

Chapter 2

Issues

2.1 The inquiry's terms of reference required the committee to consider the impact of the decision by the South Australian Government to forward-sell that state's \$2.8 billion timber assets on its economy, timber industry and on jobs, and any other broader impacts, with particular reference to:

- the likelihood of regional job losses;
- the flow-on effects to communities in timber-reliant regions;
- the potential for the private buyer not to consider local impacts;
- the potential for reduced value-adding locally and increased off-shoring; and
- any other related matters.

2.2 This chapter discusses the main issues raised in relation to each of the terms of reference.

The likelihood of regional job losses and flow-on effects to communities in timber-reliant regions

Introduction

2.3 Terms of reference (a) and (b) required the committee to consider the likelihood of regional job losses and flow-on effects to communities in timber-reliant regions.

2.4 The submission of the Construction, Forestry, Mining and Energy Union (CFMEU) summarised the general concerns of many submitters and witnesses:

...the forward sale could decimate regional communities throughout South Australia if there is an unrestrained ability of the purchasing organisation to sell saw logs and fiber overseas, potentially forcing local mill closures and causing massive job losses.¹

2.5 The committee heard from a number of local communities outlining similar concerns. The City of Mount Gambier (CMG) and Wattle Range Council (WRC) were 'extremely concerned about [the]...region's economic and social future should a sale proceed'.² The CMG and WRC submissions stated:

The forward sale of our heritage and our future poses a serious threat not only to the viability of South East timber mills and jobs right across our

1 *Submission 5*, p. 1.

2 *Submission 6*, p. 1; *Submission 11*, p. 1.

economy; it also undermines community confidence and any future industry development into our region.³

Regional job losses

2.6 The committee heard that there would be significant potential for sustained job losses if the proposed forward sale were to proceed. In terms of total numbers, the National Association of Forest Industries (NAFI) submitted that the South Australian forest and forest products industry produced \$2.6 billion in goods and services and employed 13 000 people in 2006-07.⁴

2.7 The CMG and WRC submissions provided the following snapshot of the extent to which employment in the south-east region was dependent on forestry and the associated forest products industry:

Forestry and the associated timber industry in the broader Mount Gambier region is estimated to directly contribute between 18-20 per cent of gross regional product (estimated at \$2.8 billion for 2009-10). At an activity level, forestry plantation supports approximately 600 direct jobs, with the actual value added processing of timber from those plantations by 21 milling and manufacturing facilities and numerous contractors adding approximately another 3000 jobs. The majority of wood product processing employment is associated with resources supplied from softwood plantations—including those earmarked for sale by the SA Government. In 2009-10, workers in this industry earned around \$240 million, representing approximately 18 per cent of income paid in the South East of South Australia region.⁵

2.8 In terms of the employment multiplier effect of the forestry and forest products industries, there was significant scope for broader impacts on employment and economic activity through the proposed forward sale:

There is also a ripple effect driven by the purchase of goods and services from local industries and commercial providers to support timber industry activities in South East region. These activities support another 3,500 jobs generating approximately 20 per cent of total employment in the South East region, 2009/10. We also need to consider a decline in professional services, tradespeople and educational providers; we will not have the population to support them, therefore the pool of spending will decrease, leading to business closures and the migration of skilled residents from our region.⁶

3 *Submission 6*, p. 1; *Submission 11*, p. 1.

4 *Submission 9*, p. 2.

5 *Submission 6*, p. 2; *Submission 11*, pp 1-2.

6 City of Mount Gambier, *Submission 6*, pp 2-3.

2.9 CMG observed that the proposed forward sale also carried the possibility of job losses at ForestrySA:

In addition to the jobs lost within mills, [ForestrySA's] current 190+ employees are also in limbo. The management role of [ForestrySA] would possibly change to that of potentially providing contracted services to the new purchaser, and the likely outcome of that is that [ForestrySA] jobs will also be lost.⁷

2.10 A number of submitters and witnesses suggested that there would be a strong likelihood of job losses if the proposed forward sale were to proceed. CMG and WRC noted that the South Australian Government had 'admitted that it is impossible to place conditions on a sale to protect jobs and industry, and pointed to Victoria as an example of poor outcomes for local communities':⁸

In Victoria, where similar actions were taken in the softwood industry, we have seen many small sawmills close and an increase in the export of whole logs to China, India and other developing countries with devastating affects in regional areas.⁹

2.11 As a specific example of the potential for job losses, Gunns noted that, if the proposed forward sale were to proceed without sufficient conditions protecting the viability of the local industry, the company would be likely to relocate to a region that could better support 'the investment of a modern high technology sawmill'.¹⁰ Gunns observed that its withdrawal would 'have a devastating impact [on]...local communities'. This would result in:

...significant job losses in the value add solid timber processing business in the Green Triangle, which in turn will have a devastating impact [on]...the social fabric of the Green Triangle region.¹¹

2.12 The Australian Manufacturing Workers Union (AMWU) observed that the potential unemployment effects from the proposed forward sale could exacerbate and entrench more recent job losses:

This sale is being proposed against a back drop where the region has already recently been hit by the closure of two of the oldest tissue machines at Kimberley Clark Australia's Millicent mill leading to a loss of approximately 170 permanent jobs. On top of this the Tantanoola Pulp Mill has also been placed on the market and will close towards the end of the year if a buyer cannot be found enabling the Mill to continue its operations which will lead to a further 65 job losses.

7 *Submission 6, p. 2.*

8 *Submission 6, p. 2; Submission 11, p. 2.*

9 *Submission 6, p. 2; Submission 11, p. 2.*

10 *Submission 2, p. 4.*

11 *Submission 2, p. 4.*

The forward sale adds to potentially further restrict...our members' ability to find alternative jobs if the successful buyer fails to utilise the current value adding manufacturing processes that are in place today.¹²

Flow-on effects

Impacts on forestry and forest products industries

2.13 The committee heard concerns that, should the proposed forward sale go ahead, there would be significant flow-on effects to the local forestry and forest products industries as well as more broadly.

2.14 NAFI submitted that, in contrast to current arrangements, the proposed forward sale did not include any guarantee of local supply:

The proposal does not provide any assurances to local industry of long term plantation timber supply for local processing and/or export. Part of ForestrySA's charter is to encourage the growth of the local forest industry to meet international standards. As such, it deals with local mills and provides for variable harvest rights up to 10 years. Without such guaranteed security of supply there is a greater risk to invest, which will inhibit the ability of local saw mills to invest in new technology and adapt to change.¹³

2.15 The CMG submission described significant uncertainty surrounding future supply contracts for local processors since the announcement of the proposed forward sale. It noted that, if future supply were not ensured, South Australian sawmills would not be competitive in the future:

...the longest supply agreements currently in place with local processors will expire within 10-15 years. With the proposed sale ranging between 30 and 114 years, this creates a large amount of uncertainty...Geographically, the industry is at a disadvantage in Australia as the main markets for the processed timber are on the eastern seaboard and it has only been competitive due to the high quality of the resource grown in SA. If prices for local mills to purchase log are increased and the size of the logs decrease due to shortened rotations, SA sawmills will not be able to compete with other regions in Australia or foreign imports.¹⁴

2.16 Mr Ian McDonnell, a local sawmill owner, shared these concerns over future supply:

From a business point of view it would be almost impossible to make the investment necessary to remain competitive in today's market unless longer term resource security can be guaranteed.

12 *Submission 17*, p. 1.

13 *Submission 9*, p. 3.

14 *Submission 6*, p. 2.

Sawmilling is a very capital intensive business and a medium sized business like ours needs to invest large amounts of capital every 5-10 years to remain viable, to do this we need the security of resource to be able to do this.

A reasonable supply agreement needs to be in the order of 15 years minimum. This is something private owners have not wanted to commit to in other areas and we have seen sales agreements for as short as 12 months in New Zealand and 4-5 years here in Australia.¹⁵

2.17 Mr McDonnell observed that privately owned plantations tended to prefer short supply agreements in order to 'maximise returns for that forest owner without any regard for the regional economies where the timber is grown'.¹⁶

Broader impacts

2.18 A number of submitters and witnesses expressed concerns about impacts of the proposed forward sale beyond the forestry and forest products industries. In general terms, Gunns noted that:

...the decision by the State Government to forward sell its rotations lacks any comprehensive review of the decision both from the local timber industry, social and environmental impact in the Green Triangle region.¹⁷

2.19 Similarly, the Hardware Association of South Australia (HASA) and the Timber and Building Materials Association (TABMA) submitted that:

The viability and profitability of many South Australian businesses is under threat as a result of the planned decision of the South Australian State Government to sell off forward rotations of timber products harvested from the softwood plantations managed by ForestrySA. This will have an enormous impact on the economy of South Australian, the South Australian Hardware industry and the South Eastern regions or the 'Green Triangle'.¹⁸

2.20 The HASA and TABMA submissions detailed significant potential threats to employment in the hardware and building industries and the local housing market if the forward sale were to go ahead:

The timber that originates from the South East not only provides local jobs it also provides thousands of jobs in the Hardware and Building Industries in South Australia. The timber our members sell would very likely be for the houses we build across the state. The immediate threat that is foreseen would be:

- a shortage of product;

15 *Submission 14*, p. 1.

16 *Submission 14*, p. 1.

17 *Submission 2*, p. 4.

18 *Submission 4*, p. 1; *Submission 8*, p. 1.

- poor quality timber being available to the industry and the consumer;
- loss of self sufficiency in the supply of timber; and
- increased costs.

All these would result in increased costs that will flow through to the everyday consumer, crippling the affordability of housing even further in a market that is already considered to be flat.¹⁹

2.21 CMG and WRC identified a number of negative social effects that would be likely to flow from substantial job losses in the region:

It is well documented that unemployment substantially impacts on mental and physical health, general well-being and family relationships. If the forestry sale goes ahead, greater demand will be placed on these services due to family breakdown and potential increases in domestic violence, mental health issues, young people leaving due to a lack of job opportunities, an ageing population base further isolated because young families move to where the jobs and facilities are, increased reliance on community or charitable services, and a decreased skill and education base.²⁰

Current impacts of the proposed forward sale

2.22 A number of submitters and witnesses observed that the uncertainty surrounding the proposed forward sale had already impacted on the confidence of local communities. This had created an uncertain investment environment, which was 'depressing housing prices and undermining investments by all businesses operating in the local community'.²¹ The CMG and WRC submissions observed:

Increasing uncertainty within the community caused by the proposed forward sale of the ForestrySA logs is already having an adverse impact on the South East business community particularly in the lending, retail and service sectors. The negative flow-on effects are also being demonstrated in the real estate sector in terms of regional house prices and saleability and a decline in the uptake of commercial tenancies.²²

2.23 The District Council of Grant (DCG) submission supported this view, stating that 'there is no doubt that since the announcement of the proposed sale there has been a realised impact on real estate prices, industry expansion and employment generation'.²³ The DCG submission went on to say:

19 *Submission 4*, p. 2; *Submission 8*, p. 2.

20 *Submission 6*, p. 3; *Submission 11*, p. 3.

21 Gunns Timber Products, *Submission 2*, p. 4.

22 *Submission 6*, p. 3; *Submission 11*, p. 2.

23 *Submission 10*, p. 3.

Further, it is considered that lack of confidence is causing contracts for building work to be postponed and other businesses are putting plans on hold to expand. Several of the local engineering companies have encouraged workers to take long service leave and paid annual leave to reduce their cash flow.²⁴

The potential for the private buyer not to consider local impacts

Commercial imperatives overriding local community and economic interests

2.24 CMG and WRC expressed concern that a purchaser in relation to the proposed forward sale would be primarily motivated by commercial interests, as opposed to local interests, and would 'find their commercial interests better served by exporting logs to non-regional markets'. The submissions explained:

Unlike the current...[Forestry] SA Charter, a new owner would not be constrained by regional development outcomes or bound by expectations to 'encourage and facilitate regionally based economic activity based on forestry and other industries'.²⁵

2.25 HASA and TABMA also stressed that the current ownership of South Australia's timber plantations by ForestrySA on behalf of the State Government effectively meant that the timber plantations were publically owned and operated for the benefit of South Australians.²⁶ HASA and TABMA were also concerned that an interstate or foreign buyer would effectively disregard the interests of the South Australian community in seeking to maximise return from the timber assets:

If the demand for timber were to increase in interstate or overseas the new owner would not have the same loyalty to the South Australian market as ForestrySA.

There would be a strong likelihood that timber normally destined for the South Australian market will be sold interstate or overseas leaving the market in South Australia short of timber.²⁷

2.26 On this issue, Mr McDonnell commented that a purchaser would be likely to pursue commercial imperatives at the expense of social or local economic interests:

The ForestrySA plantations are regarded as some of the best quality plantations in Australia and New Zealand for producing structural quality timber...This can be [affected]...very quickly by reducing the rotation age and or changing the [silvicultural] practices that have been such an important part of making the forests what they are today.

24 *Submission 19*, p. 4.

25 *Submission 6*, p. 2; *Submission 11*, p. 2.

26 *Submission 4*, p. 3; *Submission 8*, p. 3.

27 *Submission 4*, p. 3; *Submission 8*, p. 3.

A private company in control of this could and probably would be tempted to do this to get a quicker turnaround of rotations and selling the log to export markets.²⁸

2.27 Mayor Peter Gandolfi, representing WRC, supported these comments:

New owners are going to look for the highest bidder. I do not think they will be that interested in whether they and our local mills are supplying the domestic market with structural timber and so on. They would be looking for the biggest buck, and their demand in the future is going to come from China and India. I imagine that they will be bidding the highest for the raw product.²⁹

2.28 The DCG submitted that similar privatisations of forestry assets in Australia suggested that private purchasers would not consider the requirements of local sawmills:

Information obtained indicates that the purchaser of the Victorian Forest Assets has not considered local impacts. Indeed, it is understood that local mills in and around Mount Gambier have largely been unable to obtain log resource since this purchase occurred.³⁰

2.29 Mr Robert Eastment, who appeared in a private capacity, offered a number of insights into the economic factors and market dynamics influencing the likely commercial imperatives of a prospective buyer.

2.30 Mr Eastment noted that economies of scale and regulatory factors affecting price are critical drivers of trade in the forestry industry, and observed that timber processing community in the Green Triangle was comprised of relatively small scale operators which enjoyed access to 'cheap wood' sourced from ForestrySA. If the forward harvesting rights were sold, the purchaser would not necessarily be willing to sell locally at a price that 'would suit the sawmillers' and be competitive with what could be earned by 'putting it on a ship and sending it [to large timber processing facilities overseas]'.³¹

2.31 To illustrate such market dynamics, Mr Eastment noted that Australia currently imports '\$1 million worth of sawn [soft] wood each day', which was increasingly coming from a European producer, Stora Enso. Mr Eastment observed:

The reason that Stora Enso is able to send it here so cheaply is that the primary product its sawmills are producing in Europe is woodchips, because Europeans have a subsidy for bioenergy and they have commitments to meet certain renewable energy targets, so the logs are going into the Stora Enso sawmills, and a by-product of the sawmills is

28 *Submission 14*, p. 1.

29 *Committee Hansard*, 30 March 2011, p. 13.

30 *Submission 10*, p. 5.

31 *Committee Hansard*, p. 52.

sawn wood. Therefore, as long as the Europeans are subsidising their energy, Australia will be flooded with cheap wood. That is the reason why the guys here cannot sell it. It is because we have got this influx of cheap wood coming in. That is the straightforward dynamics of it. Yes, we have continued demand for softwood here. The only way we can stop the imports coming in is by reducing our processing costs—taking costs out of our production to be able to meet the import costs, to get import parity.³²

2.32 In terms of competing with large overseas processors to ensure that timber resources were processed in the region, Mr Eastment observed that there would need to be a significant restructuring of the local industry:

There is no doubt that, if we were to keep the timber here and process it, we would have to be looking at a million-tonne-a-year mill. Otherwise, imports are gradually going to take it away. You cannot have your cake and eat it. If you are going to keep your wood here, you have got to be able to process it sufficiently efficiently to compete. To do that, you are going to have to reduce your labour costs. But the labour that you keep will have to be of a much higher calibre. There will be far more professionals involved—technical people. A lot of it will be computer driven, made to order. Mills will be running in darkness because all the people will be sitting at consoles operating it—that type of stuff.³³

2.33 However, Mr Eastment observed that, while there would be 'some damage to the local industry' on account of such market dynamics, it would be in a purchaser's interests to ensure that the local timber processing industry was sufficiently preserved. He explained:

I assume that...[the purchaser]...would be...an international investor, and today they would be wanting to put it on a boat, because the demand in China is high. But you really would not want to lose your fallback position or plan B, which could well be selling it into the local market. So you would certainly want to keep enough of the local industry alive to ensure that, if your export markets collapsed or the dollar moved significantly against you...[that] you could have that domestic pool...[to] sell it into. So you would want to hedge your bets both ways. There could well be some collateral damage in the local domestic processing, because you may not have enough to keep everybody alive.³⁴

2.34 In addition to such economic factors, Mr Eastment also identified certain market dynamics as being likely to have a large influence on the selling strategies of a purchaser of South Australia's timber assets. He explained that whole log export market is a spot market which is subject to price fluctuations arising from ad hoc demand factors (such as the recent earthquake in Japan driving up demand) and foreign exchange rates. Mr Eastment commented:

32 *Committee Hansard*, 30 March 2011, p. 52.

33 *Committee Hansard*, 30 March 2011, p. 53.

34 *Committee Hansard*, 30 March 2011.

At the minute export markets...[are] pretty high because there are a number of drivers out there and it is reasonably competitive...There are other times when that market can really collapse. It is not the timber business or the owners who have much control over the pricing fluctuation on those markets; it is the foreign exchange. If our dollar stays high, technically the logs going offshore should be at a lower price but they are not because demand is strong. If our dollar fell back to 60c, why would you want to sell anything to a local sawmill? Put the log on a boat and get rid of it. You make more money. We are an open economy. If the dollar goes up to a \$1.50 and people simply cannot afford to do that then they will be more inclined to put it on a ship.³⁵

Discontinuation of beneficial non-commercial activities

2.35 In addition to the concerns over a purchaser's consideration of local impacts, , CMG and WRC described a number of non-commercial activities, currently fulfilled by ForestrySA, that a purchaser in the proposed forward sale would not be bound to consider in the absence of specific conditions:

Under the current ownership and operating framework, FSA, in addition to fulfilling commercial and sustainable regional development requirements, is also responsible for resourcing regional forest protection programs (eg fire and forest health), environmental sustainability (example conservation of 25,000 ha of native forest) and community, recreational and sponsorship activities. With an unconstrained sale of FSA's softwood estate, the direct resourcing of these non-commercial activities, estimated to currently cost approximately \$6.5m/yr, would have to come from elsewhere.³⁶

2.36 With particular reference to fire fighting capabilities, Mayor Gandolfi commented:

[The SA] Treasurer...[has] said that the new owners of the plantations would be responsible for the management of the forests, and added that the volunteer Country Fire Service [CFS] would take responsibility for fire prevention and fighting. This raises very serious questions about the region's future firefighting capabilities. Currently, our CFS volunteers work hand-in-hand with ForestrySA and have a cooperative relationship in fire prevention and suppression. To shift the responsibility of firefighting entirely onto our CFS volunteers would be irresponsible and put lives and property at risk.³⁷

2.37 Mayor Richard Sage, representing DCG, also commented on the potential loss of ForestrySA's current contribution to fire prevention:

ForestrySA's extensive fire prevention measures—fire breaks, roadside slashing, automatic dispatch of fire attack suppression forces—ensures a

35 *Committee Hansard*, 30 March 2011, p. 56.

36 *Submission 6*, p. 3; *Submission 11*, p. 3.

37 *Committee Hansard*, 30 March 2011, p. 2.

minimum of two ForestrySA appliances are on the scene within 15 minutes on any fire index day of 35-plus. We have seven ForestrySA Fire King appliances, valued at over \$1 million each, in the region. We are also concerned about the existing contract of aircraft for water bombing surveillance during the fire season. Who is going to pay for that in the future?³⁸

2.38 The CMG, DCG and WRC submissions also noted the cultural and heritage contributions, community engagement activities and environmental achievements of ForestrySA; as well as the extent of its fire prevention and fighting activities. The submissions observed that it was unlikely that these programs would continue and be funded under the proposed forward sale. This was particularly so in light of the South Australian Government's admission that it would not place conditions on the proposed forward sale to protect jobs and industry.³⁹

The potential for reduced value-adding locally and increased off-shoring

2.39 HASA highlighted a number of findings from a community impact statement indicating the potential for substantially reduced access of local value-adding industry to timber from the South Australian Government plantations in the event of a forward sale proceeding. The statement noted that:

- there is the potential by 2020-21 for around 40 per cent of logs from ForestrySA's softwood estate to be exported [thereby] reducing wood based manufacturing jobs in the south-east area; and
- by 2027-28 the purchaser would have the option to sell 100 per cent of logs outside the South East Region.⁴⁰

2.40 Mr Michael Bleby, who provided a submission in a private capacity, considered that the proposed forward sale 'could be very detrimental' to the region if it did not ensure the continued support of the integrated supply arrangements that existed in the region for the mix of value adding industries.⁴¹ Mr Bleby's submission explained:

The [south-east region] has companies that specialise in milling high quality sawlogs and others who have equipment and access to markets suited to lower quality logs. There are particle board plants, wood chip export outlets, and markets for by-products such as wood shavings, boiler fuel, and even bark for compost and landscape supplies. Of special importance (particularly for the Millicent region) is the existing KCA pulp mill. This, along with the roundwood preservation markets, is absolutely

38 *Committee Hansard*, 30 March 2011, p. 4.

39 *Submission 6*, pp 3-4; *Submission 10*, pp 6-9; *Submission 11*, p. 3.

40 *Submission 4*, p. 2; see also Mayor Richard Sage, District Council of Grant, *Committee Hansard*, p. 30 March 2011, p. 3.

41 *Submission 3*, Attachment 1, p. 1.

critical to the economics of thinning and the creation of the higher value forest products, later in rotations. One would hope that any forward sale provides for local pulpwood supplies into the future – but who knows?⁴²

2.41 NAFI also commented on the importance of considering the sale in the context of the vertical integration of the South Australian softwood industry.⁴³ The NAFI submission commented:

Consideration does not appear to have been given to the regional significance of the forest industry and its vertical integration. The Government's proposal appears to treat the forest resource as separate from the downstream processing and export businesses, which are reliant upon a reliable supply of timber product.⁴⁴

2.42 Mr Bleby noted that a prospective buyer would presumably want to retain control over who it might sell its wood to. Any conditions to require a buyer to sell to local industries could reduce the sale price and bring into question the value for money represented by the forward sale.⁴⁵

2.43 As a specific example, HASA and TABMA raised particular concerns that the forward sale would impact on the availability of pine bark used for the production of potting mixes and as landscape materials. The HASA and TABMA submissions explained:

The majority of potting mixes within South Australia use pine bark as the base ingredient. Much work has been done by industry over many years to prepare high quality potting mixes based on pine bark. Manufacturers have invested in the technology to produce potting mixes that suit the local environmental conditions.

If harvested logs are sent off overseas untreated...[that, is, with] the bark not removed, this will dramatically reduce the availability of pine bark for use in the production of potting mixes and as landscape materials.⁴⁶

Any other related matters

Adequacy of the justification for the proposed forward sale

Criticisms

2.44 A number of submitters and witnesses provided comment on the perceived adequacy of the stated motivation or justification for the proposed forward sale. The

42 *Submission 3*, Attachment 1, p. 1.

43 *Submission 9*, p. 2.

44 *Submission 9*, p. 3.

45 *Submission 3*, Attachment 1, p. 2.

46 *Submission 4*, p. 4; *Submission 8*, p. 3.

South Australian Treasurer, provided the following information concerning the reasons underpinning the proposed forward sale:

In the wake of the unfolding Global Financial Crisis, the South Australia Government announced in the 2008-09 Mid-Year Budget Review, several measures aimed at realising some of the value of the State's assets, with the intention of reducing net debt. Reducing the State's net debt will improve the long term sustainability of our finances, contribute to the retention of our triple A credit rating and reduce interest borrowings, thereby helping our operating balance. One of these measures was looking at options to sell the harvesting rights of ForestrySA...⁴⁷

2.45 Mr Jerry Leech, who provided evidence to the committee in a private capacity, expressed concern about the stated rationale for the proposed forward sale:

You have heard about the AAA credit rating, but if...[the South Australian Government] have got the forests in their books at, say, \$1.3 billion including the land then they are in essence mortgaging the forests at \$1.3 billion. So if you sell it for \$500 million or \$600 million, where are you going to [find] the other \$700 million of assets to support the credit rating, even if you do use that \$600 million to pay off the state debt? No-one has effectively explained that to me, and that concerns me.⁴⁸

2.46 The Treasurer noted that the South Australian Government would consider a range of relevant factors in deciding whether the proposed forward sale would go ahead:

I note that the South Australian Government is the owner of FSA and needs to consider, in the context of a tight fiscal position, whether a forward sale of FSA timber rotations will deliver better value to the State than proceeding with FSA operating on a business as usual basis. Other State Governments have taken similar decisions, albeit with different models for realising value, for example Victoria in 1998 and Queensland in 2010. Such a decision will not be taken without considering a range of relevant issues, consultation with affected parties and analysis of the regional impacts (including the factors listed at (a) to (d) in [the inquiry's terms of reference]).⁴⁹

2.47 Gunns submitted that the apparent justification for the proposed forward sale:

...indicates that the forward sale is not part of an overriding broader strategic plan by the South Australian Government where all factors of a decision of this magnitude are very carefully considered but rather a 'knee jerk' reaction to a debt position that needs rectification [for the state] to retain its AAA rating.⁵⁰

47 The Hon Jack Snelling, *Submission 7*, p. 1.

48 *Committee Hansard*, 30 March 2011, p. 42.

49 *Submission 7*, p. 1.

50 *Submission 2*, p. 2.

2.48 NAFI expressed similar reservations:

It would appear the proposed sale is not part of a genuine reform agenda and is simply a revenue raising measure, with scant regard for regional consequences and industry efficiencies and long term outcomes.⁵¹

2.49 A common view was that a balancing of future annual returns against a likely forward sale price did not indicate sufficient economic justification for the sale to proceed. HASA and TABMA, for example, criticised the decision as 'short sighted...with no long-term benefit to the state's economy'.⁵² HASA and TABMA noted that a sale price would be set against the direct income and multiplier effect which the industry currently generated. The current value of timber assets to South Australia included, for example:

- a return to the South Australian Government of \$45 million in 2009-10 (a 93 per cent increase on 2008-09) and a return of 11.5 per cent on funds invested (up 23 per cent on 2008-09);
- \$2.6 billion of goods and services produced by the forest and forest products industry in 2006-07; and
- 13 000 people directly and indirectly employed in timber and wood processing activities.⁵³

2.50 The AMWU commented:

The AMWU believes that it is not sound to sell an asset that is providing nearly \$1 million per week into the state government treasury to provide an income stream in the short term whilst risking the long term viability of employment opportunities in the south east region.⁵⁴

2.51 This view was supported by CMG and WRC, which submitted:

...the combination of consistent revenue streams from ForestrySA to the South Australian Government and a commitment to regional processing and jobs provides a clear basis of support for the continuation of current management arrangements with ForestrySA.⁵⁵

2.52 CMG and WRC provided the following analysis:

The State Government has publicly admitted that the forward sale of forestry plantations has been designed to cover lost revenue caused by the global financial crisis. Currently, the SA Government receives dividends and taxation payments from the assets managed by FSA. For 2009/2010

51 *Submission 9*, p. 3.

52 *Submission 4*, pp 1-2; *Submission 8*, pp 1-2.

53 *Submission 4*, pp 1-2; *Submission 8*, pp 1-2.

54 *Submission 17*, p. 2.

55 *Submission 6*, p. 2; *Submission 11*, p. 1.

approximately \$44m was paid by [ForestrySA] in dividends and taxes. Based on an income stream of \$41m plus pa and allowing for a more aggressive marketing approach with less social obligation, the new owners could recoup their investment money in as little as a decade, which is certainly not a good outcome for all South Australians.⁵⁶

Alternative approaches

2.53 A number of submitters and witnesses felt that the South Australian Government should consider improving the income and growth potential of the forestry and forest products industry instead of contemplating a forward sale. Mr Des Taylor, who provided a submission in a private capacity, commented:

The real way to get back South Australia's AAA Credit Rating is not to sell off what we have but to advance and expand forestry because of the demand from overseas for our timber supplies. In this way local timber communities will not be destroyed and the government coffers will be added to substantially.⁵⁷

2.54 Similarly, Mr McDonnell stated:

I believe our state government needs to look at growing its plantation estate and attracting more business and investment to our state instead of the short term cash grab they appear to be focused on.⁵⁸

2.55 Mr Leech submitted:

Given the return on equity I have great difficulty understanding why a state Government would want to sell their forestry asset that is earning 11.5% and reduce state debt when with a AAA credit rating they would be paying far, far less than 11.5% servicing their borrowings.⁵⁹

2.56 Mr Leech suggested that, given the return on equity for ForestrySA was 11.5 per cent in 2009-10, and that the forest industry was at least 'in part counter cyclical to normal investment trends', superannuation funds could invest funds in ForestrySA and provide improved growth prospects.⁶⁰

2.57 Gunns submitted that the South Australian Government should consider alternative options to the proposed forward sale. The Gunns submission stated:

The State Government [should] consider alternative sale options such as the sale of smaller parcels of standing timber to local processors as an alternative to the current mill door price sale process managed by

56 *Submission 6*, p. 5; *Submission 11*, p. 4.

57 *Submission 12*, p. 1.

58 *Submission 14*, p. 1.

59 *Submission 16*, p. 3.

60 *Submission 16*, p. 2.

ForestrySA. This will maximise efficiencies for both local processors and ForestrySA, provide long term resource security to local processors and have the added benefit of avoiding the creation of [a] monopoly private forest owner in the region.⁶¹

Adequacy of public consultation and information

2.58 The committee received a substantial amount of evidence commenting on the adequacy of public consultation and information in relation to the proposed forward sale. Gunns, for example, commented:

The decision to forward sell forestry rotations appeared to be made by the South Australian Department of Treasury and Finance with little or no consultation with any stakeholders.⁶²

2.59 Gunns noted that the lack of public consultation appeared, in the light of comments made by the South Australian Minister for Forests, to be matched by a lack of consultation within the South Australian Government, and that there appeared to be little value placed on consulting with the local community'.⁶³ The Minister was reported to have said:

...this process has been run by the Bank of Scotland and by Treasury and Finance. We didn't consult widely. My views weren't sought. I don't think [the views of the Chief Executive Officer of ForestrySA were sought]...in any depth.⁶⁴

2.60 The CFMEU commented:

The South Australian Government has taken a piecemeal, precarious approach by not comprehensively and transparently sharing their knowledge of the trade offs (costs and benefits) of the proposal with regional communities.⁶⁵

2.61 NAFI commented that, while it supported the efforts of governments to 'open up publicly held assets and businesses to competition and market efficiencies', it was important that appropriate consultation was undertaken:

...it is important that when government embarks on such a program that it is part of a transparent reform agenda, that it is cognisant of the need for appropriate and genuine consultation with the affected industries and communities that are reliant on them, and that it produces a thorough impact statement of the proposed reform.⁶⁶

61 *Submission 2*, p. 4.

62 *Submission 2*, p. 2.

63 *Submission 2*, p. 3.

64 *Submission 2*, p. 3.

65 *Submission 5*, p. 1.

66 *Submission 9*, p. 2.

Regional Impact Statement

2.62 The committee heard that, while no detailed cost-benefit analysis of the proposed forward sale was provided at the time it was announced, the South Australian Government has since commissioned a Regional Impact Statement (RIS). The South Australian Treasurer advised:

As part of the decision to investigate the sale of the forward harvest, the [South Australian] State Government has commissioned an independent external economics consulting firm, ACIL Tasman, to develop a Regional Impact Statement (RIS), to identify the potential social and economic impacts on the South-East from selling the forward harvest.

ACIL Tasman has begun a comprehensive consultation process with interested parties including local councils, timber industry representatives, unions and chambers of commerce and it is expected that ACIL Tasman will deliver its report by the end of this month [March 2011]. The report will include:

- issues and views expressed through the consultation;
- costs and benefits to the region and community, particularly looking at employment;
- the impact of the proposal on social inclusion and economic development; and
- strategies for managing identified risks and impacts, including those on downstream industries and mills in the area.⁶⁷

2.63 The committee heard that there are many considerations in relation to the broader potential impacts of the proposed forward sale. NAFI commented:

The State's plantation forests provide multiple benefits, including natural resource management outcomes (e.g. salinity and erosion control) and highly significant socioeconomic, regional development and employment opportunities.⁶⁸

2.64 NAFI identified a number of social, economic and environmental factors that should be included in a detailed cost-benefit analysis of a proposal to privatise public assets. These included:

- employment generation, training opportunities, labour force diversification;
- social stability and community cohesion;
- service quality and choice;
- cost reduction and other productivity effects;
- pricing policies and cross subsidisation;

67 The Hon Jack Snelling, *Submission 7*, pp 1-2.

68 *Submission 9*, p. 1.

- competition implications;
- environmental spin-offs;
- new investment and disinvestment;
- innovation; and
- flow-on effects to local businesses.⁶⁹

2.65 The committee heard that, based on interactions with ACIL Tasman to date, there were concerns that the scope of the RIS would be too restricted in terms of the timeframes studied as well as consideration of the broader economic implications of the proposed forward sale.⁷⁰

Issues relating to potential conditions attaching to proposed forward sale

2.66 A number of submitters and witnesses observed that there were significant areas of risk relating to the sale that could result in the seller or a prospective buyer insisting on attaching particular conditions to the sale/purchase.

2.67 NAFI, for example, identified uncertainty around water policy as an apparent risk that would be likely to have a 'detrimental effect on the viability of the proposed sale for private investors' and which might therefore affect the sale price of the timber assets.⁷¹ The NAFI submission warned that:

...without a transparent and comprehensive policy framework for future investment in the industry (e.g. dealing with current water policy and sovereign risk issues), there is the potential for perverse policy outcomes in terms of long term innovation, downstream processing and related employment and community benefits.⁷²

2.68 More generally, Mr Leech considered that risk was a critical issue in the context of the proposed forward sale:

To me the critical issue is risk; how is risk to be identified and measured, who is to carry the risk, and how is it to be accounted for in the states accounts.

The reply by [the South Australian Treasurer]...to the three Green Triangle Mayors did not address this issue at all. It would seem almost as though The Treasurer does not understand the term risk, nor understand how important risk is in forest management, nor how it should be accounted for. Risk includes the effect of fire on the future ability to maintain wood supply, the possible effects of insect or pathogenic attacks (such as the

69 *Submission 9*, p. 3.

70 Mayor Steven Perryman, City of Mount Gambier, *Committee Hansard*, 30 March 2011, pp 5, 8 and 9.

71 *Submission 9*, p. 4.

72 *Submission 9*, p. 4.

Sirex noctilio epidemic), and errors in predicting forward yields. There are many other uncertainties given the long time frame involved in forest management planning.⁷³

Lack of information regarding potential conditions of sale

2.69 A number of submitters and witnesses commented on the lack of information regarding conditions, if any, which may be attached to the proposed forward sale.

2.70 The CMG and WRC submissions noted that, although the South Australian Government had stated that the plantation estate would remain under the management of ForestrySA, it had also 'admitted that it is impossible to place conditions on a sale to protect jobs and industry'.⁷⁴

2.71 Gunns made a number of recommendations regarding conditions that should be imposed on any forward sale, generally aimed at preserving the quality and viability of South Australia's timber plantations, as well as ensuring that a purchaser is required to contribute to the maintenance and growth of the local forestry industry. Such recommendations included requiring a purchaser to:

- maintain the current clear-fell age or rotation of plantations;
- maintain the existing size of the radiata pine plantation;
- continue to invest in growing the radiata pine plantation estate;
- contribute to the growth of the local forestry industry; and
- enter into long-term supply agreements with stakeholders in the local forestry industry.⁷⁵

2.72 Gunns submitted that without such conditions as outlined above, it would not have the confidence 'to invest in its processing facilities in the Green Triangle region'.⁷⁶

Effect of conditions on sale price

2.73 A number of submitters and witnesses also pointed out that the imposition of sale conditions could affect the forward sale price, bringing into question whether the sale would represent value for money over the long term. Mr Bleby, for example, submitted:

Getting a good price for harvesting rights depends very much on where the associated risks might lie. If the Government wants to carry lots of the risk itself, or not spell out lots of conditions in any contract with a buyer, then

73 *Submission 16*, p. 1.

74 *Submission 6*, p. 2; *Submission 11*, p. 2.

75 *Submission 2*, pp 3-4.

76 *Submission 2*, p. 4.

they might get a better price for the sale. If on the other hand, it wants the buyer to take on some of the risk, then the buyer will offer a reduced price accordingly.⁷⁷

2.74 Mayor Perryman observed:

If conditions like that are applied, it will reduce the value of the asset and the sale price. If the South Australian government wants the best price it can get from the sale of the asset, it would be looking to sell it with minimal conditions. That is something that gives us concerns.⁷⁸

2.75 A number of submitters and witnesses provided evidence which suggested that a lack of appropriate conditions regarding the maintenance of plantations could negatively impact on the quality of the asset on its return to public ownership. The CFMEU noted that there were potential risks associated with private sector management of plantations:

A major risk to maintenance of softwood processing jobs in Australia is the low rate of replanting of harvested softwood plantations and their expansion. The private sector does not have a good track record of establishing and/or expanding softwood plantations.⁷⁹

2.76 Similarly, Mr Eastment observed:

...if the commercial company that is buying [the resource]...have to produce an eight per cent return instead of a four per cent return...they will therefore cut costs and some of the costs will be the work that is required to produce better timber resources for future rotations. You can argue that that has possibly happened in Victoria, Queensland and in my home state of Tasmania.⁸⁰

2.77 Mr Eastment advised that a potential solution to this problem would be to separate the right to take the timber from the role of developing the timber resources. However, such an arrangement would necessarily involve a lower sale price for the right to harvest the timber:

The problem of separating the taking of the wood from the future management of the forests is that people do not want to pay as much for the wood, because if they have to pay the government money to manage the forest it lessens the return for them.⁸¹

77 *Submission 3*, Attachment 1, p. 2.

78 *Committee Hansard*, 30 March 2011, p. 12.

79 *Submission 5*, p. 1.

80 *Committee Hansard*, 30 March 2011, p. 51.

81 *Committee Hansard*, 30 March 2011, p. 51.

2.78 Mr Eastment noted in the context of such sales that he had 'not seen a resource that has been sold that has improved in quality'.⁸²

2.79 CMG and WRC also commented on the potential for a private owner to fail to adequately maintain and enhance the plantations subject to the proposed forward sale:

...the private sector does not have a positive record of re-establishing and/or expanding long-rotation softwood plantations, yet it is only by increasing softwood resources available for processing that investment and jobs will be maintained in a price competitive and trade exposed industry such as wood processing. Wood processing industries require threshold levels (volumes) of wood input to be financially viable. It is probable that [production strategies of a purchaser]...will not only reduce the number of processing industries but also change and rationalise the mixture of small and medium size processing facilities.⁸³

82 *Committee Hansard*, 30 March 2011, p. 51.

83 *Submission 6*, p. 5; *Submission 11*, p. 4.

