



## Submission to House of Representatives Standing Committee on Industry, Science and Resources Inquiry into Increasing Value-Adding to Australia's Raw Materials

by

The National Association of Forest Industries

***The National Association of Forest Industries (NAFI)** represents companies, individuals and organisations involved in the forest and forest products industries. NAFI presents the forest industries' views to the people of Australia, governments and public authorities on matters relating to the national development and use of forests and forest products, including plantations. NAFI's vision is of an ecologically sustainable Australian society based, in part, on dynamic, internationally competitive forest industries.*

### **Introduction**

The National Association of Forest Industries is pleased to provide this submission to the House of Representatives Standing Committee on Industry, Science and Resources Inquiry into Increasing Value-Adding to Australia's Raw Materials.

The forest and wood products industry is an important component of the Australian economy contributing about 2.5% of the nation's GDP. In 1996-97, the Australian wood and wood products industry generated a total value of output of just under \$6 billion and the paper and paper products industry generated a further \$5.5 billion giving a total turnover generated by the industry of \$11.5 billion (ABARE, 1999). It is estimated that there are more than 80,000 persons directly employed in the forest and forest products industry – of which 61,500 are employed in the manufacture and processing of wood and paper products.

Despite the capacity of its forest and wood products industry Australia still imports large amounts of wood and paper products. In 1997-98 Australia's trade deficit in forest products was \$1.46 billion. Paper and paperboard products accounted for about two thirds (\$1.03 billion) of this figure. Exports of forest products totaled \$1.25 billion in 1997-98 and 50% of this consisted of woodchips.

### **Industry Commission Report - 1993**

In September 1993 the Industry Commission published a major report titled "*Adding Further Value to Australia's Forest Products*". This report provides a detailed analysis of the level of value adding in the forest industry in Australia and identifies the key issues that need to be addressed to encourage investment in the sector. Although it is now more than five years old the majority of the report remains relevant today and this is hardly surprising given the long-term investment horizons involved in forest growing and timber processing.

At the outset it is worth restating, at some length, the comments made by the Industry Commission regarding the concept of “value-adding” (Industry Commission 1993, pp. 216-217).

*“As a means of promoting development, it has been frequently advocated that Australia should add further value to its natural resources by increasing the extent of downstream processing...*

*Increasing the level of wood processing undertaken in Australia has intrinsic appeal, especially at times like the present [1993] when unemployment levels are high. Further processing of logs which are otherwise converted into export woodchips or of sawn hardwood currently sold as green scantling, could involve significant additional processing and, hence it may be seen by many as a means of increasing employment opportunities. It is also seen as a means of relieving the pressure on Australia’s balance of payments by reducing the high level of imports of wood and paper products and/or increasing exports.*

*... given the apparent advantages associated with further processing it is pertinent to ask why Australian producers of forest products do not add more value to their wood inputs?...*

*Two factors are important in understanding this issue. First, higher value added does not necessarily equate with greater efficiency...Second, higher value added does not imply higher profitability...*

*However, this in turn raises the question of whether there are factors which inhibit the profitable production in Australia of higher value added forest products.”*

The Industry Commission went on to identify a number of factors that were inhibiting the profitable production of higher value added forest products in Australia. Significant progress has been made in addressing a number of these factors. However, in other areas progress has been slow and many of the issues remain unresolved today.

In light of the Standing Committee’s current inquiry it seems appropriate to revisit some of the Industry Commission’s specific recommendations in relation to the forest products industry and to examine the extent to which they have been implemented. The headings and recommendations in italics below have been extracted from the report (Industry Commission 1993, pp. 15-17) and the subsequent comments represent NAFI’s views on the degree to which the recommendations have been addressed to date. It should not necessarily be concluded that NAFI supports each and every recommendation made by the Industry Commission. However, clearly the implementation of these recommendations must be of great significance to any analysis of the extent of value adding in the forest industry in Australia today.

#### *1. Resource Security*

*To decrease uncertainty and facilitate efficient investment decisions:*

- Commonwealth, state and territory governments accelerate the implementation of measures announced in the National Forest Policy Statement to improve resource security.*
- The processes needed to implement the National Forest Policy Statement be fully enunciated, and a timetable for implementation be established.*

These recommendations are being addressed primarily through the Comprehensive Regional Assessment and Regional Forest Agreement (RFA) processes that have been underway since early 1995. However, at this time only four RFAs have been completed and there are a further eight outstanding. The timetable for completion of the RFAs has been revised many times with continual slippage in deadlines as a result of delays in completing technical work, additional requirements for stakeholder consultation and political expediency particularly the

accommodation of election timetables. A de facto deadline for completion of RFAs has been set by the regulations on the export of unprocessed wood which prevent the export of such material after December 1999 unless it is sourced from a region in which an RFA is in force.

To date neither the Commonwealth or the states (except Tasmania) have provided legislative support to the RFAs and made commitments in relation to compensation which provide industry with a level of confidence required to encourage investment in further processing. Given the very high level of uncertainty surrounding resource supply from native forests during recent decades in Australia it is highly likely that even the existence of a RFAs may provide insufficient certainty for potential investors in the sector. It is therefore vital that Governments commit to compensating investors who are adversely impacted by subsequent policy changes that impact on resource supply. It is also essential that Governments defend the huge investment made in the CRA/RFA process by clearly explaining the process to the community, and clearly enunciating their commitment to ensuring a stable and certain long-term management regime for public forest based on the RFA outcomes.

## 2. *Public Wood Supplies*

*To improve efficiency of wood supplies:*

- *Plantations owned by state and territory governments be progressively offered for sale to private sector interests.*
- *Management of any remaining government owned plantations in each state and territory be made the responsibility of one or more corporatised government bodies.*
- *Management of crown land used for wood production in each state or territory, other than government owned plantations, be undertaken by one or more corporatised government bodies.*
- *Corporatised forest management agencies neither be obliged, nor permitted, to discriminate between wood processors on the basis of location, to make sales conditional on wood not being acquired from other sellers, or to engage in other discriminatory practices.*
- *Corporatised bodies be subject to the provision of both the Trade Practices Act and the Prices Surveillance Act, required to pay all relevant taxes and charges, meet a rate of return requirement and pay a dividend to government. Non-commercial functions which they may be required to undertake be specifically identified and separately funded. Corporatised forestry bodies should not be responsible for regulatory functions.*
- *Licences and associated log entitlements issued be state governments be both divisible and tradable.*
- *Government cease to use log royalties, log allocation procedures or any other instrument to direct output of the forest products industries towards the production of higher value added products.*

It is beyond the scope of this submission to provide a detailed analysis of the extent to which each of the states and territories has addressed each of the recommendations outlined above. However, a few general observations can be made. For example, only one state (Victoria) has sold its publicly owned plantation assets. All other states have given consideration to this issue but for various political and financial reasons have not proceeded to sell these assets at this time.

As part of the National Competition Policy agreements of April 1995, governments committed to apply “competitive neutrality” principles to all their significant business activities. Competitive neutrality involves the application to public enterprises of the same taxes, incentives and regulations as face private businesses. This allows the two sectors to compete for resources on an equal footing and encourages efficient operation of public enterprises. The

National Competition Policy requires all legislation containing restrictions on competition to be reviewed and only those restrictions found to be in the public interest retained.

All States have made progress in the implementation of the National Competition Policy agreements and there are established reporting procedures in place. However, it is probably true to say that the forestry specific issues, as outlined in the Industry Commission recommendations above, have been overshadowed by the more far-reaching reforms in relation to water, energy and transport. In some instances it is possible to identify changes which have occurred in relation to state log supplies that are directly contrary to the recommendations outlined above.

### 3. *Private Wood Supplies*

*To reduce the impact of factors which may unnecessarily restrict private sector investment in plantation development and agroforestry:*

- *The Commonwealth Government request the Australian Taxation Office to clarify the application of the Income Tax Assessment Act 1936 as it applies to sellers of immature plantations.*
- *A legal basis be established for separating the ownership of land and the trees grown on that land.*
- *State governments act to dissuade local governments from using measures such as planning controls which discriminate between plantation developments and other agricultural industries.*

All these issues were included as “Actions” needing to be addressed under “*Plantations for Australia: the 2020 Vision*”, the national plantation sector development strategy developed jointly by governments and industry. The strategy has the support of the Ministerial Council on Forestry, Fisheries and Aquaculture and was launched by the Commonwealth Minister for Primary Industries and Energy in October 1997. The fact that these issues had to be included in the *2020 Vision* clearly identifies that they had not been resolved despite the Industry Commission’s recommendations.

A number of taxation issues in relation to plantations remain unclear and a significant secondary market for plantations has not yet developed. Taxation issues have been further confused by the major tax reform agenda of the current government and, while this may have long term benefits, it does little to encourage further investment in the forestry sector until such time as the new taxation environment is clear and certain.

All States have made progress in addressing the separation of ownership issue although further complication has arisen as a result of the emergence of a third “ownership category” – the rights to carbon sequestered in the plantation. Few potential investors are identifying this issue as having a major impact on their investment decision.

The issue of local government treatment of plantations remains a major impediment to investment in some States and has been highlighted by a number of specific Actions in the *2020 Vision*. The issue is being addressed via a number of different mechanisms and in different ways in the each state. Some states have taken action to limit the discretion of local government in relation to plantations and the forest industries are endeavouring to work with local government to obtain the universal benefits of increased employment and income generation.

The actions of local government are frequently closely tied to their concerns about the lack of funding for infrastructure and the impact that expanded forest resources may have on their ailing roads and bridges. Clearly the lack of adequate infrastructure is a key impediment to investment in value adding to all raw materials including forest products.

#### 4. *Regulatory Matters*

*To remove inefficient regulation and other government policies which have the capacity to impede efficient development:*

- *All Commonwealth, state, territory and local government controls on exports of logs and woodchips, and the research levies applied by the Tasmanian and Western Australian Governments to export woodchips, be abolished.*
- *The Tasmanian Government legislate to remove licensing restrictions which limit competition in the provision of road freight services, and remove requirements that a fee apply to logs (and other designated goods) carried on routes served by Tasmanian railways. Consideration be given to modifying regulations to allow the use of B-doubles and to further extend operating hours.*
- *Building standards and associated codes be reviewed to ascertain whether the present restrictions on the use of wood in multi-storey dwellings are appropriate, and amended as necessary. Wherever possible, standards be performance based and, where appropriate, harmonised with international standards.*
- *Sales tax exemptions applying to certain recycled papers be abolished.*
- *Mandatory recycling targets and government procurement policies not be used to artificially stimulate demand for paper made from recycled fibre.*
- *Clear guidelines and more efficient administrative procedures be introduced to remove inefficiencies associated with existing project and environmental approval processes.*

As discussed in relation to the resource security issue, export controls on unprocessed wood sourced from native forests are not removed until a Regional Forest Agreement has been completed for the area concerned. Significant areas of forest are not yet covered by RFAs and the December 1999 deadline imposed by the export control regulations has the potential to cause significant difficulty for exporters if the RFA process is not completed by that time. The Commonwealth has made significant progress in the removal of export controls on plantation sourced wood although issues in Queensland and the Northern Territory are yet to be resolved.

There has been significant progress in relation to most of the other recommendations listed above. However, this progress has required a significant investment of time and money by the forest and wood products industry and even maintaining the gains made requires constant effort and vigilance. The mere potential of the re-emergence of such issues can act as a disincentive to investment unless government continually reinforces its commitment to minimising the level of regulatory control on productive activity.

#### 5. *Reform of Government Business Enterprises*

*To help ensure that goods and services provided by government business enterprises are produced and priced efficiently:*

- *The Commonwealth, state, territory and local governments accelerate the pace of microeconomic reform, particularly in the areas of land transport, sea transport and energy supply.*

Significant progress has been made in relation to these issues as a result of the implementation of the National Competition Policy commitments. Unfortunately, but not surprisingly, the fundamental nature of many of the changes involved has meant that significant delays have occurred and therefore the flow-on impact on investment has also been affected particularly as it is also subject to the vagaries of the economic climate. The negative impact of the recent Asian crisis has possibly concealed or delayed some of the potential benefits that may ultimately flow from these reforms.

## 6. Training

*To help overcome any deficiencies in the availability of management and workforces skills:*

- *The level and allocation of government funds available for training relevant to the needs of the forest products industries be reviewed.*

NAFI is not aware of such a review being undertaken in a comprehensive manner. Investment in training is a key component of any investment in value adding. The lack of investment in value adding tends to be shadowed by a lack of investment in training.

The changing nature of the log supplies available to the industry and increasing market demands for higher and more consistent product quality mean that new technologies and techniques are required in wood processing. Such changes can only be successfully implemented across the industry if there are sufficient trained staff available. Just as lack of certainty deters potential investors, it also deters potential employees, particularly those with the highest skill level and greatest mobility.

## 7. Research and Development

*To improve the basis for the funding of research and development:*

- *The levy to fund the activities of the Forest and Wood Products Research and Development Corporation not be applied to imported forest products.*

Research and development is the key precursor to investment in value adding activity. The issues outlined above, particularly the lack of certainty in the supply of hardwood from public native forests, have impacted negatively on investment in research and development.

The Forest and Wood Products Research and Development Corporation (FWPRDC) has now been operating for some four years and it has been responsible for funding much useful work. There has also been some concern amongst the sectors within the industry over the degree to which they are able to control and use the funds they contribute to the FWPRDC. As a result the Minister for Forestry and Conservation is currently undertaking a review of the R&D arrangements for the forest and wood products industry.

NAFI strongly supports the need for a national forest and wood products research body to provide leadership and direction in research and development. It should of course be noted that the funding invested in research and development through the FWPRDC is relatively small compared to the total expenditure on research and development which is made by the industry as a whole, particularly through the larger corporations and the State forestry agencies. However, the FWPRDC does play an important role in co-ordination on issues of broad relevance to industry and in providing smaller players with access to research capacity and technical information.

NAFI believes that every effort should be made to ensure that all sectors within the forest and wood products industry contribute to the work managed by the FWPRDC. To this end NAFI believes that Commonwealth funding for the FWPRDC should be increased to \$1 for every \$1 contributed by the industry rather than the current \$1 for every \$2. The forest industry feels it has been unjustly discriminated against in this regard as all other agricultural R&D corporations receive Commonwealth support at the higher rate. The negative feeling created by this lack of support for the industry has no doubt contributed to the reluctance of certain sectors within the forest and wood products industry to support the FWPRDC.

NAFI believes that it is vital that the existing voluntary (on a sector-wide basis) process for funding of the FWPRDC be maintained as it is only through this process that the responsiveness of the FWPRDC and research providers to the needs of industry can be assured. Obviously any changes to the levy rates at the request of industry must be made with sufficient lead-time to allow the FWPRDC to plan and conduct its research programs in a responsible manner.

## **Recent Trends in the Forest Products Industry**

The discussion above indicates that, while there has been significant progress in some areas, many of the issues identified as impediments to value adding in the forest sector in 1993 still have not been resolved. This lack of progress in some areas should not be taken to mean that the forest and wood products sector in Australia has not changed significantly in the past five years. In fact, significant change has occurred and will continue to do so as a result of a number of factors not all of which are within the control of industry or government in Australia. Some of the key trends currently influencing the sector are summarised briefly below.

- The supply of hardwood logs from native forest has remained reasonably constant in volume terms over the past decade. However, government (Commonwealth and state) decisions to reserve areas of mature forest in a number of states have led to a significant decline in the size and quality of logs available. The industry is investing in the technology required to process smaller logs. However, this investment is greatly constrained by supply uncertainty.
- Some consolidation has occurred in the hardwood sawmilling sector and is continuing. There has been a significant increase in further processing through drying and dressing of sawn timber and investment in this type of capacity has occurred in areas where some certainty of supply has been given for an extended period (ten years or more).
- Hardwood woodchip exports have continued at similar levels with some fluctuation due to the world market situation. However, exporters have not been able to capitalise on market opportunities where they have arisen, and wood supplies have been available, because of the ceiling imposed by the Commonwealth's export license arrangements. As a result Australia's share of the Japanese market has decreased dramatically. The signing of RFAs is alleviating this situation but unfortunately the current Asian economic situation has not allowed significant gains to flow as a result.
- There has been a significant increase in the establishment of hardwood plantations that will be managed on short rotations with the current aim of supply pulpwood for export markets.
- Production from the maturing softwood plantation resource has increased dramatically in recent years. Additional capacity in softwood sawmilling and reconstituted panel production has been installed in a number of regions. This increased capacity has contributed to a reduction in the level of softwood sawn-timber imports and an increase in exports. There have also been increased exports of softwood logs and woodchips as opportunities arise in the world market.
- The pulp and paper sector has seen some rationalisation of processing capacity as aging plants become obsolete and new capacity is installed to upgrade existing facilities. However, there has been no investment in the construction of greenfields pulp and paper capacity in Australia since the early 1980s.

## **Conclusion**

The forest and wood products industries in Australia are continually evaluating further opportunities for investment in activities that generate profits commensurate with the risks involved. Investments in forest growing and timber processing are, by the very nature of the business, long-term. Major investment in the forest sector in Australia has tended to be skewed towards the areas with the shortest lead-times (e.g. fast grown plantations). Any compounding factors that make short-term investment generally, more attractive will impact adversely on investment in forestry.

The major impediments to further investment in the growing and processing of forest products in Australia were identified by the Industry Commission in 1993. Progress in addressing these issues has been mixed and the major concern – certainty of resource supply – continues

unresolved by governments in a number of jurisdictions despite significant effort and expenditure.

It would seem appropriate for the House of Representatives Standing Committee on Industry, Science and Resources Inquiry into Increasing Value-Adding to Australia's Raw Materials to give close consideration to the issues raised by the Industry Commission in 1993 in relation to the forest products sector. The most useful course of action may then be to investigate what can be done to resolve the issues that are already on the table as quickly as possible. Further efforts to identify and refine the nature of the problem would appear to be of little value at this stage.

NAFI is happy to assisting in the provision of any additional information the Inquiry may require and looks forward to pursuing any avenues identified to increase investment and profit generation through the growing and processing of wood products in Australia.

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