

CHAPTER SIX

FUTURE PLANTATION-SOURCED SAWLOG SUPPLY

Introduction

6.1 Paragraph (d) of the Committee's terms of reference requires it to ascertain whether there is demonstrable need for government action to encourage long rotation plantations, particularly in order to increase the supply of plantation sawlogs. It is issues arising from this paragraph of the terms of reference that are addressed in this Chapter.

6.2 The Committee, in examining this issue, sought to establish the demand for longer rotation plantation timber, the extent of that demand, and the extent of any shortfall. It also examines actions that the government might pursue to encourage longer term rotation plantations.

Longer Rotation Plantations?

6.3 Evidence provided to the Committee suggested that there is general agreement regarding the need to develop longer rotation timber plantations and, as a consequence, an unmet and increasing demand for sawlogs. Sections of the Australian plantation forestry industry told the Committee that the need for longer rotation plantations had been acknowledged and that serious consideration was being given to facilitating the expansion of this sector of the industry.

6.4 The Australian Forest Growers (AFG) suggested that planning longer rotation plantations can ensure supply of logs for sawing and veneer. AFG argued that the expansion of Australia's longer rotation plantations is necessary in order to replace the declining resource available from public native forests as more of that resource is reserved from production.¹

6.5 By way of example, AFG pointed to the need for softwood plantations specifically to expand existing resources in regions where current supply is insufficient to support sustainable long-term integrated processing industries: in south west Western Australia, south east NSW, northern Tasmania, northern and south eastern NSW and northern Queensland. AFG also stressed the value of longer rotation plantations in terms of their landcare and conservation benefits, such as soil binding, nutrient recycling and habitat creation.²

1 *Submission 58*, Australian Forest Growers, p. 7.

2 *Submission 58*, Australian Forest Growers, p. 7.

6.6 The National Association of Forest Industries (NAFI) argued that future investment prospects for short-rotation pulpwood crops are positive but limited, given the current resource base and future market opportunities. As a consequence, "any additional growth in the industry would rely on investment in longer-rotation crops to produce material for sawing, peeling and slicing".³

6.7 NAFI drew attention to the West Victorian Regional Forest Agreement, which makes specific reference to the removal of export controls from unprocessed wood and woodchips sourced from Victorian plantations. It also noted agreement by parties to the West Victorian RFA, that the current scale of hardwood sawlog plantations will not be adequate to provide an alternative source of supply to native forest hardwood sawlog resources in the West Victoria region.

6.8 Signatories to the West Victoria RFA also agree that a significant expansion of both hardwood and softwood plantations (on previously cleared land) in the West Victoria Region would be advantageous to the industry. The fact that "governments recognise the need to facilitate product diversification in the plantation sector" is also seen as being beneficial to the industry.⁴

6.9 In a submission to the inquiry, Saltgrow Pty Ltd – a horticultural company with offices in New South Wales and Queensland – highlighted the fact that that some RFA agreements (particularly in Queensland) are based on the transition from native forest logging to plantation hardwoods over a 25 year period and argued that the achievement of this target will require immediate investment in long rotation hardwood plantations.

6.10 The Saltgrow submission expressed qualified support for the *2020 Vision*, describing it as both "commendable and necessary".⁵ However, the company's criticism of the current Vision strategy centred on what it described as its overly simplistic analysis in relation to the geographic and demographic distribution of plantation development; and the Vision's failure to "maximise the potential social and environmental benefits from co-ordinated and targeted plantation resource developments".⁶

6.11 It highlighted several serious impediments which need to be addressed in order to encourage private investment in longer rotation plantations, and more specifically to integrate this type of operation into agricultural enterprises on a fully commercial basis. These impediments include the long term investment required for hardwood plantations for solid wood production. The time period of approximately 20

3 *Submission 32*, National Association of Forest Industries, p. 19.

4 *West Victoria Regional Forest Agreement*, pp. 15-16.

5 *Submission 21*, Saltgrow Pty Ltd, p. 1.

6 *Submission 21*, Saltgrow Pty Ltd, p. 1.

years is greater than the seven to ten year horizons expected in the mainstream investment community.⁷

6.12 In support of longer rotation plantations, the Plantation Timber Association of Australia (PTAA) argued that they have the capacity to supply a range of logs suitable for a number of end products. They also claim to have a greater potential to supply fully integrated processing operations which have the capacity to maximise income and employment outcomes for regional communities.⁸

6.13 It was further argued that the current softwood plantation resources in Northern Tasmania, South West Western Australia, South East NSW, Northern NSW and North Queensland are not of sufficient size to support internationally competitive processing operations in the long term. They indicated that the existing longer rotation plantation resources – those that are located in regions which have not yet reached critical mass – should be expanded to enable their full potential to be realised.

6.14 However, the Institute of Foresters of Australia (IFA) argued that sawlogs are essentially no more economically valuable than other forms of wood production such as pulpwood, and that any decisions regarding longer rotation plantations should be left to the market. Nonetheless, the IFA stated that if there was a possibility for a substantial increase in public good benefits from encouraging longer sawlog rotations then government should examine this on a case by case basis:

For example there may be a case for subsidising longer rotation plantations, at least for an initial establishment period, where it can be clearly demonstrated that it would assist in smoothing industry adjustment arising from reductions in the availability of native forest sawlogs or would lead to substantial economic development outcomes. In a similar vein, there may be a rationale for government to encourage longer rotations on the basis of delivering improved environmental, especially biodiversity, outcomes in some situations. This would depend on a number of factors such as species planted, landscape context, silvicultural management regime and where it is proposed to manage surrounding land for conservation purposes. It may be that establishing an investment framework which fosters the development of secondary markets for longer rotation crops is the most efficient means of encouraging such tree crops.⁹

6.15 The IFA submission also stressed the importance of determining the types of wood processing industries that are going to be developed in specific plantation zones and then ensuring that the *2020 Vision* includes strategies aimed at facilitating the appropriate mix of short and long rotation plantations to provide the necessary resources for these industries.

7 *Submission 21*, Saltgrow Pty Ltd, pp. 1-5.

8 *Submission 9*, Plantation Timber Association of Australia, p. 12.

9 *Submission 11*, Institute of Foresters of Australia, p. 6.

6.16 In addition, the IFA suggested that, given Australia's traditional reliance on larger native forest sawlogs, the development of appropriate technologies for converting smaller diameter hardwood logs into high value products is as important as an adequate supply of sawlogs from longer rotation plantations. It argued that:

There may be a case for increasing funding for research and development into the efficient processing and marketing of products from smaller logs. Without building the expertise to commercially process and market products from small hardwood sawlogs, there may not be sufficient incentive to encourage a widespread expansion of plantations for sawlogs.¹⁰

6.17 The Committee notes that the argument that longer plantations rotations are necessary rests heavily on the view that it will be required to fill a shortfall resulting from decisions to wind down harvesting from native forests. While there are suggestions that more environmental benefits may flow from longer term rotations than short term rotations, these seem to be speculative. As outlined in the previous chapter, further research is necessary to establish what, if any, environmental benefits will result. However, what is clear is that investment for longer plantation rotation is difficult to attract. The general view is that one of the major factors creating the difficulty is the time required for investors to get a return on the investment.

Government Incentives

6.18 During the inquiry the Committee received evidence from a number of organisations outlining proposals to encourage longer term plantation rotation. These included:

- Taxation incentives;
- Harvest guarantees; and
- Research and development.

Taxation Incentives - Secondary Markets

6.19 The proposal that had the greatest support, and requires government action, was the proposition of the introduction of tax arrangements for secondary markets for longer plantation rotations. The Saltgrow submission, for example, argued that a viable solution to the problem of encouraging long term investment is the development of a secondary market for plantations. This would allow multiple investors to derive returns from the growth in asset value over the period of a solid-wood rotation – or at least provide the option of exiting from an investment prior to maturity.¹¹

6.20 The current tax arrangements were outlined by the Executive Director of Treefarm Investment Managers of Australia (TIMA):

10 *Submission 11*, Institute of Foresters of Australia, p. 6.

11 *Submission 21*, Saltgrow Pty Ltd, pp. 1-5.

... when you establish a plantation from the beginning, because it is an agricultural operation you are legitimately able to deduct the cost of that establishment. When you purchase a plantation that is already standing, the tax treatment is that that is a capital asset and, as a consequence, you cannot deduct the purchase price of that asset and you are not able to until you dispose of that asset later. The whole idea of having to hold on to an asset that is so illiquid for such a long time is the thing that has discouraged the people who would perhaps purchase such an asset. Without that, the people who are establishing the asset want to shorten the rotation link as much as possible so that they can get a return on their investment a lot sooner, rather than putting something in the ground that they could sell to somebody else, because the people are not there to buy it.¹²

6.21 The PTAA submission noted that ABARE was about to commence a study which is expected to identify the causes for the current low level of investment in longer rotation plantations – in comparison to the quite significant level of investment in shorter rotation plantations.¹³ It also anticipated such a study could identify reasons why a secondary market for immature plantations has not developed in Australia, particularly when such markets exist in other countries.

6.22 Without pre-empting the ABARE study, it was argued that:

... one possible means of increasing investment in longer rotation plantations would be through the development of secondary markets for immature plantations. The existence of such markets would allow investors to enter or exit the market at any time without waiting for a final harvest to realise a return on investment. Such markets would also allow different investors to specialise in managing the risks associated with different parts of the plantation investment cycle.¹⁴

6.23 The AFG submission also stressed the importance of developing a secondary market in order to encourage further investment, particularly in longer rotation plantations. It was argued that the capacity to trade in immature standing plantations and to freely sell out of and buy into this particular type of asset would overcome the long-term illiquidity which has made this type of investment unattractive to many investors in the past. AFG noted that while inappropriate tax treatment is often put forward as a major barrier to this type of investment:

... this has never really been tested, and the problem may indeed be one of perception. While tax is certainly an issue, there are enough alternative plantation-trading scenarios to indicate a rather more complex policy challenge.

12 *Evidence*, Mr Alan Cummine, Treefarm Investment Managers Australia, RRA & T, 21 February 2003, p. 301.

13 *Submission 9*, Plantation Timber Association of Australia, p. 13.

14 *Submission 9*, Plantation Timber Association of Australia, p. 13.

Other factors could well be part of the solution – eg, transparent and reliable market information – and alternative approaches could circumvent the 'tax problem' – eg, developing alternative investment vehicles, such as unit trusts, and trading rights to the trees.

Whatever the solutions might be, the pursuit of them must be taken seriously. The former Ministerial Council on Forestry, Fisheries and Aquaculture requested a study on this subject early in 2001. Completion of this work needs to be given a high priority, to inform the formulation of appropriate and effective policies. The importance of secondary markets for immature plantations increases to the degree that harvest guarantee loses its appeal to prospective investors.¹⁵

6.24 NAFI also pointed out that other factors may be required to be part of any equation that would include taxation provisions for secondary markets:

By improving log market transparency and access to overall market information, broadening the range of investment vehicles on offer and promoting a better use of the existing taxation provisions, it should be possible to encourage the development of active markets for buying and selling immature plantations. If those markets do arise, the level of uncertainty and illiquidity associated with long-rotation plantation investments should be reduced.¹⁶

6.25 The Executive Director of TIMA also informed the Committee:

It is not just a simple matter of a private grower to a possible private buyer later down the track; there are large corporations and state government forests are being sold. There are also problems with managed investment plantations where tax ruling TR 2000/8 on investment schemes specifically prohibits the selling of an immature plantation if there is a trail or evidence that you intended to get out before final harvest. There is a range of different scenarios for moving plantations and for buying and selling and they all have different tax consequences. Phil [Mr Phil Townsend, Deputy Executive Director of NAFI] was looking at all that and he pointed out that it was not necessarily only the conventional problem that has been viewed as the main reason for their being no secondary markets; there are other ways to look at it.¹⁷

6.26 Further, he told the Committee that as there was no chance the Commonwealth Treasury would respond positively to any request for changes to the taxation arrangements in relation to tradability of plantations, industry participants need to look at alternative ways of developing secondary markets:

15 *Submission 58*, Australian Forest Growers, pp. 9-10.

16 *Submission 32*, National Association of Forest Industries, pp. 19-20.

17 *Evidence*, Mr Alan Cummine, Treefarm Investment Managers Australia, RRA & T, 21 February 2003, pp. 301-302.

... I can tell you the Treasury has no interest in taking that seriously. I had similar discussions with the Treasury tax policy officers in 1994 and I have had several in the intervening period, and there is no traction in that argument whatsoever. They will not even countenance the idea that they would change that arrangement.

So we do have to look for alternative ways of starting those secondary markets. That is why the ministerial council in 2000 basically gave a direction to the industry to examine what the real impediments are to getting secondary markets in Australia.¹⁸

6.27 The Executive Director's view was reinforced by ABARE's submission to the inquiry; the submission focusing on economic issues affecting longer rotation plantations and the supply of sawlogs. It suggested that the decision to plant short rotation plantations to supply pulp logs or to concentrate on longer rotation plantations for the supply of sawlogs will be based on the relative returns from the two types of investment.¹⁹

6.28 Further, it commented that concerns over this issue emerge partly from the current expansion of blue gum plantations for pulpwood production, and partly from community pressure to reduce logging in native forests. It also argued that it is difficult to identify impediments that disadvantage other types of plantation investment relative to short rotation eucalypt plantations. Investment decisions for long rotation plantations are made under the same institutional conditions:

Government intervention to alter investment patterns away from short rotation into long rotation plantations needs to be clearly directed to overcoming market failures rather than simply altering the economic viability of the two types of investment. A shorter planning horizon for pulpwood plantations reduced risks for investors by reducing discounting of future returns at harvest, and reducing the risk of supply agreements with buyers. Pulpwood marketing depends more on volume and less on quality than sawlog marketing, reducing the risk to potential buyers entering into supply agreements.²⁰

6.29 The Committee notes the government's reluctance and believes that it would apply to a scheme proposed by Mr Robert Newman. Mr Newman proposed specific changes to the taxation arrangements in order to encourage long rotation species plantations that included the creation of a secondary market. His suggestions included:

- allowing an investor to sell trees which [he] originally established to a second owner at a taxation profit at the end of ten years; and then

18 *Evidence*, Mr Alan Cummine, Treefarm Investment Managers Australia, RRA & T, 21 February 2003, p. 303.

19 *Submission 26*, Abareconomics.

20 *Submission 26*, Abareconomics, p. 5.

- allowing the buyer of the ten year old plantation a tax deduction as a primary producer (on the value for which he purchased the trees).

6.30 Mr Newman told the Committee that his suggested changes to the taxation arrangements would:

... establish some interest by natural forest owners in maintaining their forests by valuing their forests at the start and end of the period and taking a taxable profit, and even enabling another member of the family to buy the interest as a primary producer. This system could be repeated on the same forest asset several times. You could have a plantation of 50-year-old red cedar with five successive owners.

...

Additionally, it would allow the creation of a secondary market for all investors, whether they have interests in 10-year-old blue gum currently growing, in eucalypt forests or in rainforests that are 100 years old. The method of calculating the profit over the 10-year periods would need to be established and the plantation blocks registered so that the tax system would receive its share each time. That would mean that the Commonwealth would get money over a shorter period than is the case now when people invest in radiata pine for 25 years.²¹

Taxation Incentives - Others

6.31 Other taxation incentives suggested during the inquiry included the proposal by the Vice President of the Conservation Council of Western Australia for a sliding scale of tax incentives:

If you are going to grow your tree on for 30 or 50 years to produce a sawlog, your tax benefit should be greater than if you are doing it on a 15 or 10-year rotation for a chip log. I have not run that by an economist, but it should not be beyond the wit of economists to work out some way of giving better taxation incentives to people who are prepared to grow their crop for longer to produce sawlogs.²²

6.32 The General Manager of Operations of Forestry Tasmania, Mr Paul Smith, told the Committee that Forestry Tasmania was very keen to see a taxation regime that would encourage longer term investment in plantations and suggested that the Commonwealth had a role to play in attracting investment to Tasmania:

Currently investors are reluctant to commit to 20 to 25 years for eucalyptus solid wood plantations and those longer rotations are required for pruning and to get the value. As I said before we are growing longer rotation hardwood crops for sawlog and rotary veneer production and we have the object of encouraging new industry to utilise these plantation products. It

21 *Evidence*, Mr Robert Newman, RRA & T, 20 February 2004, p. 287.

22 *Evidence*, Dr Beth Schultz, Conservation Council of Western Australia, RRA & T, 11 October 2002, p. 96.

would be good to see a resource grown on private property that complements that from state forests. In the expansion of processing industries, I guess the Commonwealth could assist in attracting timber investment to the state and in doing so expand the processing industry by compiling information on the comparative advantages in infrastructure, land and labour costs and make that available to potential investors.²³

6.33 In terms of current taxation arrangements, NAFI argued that in addition to the current range of managed investment projects, it is possible to use existing tax legislation for developing other project structures, particularly those that come under the Capital Gains Tax (CGT) rules and the rights provisions of the *Income Tax Assessment Act 1997*:

With the current managed investment projects, investors are in the business of growing trees for timber production. Alternatively, the investors could purchase an immature plantation (shortly after it has been established) with the intent of selling the plantation at some time prior to the clearfelling operation. Under those circumstances, investors would be in the business of buying and selling an asset and therefore come under the CGT rules and possibly the CGT exemptions.²⁴

6.34 Further:

... there is nothing to prevent plantation owners from selling the rights to the standing timber under a profit a prendre arrangement. In that case, the right becomes a tradeable commodity that can be traded like a futures contract. There is also the possibility of generating superannuation-based investment products. In those cases, the investors may be seeking to hold onto the assets for a specified period of time or liquidate their assets to fund retirement prior to the clearfelling operations.²⁵

6.35 The Committee notes that the reduction in logging native forests will create a need for longer rotation plantations. Such plantations are subject to the same taxation incentives as short term plantations and yet represent a much greater period of investment. The Committee considers that such investment may provide some security to regional communities and therefore makes the following recommendation.

Recommendation 11

6.36 The Committee recommends that the government investigate the possibility of introducing a taxation incentive related to the period of time a plantation is grown, however urges the government to keep in mind the necessity for the industry to meet environmental goals without significant subsidies and tax benefits.

23 *Evidence*, Mr Paul Smith, Forestry Tasmania, RRA & T, 29 November 2002, p. 140.

24 *Submission 32*, National Association of Forest Industries, p. 20.

25 *Submission 32*, National Association of Forest Industries, p. 20.

Harvest Guarantee

6.37 The Saltgrow submission informed the Committee that with any plantation investment and, in particular, long rotation investments, the issue of harvest security remains a significant risk in the minds of investors. It was argued that this perception needs to be addressed, and that it will require a uniform approach between states, and a clearly articulated policy at the federal level, to remove the current state of doubt and confusion.²⁶

6.38 AFG also argued that the development of workable guarantees to right of harvest remains a central objective of the *2020 Vision*. Whilst they acknowledged that states have moved, or are moving to, enact appropriate legal provisions, they added that:

Harvest guarantee will be more effective if it embodies the 'quality assurance' approach, relying upon self assessment, independent audit and penalty for non-compliance. And it is vital that provision be made for appropriately compensating the plantation grower if, ultimately, that right of harvest is withdrawn.

Since no government can make decisions that bind a future government, the security required for investment in a 30-year plantation will always be based on faith and trust. Future governments must be trusted to abide by the spirit and intention of a harvest guarantee.²⁷

6.39 The PTAA and NAFI shared similar concerns regarding harvest guarantees.

6.40 The Committee agrees that the inability to provide harvest guarantee on plantations is a factor that can act to discourage long term investment in longer plantation rotation. While it does not propose that governments legislate in an attempt to bind successive governments, it would encourage State governments to investigate the possibility of establishing shared risk proposals with the plantation industry.

Research and Development

6.41 Finally, AFG argued that additional research and new technologies are required in the area of plantation sawlog production. Examples of the type of research which is currently producing promising results were projects in relation to:

- 'high intervention' pruning and thinning silviculture to produce fat sawlogs faster, including in low rainfall environments;
- sawing and drying trials to minimise faults and maximise recovery in fast-grown young eucalypt sawlogs; and

26 *Submission 21*, Saltgrow Pty Ltd.

27 *Submission 58*, Australian Forest Growers, p. 9.

- innovative uses of small logs.²⁸

6.42 It was argued that more positive results from this type of work to shorten rotation length will provide encouragement to small-scale growers taking up a farm forestry enterprise. It will also assist those plantations managers involved in managed investment schemes to attract more growers into sawlog projects, as well as increase the possibility for successful commercial farm forestry in the lower rainfall regions where the environmental requirement for revegetation is more extreme.²⁹

6.43 The PTAA also referred to the management of existing short rotation hardwood plantations, and argued that while decisions about the marketing and use of plantation timber should be made by the owners on a commercial basis, it is:

... probably inevitable that some of these plantations will be grown on to produce larger logs for solid timber production. This will require research to identify the appropriate silvicultural systems and wood processing and marketing strategies. Research funding will assist this process but the imperative created by rapidly increasing resource availability will be a significant driver. Such a process was also undertaken for Radiata Pine, which has been transformed from a virtually unrecognised timber to a major player in the manufacture of a range of different products.³⁰

6.44 The need for additional research was also raised by ABARE as follows:

The decision to alter the supply of sawlogs from plantations requires an analysis of the lowest cost option of sawlog supply. With burgeoning plantation supply in the Pacific Rim, the lowest cost source of sawlogs could include imports, particularly from New Zealand. In other industries, the long term market implications of changing international supply are assessed using trade models that are not currently available for Australian forest products. Investment in this research would help to target the most efficient strategy for forest industry development.³¹

Conclusion

6.45 It is clear to the Committee that the industry believes that there will be a shortfall in the availability of sawlogs for the local market if strategies to encourage investment in longer rotation commercial plantations are not developed. The identified strategies that could be put in place by government were primarily investment driven. Harvest guarantees and research and development were also proposed.

6.46 The Committee has made a recommendation in relation to taxation incentives and has suggested State government action in relation to harvest guarantees.

28 *Submission 58*, Australian Forest Growers, p. 10.

29 *Submission 58*, Australian Forest Growers, p. 10.

30 *Submission 9*, Plantation Timber Association of Australia, p. 13.

31 *Submission 26*, Abareconomics, p. 6.

6.47 However, the returns on a locally grown sawlog product were less well defined. The Committee is of the view that the most significant benefits of longer rotation plantations may be environmental benefits. These, as was discussed in the last chapter, require considerable further research to understand the links between resources and plantations.