

# **Submission to Financial System Inquiry – Agriculture**

*26 August 2014*

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**Executive Summary**

**Overall Summary**

- A) What is the recent past and current financial system for Agriculture, and what impact has this had on overall production and output of Agriculture in Australia, and overall investment in Agriculture in Australia; key agricultural statistics, key agricultural performance.
- B) What do we believe should be done, the solutions, to improve the Financial System for Agriculture in Australia and what do we think would be the expected impact and improvement.
- C) Lessons we can take from New Zealand and other countries as to their Financial System in Agriculture and its impact.

Our analysis of agricultural production and output on the farm and levels of agricultural investment during this time since the 1960 indicates that during the 30 year period to 1990, agricultural production and output on the farm doubled every 10 years, as a result of agricultural investment in creating more farm land, and related agricultural investment in water systems, modernised equipment, and agricultural storage, and better use of farm inputs, plus better farm management and skills. During this 30 year period agricultural production and output grew from \$ 4.3 Billion in 1960 to \$33 Billion in 1990. Agricultural during this time was considered to be still very important to the Australian economy and farms became larger, underutilised farm land was converted to productive farm land, investments were made in agricultural storage and transport infrastructure, investments were made in significant agricultural equipment.

Banks, many in Australian government ownership back then, were prepared to lend significant amounts to farmers to improve their farms and to buy neighbouring farms; banks back then were virtually run by the “local” branch manager, who had a huge say in whether loans were approved or otherwise to farmers, and very often these bank managers knew the many farmers in their area very well, and learnt those they could trust and those they could not, learnt those that were the best farmers and operators and those that were not. These “local” branch managers in the bush understood the dynamics of farming, both seasonality and cyclicity and variability and uncertainty, and were much more flexible in their management of the various loans with many different farmers. Most importantly, they encouraged investment in the farms and were prepared to lend substantial sums, at higher risk factors than we have in recent past, higher debt /equity ratio and higher risk factors overall, even modifying loan repayments to seasonal factors, often postponing loan repayments due to adverse weather, market factors ...and all towards encouraging increasing production and output of many farms in their area and region. And thus these areas and regions thrived.

From 1990 to 2010 the rate of increase of agricultural production and output reduced by more than one third the rate, as less investment in agriculture took its course due as mining becoming more and more the centre of the Australian economy, perceived to be able to generate more wealth and better returns than agriculture and other segments of the economy, thus overtaking agriculture in both amount invested and resultant economic output, and thus agriculture was substantially reduced in its relative importance which had a huge impact on the level of subsequent investment in agriculture.

It is interesting to note that as mining has fallen in importance in the last few years, agriculture has come back to some extent and agricultural investment has been strong, on the back of foreign investment directly in farming, directly acquiring farms in Australia, as foreign investors see long term huge upside in agricultural and farm investments, prepared to wait for about seven to ten years to generate decent returns as is expected in agriculture and farm investments where farm prices should at least double during this time.

There has been a significant lack of investment in agriculture in Australia for about 30 years as mining has taken over being the engine of growth in the Australian economy, with total investments in Agriculture at about A\$ 8 b pa in recent years , with mining at about A\$ 100 b, with foreign investment being about one third to one half of this total, with farm expansion being mainly funded by lending, some A\$ 120 b in loans to the Agri segment vs A\$ 160 b in mining , with exports falling from 50% of all Australian export in 1975 to 25% by 1990 and now down to about 10%, as mining has grown from 20% in 1975 to a whopping 65% of all exports in recent years, maybe just starting to taper off this year. There is no question for us that agricultural investment has been poor for about 30 years as investors have chased returns in more certain segments with higher growth and less risk, with good returns achieved in about three to five years, vs about ten years in the case of agricultural farm investment. It no wonder that we had significantly under invested in agriculture for about 30 years at the farm level, thus achieving limited growth ,whereas the mining segment has been over invested and has grown greatly in the past 30 years. Is no wonder that Brazil has grown its agricultural investment over many recent years, and agriculture has grown greatly on the back of this, with much now going directly to China.

Going forward mining may not achieve as good returns as in recent times, in fact some cases very poor returns, but agriculture promises to achieve good returns as china and Asia require increasing amounts of food with raising middle classes, hence far more imports of food and Agri-products as China cannot produce enough to meet its own demand and growing demand. We thus have a great opportunity now for direct investment in Australian agriculture and farms, to grow our agriculture strongly over the next ten and twenty and export much of this to china and Asia. However, the key issue is how best to do so, and how to drive, stimulate and encourage much more agricultural farms investment to significantly grow our agriculture ad in this respect the Financial system as it applies to agriculture and farm investment has to change and modernise and we thus advocate certain changes to the Financial system for agriculture and farming, and some important solutions to address the key causes of lack of investment in agriculture and farming in Australia, as follows:

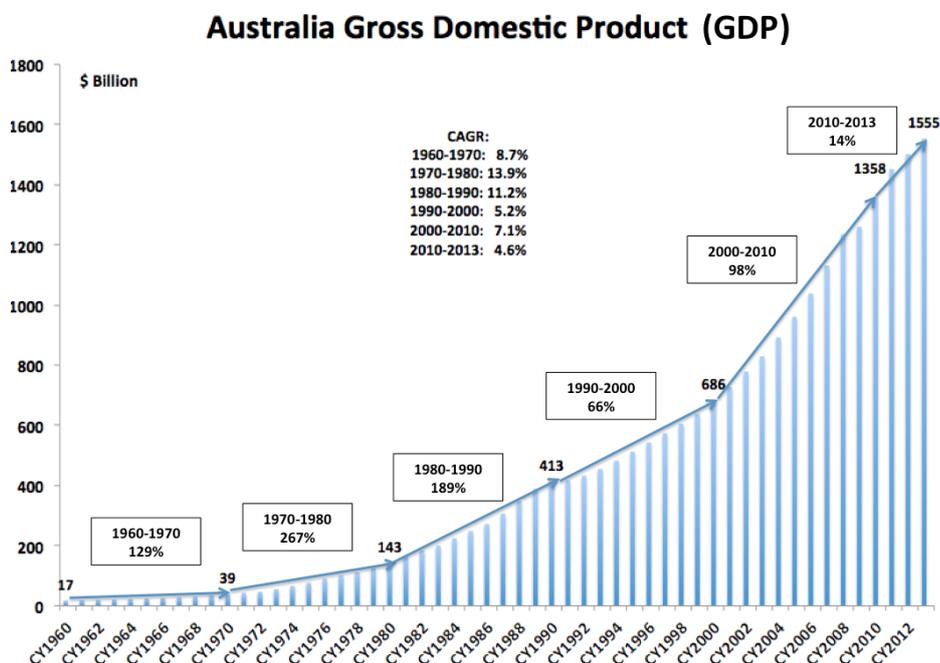
1. Most importantly when addressing this key issue of agricultural and farm investment, one must recognise and acknowledge that Agricultural farm investment is a long term investment, about ten years, requiring patient money and investment; agricultural land prices double every seven to ten years it has been found over the last fifty years in ten year increments in Australia, this is a fact; in many cases the land values go up by much more, triple or quadruple for the very better farms and better performing farms.
2. Boyce & co, the well-established accountants in the bush have done a study looking at the underlying performance of average agricultural farms in each segment in Australia over many seasons and years, and one factor which keeps on coming out is that the top 20-25% of farms across each segment make 80-90% of the profits, thus the bottom 50% make a loss or just break even, and the middle 30% make a small - modest profit.

3. there is no absolute or real reason for this, size of farm, weather, water, market, decision on what is grown and when, equipment, agronomy ...some farmers are repeatedly far better than others, period ...and these are the farmers that must be encouraged to expand and growth and take out mediocre or poorly performing farmers at reasonable prices.
4. Investment in agriculture and farms is a much higher risk than investments in other segments, as rainfall, weather, disease, agronomics, and other “external factors” play such a large part of the production and output of any given farm, and thus it is important to look at the performance for each farm across a seven year timeframe, with added seasonal elements and cyclicity, again over many years. Agricultural farm investments are also illiquid, as it is not easy or quick to sell any given farm and there are issues of working capital which must be managed well in order to provide important farm inputs. As such, there should be features when making agricultural farm investments within the financial system which make up for this additional risk, both in terms of investment returns and capital gains tax and possibly ten year tax breaks for investors, in addition to low interest rate loans, and greater flexibility on loan repayments, dependant on production output achieved and market prices over the course of the loan, as well as more flexibility on farm valuations, and equity/debt requirements. As such, more of the better farmers would be willing to take more risks in acquiring neighbouring lesser performing farms, and put the energy and extra needed capital required to bring the neighbouring farm up to his normal level of performance. This strategy needs to be introduced and advocated by Federal Parliament, as part of the Financial Systems inquiry.
5. In relation to encouraging actual levels of direct investments from superannuation and the fund management industry at large, again a directive and guideline needs to be made at Federal Parliament to greatly encourage and persuade Australian superannuation funds which have combined A\$ 2000 b, including the Future fund with A\$ 200 b alone, to invest directly in Australian farms and/or directly in farming entities of the very best Australian farmers, with appropriate levels of investment incentives but with the right approach to ten year “patient money” farm investments; which should double or triple in value over the course of ten years, thus achieving a good reasonable return on investment as compared to other segments with less risk and faster achievable investment returns. This level of encouragement should be also applicable to the fund management industry at large, not only the superannuation industry.
6. The ANZ bank commissioned a report in mid-2013 which looked at the level of investment in required in Australian farms to stimulate additional production and output, through a combination of bringing lesser performing farms up the standards of the best performing farms, of putting in place better more modern equipment and technology across many farmers in different segments, of increasing the scale of farms to get better economies of scale, and of converting underutilised farm land into productive farm land. The report claimed that Australia needed to put A\$ 1000 b into farm investment and related support, of which A\$ 400 b directly into supporting the best farmers or good farmers acquire farms from farmers who are not as good and whose farms do not perform as well, and A\$ 600 b into investments in modern equipment and technology, agricultural infrastructure to facilitate increased levels of production and output, better quality, and more exports. The Australian Financial System in respect to Agricultural investment should change to encourage significant superannuation funds and other funds to invest heavily in agriculture, and also to encourage the very best farmers to acquire neighbouring farms and increase the aggregated productivity and performance of these farms for overall increasing levels of production and output and quality.

New Zealand has been very successful at increasing both the performance and production of its agricultural segment, with a variety of important criteria and factors; banks have encouraged the best farmers to acquire neighbouring farms, and also encouraged new farmers to acquire cheaper underutilised land or grazing land in the South Island for conversion to dairy, as well as providing cheaper loans to enable farmers to acquire the very best equipment and technology to increase productivity, while making sure that quality is always high. New Zealand focus on agriculture has been excellent as they have opened different agricultural segments to the world for export, from dairy, to wine, lamb and even beef has grown in exports from nothing only five years ago. They really have done very well at building and growing their key agricultural segments very well over the last ten years to world class standard and farmers are highly respected and incentivised to expand and grow through bank facilitation, government market support, outside investment and government had made sure that agricultural infrastructure for the most part has been updated and very good, helping New Zealand export their products all over the world , especially China and Asia, and “Brand New Zealand” has been very well recognised in china and Asia for high quality agriculture and agricultural products. We should try to learn from New Zealand.

**Figure 1: Historical data of Australia’s Gross Domestic Product - GDP (\$ Billion)**

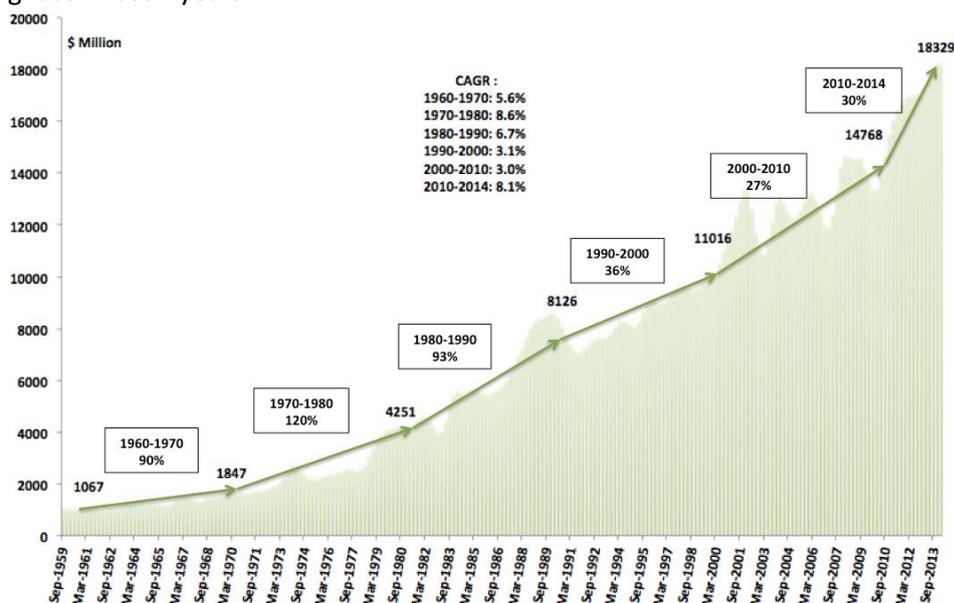
- During 1960-1980, Australia’s GDP has increased with a high annual growth rate of 11.2%. The rate declined to 8.2% during 1980-2000. Average annual GDP growth rate was only 4.6% from 2010 to 2013.



Source: Australian Bureau of Statistics

**Figure 2: Quarterly Australia’s Gross Value of Agricultural Production\* (\$ Million)**

- Gross value of agricultural production increase strongly from 1960 to 1990, followed by a slow increasing period of 1991-2010. However, Australia’s agriculture production was growing fast in last 4 years.

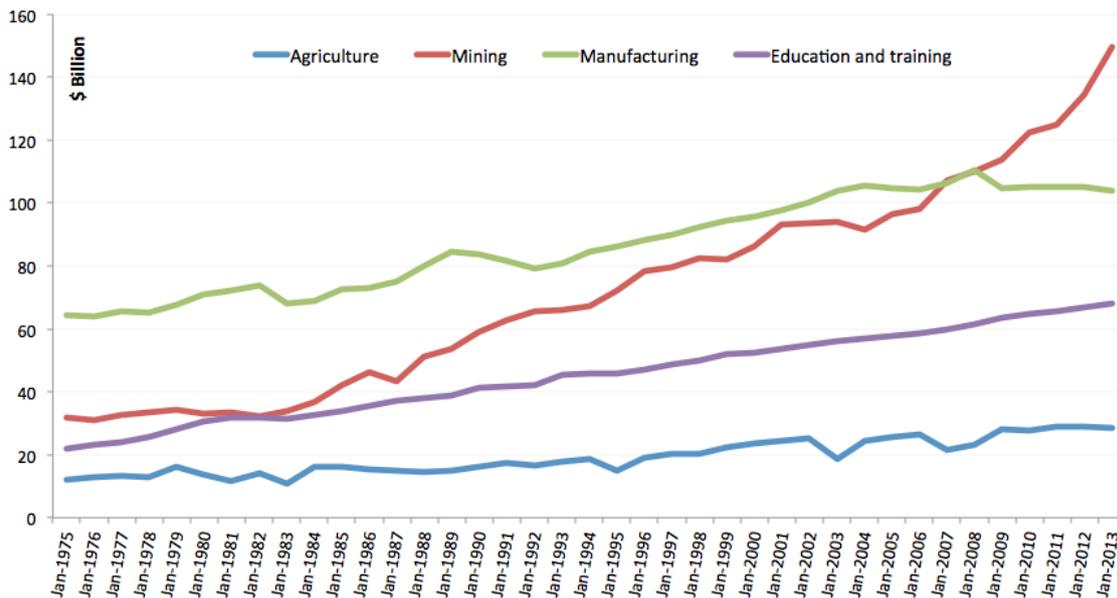


Source: Australian Bureau of Statistics

\*Gross value of agricultural production: Includes output produced by the household sector for its own consumption.

**Figure 3: Contribution of Gross Value Added Generated by selected sectors**

- Gross value added in agriculture has grown slowly from 1975, while mining industry has grown much faster than other industries.

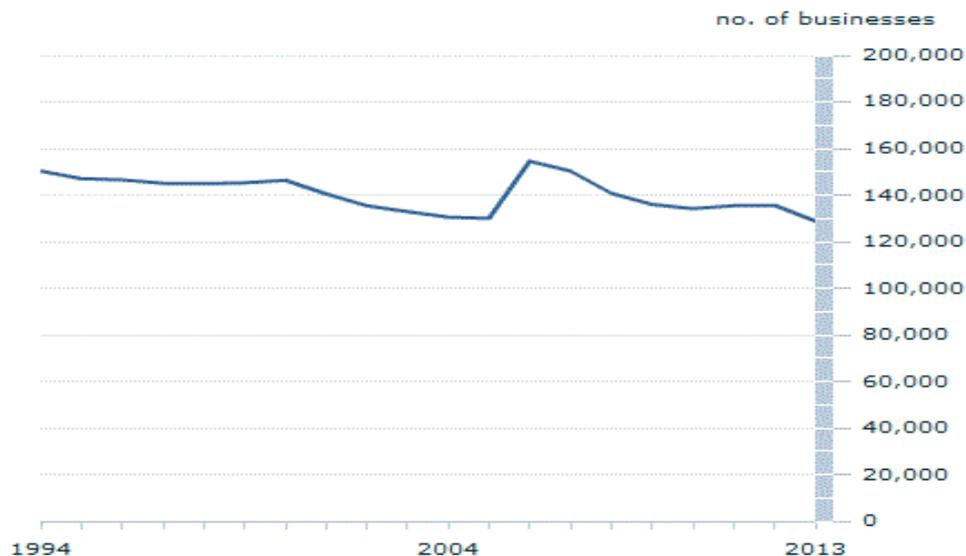


Source: Australian Bureau of Statistics

The value of all the economic activities supporting farm production through farm inputs, agriculture’s contribution to the GDP averages out at around **10 percent (or \$155 billion of Total GDP of \$1555 billion in 2013)**

**Figure 4: Number of Australia’s Agriculture Business**

- The number of Australia’s agricultural businesses is decreasing with more and more businesses are consolidating.



Source: Australian Bureau of Statistics

**Table 1: Australia’s Agricultural Businesses Number by Activity 2013**

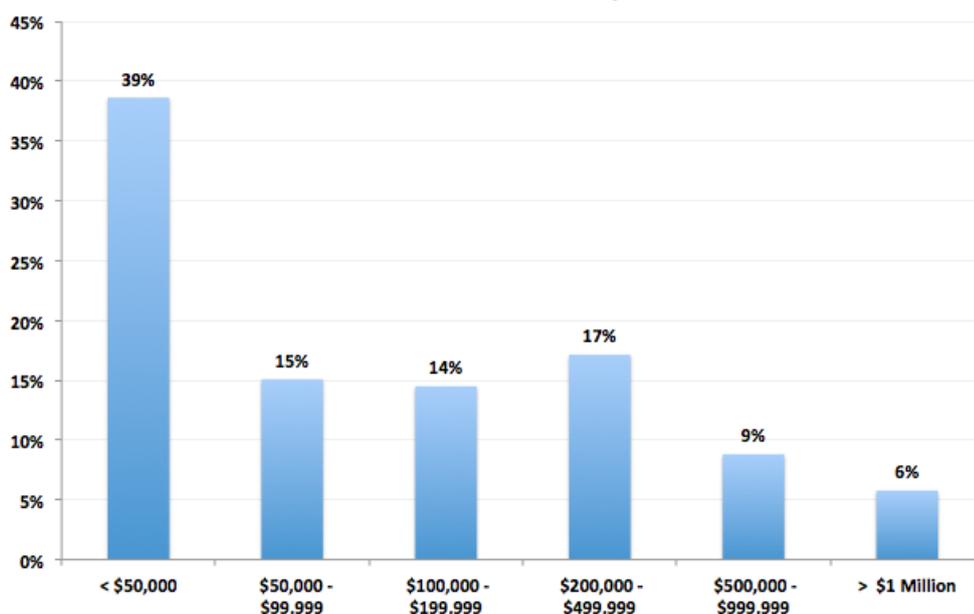
-Australia’s agricultural businesses are mostly livestock farming.

Business Activity	Business No.	Percentage
Beef Cattle Farming plus Beef Cattle Feedlots (Specialised)	39,441	30.6%
Sheep Farming (Specialised)	11,950	9.3%
Grain-Sheep or Grain-Beef Cattle Farming	11,584	9.0%
Dairy Cattle Farming	7,622	5.9%
Sheep-Beef Cattle Farming	6,470	5.0%
Poultry Farming (Meat)	755	0.6%
Poultry Farming (Eggs)	277	0.2%
Pig Farming	500	0.4%
Other Livestock	3,634	2.8%
Grape Growing	4,466	3.5%
Vegetable Growing	3,896	3.0%
Sugar Cane Growing	3,331	2.6%
Citrus Fruit Growing	1,039	0.8%
Nursery Production	728	0.6%
Cotton Growing	599	0.5%
Apple and Pear Growing	578	0.4%
Floriculture Production	548	0.4%
Rice Growing	524	0.4%
Other Grain Growing	11,099	8.6%
Other Fruit and Tree Nut Growing	4,060	3.1%
Others	15,816	12.3%
<b>Total</b>	<b>128,917</b>	<b>100.0%</b>

Source: Australian Bureau of Statistics

**Figure 5: Australia’s Farm Business Size 2011**

- Only 6% of Australia’s farm businesses exceed \$ 1million, and majority of the farms are small. We should convert those small farms to fewer large scale businesses.



Source: Australian Bureau of Statistics

**Table 2: Financial Performance in Australian Farm Business FY2013 (Average per farm)**

-The financial performance of Australian livestock farm businesses is rather poor, and dairy industry is also not the best. But Australia's wheat and crop farming is good. There is a huge potential to improve our agriculture.

	Unit	Wheat and other crops industry	Mixed livestock-crops industry	Sheep industry	Beef industry	Sheep-beef industry	Dairy industry
Total cash receipts	\$	949 400	473 500	241 000	229 600	233 800	577 300
Total cash costs	\$	668 800	346 800	177 200	181 900	176 700	533 100
Farm cash income	\$	280 600	126 700	63 900	47 700	57 100	44 200
Farm business profit	\$	121 000	13 300	-7 800	-18 000	-4 000	-33 500
Farm capital	\$	5 340 400	3 976 000	2 680 100	3 812 100	3 376 300	3 740 500
Net capital additions	\$	118 400	26 500	-700	-2 000	58 600	96 400
Farm debt	\$	1 099 600	569 800	219 100	297 000	248 600	783 700
Rate of return— excl. cap. Appreciation	%	4.1	1.6	0.4	0.2	0.5	1
Rate of return— incl. cap. Appreciation	%	4.8	1.8	-0.3	-0.9	-0.6	0.7
Off-farm income of owner-manager and spouse	\$	31 100	28 000	30 700	35 500	34 000	20 600

Source: ABARES, Australian farm survey results 2011–12 to 2013–14

**Table 3: All Banks lending to Business in Australia**

- Agriculture in Australia has high levels of debt, and currently little opportunity to attract outside equity and investment, and currently can only grow and improve through increase debt.

	2011–12			2012–13			2013–14	
	Mar \$b	Jun \$b	Sep \$b	Dec \$b	Mar \$b	Jun \$b	Sep \$b	Dec \$b
Agriculture, forestry and fishing	60.4	62.4	60.5	59.2	58.6	60.7	60.0	58.3
Mining	15.3	17.0	18.9	18.2	18.9	21.0	24.1	25.9
Manufacturing	43.7	42.5	41.0	39.8	39.7	39.6	38.7	38.0
Construction	29.2	30.3	29.1	27.8	28.0	27.5	27.8	27.7
Wholesale and retail trade, transport and storage	99.5	101.7	100.6	103.2	103.0	103.0	104.1	103.1
Finance and insurance	99.2	100.8	102.7	102.9	104.1	107.2	112.3	122.8
Other	321.6	329.3	342.6	342.6	345.2	351.3	352.8	354.5
<b>Total</b>	<b>668.9</b>	<b>683.9</b>	<b>695.5</b>	<b>693.8</b>	<b>697.5</b>	<b>710.4</b>	<b>719.8</b>	<b>730.4</b>

a Includes variable and fixed interest rate loans outstanding plus bank bills outstanding.

Source: Reserve Bank of Australia

**Table 4: Comparison of Australia’s Industries in FY2012**

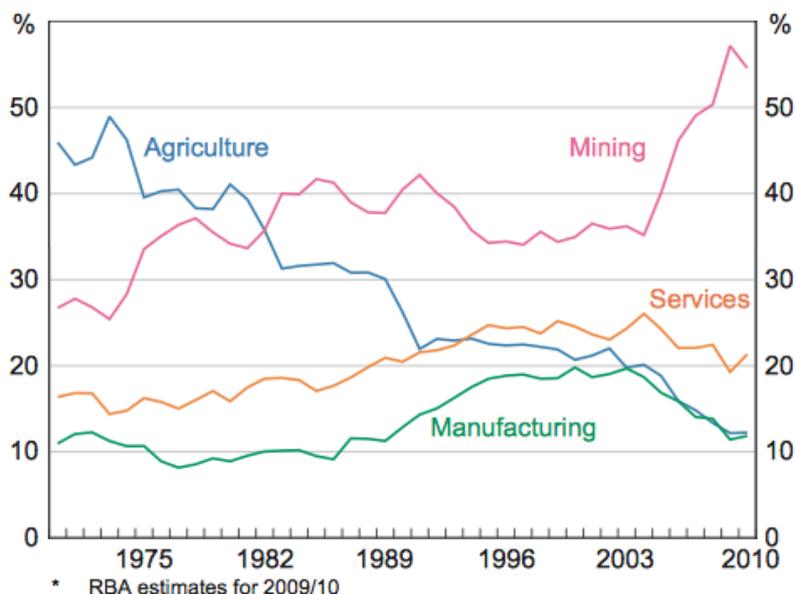
- Compared to mining and manufacturing, Australia’s agricultural investment is rather small.

	Services	Manufacturing	Mining	Agriculture, forestry and fishing	Total
<b>Industry value added <sup>a</sup></b>					
Level (\$b)	962.9	106.8	139.9	34.2	1243.9
Share of total IVA (%)	77.4	8.6	11.3	2.7	100.0
Share of GDP (%)	66.4	7.4	9.6	2.4	85.7
Annual Growth (%)	3.3	-0.9	6.7	6.3	3.4
<b>Investment <sup>b</sup></b>					
Level (\$b)	106.9	20.8	102.6	16.2	246.5
Industry Share (%)	43.4	8.4	41.6	6.6	100.0
Annual Growth (%)	0.0	5.6	57.1	18.7	20.0
<b>Exports <sup>b,c</sup></b>					
Level (\$b)	50.6	88.6	147.4	17.4	304.0
Industry Share (%)	16.6	29.2	48.5	5.7	100.0
Annual Growth (%)	0.4	5.5	7.8	23.9	6.6
<b>Employment</b>					
As at May 2012 (000)	9955.0	953.7	276.3	354.7	11 539.6
Industry Share (%)	86.3	8.3	2.4	3.1	100.0
Annual Growth (%)	1.1	-1.9	27.7	6.5	1.5

Sources: ASB 54204.0, 5302.0, 5368.0, 6291.0.

**Figure 6: Australia’s Exports Shares by Industry**

- The share of Australia’s exports in agriculture has reduced from 50% to 12% between 1970 and 2010. The share of Australia’s exports in mining industry has increased from 25% in 1970 to nearly 60% in 2010.



Source: ABS; RBA

**Table 5: Value of Agriculture in Total Merchandise Exports, Australia**

- Australia's farm exports increased 48% in last 5 year, which are mainly grains and oilseeds and meat and live animals. Dairy has increased but could do far better. Beef is now growing strongly.

**Value of Agricultural Exports in Total Merchandise Exports in Australia**

	2009–10	2010–11	2011–12	2012–13	2013–14 f	5-year Growth
	\$m	\$m	\$m	\$m	\$m	
Grains and oilseeds	6 087	8 516	11 162	12 428	11 899	95%
Industrial crops	4 830	4 812	6 203	5 999	5 406	12%
Total horticulture	1 637	1 588	1 729	1 896	2 221	36%
Other crops and crop products	2 346	2 461	2 517	2 740	3 058	30%
<b>Total crops</b>	<b>14 899</b>	<b>17 377</b>	<b>21 611</b>	<b>23 062</b>	<b>22 584</b>	<b>52%</b>
Meat and live animals	6 294	6 749	6 791	7 091	9 575	52%
Wool	2 303	3 048	3 123	2 869	2 969	29%
Dairy products	2 089	2 345	2 292	2 229	2 771	33%
Other livestock and livestock products	2 217	2 354	2 529	2 765	3 119	41%
<b>Total livestock exports</b>	<b>12 903</b>	<b>14 496</b>	<b>14 735</b>	<b>14 954</b>	<b>18 434</b>	<b>43%</b>
<b>Total Farm exports</b>	<b>27 802</b>	<b>31 873</b>	<b>36 345</b>	<b>38 017</b>	<b>41 017</b>	<b>48%</b>
<b>Total Merchandise Exports</b>	<b>200 720</b>	<b>245 724</b>	<b>264 026</b>	<b>246 980</b>	<b>274 414</b>	<b>37%</b>

Source: ABS

**Table 6: Foreign Investment Applications Approved by Sector, Proposed Investment (\$ Bn)**

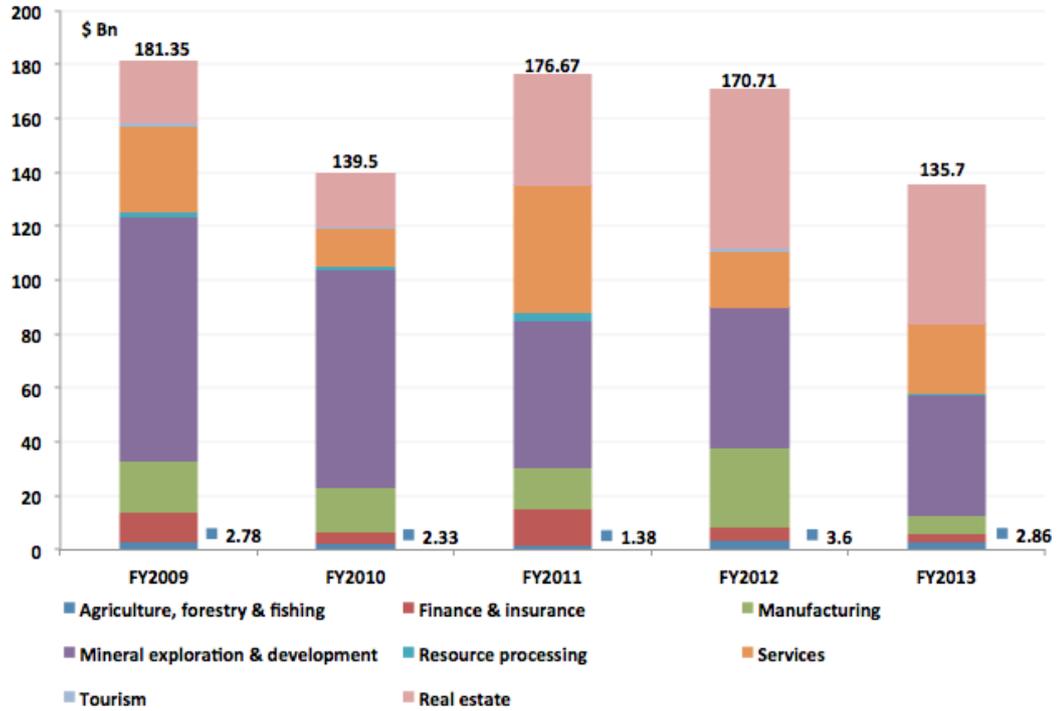
- More than 70% of foreign investment fund has been use for mining and property. Foreigners only spent less than \$3 billion to invest in Australian agriculture.

	FY2009	FY2010	FY2011	FY2012	FY2013
Agriculture, forestry & fishing	2.78	2.33	1.38	3.6	2.86
Finance & insurance	10.88	4.2	13.74	4.56	2.92
Manufacturing	19.11	16.25	14.91	29.52	6.51
Mineral exploration & development	90.62	80.92	54.9	51.65	45.14
Resource processing	1.8	1.08	2.59	0.3	0.42
Services	31.67	14	47.5	21.02	25.91
Tourism	1.06	0.71	0.14	0.94	0.02
Real estate	23.42	20.01	41.51	59.12	51.91
<b>Total</b>	<b>181.35</b>	<b>139.5</b>	<b>176.67</b>	<b>170.71</b>	<b>135.7</b>

Source: FIRB Annual Reports

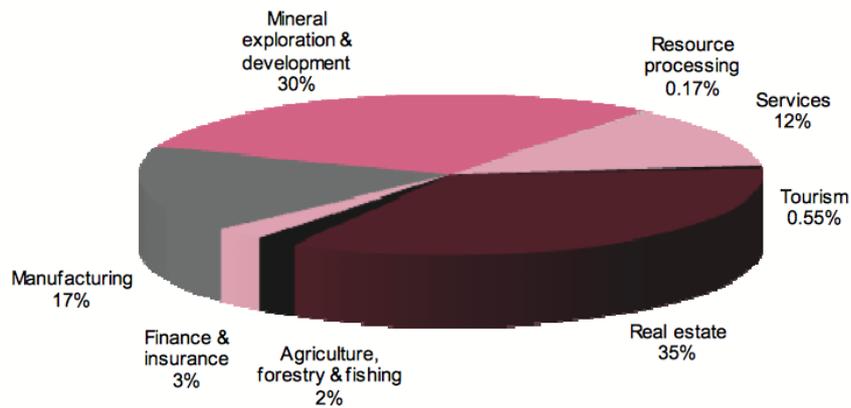
**Figure 7: Foreign Investment Applications Approved by Sector, Proposed Investment (\$ Billion)**

- Foreign Investment put less focus on Australia’s Agricultural development but this may be changing now.



Source: FIRB Annual Reports

**Figure 8: Foreign Investment Applications Approved, Proposed Investment 2013FY (\$ B)**



Note: Totals may not add due to rounding.

Source: FIRB Annual Reports