



ACF Submission to the Commonwealth Government Review of the application of taxation law to plantation forestry in the context of the Government's broader plantation and natural resource management policies.

July 2005

Balancing Commercial Objectives with a Sustainable Environment

1. Introduction

A principle issue restricting the advancement and future prosperity of a viable wood products industry in Australia and affording greater environmental protection is to deal with competitive neutrality issues between State forest agencies and private sector forest growers.

Removing subsidies applied to State native forestry will lead to greater economic viability for private sector forestry and those subsidies could be redirected to deliver the environmental services which are desperately needed through commercial reforestation in critical areas.

2. Background

Long standing subsidies have traditionally been applied to the State's native forestry operations. Their pricing policies have not been market based, considerate of full cost attribution or any expectation of profitability. They were in a sense traditionally seen as a community service obligation.

Over the past 50 years considerable Commonwealth and State investment was made in publicly owned plantation forestry, particularly in softwood production, where a clear need existed to provide a faster and more efficient product for the growing demands of Australia's building construction and paper industries. However in recent years extensive private plantation forestry investment has been made by the acquisition of public plantation estates and direct investment in the development of new plantations.

2.1 Forestry and National Competition Policy

A Report produced by economists Marsden Jacob Associates in 2001, *Forestry & National Competition Policy*¹, found that;

In all States of Australia, timber from State-owned established native forests competes with timber from plantations – but not on a level playing field. In all States, the playing field is tilted against plantations and farm forestry in favour of exploitation of native forests.

The study showed that the lack of competitive neutrality between State forestry arrangements in established forests and those of private forestry activities:

- *makes private investment in farm forestry and plantations much less attractive;*
- *distorts the allocation of wood sources within the forestry sector;*
- *undercuts competing uses of public native forests; and*
- *worsens the Australian environment and resource base.*

While some states scored better than others on individual components of National Competition Policy requirements, it is telling that all states failed the test of cost recovery.

¹ [Forestry & NCP. Marsden Jacob Assoc 2001](#)

The Victorian Auditor General, the Federal Industry Commission and Resource Assessment Commission had also previously drawn attention to the issues of inappropriate subsidies and underpricing in the native forestry sector.

2.2 National Forest Policy Statement

A National Forest Policy Statement (NFPS)² was ratified through COAG in 1995 at the time COAG also endorsed National Competition Policy (NCP). It is important to recognize the synergy of these policies. The often stated intention is that the wood products industry should be market based, less reliant upon subsidies, and create a vibrant and viable wood product industry through a competitive, contestable, market driven approach.

2.3 Plantations 2020 Vision

To address the timber plantation aims of the NFPS the Federal and State governments embarked upon the 2020 Vision for Plantations in Australia³ and set a target to treble the Australian plantation estate by the year 2020. To achieve this end in a traditionally non market driven supply chain dominated by State subsidized low price timber taxation incentive mechanisms for private forestry were necessary to meet the strategic objectives of the policy.

However this initial 'subsidy' to avail capital, designed in effect to somewhat address the price distortions of another, has done little to change if not contribute to the serious market distortion apparent in Australia's wood products industry.

A dominant focus on low value commodity production has developed that would have been economically unachievable without State native forest timber subsidies now in concert with Commonwealth taxation based concessions.

The lack of a more competitive market and cost based approach within the timber economy has also allowed this 'distortion' to contribute significantly to Australia's worsening trade performance in the sector. Currently Australia's wood production trade export tonnage exceeds imports at a rate of near 3 to 1 but leaving a near \$2 billion annual deficit in the balance of payments.

This submission aims to bring greater attention to this underlying problem which degrades the national economy, the natural resource base, and the Australian environment.

3. Current National Policy

3.1 National Forest Policy Statement

The National Forest Policy Statement ratified overarching policy direction for native and plantation forestry in Australia. The Statement set down some important basic principles.

Two of the eleven Broad National Goals were;

***Plantations** - One goal is to expand Australia's commercial plantations of softwoods and hardwoods so as to provide an additional, economically viable, reliable and high-quality wood resource for industry. Other goals are to increase plantings to rehabilitate cleared agricultural land, to improve water quality, and to meet other environmental, economic or aesthetic objectives.*

***Wood production and industry development** - The goal is for Australia to develop internationally competitive and ecologically sustainable wood production and wood products industries. Efficient industries based on maximising value-adding opportunities and efficient use of wood resources will*

² [National Forest Policy Statement](#)

³ [Plantations 2020 Vision](#)

provide the basis for expansion in wood products manufacturing, which in turn will provide national and regional economic benefits.

The NFPS recognised the CN issues surrounding State native forestry pricing including the need to develop market contestability and “a fair return on capital”.

Wood pricing and allocation

The pricing and allocation system for wood from public native forests has a major bearing on the structure and efficiency of the wood products industry and on the return to the community from use of a publicly owned resource.”

- Prices will be market based, at least cover the full cost of efficient management (including regeneration) attributable to wood production, include a fair return on capital, and provide an adequate return to the community from the use of a public resource.”

- The allocation system will be flexible and will involve competitive bidding arrangements for appropriate amounts of the resource, thus enabling the entry of new processors and allowing small operators to compete for niche markets.

3.2 Plantations 2020 Vision

Plantations for Australia - The 2020 Vision was developed in 1996 from directions contained within the National Forest Policy Statement of 1992 as:

“A strategic partnership between the Australian, State and Territory Governments and the plantation timber growing and processing industry.”

The **Vision, Target and Strategy** of the policy state;

The Vision - *The sustainable expansion of the plantation forest estate will be achieved with significant private sector investment. By 2020, the expanded plantation forest estate will provide Australia’s plantation-based processing industries with the capacity to:*

- *operate in the global marketplace;*
- *be internationally competitive; and*
- *be commercially oriented—market driven and market focused in all their operations.*

Returning trees to the landscape as a profitable crop can also significantly benefit rural and regional communities and the environment.

The Target - *The Vision has a notional target of trebling the effective area of Australia’s plantations between 1997 and 2020. This does not necessarily mean each region must treble its plantation area. Different regions will make different contributions to achieving the target, in line with the availability of suitable land and prevailing market opportunities.*

It is noted that plantation area is only one measure of the success of the Plantations 2020 Vision. The quality, product mix, location and effective management of the plantation resource will also be vital to the delivery of maximum social, economic and environmental benefits to Australia.

The Strategy - The Vision partners will collaborate in facilitating an environment that will attract the private investment necessary to develop a significant plantation resource, which will:

- *enhance the growth in Australia's forest industries;*
- *enhance the contribution made by plantations to the Australian economy, rural communities and regional development; and*
- *enhance the contribution made by plantations to solving natural resource management problems, including climate change and salinity.*

4. The Need for Policy adherence - Getting the balance right

The Plantations 2020 **Strategy** sets out the 3 nationally agreed fundamental objectives to be achieved through a balanced approach to the development of plantation forestry in Australia.

It is now abundantly clear that a much greater balance of these key factors needs to be established if the Policy is to meet the national interest for which it was intended.

4.1 Industry growth

Is statistically being achieved in terms of capitalization and increased land area however this is understandable given the previously stated incentives for large volumes of low value commodities such as woodchips and whole log exports.

4.2 Economic contribution

On a national and regional basis is highly questionable given the failure to produce a coherently strategy to reverse the national balance of payments deficit in wood products and in turn focus realistically on regional economic development.

This should be addressed by incentives to meet and alleviate imported products and with a focus from the outset on a broader species range producing high value timber products and a diversity of domestic regional down stream processing opportunities.

4.3 Solving natural resource management problems and environmental services

This is the key area where the policy focus has been most neglected. New forestry plantations have used their capitalization to primarily focus monocultures on high productivity sites to maximize rates of growth. Other than carbon sequestration environmental benefits are generally low and cost externalities such as water consumption can be high.

Moreover in Tasmania plantation development under the 2020 Vision has provided greater provision for the clearing or 'conversion' of native forests and other rare vegetation types to plantations completely eradicating ecosystems over broad areas. There is also considerable public concern over the introduction of initial and sustained broad scale chemical use.

A concerted focus for incentives toward commercially driven reforestation where the environmental benefits are maximized is required to achieve a balanced policy outcome.

5. Economic research into solving the NRM problem

A number of recent reports explore new options to leverage private sector investment aimed at delivering both economic and environmental outcomes.

5.1 “The Contribution of Mid to Low Rainfall Forestry and Agroforestry to Greenhouse and Natural Resource Management Outcomes” (AGO 2001)

In 2001 the Australian Greenhouse Office published the above Report⁴ which addresses in detail the environmental benefits and opportunities which would flow from broadening the application of plantations and agroforestry into Australia’s low rainfall and arid zones.

These strategic actions are essential in creating more sustainable land tenures including factors such as salinity mitigation, soil retention, biodiversity protection and re establishment, river and stream protection and carbon sequestration.

A key point in the Report’s Executive Summary states;

Revegetation at the required scale is unlikely to occur with either public or private investment alone. Most options currently available to farmers and communities are not commercially viable—the costs exceed the direct benefits. Many forestry industries are likely to become commercially viable in mid to low rainfall areas only if some value is attributed to the natural resource management (NRM) and greenhouse benefits they deliver by providing ecosystem services, and if mechanisms are set up to transfer this value to tree growers. Consequently, we need to identify tree crops and production systems that can provide the best opportunities for combined commercial and natural resource management benefits. To secure the commercial potential of tree crops planted to address land and water degradation, target products and markets must be selected so that appropriate species can be chosen and planted. Wherever possible, market signals should be used to guide investment in tree crops. (Exec Sum. Clause 3)

5.2 “Repairing the Country - Leveraging Private Investment” (Allen Cons. 2001)

In 2001 a partnership between leading corporations, environmentalists and scientists identified strategies to mobilise nearly \$13 billion dollars over ten years from the private sector to invest in addressing salinity and other environmental problems in rural Australia.

This Business Leaders Roundtable comprised of leaders from Southcorp, Elders Limited, Berri Limited, ABN AMRO and Macquarie Bank as well as the Australian Conservation Foundation and CSIRO. The group commissioned a Report⁵ by Allen Consulting in response to these findings.

5.3 “Environmental and Commercial Outcomes through Agroforestry” (JVAP 2002)

In 2002 a further investigative study of the opportunities for agroforestry to deliver environmental benefits were advanced in this Report⁶ commissioned by the Joint Venture Agroforestry Program and supported by the Rural Industries’ Research and Development Corporation, Land and Water Australia, the Forest and Wood Products R & D Corporation and the Murray Darling Basin Commission.

Specific incentives warranting further development include: government purchasing of environmental services; extension of existing kinds of tax concessions for investors in innovative agroforestry ventures (similar to Pooled Development Funds); and Environmental Management Systems linked to catchment plans. (Key findings-point 9)

⁴ [The Contribution of Mid to Low Rainfall Forestry and Agrofor. to Greenhouse and Natural Resource Management Outcomes](#)

⁵ [Repairing the Country - Leveraging Private Investment](#)

⁶ [Environmental and Commercial Outcomes through Agroforestry](#)

6. Review of Taxation Treatment of Plantation Forestry

Responses to the Terms of Reference

a. the commercial viability and current tax treatment of plantation investment;

To meet the objectives of stated federal policies there needs to be a greater focus on;

- The production of high end value timber products
- The capacity for downstream domestic processing within a broader market.
- A greater direction toward landscape repair and environmental benefits.

Commercial viability should be assessed on the basis of having achieved a competitive market with government processes fully pursued to ensure that Competitive Neutrality is achieved in all sectors and that price distortions between public native forest timber and plantations resources are eliminated.

Taxation benefits should be levied at the capacity of plantations and agro-forestry to deliver environmental as well as commercial benefits on a national basis in the greater public interest offsetting an inevitable need for greater direct public capital funding for environmental repair programs that will ultimately be required.

The three published Reports at Part 4 of this submission provide a range of options for this outcome to be achieved.

b. whether the operation of the Income Tax Assessment Acts impedes investment in longer term forest rotations which produce higher value products;

The current Taxation Ruling apparently restricts timber plantation woodlots into relatively short time frames (8 – 12 years) and with therefore limited application. The capacity to open up trading of these plantation investments to create a mechanism for long term growth cycles would create a basis for greater product diversity and high value product outcomes.

To this end ACF supports the recommendations of the Forest and wood products Research and Development Corporation's study "Investment to Investment in Long Rotation Timber Plantations".

c. the role of State and Territory Governments in plantation industry development as investors, growers and land managers, and any implication this has for competitive neutrality with regard to tax liabilities and incentives;

Corporatized State Agencies operating in plantations have the capacity to achieve CN by appropriate ring fencing of costs including capital returns, land rents, rates etc. They will have set expected rates of return and the obligation of the payment of tax equivalents.

The biggest issue for State agencies forestry operations and CN is the lack of a cost basis of native forestry operations and especially pricing. No attribution is made for the capital value of State forest land, no rents or rates to local governments. The lack of ring fencing of costs negates any basis of financial performance or rates of return or tax equivalents. The pricing policy of these operations is generally based on the archaic system of "residual pricing". (See *Marsden Jacob Assoc. Forestry & NCP. Part.3.3*)

d. the capacity to adapt existing tax policies to contribute to achieving the Australian and State Governments' desire to achieve a greater integration of plantation and natural resource management policies to improve the management of salinity and water quality; and

As discussed there is a fundamental need to profile the environmental benefits of the broad spectrum of plantation and agro-forestry products and "award" these benefits with appropriate credits for the consideration of support through the taxation system.

No taxation product or incentive should apply to a timber plantation that has been established as the direct result of broad-scale native vegetation land clearing.

These benefits to the environment are in the National Interest and are an insurance against what would become a greater cost to the Australian taxpayer later for much higher levels of remedial action or environmental repair.

e. the relative roles and effectiveness of tax system and expenditure programmes in the delivery of assistance to the industry.

The main focus should be seen as a broadening of the capacity to leverage private investment. More detailed discussions can be found in the Report identified in Part 5 of this submission.