

SUBMISSION No. 99
Inquiry into the Australian forestry industry



**Australian Plantation Products and
Paper Industry Council (A3P)**

Submission to the

**House of Representatives Standing Committee on
Agriculture, Resources, Fisheries and Forestry**

Inquiry into the Australian forestry industry

April 2011

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Summary of Recommendations

Recommendation 1

The Government makes a firm public commitment that it is in the national interest to maintain and strengthen Australia's forest and forest products industries, and that government policies, to the extent possible, support rather than impede the growth of these industries.

Recommendation 2

The Government recognises and acknowledges the looming shortfall in supply of sawlogs from domestic forests, and commits to working with all governments and the plantation industry to formulate and implement stable policies and programs that will ensure a sustainable long-term flow of logs of the appropriate quality to a vibrant domestic forest products and paper industry.

Recommendation 3

The Government takes specific targeted action to support investment in new and replanted long-rotation plantations at any scale, after thorough analysis of alternative policy options, in collaboration with industry.

Recommendation 4

The Government reaffirms its commitment to maintaining the prevailing basic tax entitlements for plantation growers and investors.

Recommendation 5

The Government acknowledges the realities of plantation forestry and its contribution to beneficial environmental outcomes, and makes a public commitment to restoring practical support for the growth of family farm forestry as an integral part of Australia's future wood supply.

Recommendation 6

The Government ensures that its economic and trade policies are equitable, transparent, not discriminatory among industries, and prevent the import of illegally logged timber, and that its anti-dumping and countervailing measures are less complex and costly and more accessible and fair than the current arrangements.

Recommendation 7

The Government accepts and acts upon the recommendations of the Final Report of the Pulp and Paper Industry Strategy Group for financing infrastructure investment and for improving the efficiency of transport systems and regulation.

...continued

Recommendation 8

The Government works with industry groups to identify and then take appropriate actions to correct the current and forecast distortions in labour markets, and ensure that ALL sectors of the economy are adequately resourced with suitably skilled and qualified personnel.

Recommendation 9

The Government takes appropriate, effective and sustained actions to:

- halt the decline in Australia's capacity in research, development and extension in forestry and wood and paper manufacturing;***
- restore that capacity, particularly in CSIRO and the universities;***
- restore or replace government programs to support the expanded contribution that small-scale private forestry can and should be making to Australia's future wood supply;***
- ensure the industry can take advantage of the opportunities to diversify and value-add, including by commercialising its Australian innovations.***

Recommendation 10

The Government recognises statistical data collection, analysis and dissemination for the plantation and plantation products industry as a public good, and makes a firm commitment to resource and maintain a core-funded facility to carry out these functions, within the Agriculture, Fisheries and Forestry portfolio, and allocated largely to ABARES.

Recommendation 11

The Government acts, through appropriate Federal-State mechanisms, to accelerate the adoption of environmental rating systems for buildings that recognise embodied energy and carbon stored in building products.

The Government encourages the rationalisation, or at least mutual recognition, of forest certification schemes.

Recommendation 12

The Government ensures that, as the only carbon-positive sector of the economy, commercial plantation forestry and the plantation products and paper industries:

- are at worst not competitively disadvantaged by climate change programs and the introduction of a carbon price; and***
- are appropriately rewarded for their positive contribution to carbon capture and storage and emissions reduction.***

The Government moves urgently to recognise the carbon stored in harvested wood products in the formulation of its climate change mitigation policies.

Recommendation 13

The Government puts in place stable policies and programs that encourage and support innovation, commercialisation and widespread adoption of technologies to produce solid, liquid and gaseous energy from wood, whether the wood is unavoidable surplus and residue co-product or grown in dedicated energy crops in marginal areas.

About A3P

A3P is the national representative body for the plantation products and paper industry. A3P's member companies include plantation growers, wood products manufacturers (including sawntimber and wood panels) and paper manufacturers. A3P Members employ more than 13,500 people in plantations, sawmills and paper manufacturing plants, mainly in rural and regional areas. A3P Members create and sell more than \$4 billion of products, and produce more than 12 million cubic metres of logs, 3 million cubic metres of sawn timber and more than 2 million tonnes of paper.

As A3P's membership base covers the full value chain from primary production through to the marketing of finished wood and paper products and is primarily located in regional Australia, we have a diverse range of interests and endeavour to be actively engaged in a number of national policy issues including climate change, infrastructure, energy, trade and water.

Please note that A3P members have recently agreed to the formation of the Australian Forest Products Association (AFPA) through a merger of A3P and the National Association of Forest Industries (NAFI). NAFI has made a separate submission to this Inquiry. A3P's submission and the NAFI submission are not inconsistent and cover a range of separate and overlapping issues in different levels of detail. The organizational merger is currently in transition, and A3P and AFPA will coordinate any further interaction with the Inquiry.

Introduction

Australia's forestry, wood products and paper manufacturing industries are currently facing a number of significant challenges to their medium and long-term futures, and to their capacity to continue contributing to the nation's economic, social and environmental welfare.

This House of Representatives inquiry has therefore come at an important time. It provides an opportunity to air some of the issues and to explore some possible solutions.

It is almost twenty years since the National Forest Policy Statement (NFPS) was signed in 1992 by the Prime Minister, the State Premiers, Territory Chief Ministers, and the Australian Local Government Association. The NFPS was built on the foundation created by several inquiries and reports over an extended period, the then most recent being the Resource Assessment Commission's vast Forest and Timber Inquiry (1989-1992) and the Report of the National Plantations Advisory Committee's 1991 report, *Integrating forestry and farming: Commercial wood production on cleared agricultural land*.

Together with the national plantations strategy, *Plantations for Australia: The 2020 Vision*, adopted in 1997 by the federal and state/territory governments and the three national forest industry representative bodies, the NFPS has underpinned and guided forest policy in Australia during nearly two decades of substantial change and turbulence.

These overarching national policies and strategies have been backed up at different times by various supporting Commonwealth and State farm forestry policies and programs.

The Regional Forest Agreements signed in the 1990s have provided a higher level of stability in the native forest resource than existed in the previous decade. Production from softwood plantations has increased, due to the foresight of governments in the 1950s and 1960s. A major new hardwood plantation pulpwood resource has been grown, with other carbon, environmental and social benefits. The industry has become increasingly mechanised and computerised, the scale of operations has grown, manufacturing efficiency has improved, innovations in plantation products and their use in buildings has expanded, and for the most part, competitiveness has been maintained. There have been some major changes in ownership of the plantation resource and the manufacturing facilities, including much consolidation, and investment by overseas companies and institutions. And independent certification of sustainable forest management has become common practice.

At the same time, there have been some disappointments and some loss of momentum, and an emergence of new issues, some unforeseen two decades ago. These matters will be elaborated upon in this submission, with recommendations about how to better equip the plantation products industry to face the challenges of the coming decades.

The Terms of Reference of this Inquiry are wide-ranging and ambitious in scope. Other national representative organisations are addressing issues that are both different to and overlapping with A3P's submission, from the perspective of their members and constituencies.

The submission from Australian Forest Growers (AFG) focuses on the role that farm-scale integrated plantation forestry and private native forestry could play in supplying a wood resource the growing of which would have a comparatively easily secured 'social licence' in rural communities.

In 2010, the National Association of Forest Industries (NAFI) proposed the development of a new 'industry growth strategy'. NAFI's submission essentially restates, elaborates and expands upon the main points that should be covered in a new forest industry-wide strategy.

Further, the CEOs of Australia's major large-scale commercial plantation growers, both public and private, have separately made an additional and complementary submission, particularly emphasising the looming shortfall in domestic sawn timber production and the need to invest in planting and replanting sawlog plantations.

A3P sees no reason to duplicate the work of our colleague organisations, and hence this submission has been largely designed to complement the others, and to provide more specific detail about particularly relevant priority issues facing the plantation products and paper industry.

The scope of A3P's interests cover any subject that affects the operations of our members. High priorities for 2010-11 have been:

- climate change and energy (including energy market reform, renewable energy)
- plantation investment
- implementation of the Pulp and Paper Industry Strategic Review
- timber market access and development
- trade (especially dumping and illegal logging)

Other issues of significance regularly include (in alphabetical order):

- chemical pesticide regulation
- data and statistical information
- education, training and skills availability
- fire management
- national water policy
- plantation health and biosecurity
- product stewardship
- R&D policy
- safety
- sustainable forest management certification
- timber product quality assurance
- timber standards
- transport and infrastructure

Among these, several stand out with respect to the coverage of this Inquiry, and they are the priorities to which this submission has given the most attention on behalf of plantation growing and processing, including solid wood and panels, and pulp and paper.

Our submission rearranges and regroups the Terms of Reference to reflect A3P's view of relative importance and for ease of composition to convey our main messages.

Long-term versus short-term considerations

There is little specific detail that can be certain in a long time horizon (say, longer than 25 years) for plantation growing, wood processing and paper making investment. This inevitably leads us to focus more attention on relatively short-term matters that we hope will enable us to realise whatever scenarios we might paint for the long-term future.

In this industry, the only real long-term 'certainties' are:

- Commercial plantation forests for wood and fibre production will remain a sustainable and desirable land use option for certain climatic zones and land classes, and Australia should keep this option available by having the necessary expertise and capacity.
- Society's demand for wood, paper, energy and other forest products in some form will be ongoing — both here and overseas.

Australia shall attempt to supply this domestic and international demand from its own forests and from imported products.

Unless Australia, as a nation, chooses to rely only on unfettered 'market forces' in all elements of the industry (and thus shift to higher proportions of imported products from lower-cost countries), it should and most likely will attempt to realise these 'certainties', and pursue a justifiable level of wood and fibre security, by maintaining and strengthening a diverse domestic industry along the production and distribution chain.

Few would argue that it is not in the national interest to take this pathway.

Hence, while the priority issues in this submission require relatively short-term policy measures and actions by industry and governments, these policy measures and actions are framed with the long-term in mind.

Recommendation 1

The Government makes a firm public commitment that it is in the national interest to maintain and strengthen Australia's forest and forest products industries, and that government policies, to the extent possible, support rather than impede the growth of these industries.

Long-term consideration #1:

Ensuring there can be a sustainable long-term forest resource to supply future demand for wood, paper, energy, chemicals and ecosystem products and services

ToR 1: Opportunities for and constraints upon production

ToR 3: Win-win balancing of environmental and economic outcomes

ToR 4: Creating a better business environment for forestry industries

ToR 5: Demonstrating the social and economic benefits of forestry production

ToR 7: Harmonising land use across forestry and land use sectors

It is very well documented that for at least the past twenty years, the supply of wood from public native forests to the wood and paper industries has been steadily declining, as more and more forest is reclassified as reserve and withdrawn from production. This trend is likely to continue for all but high value native forest products.

Australian softwood plantations — initially mostly in public ownership — have supplied the house framing, panelboard, packaging and industrial papers, communication papers and newsprint, landscape products and tissue sectors for years, and more recently, with product innovation and new technologies, have been increasing their penetration of heavy structural building product markets.

By contrast, hardwood plantations, originally funded largely through managed investment schemes, have focused mostly on supplying export woodchip markets (or paper manufacturing, mostly in Japan and other parts of Asia), while being ready to re-direct that resource to potential new domestic pulp and paper mills. A tiny proportion of hardwood plantations has been grown for sawlog, and indeed much of what has been planted could not easily be converted to sawlog production. It may be possible for some of this plantation resource to provide fibre for various reconstituted wood products such as veneer for plywood or other reconstituted panels.

As state government forestry agencies have wound back their new softwood plantings (after the termination of the Commonwealth softwood loans agreements), the gap in new softwood plantation establishment has not been filled by private investment.

The consequence of these trends is that sectors relying on softwood and hardwood sawlogs now face a plateauing of domestically supplied resource, over the same period where growing populations and housing demands will see an increasing demand for innovative, sustainably produced and renewable building products. This in turn threatens continued investment in internationally competitive processing facilities, with their accompanying economic and employment benefits for regional Australian communities.

The trends are illustrated in the following two graphs, Figures 1 and 2, prepared by Thompson (2010), and derived from ABARE, BRS and ABS statistics.

It has become clear, on the supply side, that directing investment into new and replanted sawlog plantations has become the most serious challenge facing Australia's plantation products and paper industry. And a recent review of Australian and overseas experience (*de Fegely et al, 2011*) reveals, universally, that supportive government policies and programs are essential to make such investment more attractive.

Figure 1. Future Sawlog Supply and Demand

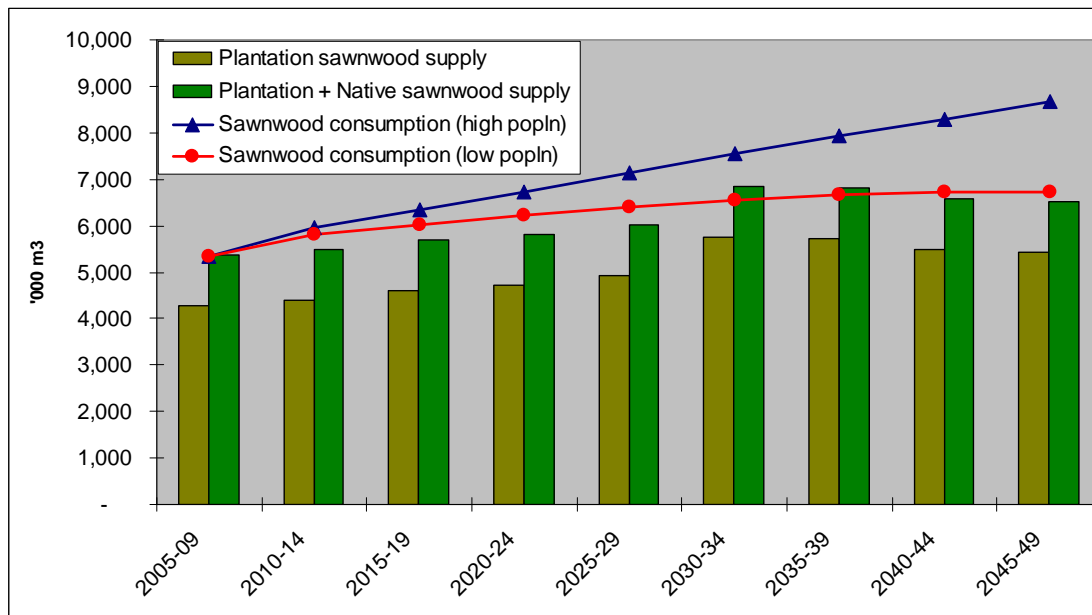
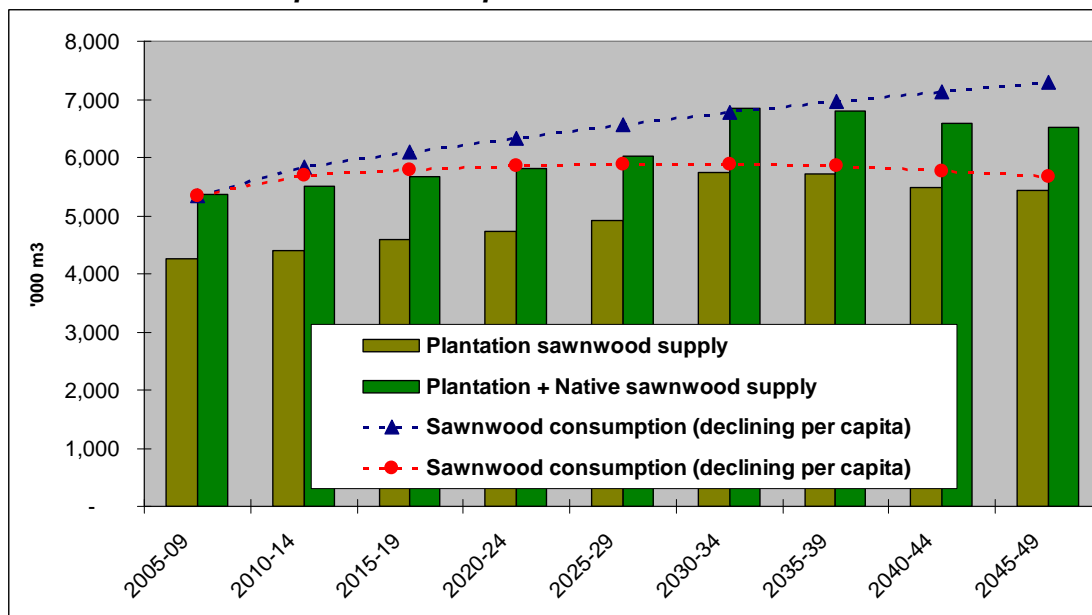


Figure 2. Future Sawlog Supply and Demand with Reduced Per Capita Consumption



This and other industry submissions suggest diverse ways in which federal government policies and programs could be introduced or revised to achieve this objective. However, in making changes, it is important to also recognise policy settings that have proven effective and to leave them in place as they are. The reason for this is worth explaining.

Processing and value-adding in the plantation products and paper manufacturing industries involves investment of tens or hundreds of millions of dollars, which is not made unless the processor is confident of having access to the necessary plantation resource. The processors seek secure supplies of harvested wood of the nominated

quality and specifications, delivered in sufficiently large volumes, consistently and continuously over a long period at competitive prices.

The corollary is that these industries try to avoid sharp and substantial fluctuations and disruptions to their resource supplies, for which 'smoothing' adjustments can be difficult and are invariably very expensive.

During the decades when state government forest agencies were the dominant plantation growers, supplemented by wood from industrial processors' own captive plantations, securing long-term access to the wood resource was simpler and more predictable.

With the shift over the past decade towards greater reliance on private investor-funded plantations, different forces have come into play, which must be planned for and managed by the processing sector.

While there is little that plantation growers and processors can do to prevent the sort of market fluctuations that have been experienced since 2008, changes in government policy and regulation are, by contrast, a factor that **can** be controlled. For example, the peaks and troughs in plantation establishment between 2000 and 2003 were directly induced by sudden changes in tax policy, will seriously disrupt harvested wood flows in 10 to 25 years time, and yet were quite avoidable.

This is the sovereign risk that governments should seek to avoid by ensuring that plantation policy and regulatory settings are as stable and predictable as they can be.

Policy changes also threaten **existing** plantations, which may never be harvested if new regional plantation estates don't continue to expand to reach the critical mass to supply new processing facilities.

Besides the downstream impacts on future wood flows, dramatic downturns in planned plantation establishment have immediate adverse consequences for the 'upstream' businesses, jobs and rural communities providing services to the plantation sector.

Attachment A contains further explanation of the impact of disruptions in wood flows.

Recommendation 2

The Government recognises and acknowledges the looming shortfall in supply of sawlogs from domestic forests, and commits to working with all governments and the plantation industry to formulate and implement stable policies and programs that will ensure a sustainable long-term flow of sawlogs of the appropriate quality to a vibrant domestic forest products and paper industry.

New policies, programs and investment structures

The two most significant outcomes to emerge from the plantation investment trends described above are:

- first, the lack of public and private investment in sawlogs for the undersupplied domestic market; and
- second, the dramatic contraction in projects funded through managed investment schemes (the main source of private funding) since and including FY2009.

Therefore, it is important to urgently explore additional investment structures and government policies and programs in order to expand and diversify the possible investment sources and pathways to produce the plantation resource most needed for Australia's future demands.

Four recent pieces of work have laid the foundation for further detailed investigation of alternative and additional approaches to plantation investment that might be deployed in Australia.

- Thompson, D (2010). *Plantation investment models and forest policy*. Australian Forest Growers Biennial Conference, Mt Gambier, 2010.
- Low, K *et al* (2010). *Models for a sustainable forest plantation industry: a review of policy alternatives*. ABARE Research Report 10.05
- de Fegely, R *et al* (2011). *Policies and additional investment models to support continued plantation investment in Australia*. FWPA Project No. PRA189-1011
- Kelly, M *et al* (2005). *Impediments to investment in long rotation timber plantations*. FWPRDC Project No PN05.1011

Possible business structures, financing mechanisms, industry initiatives and government policies that have been identified in that work (mostly in Thompson) and in other internal A3P documents include the following examples.

Business structures

- unit trusts (perhaps including annuity payment)
- incorporated limited partnerships (eg, under the *Venture Capital Act 2002* (C'th))

Financing mechanisms

- revolving loans for plantation establishment (offered by government or private institutions), to be repaid out of thinnings or harvest proceeds, or once a percentage survival has been achieved (eg, 75% in Chile)
- treating plantations as 'infrastructure', thereby enabling them to be funded by issuing infrastructure bonds
- pooled development funds (as have been used in Australia in the recent past, and as were recommended in the 1992 National Forest Policy Statement)

Industry initiatives

- joint ventures between farmers and government forestry agencies, plantation processors or large plantation investment companies — to the degree that governments action/s can facilitate joint ventures being created (eg, removing the anomalous tax treatment of profits a prendre and forestry rights)

Government policy and regulation

- cost-sharing programs and other government 'expenditure' programs (eg, grants for various plantation stages and expenses)
- carbon-related financing programs, including government purchase of the rights to stored carbon, carbon pricing mechanisms etc, funded and/or facilitated by governments

- redefining plantation forestry as a capital investment, but then treating the capital expenditure as a business deduction (as with expenditure on landcare (100% in year 1) and water conservation (100% over three years))
- rationalising revenue and capital tax treatment so as to facilitate and encourage the trading of standing plantations, thereby making long-rotation plantations a more liquid and thus more attractive investment for private growers (similar to the MIS forestry provisions)
- greater than 100% tax deductibility for the establishment of long-rotation sawlog plantations
- flow-through tax treatment, whereby the tax deductions and liabilities of the business flow through to the passive (capital) investor (shareholder) in the year they are incurred, as though they were business expenses
- income at harvest to be tax-free or taxed at a concessional rate (as has been applied in the UK and some Scandinavian countries)
- gains in the value of standing timber (not land) to be exempt from CGT (as applied in the UK)
- more flexible superannuation rules so as to not discourage the use of farm plantations as the main source of retirement income
- attaching conditions to tax-effective retail and wholesale investments, such as managed investment schemes
- enabling policies and programs, such as research, development and extension (especially for farm forestry), and regional coordination (eg through the now terminated Private Forestry Development Committees and the National Plantation Strategy Coordinator project)
- assistance with aggregating small wood 'parcels' from multiple growers (eg through cooperatives and brokers)

Recommendation 3

The Government takes specific targeted action to support investment in new and replanted long-rotation plantations at any scale, after thorough analysis of alternative policy options, in collaboration with industry.

Maintaining existing tax and regulatory frameworks for plantation forestry

While seeking to introduce additional and alternative ways to fund future plantation investment, it is important to recognise the effectiveness of existing policies and to ensure they are not disregarded. Tax treatment is a major factor influencing the level of private plantation establishment, is directly controlled by the Government, and is a subject about which there appears to be much public misunderstanding.

Attracting large-scale private investment into plantations to replace what used to be funded directly through government forestry commissions faces different and peculiar challenges flowing from the unique nature of forestry enterprises and assets.

Plantation forestry is a relatively long-term enterprise, with high establishment costs, illiquid assets, very few income events, returns coming in large 'lumps', and a large tax liability at final harvest.

This 'lumpy returns' feature creates the phenomenon of 'period inequity', a form of market failure that continues to bedevil plantation enterprises, especially smaller-scale privately funded operations. This is one of the long-running impediments to more investment through farm forestry, and is a downside to investment through managed investment schemes. Because most of the income in the occasional large income events (commercial thinning harvests and final clearfall harvest) is taxed at the forest grower's highest marginal tax rate, more income tax is likely to be paid on a plantation forestry enterprise than if the same total amount of income had been received and taxed annually — as occurs with most livestock, cropping and horticultural enterprises.

In the face of this market failure, plantation forestry nevertheless receives no subsidies or 'special tax advantages' not available to other primary producers. All that plantation forestry has is access to the same tax deductions as are available to every business in Australia. Under section 8-1 of the *Income Tax Assessment Act 1997* (the 'general business deduction' provisions), eligible non-capital expenditure is fully (ie, 100%) deductible against other income in the year the expenditure is incurred. This is clearly explained in the Australian Taxation Office (ATO) *Tax Ruling TR 95/6: Income tax: Primary production and forestry*. Quite simply, this ruling allows that all non-capital business costs associated with establishing, managing and harvesting a plantation and transporting its produce to the nearest point of conversion are fully deductible in the year they are incurred.

It is important that private forest growers continue to have access to this long-standing general entitlement. If it were to be denied, not only would that denial discriminate against one form of enterprise that is already challenged by its inherent characteristics, but it would perversely create a disincentive to further private plantation investment, as dramatically occurred in New Zealand in the mid-1980s.

In the same vein, there is no reason to change the tax treatment of forestry managed investment schemes. For plantation investment through these schemes, investors' subscriptions are subject to the same principle (ie, year-of-expenditure deductibility), although under the relatively new Division 394 of the ITAA 1997, the principle has been converted into a statutory 'specific deduction', and investors are no longer required to demonstrate that they are carrying on a business, as was the case before the new legislation in 2007.

Division 394 was introduced and passed with bipartisan support after an exhaustive review by the Treasury in 2005 and 2006. The Tax Commissioner's subsequent unsuccessful test case in the Federal Court then had no bearing on the tax treatment of MIS forestry investment.

The legislation includes four integrity measures to help ensure the investors' funds are used for the stated purpose and to maintain a tax neutral outcome for the Budget. Three of these measures must be met in order to prevent the investors having to forfeit their deductions.

One of these integrity measures — that the initial investor must hold the woodlot interest for a minimum period of four years before trading the interest to a secondary buyer — also has the desirable effect of increasing the liquidity of managed plantation investments, and will help the much-needed longer rotation sawlog plantations to become a more attractive investment prospect than they have been.

Attachment A contains more explanation of plantation tax arrangements, previously submitted to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Agribusiness Managed Investment Schemes (the Ripoll Inquiry) in 2009.

The Ripoll Inquiry recommended a number of changes in the corporate regulatory environment to increase the levels of protection for investors in these projects. Three of these have been acted upon, and will have a profound impact on managed investment schemes, and agribusiness MIS in particular.

- In 2010, the Australian Government announced tighter rules governing the behaviour, performance and modus operandi of financial advisers, who play an important role in the offering of agribusiness MISs to potential investors.
- In 2011, the Australian Securities and Investments Commissions (ASIC) will release two new Regulatory Guides — one setting out ten disclosure benchmarks for the structure and operation of an agribusiness MIS, the other imposing four new and more restrictive finance requirements on all MIS Responsible Entities (not just agribusiness).
 - ASIC is expecting that, taken together, these new Guides will help restore investor confidence in the MIS sector as an effective way of raising retail investment funds (eg, for timber plantations). It remains to be seen whether the conditions imposed by these tighter controls might not have a larger offsetting effect of discouraging companies from offering managed investment schemes at all.

It is important to note that it was the MIS forestry management companies that were closed down, not the forest growing schemes themselves. The valuable timber resource is still growing, some of the schemes remain in place, while other plantations have been sold on to new investors.

Recommendation 4

The Government reaffirms its commitment to maintaining the current basic tax entitlements for plantation growers and investors.

Plantation forestry — impacts and ‘social licence’

For more than two decades, widespread establishment of new plantations on cleared agricultural land was recommended by numerous government and parliamentary inquiries and strongly advocated by leading conservation groups. Despite the plantation industry successfully taking up that challenge, the fact and manner of its doing so has not met with universal approval.

For the purpose of this submission, we provide here the briefest summary of factual statements supporting the merits of plantation forestry. All are based on research or official statements by such national and international organisations as:

- Australian Bureau of Agricultural and Resource Economics (ABARE, then)
- Australian Bureau of Statistics (ABS)
- Australia National University (ANU)
- Australian Pesticides and Veterinary Medicines Authority (APVMA)
- Australian Taxation Office (ATO)
- Bureau of Rural Sciences (BRS — now merged with ABARE)
- Centre for International Economics (CIE)
- Intergovernmental Panel on Climate Change (IPCC)
- Murray Darling Basin Commission (MDBC, then)

Original references can be provided to the Committee if required. Supplementary information about land use and values is included at [Attachment B](#).

Land-use change

- Broadacre cropping, farm consolidation and other factors have been the main driver of land-use change in rural regions during the past decade and a half (Ref: ABARE, ABS, BRS)
- Rural residential development, urban development and land degradation are having a much bigger impact on land use change than plantation expansion is. Although timber plantations are very obvious and do change the appearance of local landscapes, the total amount of rural land planted is very small. (Ref: ABS, BRS).

Rural land values

- Rising values of rural land (particularly during the mid-2000s) have been driven by a combination of factors that include low interest rates, high commodity prices, strong international demand for Australian farm products, rationalisation in the rural sector with farm amalgamations, competition for farms from overseas buyers, and multiple changes in land use.
- Plantations are one of several competing land uses. Others include: broadacre cropping (a major land-use change); dairying and beef cattle expansion; intensive agriculture; farm consolidation; rural subdivision and lifestyle farms (especially in popular 'sea-change' and 'tree change' regions); and urban encroachment (Ref: ABS, BRS, *rural weeklies*).
- See Attachment A for revealing statistics about the non-plantation buyers and prices of dairy farms in Victoria and Tasmania.

Population, employment and services

- Empirical studies by the BRS show that, except in isolated cases, plantations tend to slow or reverse rural decline, by attracting more working-age families, creating new jobs and businesses, providing off-farm work opportunities, and increasing the demand that justifies maintaining and improving community services. These benefits accelerate as the industry matures into harvesting, processing and value-adding (Ref: BRS).
- Plantation forestry is more labour-intensive than local agriculture, providing 2.5 jobs for every 1,000 ha of plantation, compared with 1.8 jobs per 1,000 ha used by other agriculture (Ref: CIE, 2005).
- Plantations have a multiplier of ~2.5 (ie, an extra 1.5 indirect jobs for every direct job); milling operations have a multiplier of >3 (ie, an extra 2 indirect jobs for every direct job in the mill) (Ref: BRS).

Water

- Plantations, like all forms of agricultural crops, intercept and use water. Trees have a longer growing season, more foliage and deeper roots than pasture or crops, and plantations can improve water quality, and assist in reversing salinity and erosion (Ref: BRS).
- No irrigation is used in mainstream plantation forestry. Instead, plantation managers mostly utilise cleared land in higher rainfall areas. The effect on

streamflow of converting agricultural land to timber plantation is related to the catchment area affected. In smaller catchments, it is difficult to detect an impact when less than 20 percent of the catchment is planted. In major plantation regions, plantations occupy between 1 and 6 percent of large catchments (*Ref: BRS*).

- Some plantations in some parts of some catchments in some soil and rainfall conditions have the potential to reduce environmental flows (*Ref: BRS*).
- Climate change, groundwater extraction, farm dams and bushfire are all much greater threats to future stream flows in the Murray-Darling Basin than interception by the predicted levels of plantation expansion (*Ref: MDBC, CSIRO*).
- The plantation industry strongly supports and contributes to research that will enable plantations to be more strategically located in different catchments, in the context of the impacts that all land uses have on water yield and quality.

Use of chemicals

- Plantation forestry uses only chemicals registered or permitted by the Commonwealth regulator (APVMA), and applies them (mostly only in the establishment phase) in accordance with state government regulations and codes of practice. Total chemicals used in plantation forestry are a fraction of the amounts used annually in cropping, horticulture, pasture management and urban parks and gardens to control weeds, pests and diseases (*Ref: APVMA, state codes of practice*).

Fire management

- Well-managed plantations are the best insurance against the ignition and spread of fire. All commercial plantation managers protect their valuable plantations against fire by maintaining fire trails, managing fuel loads, and having on hand trained and equipped personnel capable of responding quickly to outbreaks.
- Plantation managers enhance the fire-fighting capacity in their regions, and are often the first or only crews available to fight fires on neighbouring rural properties and national parks.

Roads

- Plantation managers make significant contributions to road upgrading and repairs, and work cooperatively with state and local governments to plan future road usage and priorities for infrastructure maintenance and upgrade.
- Community safety is a priority issue. Wood haulage routes and the timing of truck movements are designed to avoid conflicts with school buses and other regular road users.

State and local planning and regulatory controls

- Plantation forestry is the most regulated and scrutinised of all broad-acre primary production. All aspects of plantation establishment, management, harvesting and transport are regulated through Commonwealth-approved state codes of practice, which are underpinned by an extensive array of legislation and regulations (*Ref: state codes of practice*).

- A number of local government planning schemes specifically regulate only plantations. In WA, plantation forestry is excluded from intensive agricultural zones.

Other environmental benefits

- Large-scale broad-acre plantations confer substantial natural resource management benefits from the various set-asides and reserves within and alongside plantations — riparian areas and drainage lines, swamps and wetlands, rocky ridges and steep slopes, and patches of remnant native vegetation, used for various conservation purposes, such as erosion control, enhanced water quality and provision of habitat (*Ref: state and company codes of practice*).
- Plantations are recognised as helping control the level of atmospheric carbon by absorbing carbon dioxide during photosynthesis, and by storing carbon in long-lived wood and paper products (*Ref: IPCC*)
- Plantations (including pine) support a greater diversity of bird species than the pasture or crop land on which they were established (*Ref: ANU, Lindenmayer et al*)
- Strategic location of commercial plantations in catchments has long been recognised as a partial solution to the problem of dryland salinity (*Ref: CSIRO, MDBC*).

Having made these factual statements, A3P nevertheless acknowledges that it is in the plantation industry's interests to engage with the communities in which it operates and to seek solutions to potential tensions and conflicts before they become embedded.

In that context, A3P acknowledges the importance to local communities of the appearance of their rural landscapes and vistas, and the changes that plantations bring to those landscapes. This tends to occur just as much when mature plantations are harvested and 'open up' the landscape as it does when plantations begin to grow above eye-height and start to 'close in' the landscape.

In terms of the need described in this submission for more plantations to be established and replanted, it is the latter of those two changes that must be better managed. With the possible exception of urban encroachment and industrial wind farms, large-scale plantations make the most obvious changes to previously pastoral and 'non-sylvan' landscapes, and are thus a relatively easy target.

Although there is a pressing need to expand Australia's plantation estate, the more immediate challenge is to attract investment to maintain the existing level of resource in key regions.

Demand for new land has been in decline for some years, as harvesting has accelerated and plantation managers have been establishing the next plantation rotations on the same harvested land. This trend will continue as more plantations reach harvest age.

However, a disturbing element of this trend is that some of the harvested land will not be replanted at all. Anecdotal estimates are that only about two-thirds of the existing hardwood pulpwood plantations are likely to be replanted — although some of that, positively, may be for softwood sawlog production. The plantation industry acknowledges that it is appropriate for some areas not to be replanted, based on a better understanding of the characteristics of the land or on other changed

circumstances. However, for many reasons (noted above), it is not desirable that we see large-scale reduction in Australia's plantation resource following harvesting of the first rotation.

Should the challenge be taken up once more to expand the area of plantation forestry, there are compelling arguments to consider alternative ways to access land so as to more easily secure the 'social licence' that is clearly necessary for plantation forestry to be a welcome part of local communities and landscapes.

Farm forestry as an integral part of future plantation expansion

Integrating plantation forestry (and private native forest management) into farming operations could enable a forestry resource to be grown on existing farmland as a complement to agricultural fibre and food enterprises and without displacing farming landholders and land uses.

From the processing perspective, the challenge is, and has always been, for enough farmers in a given region to grow enough commercial trees to provide accessible timber processors with flows of harvested wood that are:

- secure
- consistent
- long-term
- large-scale
- of the required specifications
- at competitive prices.

If these criteria could confidently be met, the plantation processing sector would find it much easier to seek or accept wood from farm forestry sources, thereby providing the market access that farm forestry has for decades been struggling to achieve to become a mainstream wood supplier in Australia (as it is in Scandinavia and north America).

Supportive government policies and programs are necessary for this to occur, mostly to remove impediments to farmer uptake and market access. For example:

- implementation of several of the policies listed above under 'new policies' that are directly and specifically aimed at encouraging the uptake of farm forestry;
- the restoration or replacement of a number of Commonwealth Government programs (namely, the Farm Forestry Program, the Joint Venture Agroforestry (R&D) Program, the regional and state coordination that was provided by the private forestry development committees and the National Plantation Strategy Coordinator project;
- resourcing and implementation of the Farm Forestry National Action Statement, and official recognition that commercial trees in farm forestry enterprises can contribute to achieving the objectives of Caring for Our Country;
- at state level, the restoration or replacement of well-resourced regional farm forestry extension services to help build the confidence of farmers and rural contractors to undertake specialised forestry operations.

Two important features of farm forestry add to the attraction of farm forestry as a potential future resource. They serve to offset or diminish conventional considerations of 'commerciality', and should be taken into account in government policy considerations. First, the engagement of family farmers using their existing land for

plantation forestry eliminates the capital outlay for land purchase and converts it either to an annual lease cost (eg, in a joint venture or partial farm lease arrangement) or to no cost at all (eg, in a 100% family forestry operation). Second, farmers gain diverse other economic and environmental benefits from their commercial trees besides just a financial return from the harvested wood, thereby rendering somewhat irrelevant the standard corporate internal rate of return measure of 'commerciality'.

Rather than have A3P take this subject further in this submission, the Inquiry should refer to the Australian Forest Growers' submission and comprehensive Policy Statements to examine a well-argued case supporting farm forestry as a significant supplement to 'industrial' plantations as part of the future wood supply solution.

Recommendation 5

The Government acknowledges the realities of plantation forestry and its contribution to beneficial environmental outcomes, and makes a public commitment to restoring practical support for the growth of family farm forestry as an integral part of Australia's future wood supply.

Long-term consideration #2:

Ensuring that society's demand for products and services can be met to the greatest degree possible by Australia's forest and wood products industries

ToR 1: Opportunities for and constraints upon production

ToR 4: Creating a better business environment for forestry industries

ToR 2: Opportunities for diversification, value adding and innovation

ToR 6: Potential for energy production (and forestry's contribution to climate change mitigation)

The issues surrounding Long-term consideration #1 — ensuring there is actually a sustainable resource to supply a wood and paper products industry — need to be addressed primarily with targeted and industry-specific policies and programs.

By contrast, issues and challenges confronting the processing of the resource into products to meet society's demands (Long-term consideration #2) tend to be shared with and linked more to those faced by other sectors in the economy. As a consequence, the government responses and measures are more likely to be found in what we might call 'broader enabling policies', although there are certainly industry-specific factors that must be taken into account.

Economic and trade policies

Although the plantation industry is a very significant part of the Australian economy, and especially regional economies, it is far from being able to have a major influence on broader government economic and trade policies. Nonetheless, to the degree possible, the industry would add its voice to the consistent and recurrent pleas from all industry sectors for the Australian Government to formulate and implement policies that at the very least maintain a 'level playing field' for Australia's export and import-competing industries.

The costs of doing business continue to rise, particularly the costs of inputs, such as energy (especially relevant in the pulp and paper industry), water, land, labour, fertiliser and chemicals. It is important that the Government's economic and trade policies and regulations are, to the greatest degree possible, equitable, transparent and not discriminatory, and are formulated with an eye to avoiding unintended consequences at other places in the supply chain.

While primarily domestically focused, the Australian wood products and paper industry is nevertheless highly exposed to international trade, with both imports and exports of most products increasing. It is of ongoing concern that the industry's competitiveness, both domestically and internationally, is diminished by the significant support that foreign governments provide to their domestic wood and paper products industries. Such assistance enables producers not only to charge lower prices in their own domestic markets but also to export products into the Australian market at less than their unassisted production cost.

To be efficient and sustainable, this industry — whether exporting or import-competing — requires Australia's trade policy to be balanced among industries in trade negotiations and agreements, and to minimise distorting measures such as tariffs and subsidies, and particularly to address dumping and illegal logging.

Current softwood import danger

Nothing can be done by any industry sector to influence a freely floating exchange rate. Unfortunately, in 2011, the very high Australian dollar is combining with a flat housing market to create a 'clear and present danger' to the softwood processing sector. This is taking the form of large volumes of imported softwood (mostly from the Baltic region) keeping a cap on domestic prices, at the expense of local processor profitability and investment. Sustained damage to softwood processors from this situation would naturally have adverse consequences for the plantation resources sector.

Anti-dumping regulations and procedures

The plantation products and paper industry takes very seriously the nature and impact of product dumping on industry members and on the wider Australian community.

Although Australia's anti-dumping and countervailing measures provide some protection against unfair imports, they could nevertheless offer better access and fairer competition, at least in the domestic market, if they were less complex, less information-intensive, less time-consuming and less costly for most businesses than they are now.

As well as the possibilities for predatory pricing that can be embodied in imports from countries with high levels of domestic industry support, the industry is particularly concerned at recent decisions by the Attorney General to revoke the anti-dumping duties on toilet paper imports, and by Customs to terminate by statement of essential facts an active plywood anti-dumping case. In both cases, it was found: that the imported products were dumped; that the Australian industry suffered injury; but that the injury caused by the dumping was 'not material'. These decisions have already significantly altered the business environment for pulp and paper manufacturing and plywood manufacturing in Australia.

The Customs' rationale for assessment of 'material injury' in these cases is perplexing, creates uncertainty, and undermines the competitiveness of the Australian industry.

A3P is also concerned to ensure that the Government does not impose an arbitrary limit on the continuation of anti-dumping measures or introduce an additional 'public interest' test that would further limit access to the anti-dumping system — as recommended by the Productivity Commission. The reasons for objecting to these proposals are explained in the Final Report of the Pulp and Paper Industry Strategy Group (pp 98-99) (Commonwealth of Australia, 2010).

A3P has made a submission to the Senate Committee examining the private member's bill, *Customs Amendment (Anti-dumping) Bill 2011*, welcoming the fact that the Bill makes no mention of these matters, and that it also proposes a clearer definition of 'material injury'.

If the Bill doesn't pass, A3P will continue urging the Government to develop and implement another pathway to strengthen, simplify and improve access to the current anti-dumping and countervailing measures system in order to provide a level playing field for Australia's internationally competing industries.

Illegal logging

Australia's domestic timber processors and paper manufacturers are similarly at a competitive disadvantage when timber imports are sourced from countries where illegal logging is prevalent.

Appropriate measures to address illegal logging can benefit the domestic forest industry by resolving trade disadvantage, yielding international altruistic benefits, and clearly illustrating again the quality of Australia's forest growing, forest products, and paper industry on the world stage. However, it has the potential to add an extra burden and regulatory layer on the domestic industry if it is handled poorly. It is important to avoid 'collateral damage' to the domestic industry in trying to solve an international problem.

The Government is committed to preventing the import of illegally logged timber, and has tabled the *Illegal Logging Prohibition Bill 2011*, which is currently before a Senate Committee. A3P is making a submission.

A3P's strong and public view is that any mechanism proposed to address illegal logging should be risk-based, flexible, and not prescriptive, so that producers and importers can demonstrate compliance as efficiently and effectively as possible.

The approach taken in the Bill requires mandatory licensing of importers and processors, new codes of practice that Government must endorse, Government accredited 'timber industry certifiers', and it treats importing illegally logged timber products as a criminal offence penalised by a mandatory jail term. A3P is very concerned that the Bill is heavy-handed and prescriptive, is unclear and uncertain in some areas, unnecessarily adds extra layers of inflexible regulatory burden on the domestic industry, and undermines the credibility of the sustainable forest management (SFM) certification systems that have been hard-won in Australia.

An alternative system could require that importers and processors put in place a due diligence system to minimise the risk of supporting illegal logging, with which compliance is policed by random Government audits. Such a system would also enable Government to approve systems that are 'deemed to comply'; ie, that use existing codes of practice and have been certified under the internationally supported SFM and chain-of-custody certification schemes.

Recommendation 6

The Government ensures that its economic and trade policies are equitable, transparent, not discriminatory among industries, and prevent the import of illegally logged timber, and that its anti-dumping and countervailing measures are less complex and costly and more accessible and fair than the current arrangements.

Provision of efficient transport and port infrastructure

Plantation forestry and the wood and paper industries are very significant users of transport and infrastructure, particularly in regional Australia. Productivity and competitiveness of the industries are closely linked with efficient and effective transport services and regulation.

Investment in new and upgraded road, rail and port infrastructure is needed economy-wide. The plantation industry faces some particular constraints in regions where plantations are already at or approaching the harvesting phase — such as the Great Southern region of Western Australia, the Green Triangle of Victoria and South Australia, northern Tasmania, and the Murray Valley in NSW and northern Victoria.

There are some prominent examples of relatively straightforward transport and infrastructure improvements that would significantly increase the plantation industry's productivity and competitiveness.

- Harmonising road regulations, especially heavy vehicle and 'road mass' limits and tolerances, not only across all spheres of government, but also from road to road within jurisdictions.
- Working with the industry to identify and upgrade specific roads and even corners (eg, realigning a corner to facilitate safer log truck movement might save 50 kilometres of travel).
- Making changes to several bridges and tunnels so as to enable double-stacking of containers on interstate freight trains from Melbourne.
- Track investment to remove the imposition of 'no go' times for freight trains where they share track with suburban passenger services.
- Better intermodal terminal access, better connectivity between road and rail, rail and ports, and rail gauges, and better inward/outward port logistics (eg, different entry and exit routes).

The Final Report of the Pulp and Paper Industry Strategy Group (*Commonwealth of Australia, 2010*) makes a number of recommendations for financing infrastructure investment, and for improving the efficiency of transport systems and regulation. A3P draws these recommendations to the attention of this Inquiry.

Recommendation 7

The Government accepts and acts upon the recommendations of the Final Report of the Pulp and Paper Industry Strategy Group for financing infrastructure investment and for improving the efficiency of transport systems and regulation.

Skills development and availability

Although estimates vary (depending on assumptions), the Australian Bureau of Statistics official statistics for 2008 were that over 85,000 people were directly employed in Australia's forest and forest products industries. Applying slightly broader assumptions, the ForestWorks estimate is around 120,000 people. These jobs are located mainly in rural areas, and are especially concentrated where there is an integrated plantation products sector — plantation growing, management, harvest and haulage, supplying sawmills, veneer mills, landscape products, engineered wood products, pulp mills and paper manufacturing, secondary manufacturing, and utilising sophisticated transport and logistics systems.

It is obvious that diverse careers are available in this industry, from skilled and semi-skilled labour, through plant and equipment operators and a wide range of technical trades and clerical skills, to graduate careers in forestry and agricultural and environmental sciences, mapping, engineering, computer programming, economics and accounting, legal and business management, and many more.

Many more jobs are created in support businesses and contracting and service industries.

Despite these diverse jobs and careers, the plantation industry, in common with much of Australia's economy, is suffering skills shortages, intensifying since the rapid expansion in the mining sector. The problem is keenly felt in this industry because of the difficulty attracting employees to move to and settle in the rural and regional locations where most of the industry is based. And at the most important basic scientific level, forestry as a professional career has been declining in popularity, partly as a response to an adverse public perception of forestry in general, not helped by the loss of professional forestry jobs in scientific and extension organisations.

The industry has embarked on a number of its own initiatives to address these challenges, with some government funding assistance — for example, an industry-wide 'skills shortage audit' in 2006; special undergraduate and post-graduate recruitment programs; establishment of a new forestry faculty from Southern Cross University regionally located in Mt Gambier; careers promotion through a film and DVD ('Reach for the skies', 2007) and two industry websites (www.treedudes.com.au and www.growingcareers.com.au); and strengthening of the Industry Skills Council, ForestWorks.

The 'Growing Careers' website is part of a broader integrated program, run by Forest and Wood Products Australia (FWPA), linking those curious about or actively seeking careers in the forest and wood products industry with prospective employers and with diverse sources of useful information about the industry. The website is complemented by outdoor posters, print advertising, and digital communications that include online advertising, emails, newsletters and a social media campaign.

ForestWorks is also helping the industry to secure government funding and organise intra-industry training in language, literacy and numeracy skills, which have been identified by the eleven industry skills councils as being deficient in all industrial sectors.

And there has just been a new call by the Australian Industry Group for the Australian Government to take the lead and create a new national workplace training body to address skills shortages and declining productivity in a more formally coordinated way, including creating a new national apprenticeship program and new functional literacy and numeracy programs.

Recommendation 8

The Government works with industry groups to identify and then take appropriate actions to correct the current and forecast distortions in labour markets, and ensure that ALL sectors of the economy are adequately resourced with suitably skilled and qualified personnel.

Research, development and commercialisation policies and programs

Ongoing and effective research and development, commercialisation and extension are all critical to underpin technological innovation and international competitiveness in any industry.

The plantation industry conducts research and development on a company-by-company basis and through financial and in-kind contributions to R&D conducted by such organisations as the CRC for Forestry, the Southern Tree Breeding Association and CSIRO, and indirectly through a levy to the industry R&D corporation, Forest and Wood Products Australia (FWPA).

Unlike other rural industries, forest and wood products comprises not only numerous large and small private growers and processors, but also several large state government forest growers and managers. The whole industry recognises the need for Australia to have a basic core R&D capacity in understanding and managing trees and forests and in developing diverse wood-based products, including timber, paper, and emerging energy, chemical and plastic products for use in a future carbon-constrained world.

The native and plantation forests are located in Australia, most of the forest products are being used in Australia, and there is a drive to strengthen our own domestic capacity for processing forest products. Thus there is reason to have domestic R&D capacity, even if only to evaluate work done overseas for Australia's circumstances. Such capacity also offers a substantial 'public good' derived from a large area of publicly owned forest, and significant environmental (including greenhouse abatement) and social/community benefit delivered by appropriate management of forests and use of wood products.

For decades, forest and wood products RD&E has served the sector well, with many examples of world-leading technology and productivity advances directly linked to Australian research. Despite these achievements and their contributions to productivity and profitability, there is clear evidence that the sector's RD&E effort is in decline.

Much has been written about Australia's RD&E policies and programs in the past fifteen years — both generally, and in primary production more particularly, including in the forestry and forest products sector.

At the moment, there are three concurrent activities in the sector:

- the National Strategic Rural R&D Investment Plan, being developed by the Rural Research and Development Council
- the National Primary Industries RD&E Framework, being developed (since June 2009) by the Primary Industries Ministerial Council — which has to date (March 2011) endorsed RD&E strategies for twelve food and fibre industries, including the forest and wood products industry
- the Productivity Commission's Inquiry into Rural R&D Corporations (final report submitted to Government in February 2011).

Despite these reviews and inquiries, and grand statements of intent in political party platforms and government policy documents, the opposite outcome has been the reality — ie, an attempt to weaken government support for R&D (the amended R&D tax 'incentive' legislation), and to wind back, dismantle or threaten primary production RD&E, and forestry and wood products RD&E in particular.

Introducing the amended R&D tax credit legislation, the Government stated that its intent was to deliver a “more generous, more predictable, and less complex tax incentive”, and to tighten eligibility in order to minimise the potential to rot or otherwise misuse the concession. The legislation is still to be debated in the Senate, but has been almost universally condemned by all the major accounting firms and industry groups as being guaranteed to have the opposite outcome to the stated intention, to reward failure, and thereby to discourage business R&D investment.

The Productivity Commission's final report on rural R&D corporations is due to be tabled in mid-June 2011, until which time, only the Draft Report indicates the Commission's thinking. Positively, the Commission is proposing a new overarching, cross-discipline/cross-commodity rural R&D corporation — largely to replace Land and Water Australia, which the Government suddenly closed down in 2009. Unfortunately, this new RDC is proposed to be funded by a delayed but eventual winding back in Government funding for the commodity RDCs. This proposal was almost universally objected to in submissions, including A3P's.

Caught up in the winding back of agricultural extension generally, state government forestry extension services have largely disappeared in the past five years, or are operating with only skeleton staff. At the Commonwealth level, the termination of the Commonwealth Farm Forestry Program, the Joint Venture Agroforestry (R&D) Program, the regional private forestry development committees and the National Plantation Strategy Coordinator project, as well as the exclusion of commercial agroforestry from the Caring for Our Country funding criteria, have all worsened the impact of this loss of capacity for disseminating innovation in forest management.

Arguably the greatest disappointment is the CSIRO. As well as conducting focused, applied R&D — often in collaboration with industry and its contributory funding — CSIRO also has a responsibility to carry out long-term ‘public good’ research. Yet the past two decades has seen CSIRO carry out repeated ‘reorganisations’ of its forestry and forest products divisions, with each one — contrary to stated intentions — leading to further loss of experienced and world-acclaimed scientists and continued erosion of Australia's forest industry R&D capability. In the past year and a half, it has dispersed its forestry researchers to other divisions and then completely dismantled its wood and paper products scientific capability and technological infrastructure.

Over the same period, FWPA has been transforming from a relatively minor, generic, pan-sectoral player in a bigger stronger national forest and wood products R&D framework into the very core of that framework — almost by default. But there must still be a critical mass of forest and wood products researchers to carry out whatever R&D the FWPA and other partners are able to fund. Unless the overall decline described above can be turned around relatively quickly, the loss of research capability may become irreversible.

Such a prospect is inconsistent with the Government's stated policies about the forest and wood products industries and about innovation and value-adding within Australia. Further, it is incongruous in an era of increasing emphasis on carbon-neutral and renewable materials. Wood is an abundant and renewable feedstock for an increasingly wide range of products, on which all other comparable countries are expanding their national research efforts to develop new opportunities for wood in energy, chemicals and traditional products to replace fossil-based feedstocks.

The newly established Pulp and Paper Industry Innovation Council would appear to be the only initiative moving in the opposite direction to this disturbing trend.

Diversification, value adding and innovation

Historically, forests have produced many different products to meet highly diverse society demands.

As described above, R&D must be at least maintained or, better still, returned to former levels, and be supported by help to commercialise innovations and new technologies.

A brief selection of some known opportunities for diversification, value-adding and product innovation with respect to timber plantation products would include:

- energy production (see more detail below)
- pulp production
- composite wood products
- new structural and panelling technologies to utilise smallwood and residues, and to use timber construction in high-rise buildings
- log assessment and grading technologies
- higher product recovery from harvest and milling
- biochemicals, textiles, solvents, plastics, lubricants, fragrances, and other outputs from 'biorefineries'.

Recommendation 9

The Government takes appropriate, effective and sustained actions to:

- *halt the decline in Australia's capacity in research, development and extension in forestry and wood and paper manufacturing;*
- *restore that capacity, particularly in CSIRO and the universities;*
- *restore or replace government programs to support the expanded contribution that small-scale private forestry can and should be making to Australia's future wood supply;*
- *ensure the industry can take advantage of the opportunities to diversify and value-add, including by commercialising its Australian innovations*

Data collection, analysis and dissemination

For many years, the collection, analysis and dissemination of basic industry data and essential statistics was conventionally accepted as a legitimate and justified function of government — to guide and inform public policy formulation, implementation and monitoring, as well as industry planning and investment.

In the past decade, however, basic economic, environmental and social data about the plantation growing and processing industry has been collected and reported mostly when the relevant Commonwealth Government agencies (eg, ABARE and BRS) have successfully competed for funds under various grants programs (such as the Natural Heritage Trust), with no certainty of long-term ongoing funding. Although the agencies have for the most part been able to find the funds from one source or another, the ad hoc funding has proven to be problematic. Not only have overall funding levels been less than optimum, but funding deferrals and inflexible staffing arrangements have made it difficult to maintain a core group of qualified staff and to plan beyond the funding cycles.

A3P collects some selected plantation industry statistics and disseminates them back to members and others. These statistics are quite specific and sometimes cannot be generically converted for public access, thus can only supplement the range of data covered by sustained government statistical compilations.

A3P advocates that the **collection, analysis and dissemination of the core high-level statistical information for the plantation products and paper industry should be considered a public good and made an ongoing core-funded Budget item** within the Agriculture, Fisheries and Forestry portfolio, allocated largely to the newly merged Australian Bureau of Agricultural and Resource Economics and Science (ABARES).

The broad data categories that should ideally be covered, in collaboration with the industry, include:

- maintenance and refinement of a comprehensive database of Australia's plantation resources at national and regional level (as under the National Plantation Inventory and the National Farm Forestry Inventory)
- timely regional and national analyses and forecasting of plantation resource status, future wood availability, and processing and market capabilities
- social profiling and assessment of Australian communities reliant on the forest industry, including further refinement of social indicators to allow ongoing monitoring and evaluation of the social benefits and impacts of plantation industry development
- annual economic survey of the forest and wood products industry, similar to those ABARES conducts for the agriculture, fishing and energy sectors. (Information gathered could include — log prices by region, type and grade; capacity of regional processing infrastructure by species and input type, sales volumes and values of products; log flows; efficiency of processing and end-use; and employment and expenditure patterns)
- continued publication of Australian forest and wood products statistics
- a regular international competitiveness and market access analysis

Ensuring there is a full spectrum of interrelated and consistently measured information will (a) enable the Government to assess whether its policies are delivering their stated objectives and to revise policies accordingly, based on reliable data and analysis, (b) underpin better investment, marketing and growth decisions within the industry, and (c) enable public debate to be informed by reliable independent statistics and evidence rather than anecdote and innuendo.

Placing the public good plantation industry data collection/analysis complex under one project funded as core activity will generate substantial gains in productivity from not having to repeatedly seek grant funding and recruit and retrain staff depending on the flow of project funds. It will also address the problem of 'corporate amnesia' that recurs under the project-to-project funding scenario, which undermines the integrity and consistency of core collection and analysis capabilities.

Recommendation 10

The Government recognises statistical data collection, analysis and dissemination for the plantation and plantation products industry as a public good, and makes a firm commitment to resource and maintain a core-funded facility to carry out these functions, within the Agriculture, Fisheries and Forestry portfolio, and allocated largely to ABARES.

Timber market access and development

Many issues associated with production, end-use application and marketing, and disposal of timber products require an industry approach rather than individual company approach, and have the potential to affect the profitability of the sector and its reputation as a credible supplier of fit-for-purpose building products.

These issues include, for example:

- timber and associated technical standards, codes and specifications
- timber product quality assurance and certification systems
- certification of sustainable forest management and 'chain-of-custody'
- product stewardship with respect to intermediate waste and end-of-life disposal
- environmental and energy ratings systems for building and related products

The forest products industry is actively involved in all these fields, mostly without the need for direct government intervention. Indeed, as a general principle — except for building and energy efficiency regulations — the call to the Government is for it to be aware of and recognise the industry's initiatives, and for it to ensure that government policies, actions or inactions do not, even unintentionally, serve to undermine these initiatives or discriminate against the appropriate use of wood products in the economy.

The industry works actively with Standards Australia to prepare and upgrade a wide range of **timber and associated standards**. These standards can be used by designers, manufacturers, specifiers, purchasers, certifiers and others. They engender confidence in the use of timber products and provide the basis for trade. Examples of the extensive coverage of these standards include: design methods for timber structures; residential timber frame construction; stress-grading of structural timbers; structural timber testing, assessment and properties; heavy structural products (eg, marine piles, wharve decking, building poles, railway sleepers); preservative treatments for solid and engineered wood products; performance requirements for engineered wood products; bonding performance of structural adhesives in manufactured timber components; installation and maintenance of timber components and structures; and construction in bushfire zones.

The accuracy and reliability of these standards, and their widespread promulgation, can help to encourage architects, engineers and specifiers to be confident in proposing conventional timber-framed buildings, as well as multi-storey timber-framed and panelled housing and commercial buildings, and the use of structural timber in large-scale industrial constructions.

Complementary to these technical standards, in the highly competitive modern marketplace, it has become necessary for plantation product processors to engender market confidence and assurances that the industry is competent and supplies products that are 'fit-for-purpose' and comply with relevant standards. The industry has in place an independent third-party-audited **timber product quality certification scheme** — the Plantation Timber Certification System (PTCS), accredited by JAS-ANZ. It has recently been agreed to transfer the PTCS from the National Association of Testing Authorities (NATA) subsidiary, NCS International, to the Engineered Wood Products Association of Australasia (EWPAA), which is also an internationally recognised certification body.

Independent certification of **sustainable forest management** has also become a standard 'market access' threshold in the past decade. Two systems operate in Australia — the Australian Forestry Standard (AFS), linked internationally to the

Program for the Endorsement of Forest Certification schemes (PEFC), and the Forest Stewardship Council (FSC) system, still operating here under the FSC's 'interim standard' while FSC develops a national standard specifically for Australia. Most large-scale commercial and government plantation growers have secured certification under one or both schemes. A3P is involved with both schemes, and would like opportunities for mutual recognition between the two schemes to be seriously explored. A3P also advocates that environmental codes, specifier tools and other construction guides should give appropriate recognition to these schemes rather than create additional new certification systems. Overlapping and duplication in these areas creates confusion and additional expense for the industry.

Timber (and paper) have also been caught up in a broader move by State and the Federal Governments to make product manufacturers more responsible for intermediate and end-of-life waste, in order to minimise landfill and disposal costs. The forest products industry took an early initiative by setting up the **National Timber Product Stewardship Group** in 2008, with an active educational website www.timberstewardship.org.au, and an industry program that is leading to significant levels of 'post-consumer' recovery, re-use and recycling of timber products, and as a renewable energy feedstock.

These industry initiatives demonstrate that the whole forest and wood products industry is determined to demonstrate its credibility in supplying fit-for-purpose products to satisfy the expectations of consumers who are becoming ever more conscious of the environmental credentials of their purchases.

Thus it is of particular concern to the industry, with respect to an issue that does involve governments, that wood products are enduring such a troubled journey on the inexplicably long road to full recognition and endorsement of their **ecological, energy and carbon benefits**.

Well over a decade ago, an independent research project published a comparison of the energy and carbon balances in the production and use of the major structural building materials — timber, bricks, concrete, steel and aluminium. Not surprisingly, timber products had many times less impact on the environment than all the alternative materials.

Similarly, the value of the carbon stored in harvested wood products, especially long-lived building materials, has been well-known and acknowledged by governments during at least a decade of climate change policy negotiations.

But it has taken years for the industry to even begin to shift the thinking behind the energy efficiency ratings in the Building Code of Australia, and there is yet to be any official accounting for carbon in harvested wood products in Australia's carbon reduction policy response.

The 5-star energy efficiency regulation in the 2006 Building Code (recently changed to the National Construction Code) applied only to the thermal efficiency of the building envelope and its impact on heating and cooling, and the energy rating software, *AccuRate*, contained flaws that specifically disadvantage low thermal mass material such as wood plus insulation. This has progressed a little with the 6-star regulation in the 2010 BCA, which includes ratings for hot water and lighting, although the *AccuRate* model remains flawed. In September 2010, A3P wrote to the Minister for Climate Change and Energy

Efficiency in an attempt to have this matter rectified in conjunction with CSIRO, but has received no response.

The law of diminishing returns will start to impinge if future 'upgrades' to the energy efficiency ratings continue to apply only the operational energy of the buildings.

The next advance in this part of the building regulations should be the adoption of environmental ratings that are based on direct and indirect greenhouse gas emissions (broader and more meaningful than just energy efficiency) over the life of the building. Appropriately designed, such a system could account not only for all the 'operational' emissions described above, but also for the embodied CO₂ impact of the product manufacture, the building construction and demolition, and the end-of-life phases.

Timber's unique environmental benefits would be recognised under such a rating system. Trees absorb CO₂ store carbon, and can regrow or be replaced after harvest. Timber products have a low embodied energy in manufacture, they continue to store carbon while in use, and can be re-used or recycled. And end-of-life timber can be converted to energy, in place of non-renewable fossil fuels.

The forest and wood products industry is highly committed to sustainability principles, and has demonstrated its willingness and its capacity to provide innovative and environmentally credible solutions for the sustainable housing and commercial buildings markets. Yet, despite success in continuing to increase its efficiency and productivity, despite the inherent environmental attractions of timber products, and despite its own efforts to engender market support and confidence and promote its products (such as through the generic marketing campaign *Wood. Naturally Better* — www.naturallybetter.com.au), the industry is facing serious challenges to its long-term survival — challenges that go beyond the current danger posed by an out-of-control Australian currency.

The industry needs the Government to be more pro-active and urgent in ensuring its own policies do not discriminate against the use of timber products in diverse markets and thereby undermine the industry's own concerted efforts and campaigns.

Recommendation 11

The Government acts, through appropriate Federal-State mechanisms, to accelerate the adoption of environmental rating systems for buildings that recognise embodied energy and carbon stored in building products.

The Government encourages the rationalisation, or at least mutual recognition, of forest certification schemes.

Policies to mitigate climate change and to encourage renewable energy from biomass

Much has been written about proposed government measures to mitigate climate change, and the possible contribution of forestry to achieving those objectives.

Forestry's contribution is neatly summarised in the Fourth Assessment Report of the International Panel on Climate Change (IPCC).

"A sustainable forest management strategy aimed at maintaining or increasing forest carbon stocks, while producing an annual sustained yield of timber, fibre or energy from the forest, will generate the largest sustained mitigation benefit."

A3P would elaborate on this concise description in the following way.

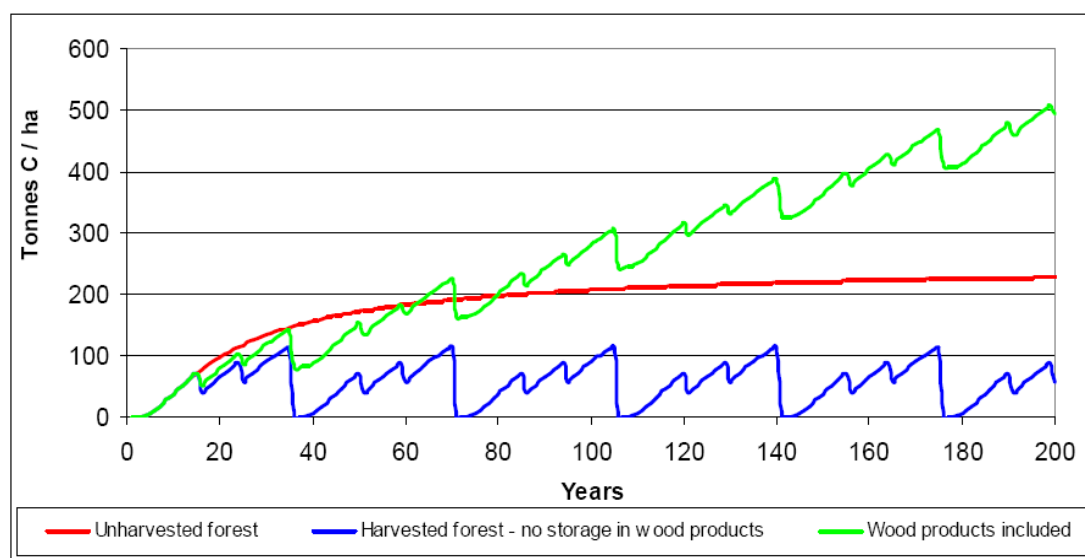
The plantation forestry and products industry supply chain begins with a tree — a natural vessel that captures and stores carbon. Harvested and finished forest products perpetuate that carbon store, during their use and even after disposal. Forest fibre is often recycled, residues and by-products are turned into renewable heat and power, and carbon capture and storage in the forest stand can be maintained through the continuous cycle of harvesting and replanting.

This industry is the only carbon-positive sector in the Australian economy, and should logically remain vibrant with the introduction of climate change policies. A3P members certainly hope to participate in the implementation of such policies by adjusting the way they do business to the goal of reducing the carbon intensity of our way of life. This must be facilitated by sound policy that acknowledges the global economic context in which the Government's proposed reforms are enacted.

With respect to 'supply side' considerations, A3P wishes to emphasise three points.

- The unequivocal scientific evidence is that periodically harvested and replanted plantations, in combination with their long-lived harvested wood and paper products (particularly where they are used in place of highly emissions intensive building materials) outperform permanent revegetation (so-called 'carbon sink') forests as vehicles for capturing and storing carbon (Figure 3).
- Use of surplus and residual biomass from plantation management, harvesting and processing to produce heat, electricity and liquid or gaseous fuels would further contribute to greenhouse gas reduction as well as increasing the commercial viability of the plantation.
 - Production of bioenergy as a co-product could also offer a pathway to improving the commercial value of timber plantations on more 'marginal' sites and regions.
- Unless the much-heralded Carbon Farming Initiative (CFI) undergoes significant changes (especially with respect to the conditions of 'additionality', 'permanence', and several sovereign risk elements), the Government cannot expect the CFI to have any notable impact on commercial plantation investment.

Figure 3: Carbon storage in harvested and unharvested forests



Source: FWPRDC and CRC for Greenhouse Accounting (2006)

In seeking to attract political and popular attention by highlighting the carbon credentials of plantation forestry, the primary purpose of timber plantations — ie, to produce a renewable resource for a national plantation products industry — must not be lost sight of. In the past couple of years, policymakers appear to have become preoccupied by the notion of trees as a carbon sink only, and not as producers of diverse products used in daily life by everyone in the community.

To this end, it is most important that, as the only carbon-positive sector of the economy, commercial plantation forestry and the plantation products and paper industries are, at worst, not disadvantaged by climate change programs and the introduction of a carbon price. Better still, they should be appropriately rewarded for their positive contribution to carbon capture and storage and emissions reduction.

The potential loss of competitiveness in emissions-intensive trade-exposed (EITE) industries under carbon pricing or trading policies is now well-documented. Pulp and paper manufacturing and panel board manufacturing are among those industries, and A3P has been very active in consultations with other EITE industries and the Government in the consideration of how to implement a carbon pricing policy without unfairly penalising the affected industries with respect to their international competitors, many of which receive substantial domestic assistance not available in Australia.

A long-running discussion still to reach a conclusion concerns the industry's proposal that the Government should recognise the carbon stored in harvested wood products during use and after disposal. The Kyoto Protocol accounting rules do not include this carbon, meaning that timber harvesting is currently accounted for as a 100% carbon emission — a scientifically indefensible position. The Government accepts the arguments for inclusion, but has been adhering to a fixed policy of working only within the Kyoto rules.

There is inherent danger in adhering to this position in the development of a carbon pricing or trading system. Significant distortions may arise if domestically produced high-emissions/nil-carbon-storage materials (such as concrete, steel and aluminium) competing with harvested wood products are granted EITE compensation at the same time as the carbon stored in harvested wood products are not included in the system. This is especially the case for solid wood products (eg, sawn timber) and manufactured wood products (eg, plywood, MDF) used in buildings.

There is no justifiable reason for the Government not to recognise the carbon stored in harvested wood products in the design of any carbon pricing or trading system, regardless of the Kyoto accounting rules.

Recommendation 12

The Government ensures that, as the only carbon-positive sector of the economy, commercial plantation forestry and the plantation products and paper industries:

- are at worst not competitively disadvantaged by climate change programs and the introduction of a carbon price; and***
- are appropriately rewarded for their positive contribution to carbon capture and storage and emissions reduction***

The Government moves urgently to recognise the carbon stored in harvested wood products in the formulation of its climate change mitigation policies.

Potential for energy production

Apart from the recognition of the carbon stored in harvested wood products, the best contribution plantation forestry can make to the climate change mitigation campaign is as a substitute for fossil-derived energy.

Australian forestry has a very significant potential to produce renewable energy (firewood, wood pellets, electricity, gas, methanol, ethanol and diesel), for use in stationary and mobile applications, alone or in combination with fossil fuels.

As well as reducing the build-up of greenhouse gases, energy from 'homegrown' woody biomass has three other attractions.

- It offers the prospect of a comforting level of energy security, which is re-emerging as an element of the current public conversation.
- It can value-add in processing facilities such as sawmills, pulp and paper mills and engineered wood manufacturing by applying energy conversion technologies to residues and waste material.
- By providing a market for otherwise unmerchantable silvicultural surplus and forest residues, it can make thinning and pruning operations commercially worthwhile, thereby improving the health and productivity of the forest. This is particularly important to the economic viability of long-rotation private forest enterprises.

There are three main potential sources of wood for energy:

- Dedicated energy tree crops in marginal areas — which offer vast potential (although are not the most urgent priority), and could underpin serious investment in and revival of rural communities and economies as well as contributing land repair and other environmental benefits.
- Surplus and residues that are unavoidable co-products of forest management and sawmill operations during the production of higher value fibre-quality products — which, if converted to energy (as just noted above), could add value to plantation production if the material is not already committed to panelling and paper production. This material is continually available at a regional level, and is the more urgent priority.
- Urban trees that die and are replaced, and manufacturing, construction and demolition waste.

Use of marginal rural land and waste and surplus woody biomass also offers the way to use biomass feedstocks without increasing competition for prime arable land or diverting food crops into the fuel cycle. That is, it solves the 'food-vs-fuel' dilemma.

Leaving aside simple firewood, wood-for-energy technologies fall into three broad categories — direct combustion for heat and power; gasification and pyrolysis; and wood-to-liquid fuels. An expanded but concise summary of the technology categories can be found in Cummine (2007), from which this section is derived, with permission.

Direct combustion for heat and power

- Mostly small, bone-dry, energy dense wood pellets or briquettes, burnt in a furnace to create heat energy for steam for process heating, drying and electricity generation
 - Modern systems are efficient and clean, and especially good for small on-site combined heat and power

Gasification and pyrolysis

- Thermo-chemical processes, burning biomass with low oxygen (gasification) and with no oxygen (pyrolysis)

- Gasification produces a synthetic gas (hydrogen, CO and methane) suitable for turbine, combustion engine and steam boiler, good for small-scale electricity with low emissions
- Pyrolysis produces gas, olefin liquid and char, good for stationary engine, gas turbine or boiler, and char can be used as fuel or gasified

Wood to liquid transport fuels

Woody biomass can produce at least three renewable liquid transport fuels – synthetic diesel, methanol and ethanol, with some emerging interest in butanol. The technologies for the first two of these are well known and established. Ethanol-from-lignocellulosics (EXL) technology is still being proven at a pre-commercial scale.

- **Synthetic diesel** — Fischer-Tropsch (F-T) process well-known, used by Germany and Japan in World War II and South Africa during the apartheid sanctions
 - Biomass is gasified, then condensed to liquid hydrocarbon by catalytic conversion
 - Interest is reviving in Germany — Freiberg plant producing 18ML of diesel a year from about 70,000 tonnes of dry wood, an ideal scale for Australia's forestry regions
- **Methanol** can be produced from wood, but mostly from natural gas and sometimes coal. Well-established process (steam reforming to a synthetic gas then catalysed into methanol and water vapour)
- **Ethanol** — conventionally uses steam distillation to recover ethanol from grain and sugar feedstock ('first generation')
 - Rapid growth in production has attracted public criticism, particularly about competition for arable land and end-use of food crops (food-vs-fuel)
- New ethanol-from-lignocellulosics (EXL) technologies ('second generation') will solve the food-vs-fuel criticism, as well as problems of energy imbalance, endless subsidy, and large volumes of noxious effluent when using conventional steam distillation
 - No commercial EXL plants anywhere in the world yet (only pilot plants) — but it's now a worldwide R&D priority
- Australia is in the vanguard, with the Ethanol Technologies Ltd pilot plant in northern NSW now demonstrating technologies that promise commercial production of ethanol at a competitive cost without subsidy or excise relief, with substantial water and greenhouse benefits, and with the capacity to establish the first stage of the process near the feedstock source
 - The same company is also commercialising a world-first technology for emulsifying ethanol with diesel at up to 30% (Diesohol) with significant environmental benefits

Successful demonstration of these novel technologies has been long-awaited in Australia. It can open the way to the development of regional industries providing markets for silvicultural surplus, sawmill residues and dedicated energy crops, and supplying renewable transport fuels on a large scale.

Resource constraints on energy production

Some States have commissioned work to estimate the forest resource that would be/could be available as a long-term feedstock for bioenergy production. The Bureau of Rural Sciences Bioenergy Atlas is a useful reference to begin assessing potential resource availability, as well as a 2004 FWPRDC project conducted by MBAC Consulting. (FWPRDC, 2004)

More recent broad estimates of known and potential resource volumes and potential biofuel production have been published in RIRDC reports, eg, *Biofuels in Australia* (O'Connell, 2007). Any serious assessment leading to investment must, of course, be specific to the region and to the technologies under consideration.

Such inventory and wood flow forecasting must be done in the context of competition within the wood and paper industries for the same fibre — particularly if that fibre meets specifications and is economically accessible. It would be rash to assume that all the currently available surplus and residue from forest and timber operations will remain available as a bioenergy feedstock.

Competition is also likely to emerge in the future from industries based on new or revived technologies to use residues for such products as textiles, solvents, plastics, lubricants and fragrances. The forest-based 'biofactory' concept that was being promoted in CSIRO's Energy Transformed Flagship program is instructive in this regard.

The fact that 'wood waste' is a co-product or by-product of higher-value primary products (as are other cellulosic feedstocks such as stubbles, straw, cotton gin trash, sugar cane bagasse, etc) can help to reduce the criticism of biomass fuels associated with their derivation from agricultural food crop feedstocks — that their demand for use in the fuel cycle creates damaging competition with food production and other arable land use.

As recommended by the Prime Minister's Biofuels Taskforce in 2005 and the Senate Rural and Regional Affairs and Transport Committee in 2007, these emerging 'second generation' biomass technologies should be the main focus of relevant government policies.

Recommendation 13

The Government puts in place stable policies and programs that encourage and support innovation, commercialisation and widespread adoption of technologies to produce solid, liquid and gaseous energy from wood, whether the wood is unavoidable surplus and residue co-product or grown in dedicated energy crops in marginal areas.

References

(in addition to websites and other references embodied in the text of the submission)

Diverse specific sources referred to under the heading *Plantation forestry — impacts and 'social licence'* (pp 14-17) can be provided to the Committee on request.

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Attachment A

Source — A3P-NAFI submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Agribusiness Managed Investment Schemes, July 2009

Extract from the submission's response to: Term of Reference 2: Impact of past and present taxation treatments and rulings relating to managed investment schemes

The tax treatment of timber plantations needs to be considered in two broad contexts:

- the market failure that confronts the attraction of large-scale private investment into long-term enterprises characterised by agricultural risk, only one to three income events over that period, and 'period inequity' (defined below); and
- the relationship of timber plantation enterprises to the whole upstream and downstream production and distribution chain.

This section addresses these questions as a background to summarising the impact of changes in the tax treatment of timber plantations that have taken place over the past three decades, as well as the importance of minimising the sovereign risk to the plantation industry created by periodic changes in public policy.

Tax and plantation forestry — addressing market-failure

Although plantation forestry has features not shared by annual agricultural crops (for example, flexible harvest dates, within reason), it still faces the same general agricultural risks – rainfall variability, flood, fire, pest and disease outbreaks, commodity market volatility, etc.

But attracting large-scale private investment into plantation forestry to replace what used to be financed directly through government forestry commissions faces different and peculiar challenges flowing from the unique nature of forestry enterprises and assets.

Plantation forestry is a relatively long-term enterprise, with high establishment costs, illiquid assets, very few income events, returns coming in large 'lumps', and a large tax liability at final harvest.

This 'lumpy returns' feature creates the phenomenon of '**period inequity**', a form of market failure that continues to bedevil private plantation enterprises. Because most of the income in large income events (commercial thinnings harvests and final clearfall harvest) is taxed at the forest grower's highest marginal tax rate, it can be seen that, subject to the taxpayer's individual circumstances, more income tax is likely to be paid on a plantation forestry enterprise than if the same total amount of income had been received and taxed annually – as with most livestock, cropping and horticultural enterprises.

In the face of this market failure, plantation forestry receives no subsidies or 'special tax advantages' not available to other primary producers. Plantation forestry accesses the same tax deductions as are available to every business in Australia – including other primary production enterprises. Under section 8-1 of the *Income Tax Assessment Act 1997* (the 'general business deduction' provisions), eligible non-capital expenditure is deductible against other income in the year the expenditure is incurred.

If access to this general entitlement was to be denied to plantation forestry – as nearly occurred during the Ralph Review of Business Taxation in the late 1990s – not only would

that denial discriminate against one form of enterprise that is already challenged simply by its inherent characteristics, but it would perversely create a disincentive to further such investment, as occurred in New Zealand in the mid-1980s.

The relationship of this tax treatment to retail forestry investors is explained in the next section.

Tax arrangements for forestry managed investment schemes

Retention of the general business deduction and the statutory arrangement is important for continued large-scale private plantation investment in Australia.

The Australian Government conducted an exhaustive review of plantation forestry taxation in 2005 and 2006, which culminated in its decision in December 2006 to introduce a statutory deduction for forestry managed investment schemes.

For many years before that, investors in retail forestry projects – one small category in the diverse array of pooled investments closely regulated by ASIC and the ATO – fell under the general business deduction provisions of the *ITAA 1997* (section 8-1), described above. As growers carrying on their businesses collectively through a manager, they were entitled to deduct their eligible business expenses in the year they (the growers) incurred them.

The growers had no special incentive other than this standard business deductibility. The 12-month prepayment rule (2002 to 2008) provided no extra incentive for the growers, but allowed the plantation investment companies to secure the land and nursery stock and establish the plantations in a prudent and seasonally appropriate manner.

The new statutory deduction for forestry managed investment schemes was enacted in June 2007, as a new Division 394 of the *ITAA 1997*. Although investors are no longer required to demonstrate that they are carrying on a business in order to access the deduction, the new law retains the same simple basic principles described above—year-of-expenditure deductibility for investors' contributions to the project, and a prepayment provision.

Three important integrity measures have been embodied in this new arrangement, which must be met to enable the investors to claim and retain their tax deductions.

- First (and most important to project integrity), at least 70 percent of the project expenditure over the life of the project must be 'direct forestry expenditure' (the '70% DFE test'), determined at net present value against arm's length prices.
 - DFE is defined as expenditure associated with planting, tending and harvesting of trees, plus the annual costs of the land. The legislation specifically excludes such expenses as marketing the investment, commissions, insurance, contingencies, and general business overheads.
- Second, all the trees must be established within 18 months of the end of the income year in which the investors enter the project.
 - The time limit for tree establishment is accompanied by a legislated requirement to officially notify the ATO of a failure to comply, retrospectively exposing the taxpayer to lost deductions and the company to the 'promoter penalties' legislation.
- Third, the initial investor in a forestry managed investment project must hold the woodlot interest for a minimum period of four years before trading the interest to a secondary buyer.
 - Special provisions have been legislated to prevent tax mischief.

The 'secondary markets' thus created by this third integrity measure will increase the liquidity of managed plantation investments, and will especially help the much-needed longer-rotation sawlog plantations to become a more attractive investment prospect than they have been.

It is important to note the 'tax neutrality' condition embodied in both the former 12-month prepayment rule (section 15-45 of ITAA 1997) and again in the new statutory deduction arrangements (section 15-46 of ITAA 1997). In order to maintain temporal 'tax symmetry' between public tax expenditures (deductions) and public revenues (income tax), this provision requires the plantation investment company to bring forward its own income tax liability into the same year that the investors claim their tax deductions. Additionally, the company must recognise the *gross* receipts from investors, which can only be offset by deductible expenditure that the company incurs in managing the previous years' projects. In effect, this provision imposes a tax prepayment on managers, with potentially a serious burden on cash flow.

It does, however, bring about a level of tax neutrality, such that the only cost to the public revenue of the prepayment provision is the difference between the marginal tax rates of investors and the company tax rate, a tax policy feature that is unrelated to the specific tax arrangements for retail forestry.

The Government's reason for legislating the new tax arrangement was to quarantine plantations funded through managed investment schemes from whatever might be the outcome of a test case that the Tax Commissioner was planning in 2006. On the basis of evolving case law, the Commissioner had changed his legal interpretation of the proper tax treatment of all agribusiness managed investment schemes, meaning the standard year-of-expenditure tax deductibility entitlement for the investors would no longer apply, thereby bringing an end to large-scale private plantation investment in Australia.

For good policy reasons discussed in the previous section, the Government and the Parliament were unwilling to let that happen.

The Federal Court, on 19 December 2008, found unanimously against the Tax Commissioner's new arguments. The Court confirmed that, subject to appropriate project structures and documentation, investors in agribusiness managed investment projects could indeed be carrying on a business, and thus be subject to the same tax deduction entitlements as other businesses (as described in the previous section).

It is sometimes claimed that tax deductibility for retail forestry investors leads to foregone tax revenue that the Government could spend on diverse public services and infrastructure. Such a claim is misleading, on two counts. First, if investment in retail forestry projects was denied, the investors' deductions would not suddenly become available to the Budget. Rather, most of that investment would be redirected into the much larger pool of highly tax-effective negatively-g geared share and property portfolios, rather than into rural Australia to create jobs, businesses and wealth.

Second, all the funds collected from retail forestry investors quickly become taxable income in the hands of the plantation investment companies and their employees, contractors and suppliers, and the investors later pay income tax on their net income from harvest. Independent research analysts, Australian Agribusiness Group (AAG), have estimated that lifetime tax revenues to the Government from all agribusiness projects can be as much as three times higher than the initial deduction entitlements claimed by the investors.

Plantations in the production and distribution chain

Processing and value-adding in the plantation products and paper industries involves investment of tens of millions of dollars, and is not made unless the processor is confident of having access to the necessary plantation resource.

Demand for resource continues to rise in line with the increasing scale of new processing investment required to remain internationally competitive.

The domestic and export wood and paper industries seek secure supplies of harvested wood of the nominated quality and specifications, delivered in sufficiently large volumes, consistently and continuously over a long period at competitive prices. (This is one of the reasons why small, diverse and dispersed farm forestry operations continue to find it difficult to access markets for their harvested logs.)

The corollary is that these industries try to avoid sharp and substantial fluctuations and disruptions to their resource supplies. The advantage of plantation forestry is that it is possible to delay harvest for two or three years if mills are experiencing a downturn in demand and there is a 'surplus' of resource.

Wood supply disruptions present different problems, however. 'Smoothing' adjustments to compensate for such disruptions are possible, as long as the mill can find an alternative source of the appropriate resource. But these adjustments are invariably very expensive. It may mean transporting wood from a distant location, at a haulage cost of approximately 10 cents per tonne per kilometre. Transporting wood more than about 100 kilometres can become economically unattractive, and at anywhere near 300 kilometres, a big financial loss is a likely outcome.

Furthermore, if domestic wood is unavailable, the only alternative is either to limit production in that year or to purchase imported wood, contributing to Australia's current account deficit, something the Australian Government has sought to overcome by encouraging the continued development of the national plantation estate.

During the decades when state government forest agencies were the dominant plantation growers, supplemented by wood from industrial processors' own captive plantations, securing long-term access to the wood resources was simpler and more predictable.

With the shift over the past decade towards greater reliance on private investor-funded plantations, different forces have come into play, which must be planned for and managed by the processing sector. Economic conditions, such as those now confronting the national and global economies, can affect the flow of investment into new and replanted plantations, with inevitable impacts on long-term wood flows. There is not much that plantation growers and processors can do to prevent such market fluctuations.

By contrast, changes in government policy and regulation are a factor that **can** be controlled. In Australia, forestry at large has been subject to 'sovereign risk' for decades. Plantation forestry is no exception. As indicated in the summary below, changes in the tax treatment of plantation forestry, and managed plantation investment in particular, have created wide fluctuations in the annual rates of plantation establishment, which processors are now having to factor into their future operations.

Avoiding adverse changes in the corporate regulatory framework for managed plantation investment and the plantation investment companies is similarly within the control of the Government.

Besides the impact on future wood flows, and thus on 'downstream' employment and contracting businesses, dramatic downturns in planned plantation establishment has immediate adverse consequences for the 'upstream' businesses, jobs and rural communities providing services to the plantation sector.

There would also be – as is currently being experienced – an immediate loss of confidence in the sector, which in turn would jeopardise the continued signing of multi-million dollar long-term supply contracts and future plans for the development of processing infrastructure, including new and upgraded chip mills, saw mills, pulp and paper mills, and port and transport infrastructure. These investments rely on steady continuity of resource to underpin the substantial capital investment required and to avoid high cost solutions to sudden fluctuations in supply to mills.

Policy and regulatory changes can even threaten the marketability of existing plantations, if regional estates don't continue to expand to the size of the critical mass needed to supply new processing facilities.

We urge the Committee to take account of these unique features of the plantation products and paper industries when formulating its recommendations.

... ..

Attachment B

Supplementary information about land use and values (see the section on 'social licence')

The following information relates mostly to the middle of the last decade, the period of the most rapid plantation expansion in recent times.

Land-use change

- Broadacre cropping, farm consolidation and other factors have been the main driver of land-use change in rural regions during the past decade and a half (Ref: ABARE, ABS, BRS)
 - Eg, from 1994 to 2004, the total area of land used for cropping and grazing fell by 29 million hectares, compared with an increase in the area of plantations of less than 0.7 million hectares
 - In the same period, cropping specialists doubled (from 10% to 20% of total agriculture); also, total number of dairy farms fell by 27%, but dairy cow numbers rose by 14%

Rural land values

- Plantation companies buying properties are welcomed by retiring farmers, many having had their properties on the market for some years.
- In 2005, BRS confirmed that WA's Great Southern region saw a steeper increase in land prices since 2002 in non-plantation regions because farmers had experienced "a couple of good seasons". (Ref: BRS)
- Nationally, average prices of broadacre farms sold in Australia rose by 34 percent in 2004-05, following an average increase of 19 percent in 2003-04 (Ref: Elders Rural Property Index). At that time, plantation investment companies had purchased around 3 percent of the total of around 10,000 broadacre properties sold in each of the previous four years. It is simply not possible that 3 percent of sales could drive a 34 percent increase in land values.
- A rural property forum convened by National Australia Bank Agribusiness presented comparative land values and capital growth in eleven NSW regions from 1978 to 2006. Most notably, "values for most classes of property are shown as having at least doubled since 2002, and in some cases (like Mudgee) nearly trebling, or even quadrupling (Yass)," (*The Land*, 22/6/06). Plantations are not being established or expanded in either of the Mudgee or Yass districts.
- Research by Australian Agribusiness Group (AAG) into the effects of retail managed investments on land values concluded that retail managed investment projects were not the major driver of rural property prices. Using statistics from the Valuer-General Victoria, AAG compared rises in values for specific areas in the state. It contrasted areas where there was a strong level of retail managed investment purchases with areas that had few or no retail managed investment purchases. AAG concluded that land prices in retail managed investment activity areas did not go up any differently to other areas (*Financial Review* – Matthew Cranston P47, 29/6/09).

Dairy farms

- According to Elders (December 2005), several dairy farms in Tasmania were purchased in 2005 by forestry companies at prices of \$3,000 to \$6,500 per hectare, while interstate and international dairy farmers had pushed the price of established dairies in prime areas up to \$14,000 per hectare.
- According to the Commonwealth Bank (*Stephen Rafferty, 15 Dec 2005*), dairy farmers seeking to expand their holdings in western Victoria had met stiff competition from overseas farming interests — particularly from NZ (where dairy land was about \$25,000 per hectare), but also from Holland, England, Germany, Switzerland and Canada. At least 100 overseas families invested in SW Victorian dairy farms between 1996 and 2005.
- In March 2006, 164 dairy properties were advertised for sale in Victoria, at an average asking price of \$11,500 per hectare. Advertised prices for dairy farms currently on the market in SW Victoria at the time ranged from \$12,000 to \$15,000 per hectare. (*Ref: Stock and Land rural weekly*)
 - These prices were almost double what plantation investment companies could afford to pay for land. It is illustrative that the three plantation investment companies that had been purchasing such land in Corangamite and Colac Otway Shires in SW Victoria were no longer actively seeking land in that region, and had made no purchases since mid-2005.
 - Thus, although blue gum plantations had been established on those properties over the succeeding 12 months, the plantation investment companies had not been a force in the market for at least a year, yet were still being blamed for forcing up the price of rural land.

Land purchase statistics

- As at mid-2006, plantation investment companies had purchased only several hundred of the thousands of properties inspected over the previous five years. Averaged over the total estates of the major companies, 12 to 35 percent of all properties inspected were purchased. The average was less than 20 percent.
- Many a property is offered to a plantation company but not inspected, because the manager already knows the property to be unsuitable (eg, too far from existing or future processing or port facilities, or fails an initial desk-top analysis). However, for properties that have been inspected, the main reasons for not purchasing, in order of importance, are:
 - property was too expensive (in one-to-one sales);
 - percentage of net plantable area was too small (a sub-set of 'too expensive');
 - soils were unsuitable;
 - company was the losing bidder at auction or tender, mostly to farmers;
 - vendor was not serious, and withdrew once commitment was required; and
 - property was too controversial (e.g. near a town or a tourist feature).
- Contrary to some local stories, the majority of houses on farms purchased or leased by plantation companies remain occupied, being let to company employees, contractors, or external tenants (including the previous owners, in some cases).