

**Submission to the Senate Select Committee
on Agricultural and Related Industries**

**~ Inquiry into food production in Australia - Impact of
Managed Investment Schemes ~**

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Table of Contents

Executive Summary	3
1 Land and land prices;	5
2 Water resources and water prices;	5
3 The efficient production of food, including the impact of MIS on supply and demand and on the availability and efficient use of capital.....	6
4 The social fabric of rural and regional communities, particularly the availability of employment and capacity building opportunities within these communities;	7
5 Returns to farmers;	7
6 Conclusion;	8

Executive Summary

- **The NSW Farmers' Association is opposed to the current Managed Investment Schemes ('MIS') schemes and their distortionary impacts on rural and regional Australia.**
- **The Association calls upon the Federal Government to effect legislative reform through the removal of all MIS tax concessions that are not available to traditional primary producers,** thereby ensuring that MIS investors have an operational interest in the scheme and not merely a capital interest.
- **MIS create inequitable tax driven investment opportunities.** The lower cost of capital available to MIS affords them a financial advantage which enables them to outcompete farmers for land acquisition. This impedes traditional family farming businesses ability to expand in areas where MIS operate.
- **MIS significantly impact regional hydrology and downstream water use.** The deep ripping practices of MIS plantations are tantamount to the creation of linear farm dams and are greatly exceeding the harvestable right for farmers set by legislation. These practices also affect water tables leading to a higher probability of more frequent low or zero water flow days.
- **MIS distort market signals and investment decisions.** MIS can send incorrect market signals and distort investment decisions. This can have significant commercial repercussions in the agricultural sector which is heavily dependent on these indicators to guide long-term business planning and investment.
- **MIS severely undermine local communities and associated services.** Plantation workers are often transient seasonal workers and rarely replace the families who formerly lived on the farms purchased by MIS managers. This affects the demographic composition of communities, often undermining local community schools and local services through loss of participants and population drift to larger centres.
- **MIS disrupt and distort supply signals.** The rapid expansion of non-forestry MIS has significantly affected the supply levels of some commodities. This inevitably has a deflationary effect on the prices received by traditional farm producers. When major MIS operators become insolvent and exit the industry, affected commodity sectors experience significant restructuring to return to a commercially viable level that is attractive to potential investors.

Introduction

The NSW Farmers' Association (the 'Association') is Australia's largest state farming organisation representing the interests of commercial farming operations within NSW. Through its commercial, policy and apolitical lobbying activities, it provides a powerful and positive conduit between farmers, the Government and the general public.

The Association is the key state representative body for both intensive and extensive industries, ranging from broad-acre, meat, wool and grain producers, to more specialised producers in the horticulture, dairy, poultry meat, egg, pork, oyster and goat industries. The Association also represents the interests of rural and regional communities and the important issues associated with natural resource management, economics and trade.

The Association welcomes the opportunity to provide a submission to the Senate Select Committee on Agricultural and Related Industries Inquiry into food production in Australia – Impact of Managed Investment Schemes ('MIS'). The Association is alarmed and concerned at the rapid growth in MIS forestry projects and seeks the removal of the concessional taxation arrangements that drive these otherwise unviable schemes.

MIS do not promote sound investment decisions in rural and regional Australia. Inefficient tax driven resource allocation does not price in the negative externalities that arise from these investments, including:

- i. the distortion of land values;
- ii. the over-supply of scheme commodities;
- iii. the hydrological impact on water quantity and quality; and
- iv. the irreversible decline in rural communities and associated services.

Investors are drawn to the 100 per cent tax deductibility of contributions made to a MIS ('the tax incentives'), not the operation's long-term profitability. This is evident, given the upfront payment of capital to fund the project, with returns often not paid until the timber is harvested, between 15 and 30 years later. However, the recent collapse of Timbercorp and Great Southern clearly demonstrates that tax driven MIS business models are fundamentally flawed and often commercially unviable.

The Australian Agribusiness Group ('AAG') estimates that non-forestry MIS contributions (excluding commitments for future payments) have almost tripled in three years, from \$160 million in 2004 to \$467 million in 2007.¹ This rapid expansion has delivered significant negative externalities, affecting many traditional agricultural industries, with little regard to the social, environmental and market effects arising from these practices. From an international perspective, as the world starts to grapple with the effects of the world food shortage, consideration of these affects will be essential if Australia is to remain a dedicated supplier into global food markets.

¹ Australian Treasury Review of Non-forestry Managed Investment Schemes, pg 1, Available at http://www.treasury.gov.au/documents/1401/PDF/Non-Forestry_Managed_Investment_Schemes_Issues_Paper.pdf Viewed 21 June 2009.

1 Land and land prices;

The high levels and low cost of capital funding of MIS provides a competitive advantage that few, if any, traditional grazing and cropping operations are able to match and compete with for land purchases. This issue was highlighted in the Treasury's recent review of non-forestry managed investment schemes which concluded that MIS' beneficial tax arrangements - "*alters investment decisions by giving the MIS manager a lower cost of capital than businesses that structure themselves in other ways.*"² Utilising a greater and less expensive access to capital, MIS have significantly altered land prices in many regional areas where MIS operate, such as the Bombala and Delegate communities, which enables them to outcompete farmers for land acquisition, significantly impeding the traditional family farming businesses ability to expand.

The Association is aware that land acquisition markets should enable the transfer of title to the highest bidder. However competitive bargaining for land needs to be done between potential bidders from a level playing field. The Association is, therefore, of the view that the lower cost of capital available to MIS affords them an advantage that enables them to outcompete farmers for land acquisitions.

The lower cost of capital available to MIS affords them a financial advantage that enables them to outcompete farmers for land acquisition. This impedes the ability of traditional family farming businesses to expand in areas where MIS operate.

2 Water resources and water prices;

The high water consumption of plantations is a significant water allocation problem which has yet to be addressed by government. The high consumption is due to higher evapotranspiration rate of trees compared to pasture and crops, and also to the deep contoured furrows established by plantation operators to maximise the capture of rainwater.³

Pursuant to section 54 of the *Water Management Act 2000*,⁴ landholders have the right to capture 10 per cent of the average regional rain water run-off on their land by means of a dam (this applies to all lands in the Eastern and Central Division of New South Wales). The intent of such legislation is to ensure that downstream farmers are able to share water falling upland in the catchment. However, because tree root systems to grow at levels much deeper than, for example grain crops, MIS operations establish their sites with very deep permanent furrows. These furrows greatly increase water interception and limit the amount of water made available to downstream farmers.

Farmers have raised concerns that permanent contoured furrows established in plantations capture water in a similar way to farm dams and therefore are enabling operators to exceed the harvestable right set by legislation.

Research also suggests that the level of the water table can be affected by plantation forests.⁵ In this situation, a greater proportion of rainfall may be needed to recharge groundwater rather than contributing to runoff which affects the pattern of stream flows.

² Australian Treasury Review of Non-forestry Managed Investment Schemes. Available at http://www.treasury.gov.au/documents/1401/PDF/Non-Forestry_Managed_Investment_Schemes_Issues_Paper.pdf page 18, viewed 21 June 2009

³ Department of Agriculture, Fisheries and Forestry, Australian Government Bureau of Rural Sciences, *Plantations and Water Use*, August 2007

⁴ Department of Natural Resources Official Notices. Available at http://www.dwe.nsw.gov.au/water/pdf/leg_policy_amended_hr_orders_eastern_and_western_govt_gazette_31march2006.pdf Viewed 27 July 2009

⁵ Department of Agriculture, Fisheries and Forestry, Australian Government Bureau of Rural Sciences, *Plantations and Water Use*, August 2007

Flood peaks may be lower and there is a higher possibility of more frequent low or zero flow days following reforestation.

Effectively, plantation operators are able to source water more cheaply than other producers because they are able to meet a larger proportion of their water needs free of charge. Equally, water harvesting by plantation operators (where this may be in excess of the established right) increases water scarcity, which increases prices for those who must purchase water for production purposes.

Deep contoured furrows established for MIS plantations may enable operators to exceed the harvestable water right set by legislation. High water use and high water harvesting by plantations also affects water tables leading to a higher probability of more frequent low or zero water flow days. The net result is a competitive advantage for plantation operators in comparison to other producers.

3 The efficient production of food, including the impact of MIS on supply and demand and on the availability and efficient use of capital

The collapse of Great Southern and Timbercorp, two companies who collectively made up 46 per cent of the funds raised by MIS operators,⁶ highlights the structural flaws of particular MIS business models. When firms are selling products (i.e. woodlots, olive groves etc.) and investors are primarily focused on buying something else (receiving a tax deduction), issues develop when the financial focus is shifted away from the commercial viability of the business' productive operation. The result sees a business entity not operating under the normal market supply and demand forces that guide sound operating decisions. Furthermore, the recent collapse of these two market leaders diminishes the reputation of Australian agriculture as a sound investment vehicle.

The Treasury Review of Non-Forestry Managed Investment Schemes⁷ concluded that MIS can send incorrect market signals and distort investment decisions, resulting in inefficient resource allocation. These distortions have significant commercial repercussions in the agricultural sector, which is heavily dependent on price signals to guide long-term business planning and investment. For instance, a traditional farmer who has already invested heavily in a horticultural planting is unlikely to be able to match the lower cost of capital, and in turn lower cost of production, of a non-forestry MIS, and may be forced to exit the market.

While this situation may indicate an increase in the efficiency of the sector, it is based on the false premise of commercial sustainability that only arises from inequitable and distortionary tax concessions provided to MIS schemes. As a result, related markets, for example machinery suppliers, may grow to support the MIS operation's expansion. The consequent market adjustment and capital realignment is not based on the natural market supply and demand forces which help foster efficient market development. Instead, when the commercial realities of normal market practices are realised, as has been seen in the recent collapse of Timbercorp and Great Southern Plantations, the market requires further adjustment, yet again.

MIS can send incorrect market signals and distort investment decisions. This can have significant commercial repercussions in the agricultural sector, which is heavily dependent on these indicators to guide long-term business planning and investment.

⁶ Australian Agribusiness Group 'Managed Investment Schemes – Is the party over?' Available at - http://ausagrigrp.com.au/090626_aagpres_lee.pdf. Viewed on 26 June 2009

⁷ Federal Treasury 'Review of Non-Forestry Managed Investment Schemes' (December 2008), pg 11. Available at http://www.treasury.gov.au/documents/1549/PDF/Review_of_non_forestry_MIS.pdf. Viewed on 26 June 2008

4 The social fabric of rural and regional communities, particularly the availability of employment and capacity building opportunities within these communities;

Regional communities are heavily reliant on contributions from the local population for the maintenance of numerous community services. This includes institutions and organisations, such as schools, hospitals, sporting clubs and volunteer contributions to services such as the Rural Fire Services. The demographics of plantation workers, who for the most part are transient seasonal workers, tend not to replace the settled families who lived on farms purchased by MIS managers. This then affects the demographics of communities, often undermining local community participation in schools and local services by loss of numbers.

Concerns have also been raised with the Association as to whether failed MIS operations have allocated sufficient funds to the fire preparation and management of the now insolvent plantation areas.

Plantation workers, are often transient seasonal workers, and rarely replace the families who formerly lived on the farms purchased by MIS managers. This affects the demographic composition of communities, often undermining local community participation in schools and local services loss of participants and population drift to larger centres.

5 Returns to farmers;

The onset of non-forestry MIS into markets with high levels of upfront costs has significantly affected the production levels of many agricultural commodities. For instance, there has been an approximate 1,600 per cent increase in almond planted areas between 1999 and 2007 (with corporate plantings now representing more than 80 per cent of Australia's almond plantings).⁸ According to a 2004/05 Timbercorp factsheet,⁹ there were around 30,000 horticultural hectares planted under MIS, accounting for six per cent of total Australian horticulture plantings, of which Timbercorp was responsible for over 18,000 hectares. The same factsheet highlights the significant impact non-forestry MIS has had on the supply of certain commodities, including:

	Value of the Industry (m)	Estimated MIS share 2004/05
Olives	N/A	65%
Almonds	\$76.6	50%
Avocados	\$90.5	18%
Mangoes	\$134.6	15%

This information highlights a number of important issues.

1. The rapid expansion of non-forestry MIS has significantly affected the supply levels of certain commodities which inevitably has a deflationary effect on the prices received by traditional farm producers of those commodities.
2. MIS operators are playing a larger and more central role in the supply of these commodities and the market structure in which they operate. This is a major concern for the Association. How can a market deliver the necessary price signals to all relevant industry participants (competitors, customers and suppliers) so as to

⁸ Almond Board of Australia Submission, September 2008 *Review of Non-Forestry Managed Investment Schemes* (page 3)

⁹ Timbercorp Agribusiness Investment Managers Fact Sheet - http://www.timbercorp.com.au/userdocs/1/company_information/documents/Fact%20Sheet%20MIS%20and%20Horticulture.pdf viewed 15 July 2008

facilitate sustainable market development if the major industry participants do not operate with the basic commercial focus of long term sustainability and profitability?

Consequently when major MIS operators, such as Timbercorp and Great Southern, become insolvent and exit the industry, reverberations are felt throughout the market. While this may open opportunities for the traditional farming sector to capture new business, Australia's farming reputation as a sound investment option is tainted. Furthermore the market must go through significant restructuring to return to commercially viable production levels. This restructuring is felt throughout rural communities including secondary markets which were built to support the rapid market growth, and which may now also be forced to exit the industry.

The rapid expansion of non-forestry MIS has significantly affected the supply levels of some commodities. This inevitably has a deflationary effect on the prices received by traditional farm producers. When major MIS operators fall over and exit the industry, those affected commodity sectors experience significant restructuring to return to a commercially viable level that is attractive to potential investors.

6 Conclusion;

The rapid expansion of MIS operators in agricultural commodity markets has developed a number of negative externalities, significantly affecting regional communities and local family farming businesses. These include;

1. the inability of traditional farmers to expand their operations,
2. the overuse of water,
3. market distorting price signals,
4. a decline in local community services and volunteer organisations, and
5. the deflationary effect on the prices received by farmers competing with MIS operators.

The collapse of Timbercorp and Great Southern clearly demonstrates that business models combining tax incentives with investors who have no real interest in the long term profitability of the operating entity, is both fundamentally flawed and commercially unviable.

The Association calls upon the Federal Government to effect legislative reform through the removal of all MIS tax concessions that are not available to traditional primary producers, thereby ensuring that MIS investors have an operational interest in the scheme and not merely a capital interest.