth. The capital market for Australian agriculture is as strong as any industry in Australia. This can be easy identified by the fact that capital assets such as land and water are highly overpriced given their earning capacity. The last thing Australia agriculture needs is increased demand for these scarce resources thereby driving the prices up further. The only place where there is a lack of capital is in the industries that cannot provide an economic return.

It has been held that the failure of Timbercorp and great Southern can simply be put down to poor management, the Global Financial Crisis (GFC) and too much debt and that they are the exception to the rule. However, this does not account for the failure of the other MIS schemes that occurred before the GFC and where debt and management where considered by the so called experts not to be an issue at the time of analysis. The real reason for failure of MIS schemes was again highlighted in the 2006 submission.

The overall lack of underlying commercial validity of most MIS was noted by Lacey and Watson that, 'one independent assessment of schemes offered to the public in 2002-03 found that less than ten percent were sufficiently sound investments to warrant their recommendation. These assessments are based on schemes that have been given product ruling by the ATO. Product Ruling may have provided greater tax certainty for individual investors in projects, but from the community's point of view resources are wasted if investors are being encouraged to invest in non-commercial projects by optimistic forecasts and/or inadequate regulation.'[3]

To put it simply, the structure of these schemes and the activities they are involved in means that an investor is highly unlikely to ever receive a consummate return for the risk they take even given the tax benefit of the schemes. After a time the investor will wake up to this fact and will no longer invest in the scheme. No new investors means no cash flow for the promoter and so the schemes fail. This is a systemic structural problem and will continue to happen GFC or no GFC.

What has also been lost in this debate is the lack of efficiency of the MIS schemes. It costs a substantial amount of money to regulate and manage the process. ASIC pointed out in past senate inquiries into MIS schemes that agribusiness MIS projects chew up a disproportionate amount of time in regulation and administration which far outweigh any perceived benefit they may provide to the Australian community.

In summary the effect of the Government MIS policy has been to deliver a misallocation of scarce resources delivering a smaller economic pie. A smaller pies means less wealth less wealth means less people and so on. The Government must now extract itself from the business of picking winners and distorting capital markets to one that facilitates those farmers that have a proven track record. Further to this, a lack of Government action in 2006 to do anything to improve the compliance and reporting requirement by the industry, makes it morally complicit in the losses that have been incurred by investors and shareholders from 2006 onwards. It is now

3 Lacey and Watson RIRDC(2004) p12

an undisputable fact that Government policy has allowed both the tax payer and the investor to be taken for a ride. The continuation of this form of investment structure will be rightly damned by future generations.

If you have not already read it I would implore the committee to review the 2006 submission and supporting documentation. It is a sad fact that if in acted in 2006 it would have ensured that the current shambolic mess now faced by Rural Australia would have been reduced significantly.

Yours Sincerely

David Cornish