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Executive summary:

The Commonwealth Government has called for proposals relating to the effects on the Australian Securities Market of a reduction in the quantum of Commonwealth Government Securities (CGS) in issue (Review of the Commonwealth Securities Market – Discussion Paper, October 2002).

The Discussion Paper lists three alternatives currently available to the Commonwealth:

- Option 1 - to wind down the CGS market,
- Option 2 - to consolidate Commonwealth and State government debt markets,
- Option 3 - to maintain the CGS market and fund the Commonwealth's unfunded superannuation liabilities.

This paper has been submitted in support of option 3 – i.e. retention of the Commonwealth Government Security market and funding the Commonwealth's unfunded superannuation liabilities. The Forest Products Commission of Western Australia and Dr Marilyn Clark-Murphy of Edith Cowan University believe that investments in plantations will provide the Commonwealth Government with the ideal vehicle through which a substantial portion of funds raised through the issue of additional CGS to meet Superannuation liabilities can be invested.

Investment in plantations avoids many of the difficulties with government investment in financial assets raised in the Discussion Paper and leads to a virtuous circle which achieves multiple desirable policy outcomes:

- The CGS market is retained.
- All or part of the government's superannuation liability is funded.
- Significant gains are made in addressing dryland salinity.
- Jobs are created in regional areas.
- Australia's ability to meet greenhouse gas emission targets is significantly increased.
- Australia's dependence on imported forest products is reduced.

This paper provides the Commonwealth with brief details of opportunities available for investments in plantations. These include:

- Providing long-term secure returns to match the long-term liability profile of superannuation liabilities
- Providing environmental benefits in terms of addressing salinity problems, improving water quality etc.
- Providing opportunity for the creation of saleable carbon sequestration credits
- Through securitisation, provide means for investments to be realised in the short-term should the Government wish to liquidate investments
- Providing regional employment
- Providing means through which foreign investment can be drawn to the country by creating potential market for carbon credits

The paper is intended only as a brief overview of the opportunities presented by investments in plantations, and is tabled as a concept that will require further detailed analysis and review were interest to be shown.

1. The Concept

Plantations provide a long-term secure investment which, as well as providing a good return on investment, make a significant contribution to the massive land degradation problems which occur throughout Australia and which have been identified by the Commonwealth Government as a national priority for action.

As an investment, commercial trees are commonly embraced by the superannuation industry worldwide. Investment in plantations provides a secure return over periods in excess of 30 years and in addition, would address the three key investment issues identified in the Discussion Paper (page 90):

- First, low tolerance for risk – over an extensive plantation estate, physical risks can be effectively minimised and long-term markets are relatively secure. Plantation investments have a relatively low volatility of returns. The ability to diversify across tree species diversifies markets for the final product and lowers systemic risk. Systemic risk is further lowered by the potential for return from both the sale of timber and the sale of carbon credits.
- Second, need to limit impacts on the prices of markets or assets – increases in supply can be accommodated as markets for timber are expanding both domestically and internationally as supply from native forests both at home and overseas is tending to decline. (Australia's annual trade deficit in forest products is currently \$2.02 billion per annum). It is considered unlikely that the type of investment contemplated would cause any undue distortions in the timber or associated markets. Indeed opportunities such as biomass energy, discussed later in this paper, mean that entirely new markets could be created in Australia;
- Third, public policy considerations of ownership or influence over private or public sector entities – Governments in Australia and all over the world already have substantial investments in plantations and are key players in the industry. These investments are justified on the basis of environmental benefits, as well as the long-term nature of the returns and have not caused any significant conflict with the private sector. The additional benefits to the nation beyond purely financial return are likely to significantly reduce any potential for conflict of interest.

Plantations offer a long-term investment with secure returns and significant associated benefits for the nation.

2. Key Questions

Page 104 of the Discussion Paper lists key questions with regard to Option 3, on which the Commonwealth would like comment from stakeholders. Our submission addresses these key questions:

2.1 **Governance arrangements for a hypothecated asset fund that would insulate investments from direct Government control:**

Funds available for investment in plantation assets could be transferred to a central Commonwealth body, such as the body currently managing the allocation and distribution of Commonwealth National Action Plan funds for the redress of salinity and water degradation. This body would have responsibility for reviewing business cases submitted by State and private plantation investment organisations to ensure the optimal allocation of funds for investment in plantations. The criteria for the allocations can be a mixture of best environmental returns as well as projected financial returns. This body would then monitor investment to ensure revenue flows and environmental impact is in line with original submissions.

The body could also arrange for the securitisation of the assets should there be a need to realise any of the investments in a shorter timeframe than the underlying revenue streams from the plantations.

2.2 **Funding the unfunded superannuation liability through a superannuation fund to deal with governance issues:**

We do not seek to address this issue in any detail, however there is no reason why investments in plantation assets should not be held in a superannuation fund. Having said this, if a policy decision is made to fund all or part of the unfunded superannuation liability by investment in plantation assets for all of the benefits they can provide to the nation, then many of the governance issues which make the establishment of a superannuation fund desirable are removed.

2.3 **The appropriate limits on holdings of any single instrument or company, if the Government were to invest in debt or equities:**

Investment in plantation assets avoids the difficulties that arise from high levels of Government investment in the debt or equity of private companies. The potential for perceived or actual government interference in the operation or governance of private companies does not arise. As already mentioned, diversification can be achieved by diversity in species and in sources of return.

2.4 The likelihood of Government investments distorting asset prices:

Large investment in plantations could affect pricing and costs within the plantation industry. However, it is submitted that this effect would be gradual and long-term, in line with the financial yields from these investments. When compared with the effects of large-scale investments in equities or bonds, investment in plantations is considerably less likely to have adverse short-term effects on market prices or on any particular organisation's cost of capital. In fact, the short-term effects of a significant increase in plantation investments are likely to be positive, bringing increased efficiencies and reductions in costs associated with the establishment and monitoring of plantations throughout Australia.

2.5 Impact of restricting Government investment to foreign securities

Investment in plantations allows the Government to invest in domestic assets without the disadvantages that might otherwise necessitate a restriction to foreign securities. Thus the potential additional risks of international investment are avoided.

2.6 The increased uncertainty for fiscal policy arising from variations in investment returns:

Plantation investments provide sound and stable long-term investment returns (see comment under 4 below). There is therefore little likelihood of short-term impacts on fiscal policy as a result of variations in investment returns as might be the case with investment in equities.

3. Other key considerations:

In addition to addressing the issues outlined above, this proposal has a range of other benefits that will help address some of the nation's greatest environmental, social and economic problems.

3.1 Investments closely matching payments profile

The Discussion Paper (page 93) mentions that a superannuation fund would usually take an investment strategy that delivers returns that closely match its payment profile. Plantation investments would achieve this objective, with returns 30 years and more from date of initial investment, while also providing possible short-term returns through the sale of carbon credits and/or securitisation.

3.2 Support for regional employment and industry

A significant increase in the plantation estate in Australia would lead to a flow of additional benefits to key areas of regional development, both from industries to support plantation growth and harvesting, and from mills and other down-stream processors such as the Laminated Veneer Lumber project recently launched in Western Australia, with the attendant creation of jobs in rural areas.

Tree farming increases economic activity and regional employment during establishment of plantations and harvesting of timber products. Implemented in partnership with landholders, they enable the tree crops to be integrated with agricultural pursuits and landholders to remain on the land. Employment is created during establishment of plantations as well as subsequent processing.

Tree farming will contribute to the ongoing economic viability of communities in the agricultural zone through the diversification and drought-proofing of farm enterprises and the maintenance of productive capacity of large areas of land that may otherwise become degraded by salinity, waterlogging and erosion. Tree farming projects rely heavily on the use of rurally based contractors for on-ground implementation.

Expansion of tree farming will also promote the development of processing facilities in rural areas (close to the plantation resources) and will further enhance the development of port facilities in adjacent coastal centres.

In addition, the project offers the potential for significant export of wood and non-wood products.

3.3 Scale

The scale of investment required to achieve desirable CGS outcomes and to address the unfunded superannuation liability can be accommodated by investment in plantations. The scale of investment needed to address salinity and import reduction is also of a similar magnitude.. Plantations in the order of 5 million to 10 million hectares across Western Australia and the Murray Darling Basin can be accommodated, with investments of \$10b to \$20b over the life of a project (or \$0.5b per annum).

3.4 Environmental benefits

The re-establishment of trees on cleared farmland has been identified as a key national strategy to assist in dealing with problems of salinity, land degradation, biodiversity loss and rural decline. This proposal would enable the re-establishment of trees on cleared farmland at an unprecedented scale that would make a truly significant contribution to these national problems. At the same time such investment would deliver a significant carbon sink, thus contributing to Australia's response to the greenhouse effect.

The situation in Western Australia reflects that in Australia as a whole. The state has a requirement for widespread tree planting in the south-west agricultural region in order to gain environmental benefits for nature conservation, water quality and agriculture.

Dryland salinity, caused by rising watertables, is a key issue for the State, posing a threat in a region that is internationally acclaimed for its diversity of native vegetation. 70% of Australia's recognised dryland salinity occurs in WA. The south-west land division has an estimated 9,000 plant species of which more than 70 per cent occur nowhere else in the world. Loss of vegetation in turn means loss of habitat for native animals.

Rising salinity levels are the result of over clearing native vegetation, allowing watertables to rise and bring salt stored in the soil towards the surface.

The capacity of tree farming to reduce watertable levels significantly by using water stored in the soil profile has been demonstrated in trials with several different species. It has been established that provided trees are strategically located, groundwater control can be achieved by revegetating a portion of the landscape with trees.

3.5 Greenhouse

As they grow, trees remove carbon dioxide from the atmosphere and thus reduce greenhouse gas concentrations. Australia's National Greenhouse Strategy explicitly aims to encourage plantations for carbon sequestration.

Australia's State and Commonwealth governments have yet to approve final policies on emissions trading, pending progress with international negotiations. However, the introduction of an emissions trading scheme, either nationally (without ratification of the Kyoto Protocol) or internationally after ratification, would create a market for sequestered carbon and thus add significant economic value to the plantation estate with an associated increase in returns on any CGS derived funds..

3.6 Bioenergy

Bioenergy is energy derived from biomass. Biomass may be produced from purpose-grown crops or forests, or as a byproduct of forestry, sawmilling and agriculture. Biomass can be utilized directly for heat energy or converted into gas, electricity or liquid fuels.

WA has commissioned a number of studies to investigate the potential for bioenergy plants in the south west of the state. The studies conclude that with the significant resource which will become available from the plantation industry, there is considerable scope for development in this field. As part of WA's oil mallee industry's development, a pilot bioenergy plant is shortly to be constructed in Narrogin east of Perth. Residues from other plantation species are also suited for this form of environmentally benign energy which will make a further contribution to Australia's greenhouse gas targets.

Further development of tree farming will increase the range of potential sites for bioenergy, based on residues from processing and production of solid wood products.

3.7 Reduction in Timber Imports

Australia's annual trade deficit in forest products is \$2.02 billion; \$1.8 billion in exports as against \$3.8 billion in imports. While Australian exports of forest products continue to increase, Australian forests produced only 70 per cent of the total forest products consumed in Australia in 2000-01. There is a clear opportunity to reduce Australia's reliance on imports of forest products through the expansion of our plantation resources. This is particularly so in view of declining access to native forest timber resources.

4. Financial returns possible from investment in timber assets

Returns vary depending on plantation species, location and markets. Provided plantations are carefully planned and well-managed, returns in line with, and exceeding, the average long-term yields quoted in the Discussion Paper are achievable.

5. Conclusion

This paper is intended to demonstrate that one of the alternatives available to the Commonwealth, should it select Option 3 of the Discussion Paper, will be investment in plantations within Australia. This investment can be managed to avoid concerns the Commonwealth has raised under "key issues to be addressed" under Option 3, as well as providing long-term social, financial and environmental benefits for the people of Australia.

Attachment

An attachment (Investing in Maritime Pine) has been included for reference. This document, although some 2 years old and produced before the formation of the Forest Products Commission out of the Western Australian Department of Conservation and Land Management, highlights the potential benefits and returns available from investments in plantations. It should be stressed, however, that the potential for investment is not limited to pines, many different opportunities exist to satisfy economic and environmental requirements in different areas of the country¹.

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¹ Further information can be obtained from the FPC's website www.fpc.wa.gov.au