AUSTRALIAN CONSERVATION FOUNDATION

FORESTRY AND NATIONAL COMPETITION POLICY

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Marsden Jacob Associates

Consulting Economists

Level 3, 683 Burke Road, Camberwell, Victoria 3124
Tel: (03) 9882 1600 Fax: (03) 9882 1300
Email : economists@marsdenjacob.com.au

FOREWORD

by Don Henry, Executive Director, ACF

For more than two centuries, Australia's native forests have been cleared and logged by a growing nation keen to house and feed its burgeoning population, and to develop domestic and export markets.

Today, however, native forest logging has attracted increasing criticism due to its destructive impact on our native plants and animals and other forest values such as water supplies, recreation and tourism.

Logging native forests is also under scrutiny because, increasingly, timber products can be sourced far more efficiently from plantations.

Despite the negative impacts of native forestry practices and the availability of alternative timber sources, State Government departments in NSW, Victoria, Tasmania and WA, continue to pour multi-million dollar subsidies into their own departments to ensure the continued logging of native forests for woodchipping, firewood and sawn-timber markets.

Traditionally, State Governments have considered these subsidies to be justified because of the creation of wealth and jobs. And in the past, strong arguments have been made to support such subsidies.

But with the advent of the National Competition Policy in 1995, State Governments are now required to remove these unfair advantages which their forestry departments have enjoyed over the private plantation sector in competing for timber and fibre markets.

This Report clearly identifies that state forestry departments are continuing to under-cut private plantations by subsidising the logging of native forests with taxpayers' money. The Report states 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 Report further states that the absence of a level playing field;

- *Makes private investment in farm forestry and plantations much less attractive;*
- *Distorts the allocation of wood sources within the forest sector;*
- *Encourages greater exploitation of the public native forests in each State;*
- *Undercuts competing uses of public native forests; and*
- *Worsens the Australian environment and resource base.*

Given the above, there can be no doubt that the continued injection of taxpayers' money into an increasingly marginal and environmentally damaging industry has led to a much faster rate of logging than would be possible if forest departments were forced to operate at a profit.

Similarly, and at a time when plantations and farm forestry are recognised as being a key weapon in the battle against salinity, the supply of cheap, subsidised timber from native forests is under-cutting the prices for plantation timbers, and hence serves as a disincentive to invest.

These disincentives to plantations investment persist at a time when analysts forecast that plantations and farm forestry have the potential to increase wood production four fold with a market value of $20 billion and increased regional employment of 40,000 people.

Meanwhile, other values and services that forests provide, such as biodiversity habitat, water quantity and quality, and employment in tourism and recreation industries, have been assigned a lower priority in State Government plans for our forests.

In short, these non-timber values have been under-valued relative to timber, especially as most of the timber sourced from our native forests is being chipped for export and sent to Asia for paper production.

Which raises the question. *How much is timber from our native forests really worth?* And specifically, what is the basis for setting prices for timber sourced from native forests?

National Competition Policy requires that forestry departments:

- recover all of their costs,
- provide a return (i.e. profit) to government,
- be subjected to the same taxes and charges that other businesses face,
- should not abuse monopoly powers
- should not regulate themselves, (ie. they should be independently regulated), and
- should not be given any unfair advantage over the private sector.

The Report clearly identifies that forestry departments in the four major logging States fail to satisfy all of the above criteria, and notes that the public interest arguments are overwhelmingly in favour of a reduction in logging pressure in native forests, and an increase in plantations investment.

The Australian Conservation Foundation is pleased to present this Report as the first and most comprehensive national assessment of the performance of forestry departments against the reform commitments of National Competition Policy.

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

Which begs the question: In a time of unprecedented competition for scarce public funds between many competing public policy objectives, *precisely how big are the taxpayer-funded subsidies that are directed towards propping-up clearfelling in public native forests?* We hope that Governments will now provide answers to this question.

We urge State Governments, and competition watchdogs nationally, to act immediately to eliminate forestry subsidies, and to reform forest planning and regulatory arrangements.

At a time when the rest of the Australian economy is coming to grips with expectations of a level playing field in a global market, Australia's state-owned forestry departments are living in a time warp. While water, telecommunications, electricity and gas must stand on their own two feet, forest departments remain insulated and protected from competition.

Australians' values and priorities are changing. As illustrated in the recent battles for WA's, Tasmania's and Victoria's forests, opposition to old growth logging is a major concern throughout the entire spectrum of Australian society. Australia's remaining natural places are

valued more highly, and for a wider range of reasons, than ever before. And community expectations of transparent and accountable government mean it is no longer acceptable to unfairly favour one sector or industry ahead of others.

I commend this Report as a welcome, indeed overdue, contribution to the debate on the future of our native forest estate.

Don Henry
Executive Director
Australian Conservation Foundation

ACKNOWLEDGMENTS

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ACF also acknowledges the efforts of John Marsden and his associates in undertaking this pioneering analysis.

DISCLAIMER

The views expressed in this Report do not necessarily reflect the views and policies of ACF.

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Glossary

CALM	(Department of) Conservation and Land Management (Western Australia)
CAR	comprehensive, adequate and representative
CC	Conservation Council (Western Australia)
CPA	Competition Principles Agreement
CRA	Comprehensive Regional Assessment
DIER	Department of Infrastructure, Energy and Resources (Tasmania)
DITM	Department of Information Technology & Management (New South Wales)
DLWC	Department of Land and Water Conservation (New South Wales)
DPI	Department of Primary Industries (Queensland)
DSRD	Department of State and Regional Development (New South Wales)
DUAP	Department of Urban Affairs and Planning (New South Wales)
EPA	Environmental Protection Authority (New South Wales)
FISAP	Forest Industries Structural Adjustment Package
FPB	Forest Practices Board (Tasmania)
FPC	Forest Products Commission (Western Australia)
FS	Forest Service (Victoria) – within NRE
FSAC	Forest Structural Adjustment Committee (New South Wales)
FV	Forestry Victoria
GARP	Government Appeals and Review Panel (New South Wales)
GBE	government business enterprise
GST	Goods and Services Tax
IFOA	Integrated Forest Operations Approvals (New South Wales)
IPART	Independent Pricing and Regulatory Tribunal (New South Wales)
LVPS	(Hardwood) Log Value Pricing System – log pricing used in New South Wales
NCC	National Competition Council
NCP	National Competition Policy
NFPS	National Forest Policy Statement
NGO	non-government organisation
NPWS	(Department of) National Parks and Wildlife Service (New South Wales)

NRE	(Department of) Natural Resources and Environment (Victoria)
OPF	Office of Private Forestry (New South Wales)
PFT	Private Forests Tasmania
PTE	public trading enterprise
RACAC	Resource and Conservation Assessment Council (New South Wales)
RES	Royalty Equalisation Scheme – log pricing used in Victoria
RFA	Regional Forest Agreement
SFA	State forestry agency
TER	Tax Equivalent Regime

EXECUTIVE SUMMARY

1. The Australian Conservation Foundation engaged Marsden Jacob Associates "*to assess State forestry agency performance in native hardwood forestry in relation to employment, investment trends and the National Competition Principles Agreement*". The Australian Conservation Foundation requested that this assessment focus on Western Australia, Tasmania, Victoria and New South Wales.

2. The prime focus of this report is on the matter of the compliance of each of the four States with the Competition Principles Agreement in regard to forestry.

   This report finds major deficiencies in the arrangements for Australian forest industries when assessed against the Competition Principles Agreement – an Agreement to which all States and Territories are voluntary signatories. These concerns are independent of any environmental concerns/objections other than those stated in the legislation. However, the deficiencies in current arrangements and lack of compliance with the Competition Principles Agreement can be shown to have adverse impacts on conservation objectives for Australia's native forests.

3. Forestry – like every other area of Australian economic activity – is covered by one or more of the generic clauses of the Competition Principles Agreement. Suggestions that the Competition Principles Agreement might not apply to forestry are simply incorrect. All States and Territories signed to the Competition Principles Agreement, the Conduct Code and the Agreement to Implement Related Reforms.

4. In essence, the key clauses of the Competition Principles Agreement are:
   - Competitive Neutrality (clause 3) which seeks to eliminate resource allocation distortions arising out of the public ownership of entities engaged in significant business activities;
   - Prices Oversight (clause 2) which imposes independent pricing regulation on significant government enterprises that are at least near monopolies;
   - Structural Reform of Monopolies (clause 4) which contains generic requirements of competition reform, reflecting well-established and broadly applied principles, for markets previously supplied by government monopolies;
   - Legislation Review (clause 5) which requires that legislation that restricts competition must be removed unless (i) benefits outweigh the costs and (ii) there is no competitive means of achieving the same results; and
   - Access to Infrastructure (clause 6) which establishes a regime for third party access to significant infrastructure facilities.

5. However, clause 6 (Access to Infrastructure) is unlikely to apply to forestry.

Competitive Neutrality

6. Clause 3 requires "*the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. These principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities.*"

7. 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.

8. Moreover, there are wider impacts in favouring logging of native forests over establishment of plantations. For instance, large-scale revegetation of the rural landscape is required if dryland salinity is to be mitigated effectively. Revegetation through market mechanisms to promote farm forestry is given prominence in the MDBC's Basin Salinity Management Strategy, the Victorian Salinity Management Framework, the NSW Salinity Strategy and the Salinity Expert Group's *Report to the NSW Government on Market-based Instruments*. However, the extent of revegetation is unlikely to be material unless farm forestry or other forms of revegetation can be made profitable.

9. The lack of competitive neutrality between State forestry activities in established forests and private forestry activities:
   - makes private investment in farm forestry and plantations much less attractive;
   - distorts the allocation of wood sources within the forest sector;
   - encourages greater exploitation of the public native forests in each State;
   - undercuts competing uses of public native forests; and
   - worsens the Australian environment and resource base.

10. In terms of the specific minimum requirements, at the current time, New South Wales, South Australia, Western Australia and Tasmania have each established their State forestry agencies as separate legal entities. For such separate legal entities, clause 3(4) sets minimum requirements as well as corporatisation. The agencies in these three States have met two of the three specific requirements i.e., tax equivalent regimes and debt guarantees. The third specific requirement for regulatory neutrality has been most obviously observed in Tasmania.

11. Overall, in terms of the specific minimum requirements for competitive neutrality, three of the four States examined, New South Wales, Western Australia and Tasmania, comply wholly or partially with the minimum requirements specified in Clause 3(4).

    One area of weakness for these jurisdictions, however, may be the issue of regulatory neutrality.

12. Forests Victoria (a ring-fenced service unit within the department) is not recognised as a significant business activity through formal classification as a Public Trading Enterprise (and therefore not subject to clause 3(4)); has not been corporatised; has no independent board; [and meets none of the three minimum requirements].

13. Because in all other States the forest agencies are formally classified as significant business enterprises or have been corporatised, Clause 3(5) applies only to Victoria. Clause 3(5) applies to significant business activities not undertaken by government trading enterprises.

14. By retaining Forestry Victoria within the Department of Natural Resources and the Environment, Victoria has avoided Clause 3(4) but has not applied Clause 3(5). While State and Territory governments have substantial discretion to exercise judgement in the application of clauses 3(4) and 3(5), the previous Victorian Government chose to make judgements which are fundamentally at variance with those made in all other States and (it would appear) made by independent reviewers.

15. We conclude that there is a *prima facie* case that with respect to forestry activities, Victoria does not comply with the minimum requirements for competitive neutrality.

16. Clause 3 is not limited to these three minimum requirements. More generally, a government business may avoid other costs, as well as those three specified.

17. The native hardwood activities of the State forest agencies cover literally thousands of hectares of high rainfall countryside. This land and associated forests have substantial opportunity costs in terms of alternative uses. Yet, the State forest agencies are able to treat these huge areas of land as if they were free.

    In contrast, plantations regardless of whether publicly or privately owned, must generally buy or lease land, generally from farmers and graziers. As a result, plantations must face full cost while native hardwoods do not.

18. With the exception of South Australia, failure to pay local government rates in a second universal failing to observe the objective of competitive neutrality.

The Victoria Government should ensure that Forestry Victoria faces the minimum requirements under clause 3(4) or their equivalent under 3(5).

All States should review the competitive advantage obtained by State-owned native forests from exemption to pay for land and local rates.

This review could be on a state-by-state basis or jointly using the National Competition Council under section 10 or another appropriate body, such as the Productivity Commission.

In its assessment for the Third Tranche, the National Competition Council should pay specific attention to Victoria and its application of clauses 3(4) and 3(5). The Council should also provide guidance on the generic issues of land costs for Crown land and local government rates.

Pricing and Competitive Neutrality

19. To the extent that agencies are monopoly suppliers of native forest timber, they would appear to fall within the ambit of Prices Oversight (clause 2). However, this clause typically relates to curbing overpricing by State-owned monopolies. To the extent that the State-owned monopoly supplies logs to sawmills, for pulping or for export woodchips, they compete with other sources of timber and woodchips and would therefore be subject to Competitive Neutrality (clause 3).

20. The pricing of hardwood timber from public native forests is therefore a major issue for competitive neutrality. In a broader sense, competitive neutrality should be concerned not only with the competitive advantages which accrue via lowered costs to government business activities simply as a result of their ownership. It should be concerned with the advantages which accrue because government ownership means that costs are not adequately reflected in prices.

21. In any market, prices will determine the volume of the product sold. In the forestry market, the prices determine how much of the resource is exploited.

22. Log prices/stumpage rates from native forests are not set directly by the market but are administered by State forest agencies through their forestry Acts and related regulations. Only the Western Australian legislation details the components that must be taken into account in setting a contract price. In the other States, the provisions in the forestry acts relating to pricing are brief and broadly expressed, giving the State forest agencies wide discretion in the methodologies used and levels at which prices are set.

23. There is little doubt that the lack of specificity in the legislation has contributed to a lack of transparency, independence and consequently, public confidence in pricing, particularly in NSW and Victoria.

24. The pricing principles set out in the 1992 National Forest Policy Statement do not provide adequate guidance because the key phrase used "market based" is capable of widely differing interpretations and continues to receive wide support.

25. Consistent with rational and efficient pricing, the pricing objectives of governments and the State forestry agencies should be limited to:
    - ensuring revenue to maintain and regenerate Australia's forest stocks;
    - providing a full return to the community from use of a public resource;
    - allowing more efficient loggers and millers to secure more of the resource by bidding more, i.e., allow competition;
    - ensuring that there are no subsidies favouring exploitation of native forests over the establishment and harvesting of plantations; and
    - ensuring equity in pricing in the sense that equally situated businesses are treated equally, i.e., to ensure horizontal equity. (This does not, however, mean subsidising unprofitable businesses to ensure that they receive the same profits as other businesses).

26. Overall, these principles should provide that:
    - prices should be subsidy-free and recognise the full cost of production including the price of alternative uses.
    - the full cost of production should include a rate of return. The rate of return on capital in the forest sector should also be equivalent to the risk-return rate of 'equivalent' businesses - this is very important for considering the investments in new trees represented by seeding and establishment costs. Plantations must earn commercially effective rates of return on their 'investments' - the forest agencies must do the same - it is not costless to re-seed a logged forest coupe and bring it into production;
    - auctions and open competitive tenders should be applied to all licences for saw logs and pulp;
    - logging licences should be contestable by all natural persons; and
    - the full cost of production of timber for State forests agencies should be defined and measured to remove any advantages or disadvantages stemming from the public ownership of the business, i.e., in accord with the principles of competitive neutrality.
27. Current pricing practices include the exclusive or combinatorial use of three methods:
    - the cost of growing/production which provides a return to the community sufficient to pay for the cost of establishing and managing that forest in the first place (a similar method, the cost of replacement has a similar approach but gifts the forest to the forest industry);
    - the residual value pricing which subtracts 'reasonable' costs from the prevailing market price and may include differing transport costs to different forest areas. This method effectively estimates a derived demand curve for sawmills and chippers;
    - auctions and tenders which sets prices based on what the market will bear. This method derives directly from the millers demand schedule.

    Each method, in isolation, focusses on either the implicit/explicit demand or supply curve for native forest timber. To obtain a more efficient price, the price used should reflect both aspects.
28. In particular, the use of residual value pricing alone adversely affects:
    - the commercial performance of the suppliers of the forest, the State forest agencies, since it decreases their profits;
    - alternative suppliers of hardwoods and suppliers of substitutes for hardwoods whose operating costs are considerably higher than those of the native forest dependent industry; and
    - the value of the forest for other uses (e.g., conservation, water production and tourism) since the approach distorts the value of the forest for these purposes.

Reliance on the residual value pricing method alone thereby increases the rate at which native forests are logged, especially in remote areas. It encourages State forest agencies to exploit native forests rather than to develop plantations or farm forestry. This would not happen under a fully commercial arrangement since the prices for timber that would be charged by a commercial enterprise would more closely reflect the costs of supply so that more remote forest resources would not be subject to utilisation.

29. To improve competitive neutrality, log pricing needs to be both cost and demand reflective. The need to ensure that log prices cover costs is especially evident in New South Wales and Victoria where pricing continues to be based on the residual value approach with its attendant cross-subsidies and disregard of underlying costs.

30. *Prime facie*, New South Wales and Victoria violate competitive neutrality due to their current pricing approaches.

31. To achieve cost reflectivity, these costs must be properly measured. These costs must then feed into a model which allows commercial negotiations and/or auctions. In the case of a government-owned enterprise, this requires a formal set of rules and supervisory functions that allows the entity to maintain its commercial advantages in negotiation/auctions, but ensures the output covers all costs (including any externalities).

32. One option for achieving compliance with this competitive neutrality issue would be to expose log pricing to the transparent process of independent prices oversight. This option is consistent with the role of the State forest agencies as monopoly suppliers of hardwood logs as inputs into subsequent and progressively more competitive markets. This option would therefore meet the commitments of each State and Territory under clause 2 to independent prices oversight of all significant government business enterprises which are monopoly or near monopoly suppliers.

33. More broadly, auctions with reserve prices established through independent prices oversight and independent monitoring of code compliance and certification are methods of:

    - combating the pressures of increasing conservation demands, a dwindling resource base for logging and exploitation, increasing constraints on management discretion plus the desire the sustain jobs in rural areas and electorates; and
    - ensuring that the community receives a return on the use of its forests and that there is certainty that this use is sustainable.

34. The pricing of forest produce to reflect the actual costs of providing the resource should provide a market mechanism that would 'protect' high cost and/or low value output from extraction. Measures, such as residual value log pricing circumvent this mechanism. As a result, maximum sustainable yields, rather than being a backstop, are now the only stop. The maximum becomes the default value.

New South Wales and Tasmania should undertake a review of price regulation for forestry agencies as required under clause 4.

Victoria and New South Wales should examine the current pricing methods and reconcile these with the general objective under clause 3 that resource allocation should not be distorted because of government ownership.

In examining Competitive Neutrality issues arising from pricing the National Competition Council should review all existing pricing methodologies, particularly where there is a lack of reserve prices and the use of residual value pricing methodology, and examine alternative means to promote efficient prices.

Structural Reform

35. Clause 4 outlines a series of requirements for governments introducing competition into a market previously serviced by a public monopoly.

36. In each of the four States reviewed here (New South Wales, Victoria, Western Australia and Tasmania), the forestry sector was traditionally controlled and supplied by a public monopoly. In each State, governments have introduced and/or increased competition for some functions in the forestry sector. The degree of competition introduced varies across the States. This has not been the result of a single decision or event. Rather it has been progressive and is continuing. Changes in market forces have also contributed to this increased competition.

37. A key principle, perhaps the key principle arising from of Clause 4 of the Competition Principles Agreement in relation to the forestry industry is separation of responsibilities for undertaking these different functions. The concern with respect to application of this principle is not so much whether there is some separation of functions within State-based forestry operations but how adequate is the level of separation. We consider two benchmarks: a strong model of separation and a minimal model, which define three cases (strong, minimal and inadequate separation).

38. A **strong model of separation** of the regulatory and commercial functions of the forestry industry would be one where:
    - responsibilities for the regulatory and commercial functions are fully separated at both the ministerial and agency levels;
    - the service provider agency is corporatised, with an independent board;
    - the powers of the regulator are well defined; and
    - monitoring and reporting processes are independent and transparent.

39. Separation of responsibilities for the regulatory and commercial functions at the agency level but not the ministerial level could be regarded as an **minimal model of separation**, provided the service provider is corporatised. Separation of responsibilities at neither the agency level nor at the ministerial level is likely to be **inadequate** for the purposes of complying with Clause 4 of the CPA.

40. Separation of policy, operational and regulatory functions in Victoria is clearly not adequate. Not only are all of the functions under the same minister but they are all undertaken in the same department. There is no independent board for operations and no independent, transparent processes for standards setting, monitoring and enforcement.

41. There is a greater level of separation of functions within Tasmania and NSW but it is likely to be only minimally compliant. In their favour, the agencies responsible for commercial operations in the two States, Forestry Tasmania and State Forests of NSW respectively, have separate legal status. However, these two agencies also have a role in the policy and regulatory functions in their respective States. Furthermore, in Tasmania the same minister is responsible for both Forestry Tasmania and the Forest Practices Board.

42. In terms of framework and structure, Western Australia goes furthest towards meeting the strong separation test having established separate institutions, with separate ministers, to deal with policy, commercial and regulatory functions.

43. The clause also requires consideration of:
    - the appropriate commercial objectives of the monopoly;
    - separation of competitive from monopoly elements;
    - separation of potentially competitive elements;
    - the means of implementing competitive neutrality;
    - the merits of any community service obligations and funding of these;
    - price and service regulations; and
    - the financial relationship between the monopoly and the owner.

44. A state-by-state examination of the application of these objectives gives, at best, mixed results, with no State having fully independent and transparent processes for setting price and service regulations.

LEVEL OF COMPLIANCE WITH KEY OBJECTIVES OF STRUCTURAL REFORM

STRUCTURAL REFORM KEY OBJECTIVE	NSW	VIC	TAS	WA
Separation of policy and regulatory from commercial functions	❍	✗	❍	✓
Independent and transparent monitoring and enforcement of plans, codes and standards	❍	✗	❍	❍
Independent and transparent setting of reserve prices	✗	✗	✗	❍
Separation of native forest logging from the promotion of private plantations	❍	❍	✓	✗
Commercial focus of SFA	❍	✗	✓	✓
Competitive neutrality				
TER etc	❍	✗	❍	❍
Regulatory neutrality	✗	✗	❍	✗
Land / rates / full cost recovery	✗	✗	✗	✗

Key: ✓= full compliance; ❍ = minimally compliant; ✗ = non-compliant

45. Although **New South Wales** has made some tentative steps towards structural reform, establishing an Office of Forest Products and removing some aspects of forestry policy and regulation away from State Forests of NSW, separation of the policy and regulatory from commercial functions of the industry is minimal, at best. A similar conclusion is reached with respect to the independence of monitoring and enforcement of codes and standards. *Prima facie*, NSW does not comply with major components of the competitive neutrality test of Clause 4.

46. In **Victoria**, non-compliance with key objectives of Clause 4 is apparent virtually across the board. Forestry Victoria is not a separate legal entity and clearly fails compliance tests with respect to both commercial focus and competitive neutrality. Although policy and regulatory functions are now undertaken by the Forests Service section of Department of Natural Resources and the Environment, separation of Forests Service from Forestry Victoria is clearly inadequate in terms of the key principles of agency and ministerial separation. For similar reasons, Victoria is also non-compliant with respect to the tests for independent monitoring and enforcement of standards and codes and independent setting of pricing rules.

47. In **Tasmania**, the corporatisation of Forestry Tasmania has provided the body with a clear commercial focus. However, the Tasmanian Government compliance with the competitive neutrality test is only partial with respect to its application to Forestry Tasmania. The Government does not require Forestry Tasmania to pay local government rates or land costs. Although significant reforms have been undertaken to the structure of the forestry industry in Tasmania, including through creation of the Forest Practices Board, separation of the policy, regulatory and commercial functions of the industry is still minimal, at best. For example, both bodies still report to the same minister. Similarly, the independence of the process for developing and monitoring codes and management plans is at best only poor-to-fair, since Forestry Tasmania and private industry play, arguably, a significant role in policy development and regulation.

48. In **Western Australia**, structural reforms undertaken in 2000 have achieved considerable advances in terms of the separation of the policy, regulatory and commercial functions of the industry. However, processes for the development, monitoring and enforcement of management plans and codes of conduct, while ostensibly the responsibility of the independent Conservation Commission, can still be heavily influenced by the Department of Conservation and Land Management and the Minister for Forest Products. The Forest Products Commission is an independent statutory authority with a strong commercial focus. Nevertheless, it fails the important elements of the competitive neutrality test. Furthermore, separation of responsibilities for the promotion of native forest logging and promotion of private plantations has not been achieved with reforms in the State.

Victoria should review the operations and arrangements for Forestry Victoria to ensure that it complies with the specific requirements of Clause 4 of the Competition Principles Agreement.

Legislation Review

49. Forestry-related activities in each State and Territory are subject to extensive legislation and regulation, as they are in all jurisdictions.

50. Victoria, Tasmania and Western Australia have all completed legislation reviews of the main pieces of forestry legislation in their respective States, but only Victoria has published the review with an initial Government response.

51. New South Wales has not listed its key forestry legislation, the *Forestry Act 1916*, in its inventory of review. *Prima facie*, this is a breach of sub-clause 5(3) of the Competition Principles Agreement, which states that all Parties should have reviewed 'legislation restricting competition' by the year 2000. It is important that the National Competition Council ensures that any review of forestry legislation being undertaken by NSW fully addresses clause 5.

52. National Competition Policy requires clarification of the objectives of legislation. These objectives relate to both the objectives of the policy and separately to the objectives of the institution established by the legislation. It is notable that in no State does the major State forestry legislation contain objectives for government involvement in the forestry sector.

53. In terms of institutional objectives:
    - of the four States, the Tasmanian forestry legislation contains the clearest institutional objectives which are supported by a more detailed set of corporate functions;
    - the institutional objectives in the NSW *Forestry Act 1916* are quite general. The objectives are not entirely consistent with the more explicit objectives of State Forests of NSW;
    - The *Forest Products Act 2000* of Western Australia contains a comprehensive list of institutional functions and objectives that are bundled together under the generic heading of 'Functions of the Commission'. As a result of this bundling, the overriding objectives of the Forest Products Commission are difficult to ascertain and include non-commercial objectives;
    - The Victorian *Forests Act 1958* does not contain institutional objectives per se but section 18 of the Act does set out the general powers and duties of the Secretary of the Department. They are very general and broad.

54. State forestry acts contain many elements that are potential restrictions on competition. These include:
    - the requirement to log under logging licences;
    - the term of logging licences;
    - the allocation of logging licences;
    - responsibility for forest management;
    - the methodology for setting log prices/stumpage; and
    - the role of sustainable yields and logging supplies.

55. Logging licences generally require certain areas of forest to be logged or they restrict access to the 'timber reserves' for other uses. A consortium of say apiarists, environmentalists and tourism operators could not bid for a timber licence, pay the required royalties and then **not** cut the forest. Furthermore, they could not preserve the forests through, say, purchasing the land, since the forests are on Crown land.

56. Logging and milling licences in NSW, Victoria and Western Australia are negotiated for up to 20 years, without recourse to open tenders. A further concern is that provisions of the forestry legislation regarding allocation of licences or contracts are very generally expressed. Consequently, the generality of the provisions means that the relevant agencies have considerable discretion in the design and the operation of the licensing system. Thus, even though the legislation in Victoria, Western Australia and Tasmania provides for the option of licences being issued through auctions or tenders, in practice only Tasmania has applied this option on a regular basis to quality sawlogs.

57. Forestry legislation in Victoria and Tasmania vests exclusive control and management of the policy, regulatory and commercial functions of the forest to a single agency or corporation.

58. The independent reviewers of the Victorian *Forests Act 1958* indicated their concern regarding the implications of the term 'exclusive control and management' for competition in the potential market for commercial forestry management services. They considered it desirable to amend the Act to allow for the possibility of the provision of commercial forestry services by entities other than the department administering the Act.

59. Forestry Agreement Acts typically specify the amount, and conditions under which, the Government will supply timber to a particular company. Acts related to the supply of native hardwoods raise a number of issues worthy of further attention:
    - the Agreements can extend for much longer than other forest licences;
    - while the Agreements do not provide an exclusive right of access to a particular Forest Area, they nonetheless restrict competition across the entire State since they entitle the named company to a significant proportion of the overall volume of timber available for felling in a particular year;
    - the Agreements sometimes include provisions that waive the payment of licence fees which, to the best of our knowledge, all other companies have to pay; and
    - individual Agreement Acts may confer substantial competitive benefits on the company on the basis of ministerial discretion.

In considering legislation reviews under clause 5, the National Competition Council needs to pay particular attention to clarifying the objectives of the relevant legislation and the institution responsible for administering the legislation for each State.

Each State should also pay attention to the potential restrictions in their legislation to competition from activities not related to timber production and potential restrictions on entry to forest management.

Victoria, NSW and Tasmania need to amend the pricing provisions of their respective State legislation to reduce the discretionary nature of pricing policy and explicitly establish the need for full cost recovery.

Employment and Investment

60. The terms of reference request specific attention to employment and investment information on the native forest sector.

61. Employment in forest-based industries is estimated to be between 75 to 80 thousand persons according to the ABS Labour Force statistics.

62. With more than half of Australia's sawlog production now coming from plantation softwood and the area of hardwood plantations now expanding rapidly, strong employment growth in plantation-based activities while unobservable, appears to be a logical inevitability.

63. Regrettably, the available statistics do not mirror or illuminate the policy debate since:
    - they do not draw the relevant distinctions. The industry sectors used by the ABS are based on industry sectors rather than products. These classifications do not take account of the source of the trees;
    - confidence in the survey data for forestry and logging activities is too low for the data to be useful.

64. If employment in traditional forestry is a policy objective then we ought to define and measure it with necessary accuracy. The existing statistical base is so poor that we cannot tell how much employment is being generated by 'new forestry' in the form of plantations and how much by traditional forestry. Nor can we tell how much the subsidisation of logging in the remote areas of NSW and Victoria damages plantation-based employment.

65. The centrality of employment to the public policy debate over the logging of public native forests necessitates good quality data on employment in the native forest, plantations and farm forest sectors. Unfortunately however, none of the ABS, ABARE and the BRS can currently identify those whose employment is associated with either plantation or native forests, despite what appear to be very real opportunities to do so through existing programs, e.g., the National Forest Inventory, and ABARE forestry economic work.

1. INTRODUCTION

The Australian Conservation Foundation (ACF) engaged Marsden Jacob Associates "*to assess State forestry agency performance in native hardwood forestry in relation to employment, investment trends and the National Competition Principles Agreement*". The ACF requested that this assessment focus on New South Wales, Victoria, Western Australia and Tasmania.

The prime focus of this report is on the matter of the compliance of each of the four States with the Competition Principles Agreement (CPA) in regard to forestry. The report focusses on the structures promoted by National Competition Policy. Employment and investment trends are outlined in the Attachment A.

1.1. NATIONAL COMPETITION POLICY

National Competition Policy (NCP) is a set of policies voluntarily agreed in April 1995 between the Commonwealth, State and Territory Governments to promote the efficiency, growth and well-being of the Australian economy and people. The original communique from the 1994 COAG meeting agreeing on these principles stated:

> *The Council agreed on the need to accelerate and broaden progress on microeconomic reform to support higher economic and employment growth on a sustainable basis. Accordingly, it has agreed to pursue a more extensive microeconomic reform agenda and to establish a standing committee of senior officials to manage this continuing agenda of microeconomic reform.*

NCP has three components:

- **Competition Principles Agreement** which sets out the key principles to
  - consider and test arrangements relating to their business activities which are significant and/or hold monopoly power
  - review all legislation in terms of anti-competitive effects;
  - encourage and provide third party access to bottleneck facilities (Access to Services Provided by Means of Significant Infrastructure Facilities);
- **Conduct Code** extends coverage of Part IV of the Trades Practices Act to all businesses irrespective of ownership;
- **Agreement to Implement the National Competition Policy and Related Reforms**. The Agreement to Implement sets out the conditions for payments to the States for the first, second and third tranche assessments and payments. The related reforms are those previously and separately agreed in the areas of electricity, gas, water and transport.

Although the 1992 National Forest Policy Statement was signed by the Commonwealth and all States at a COAG meeting (albeit Tasmania signing later), the NFPS did not become an element of the Agreement to Implement Related Reforms.

Nonetheless, NCP – particularly the CPA – applies to forestry as it does to all sectors of activity within the Australian economy.

1.2. COMPETITION PRINCIPLES AGREEMENT

The CPA contains several important generic commitments by signatory governments, each of which are potentially applicable to forestry. Whether as significant business activities, past monopolies or as current monopolies or current near monopolies, the State forest agencies (SFAs) are bound by one or more clauses of the CPA. These include:

- prices oversight of government business enterprises (clause 2)

  … should apply to all significant government business enterprises that are monopoly, or near monopoly, suppliers of goods and services, or both.

- competitive neutrality policy and principles (clause 3)

  the objective of competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. These principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities.

- structural reform of public monopolies (clause 4)

  For instance, "*…it will remove from the public monopoly any responsibility for industry regulation …*"

- legislation review (clause 5)

  the guiding principle is that legislation … should not restrict competition unless it can be demonstrated that: a) the benefits to the community as a whole outweigh the costs ….

- access to services provided (clause 6)

  …a regime for third party access to services provided by means of significant infrastructure facilities.

The full text of the Competition Principles Agreement is shown in Attachment B. Chart 1-1 summarises the application of generic clauses (2-6) of the CPA.

CHART 1-1 : APPLICATION OF CLAUSES OF COMPETITION PRINCIPLES AGREEMENT

CLAUSE	APPLICATION	APPLICATION IN FORESTRY
Prices oversight of Government Business Enterprises (Clause 2) • by State or Territory owning the enterprise	at least to all significant GBEs that are monopoly or near monopoly suppliers	Subject to interpretation of 'significant', and GBE at least to all State forest activities in markets where they are monopoly supplies (e.g., hardwood logs). May be appropriate to restrict prices oversight to pricing methodology rather than actual prices. This approach will also focus on reserve/minimum prices
• by NCC	GBEs whose pricing: • is not already subject to independent prices oversight; and • has a significant direct or indirect impact on constitutional trade or commerce. And where an affected jurisdiction considers it is adversely affected by lack of prices oversight	As above, subject to other identified conditions As with IPART's reviews of bulk water prices, independent oversight may tend to increase price where existing prices are below production costs.
Competitive Neutrality (Clause 3) Generic requirements Clause 3 (except sub-clause 4) • tax equivalent regimes • debt quarantee • equivalent regulation or • full cost pricing	All significant business activities under public ownership subject to benefits outweighing costs	All activities of State forest agencies, other than non-profit activities.
Specific requirements for corporatisation Clause 3 (4)	All significant GBEs (as defined by the Government Financial Statistics Classification) subject to benefits outweighing costs.	Dependent on: • interpretation of 'significant' and 'where appropriate' • benefits compared with implementation costs. Consideration of other uses: • eco-tourism • conservation values • farm forestry • plantations
Structural Reform of Public Monopolies (Clause 4)	Sectors traditionally supplied by a public monopoly where competition is introduced [or progressively increased].	All State forest agencies.
Legislation Review (Clause 5)	All existing legislation plus new legislation.	All legislation relevant to forestry
Access to services provided by means of significant infrastructure facilities (Clause 6)	Infrastructure facilities where: • not economically feasible to duplicate; • necessary to permit effective competition in a downstream or upstream market; • facility is of natural significance; and • safe use of the facility can be ensured.	Problematic. Unless the NCC sees natural resources as constituting an 'infrastructure facility'.

1.3. APPLICATION OF CPA CLAUSES

While clause 2 (Prices Oversight) relates to government business enterprises (GBE) which are monopoly or near monopoly suppliers, clause 4 (Structural Reform of Monopolies) relates to GBEs in transition from monopoly to a more competitive status.

Clause 3 (Competitive Neutrality) makes no reference to monopoly status at all.[1] Rather it applies to government activities which are in competition with other enterprises.

The application of clause 5 (Legislation Review) requires neither monopoly nor competitive status for a government business activity. Rather, it applies to all economic activities, regardless of sector, impacted by legislation and regulation reducing competition.

Finally, clause 6 (Access to Infrastructure) applies to any entity (public or private) owning or controlling essential facilities where third party access would promote competition in a related market.

In summary, clause 5 (Legislation Review) applies to all market structures and is not limited to government activities while the remaining clauses 2–4 and 6 apply to specific market structures/ situations.

1.4. CONDUCT CODE

The application of Part IV of the Trade Practices Act (concerning restrictive trade practices) means that unless allowed by legislation, State businesses may not operate to restrict competition, misuse market power, engage in resale price maintenance, nor obtain shares in other businesses that will have the effect of substantially lessening competition.

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[1] The requirements under clauses 2 and 3 relate to two significantly different market structures. Clause 2 (price oversight) refers to approaches to limit the monopoly pricing behaviour of a dominant public sector business. Competitive neutrality (clause 3) refers to removing those competitive advantages and disadvantages of a public sector business which is competing with other (private) businesses, where these distortions arise from public ownership. It is important, therefore, to identify clearly that we are talking about enterprises (or one enterprise) operating in different markets.

While the prices oversight clause refers to the goal of efficiency, the typical intervention has been to stop overpricing rather than underpricing. The Hilmer report, which is not a binding document, focussed on restraining prices rather than putting floors under them. The remainder of this Chapter provides a summary of the application of the key clauses of the CPA in general and how they might apply to forestry.

1.5. AGREEMENT TO IMPLEMENT

The third component of the NCP agreements sets the timetable for meeting certain components of NCP reform (in both the CPA and the Agreement to Implement), the amount available from the Commonwealth for payment to the States and Territories and the method of distribution across States and Territories, and the condition to be met to receive these payments. The National Competition Council has been entrusted with reviewing the progress of reform and reporting to the Commonwealth. Chart 1-2 shows the magnitude of the payments for remaining years. .

CHART 1-2 : COMPETITION PAYMENTS TO ALL STATES

JURISDICTION	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-6
New South Wales	211.9	156.5	241.5	248.0	253.5	260.4	267.4
Victoria	153.8	115.1	177.7	182.4	186.3	191.2	196.2
Queensland	120.4	86.4	133.8	138.2	142.2	147.1	152.2
Western Australia	62.5	45.8	70.8	73.1	75.1	77.6	80.2
South Australia	54.2	36.1	55.3	56.4	57.3	58.6	59.8
Tasmania	19.1	11.3	17.2	17.4	17.6	17.9	18.2
Australian Capital Territory	10.9	7.5	11,6	11.9	12.1	12.5	12.8
Northern Territory	14.7	4.7	7.3	7.6	7.8	8.1	8.4
Total	**647.6**	**463.4**	**715.2**	**735.0**	**752.1**	**773.4**	**795.3**

Source: National Competition Council (2000) *Annual Report 1999-2000*, Ausinfo, Canberra

As a signatory to CPA, each State and Territory government is obliged to undertake a suite of reforms to government business enterprises, public monopolies and related markets. In recognition of meeting these obligations, the States will receive these substantial Competition Payments, i.e., 'efficiency dividends', from the Commonwealth. Payments to the States under the third tranche of national competition policy, commencing in 2001-2002, will be up to $3.8 billion over five years. These payments will only be made though, if progress has been made on implementation of reforms including progress in "*reviewing, and where appropriate, reforming legislation that restricts competition*".[2] Forestry is one of the sectors to be considered by the National Competition Council (NCC) in its third tranche assessment.[3] An extract from NCC (2001) *NCP – Third Tranche Assessment Framework* is at Attachment C.

1.6. CPA AND FORESTRY

Forestry – like every other area of Australian economic activity – is covered by one or more of the generic clauses of the CPA. Suggestions that the CPA might not apply to forestry are simply incorrect.

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2 National Competition Council (2001) *NCP - Third Tranche Assessment Framework*, AGPS, Canberra, p. 2.2.

3 National Competition Council (1999) *Second Tranche Assessment*, p. 163.

However, the relevance and application of these clauses must be tested on a state-by-state and function-by-function basis. In particular, as expressed in the CPA, access is unlikely to be applicable to forestry. Clause 6may not apply as:

- forests are not infrastructure – they are a resource;
- there is no 'bottleneck' facility;
- it is not the type of asset envisaged by Hilmer;
- individual forests/coups are difficult to describe as a facility of national significance; and
- individual forests/coups are not seen as central to business activities or competition in upstream or downstream markets.

The difference in resources such as forests versus infrastructure may be semantic. A forest is 'infrastructure' to water production, honey production and tourism whilst it could be considered a resource for forestry and conservation. Hilmer's approach which forms the basis of NCP was focussed on issues of concern to large business such as electricity generation - overlooking, but not necessarily missing, many other forms market manipulation and infrastructure – urban forms, resource exploration and development, shopping centre development, forests and other natural resources. Hilmer's fault was not noticing these other forms of national 'infrastructure' or 'resources'. The essential point remains that forests constitute single 'objects' to which different industries (including the public sector - conservation, science) require access in order to provide value. That this value should be produced efficiently is beyond doubt – the access modality therefore becomes critically important to any policy premised on efficient value creation. The role of clause 6 should be seen in this light of ensuring that the access modalities to resources/infrastructure are constructed in a manner consistent with efficient value creation

Under Part IIIA of the *Trade Practices Act 1974*, Section 44G(2) requires the National Competition Council not declare (to be under an access regime) a service unless all of the following apply

(a) *that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service;*

(b) *that it would be uneconomical for anyone to develop another facility to provide the service;*

(c) *that the facility is of national significance, having regard to:*

(i) the size of the facility; or

(ii) the importance of the facility to constitutional trade or commerce; or

(iii) the importance of the facility to the national economy;

(d) *that access to the service can be provided without undue risk to human health or safety;*

(e) *that access to the service is not already the subject of an effective access regime;*

> *(f) that access (or increased access) to the service would not be contrary to the public interest.*

Application of Part IIIA would particularly require that proponents could show that markets in say, water production, honey or tourism would see greater competition from increased access, and that these are significant industries.

An alternative approach would be to consider property rights. The concepts of access and property rights associated with historical exploitation of the resource can be seen as restrictive when compared with other resource-based property rights. For instance, logging rights do not provide a right to **not** harvest timber. In contrast, it is possible for a conservation group, for example, to purchase water rights and not use them. Consequently, if an urban community wanted to establish a conservation trust to purchase the logging right for an area, it would be unlikely/unable to be awarded the licence/tender. Licence is solely to log. Implicit in this requirement is a desire to sustain timber-related employment in the region. Not only is there an employment target but it is employment in a particular industry.

As a result, there is little doubt that the property rights associated with forests are poorly defined and a legislative/regulatory restriction on competition due to their restriction in 'suffrage'. Non-foresters cannot bid for conventional forest licences since these require a guaranteed level of investment and employment in forestry.

This issue is one which should be examined when the forestry legislation in each State is reviewed in terms of anti-competitive impacts.

The National Competition Council has released its preliminary report outlining the framework for its third tranche assessment. There is little doubt that forestry activities fall squarely within their ambit. It reported[4]

> *It is only since the second tranche assessment in June 1999 that the Council has started to examine progress with applying NCP to forestry regulation and management. For the third tranche assessment, the Council will be examining jurisdictions' forestry regulation and their approaches to its review (clause 5). The Council will also, where relevant, look at the application of competitive neutrality (clause 3) and structural reform (clause 4) obligations.*
>
> *Governments will need to report on progress with the review and reform of forestry regulation and the application of, and compliance with, competitive neutrality and structural reform commitments.*

[4] NCC (2001) *op. cit.*, p. 14.3.

1.7. STRUCTURE OF REPORT

Chapter 2 examines the requirements for compliance with the objective and principles of competitive neutrality, noting that the minimum requirements specified leave land acquisition and/or rental costs and local government rates as major sources of non neutrality between public native forests and plantations/farm forestry.

Chapter 3 extends the principle of competitive neutrality to the pricing of hardwood logs from native forests, i.e., to the method and processes for hardwood logs in each State.

Chapter 4 examines the application of the CPA's requirement for structural reform where competition is introduced into activities previously supplied by monopolies.

The CPA requirements for legislation review are examined in Chapter 5. These requirements strengthen the need for clear and appropriate commercial objectives.

The final Chapter reviews employment and investment in forestry.

2. COMPETITIVE NEUTRALITY

2.1. RELEVANCE OF COMPETITIVE NEUTRALITY TO FORESTRY

In all States of Australia, timber from established forests competes with timber from private plantations. Wood products from softwood plantations have successfully competed and largely supplanted native hardwoods in home building, scantlings and other related uses. In addition, private investment in hardwood plantations for woodchips is rising significantly and has the potential to expand further. Taken together, some analysts believe that existing and potential plantations could soon meet Australia's total wood needs, thereby removing the need to log native forests. Nonetheless, the point of principle is that any subsidy or differential in favour of logging native forests undermines the viability and competitiveness of private plantations.

> *The fact that the state is the majority supplier of most logs from both plantations and native forests ensure that state policies have enormous impacts on the market for farm forestry products. There is no other primary product where the state is the major supplier of raw materials to industry, for example, we do not have state wool, wheat or beef farms.*[5]

Moreover, there are wider impacts. For instance, large-scale revegetation of the rural landscape is required if dryland salinity is to be mitigated effectively. Revegetation through market mechanisms to promote farm forestry is given prominence in the MDBC's Basin Salinity Management Strategy, the Victorian Salinity Management Framework, the NSW Salinity Strategy[6] and the Salinity Expert Group's *Report to the NSW Government on Market-based Instruments*. However, the extent of revegetation is unlikely to be material unless farm forestry or other forms of revegetation can be made profitable.[7]

As a result, it is important that there is a level playing field between forestry activities based on public native forests and activities based on plantations. Any lack of competitive neutrality between State forestry activities in established forests and private forestry activities:

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5 J. Alexandra & M. Hall (1997) "Creating a viable farm forestry industry in Australia – what will it take?", Draft Final Report of the project "Policy Reforms for Farm Forestry – Post NPAC", p. 16.

6 This highlights the use of trading arrangements between farmers, State Forests and irrigators.

7 Pannell, D.J. (2001) "Explaining non-adoption of practices to prevent dryland salinity in Western Australia: Implications for policy" in Conacher, A. *Land Degradation*, Kluwer, Dordrecht. See also Pannell, D.J. (1999) "Social and economic challenges in the development of complex farming systems", *Agroforestry Systems*, Vol. 45 No. 1, pp. 393-409; Bathgate, A. and Pannell D.J. (2001) Economics of deep-rooted perennials in southern Australia" *Agroforestry Systems*, forthcoming; Pannell, D.J., M^{c}Farlane, D.J. and Ferdowsian, R. (2001) "Rethinking the externality issue in dryland salinity in Western Australia", *Australian Journal of Agricultural and Resource Economics*, forthcoming. Assoc. Prof. David Pannell, (2001) *Dryland Salinity: Inevitable, Inequitable, Intractable?* , Productivity Commission seminar, 5 March, Dept of Agriculture, WA Univ.

- makes private investment in farm forestry and plantations much less attractive[8];
- distorts the allocation of wood sources within the forest sector;
- encourages greater exploitation of the public native forests in each State;
- undercuts competing uses of public native forests; and
- worsens the Australian environment and resource base.

The objectives of the competitive neutrality policy and principles of the CPA are therefore particularly relevant to forestry and the activities of the respective SFAs.

The NCC's framework for the third tranche assessment reported:[9]

- **New South Wales**

  New South Wales will also need to show that it has met its competitive neutrality commitments in relation to State Forests of New South Wales.

- **Victoria**

  The sale of the Victorian Plantations Corporation and establishment of Forests Victoria raises structural reform obligations and regulatory neutrality issues under clauses 4 and 3 of the CPA, respectively. The Government will need to demonstrate that its approach to, and the outcomes of, these institutional changes are consistent with its CPA obligations.

- **Western Australia**

  Western Australia will need to report on its adoption of the recommendations of the competitive neutrality review and show that its approach is consistent with its competitive neutrality obligations (clause 3) in relation to the corporatisation of the Department's plantation business unit.

- **Tasmania**

  Tasmania will need to provide information on the application of competitive neutrality to forestry and confirm that its approach meets its competitive neutrality obligations.

2.2. OBJECTIVES OF COMPETITIVE NEUTRALITY

Clause 3(1) of the CPA confirms that:

> *The objective of competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged*

[8] Competitive Neutrality is the strongest and most pervasive principle within the CPA, strengthening and underpinning the other five classes.

[9] NCC (2001) *op. cit.*, pp. 14.5-14.14.

> *in significant business activities: Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. These principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities.*

This policy objective is not limited by the two main clauses (3(4) and 3(5)) which specify minimum actions required under specific circumstances.

To meet the objectives specified in Clause 3(1) requires that government business activities – regardless of sector – are not advantaged simply by their government ownership. Such advantages may arise in terms of:

- legal structure;
- income tax and other State and federal taxes;
- borrowing costs;
- regulatory standards;
- direct and indirect subsidies affecting input costs and output prices;
- local government rates and charges; and
- dividend requirements.

2.3. MINIMUM REQUIREMENTS

Within Clause 3, subclauses (4) and (5) set minimum requirements to be met under particular circumstances. The application of these minimum requirements is in both cases conditioned by Clause 3(6)

> *Subclauses (4) and (5) only require the Parties to implement the principles specified in those subclauses to the extent that the benefits to be realised from implementation outweigh the costs.*

2.3.1. PUBLIC TRADING AND PUBLIC FINANCIAL ENTERPRISES

Clause 3(4) applies to

> *where appropriate, significant government business enterprises which are classified as 'Public Trading Enterprises' and 'Public Financial Enterprises' under the Government Financial Statistics Classification:*

Since the individual States and Territories determine which of their business enterprises are classified as public trading enterprises or public financial enterprises, the application of Clause 3(4) is in part discretionary. States can change their decisions by adding or subtracting from the listed enterprises and may reach quite different judgements from those made in other States.

For significant government business enterprises listed under the Government Financial Statistics Classification,

> *(a) the Parties will, where appropriate, adopt a corporatisation model for these government business enterprises …; and*
>
> *(b) the Parties will impose on the Government business enterprise:*
>
> *(i) full Commonwealth, State and Territory taxes or tax equivalent systems;*
>
> *(ii) debt guarantee fees directed towards offsetting the competitive advantages provided by government guarantees; and*
>
> *(iii) those regulations to which private sector businesses are normally subject, such as those relating to the protection of the environment, and planning and approval processes, on an equivalent basis to the private sector competitors*
>
> *(7) Subparagraph (4)(b)(iii) shall not be interpreted to require the removal of regulation which applies to a Government business enterprise or agency (but which does not apply to the private sector) where the Party responsible for the regulation considers the regulation to be appropriate.*

Clause 3(4) therefore applies to formally identified significant government business enterprises and requires corporatisation and three other specific actions (tax equivalent regimes, debt guarantees and regulatory neutrality) to promote competitive neutrality. Not only do the States have the discretion to determine which business enterprises are formally identified as significant under the Government Financial Statistics Classification, they also have the discretion under clause 3(7) to determine whether and where it is appropriate to take these actions.

At the current time, New South Wales, South Australia, Western Australia and Tasmania have each corporatised their SFAs as separate legal entities and have met the specific requirements for tax equivalent regimes (TERs) and debt guarantees. The requirement for regulatory neutrality has been most obviously observed in Tasmania.[10]

In contrast, Forests Victoria is a ring-fenced service unit within the Department of Natural Resources and Environment (NRE); is not recognised as a significant business activity through formal classification as a PTE; has not been corporatised; has no independent board; and meets none of the three other minimum requirements.

This contrast illustrates:

10 In Queensland, DPI Forestry is a ring-fenced business unit within the department; is classified as a PTE and is subject to a TER but has not been corporatised.

- the discretion available to a State government to avoid the application of the competitive neutrality principles and the self defining characteristic of Clause 3(4) in its reliance on the Government Financial Statistics Classification; and
- the interaction between the definition of a significant business enterprise and the application of specific competitive neutrality policies. For instance as noted below, the Victorian policy of limiting the application of Tax Equivalent Regime (TER) to entities which have a separate legal status effectively removes the requirement for a TER in forestry. The differing criteria in each State for the application of TERs are discussed in Chart 2-1

2.3.2. DIFFERING APPLICATION OF TERS

General Criteria

In determining whether a TER should be applied, most States have reached a common judgement on the relevant criteria, i.e. a significant business activity which is ring fenced with separate accounts. Only in Victoria is the application of TER restricted to separate legal entities.[11]

In effect, this uniquely Victorian policy allows compliance with Clause 3(4) but precludes compliance with Clause 3(5).

In terms of compliance with Clause 3(5) both New South Wales and Queensland have applied TERs to ring fenced units operating under departmental umbrellas and this arrangement will continue under the proposed arrangements for the ATO to act as the common tax collective in each State and Territory from 1 July, 2001.

Application of TERs to Forestry

In the specific case of forestry activities:

- TERs are applied to State forestry activities in New South Wales, Queensland, Western Australia and Tasmania; and
- in contrast, Victoria does not apply a TER to NRE's Forests Victoria because of its restrictive TER policy.

In particular, Victorian hardwood operations are competitively advantaged (against both plantation-based operations in all States and against other native hardwood operations in other States) since there is no compliance with any element of the clause 3(4) or clause 3(5) requirements.

[11] However, tax equivalent payments are only relevant where a government business makes a profit. In cases where the products are underpriced, this is less likely.

CHART 2-1 : CRITERIA FOR APPLICATION OF TAX EQUIVALENT REGIMES IN EACH STATE

		NSW	VIC	QLD	WA	SA	TAS
(i)	ring fenced with separate accounts	✓	✓	✓	✓	✓	✓
(ii)	significant business activity	✓	✓	✓	✓	✓	(1)
(iii)	private sector competitor	✓	-	-	✓	✓	(2)
(iv)	separate legal status	-	✓	-	-	-	
(v)	individual consideration of benefits and costs	✓	✓	-	✓	-	✓

1. No single criteria, agencies themselves make judgement.
2. Actual or potentially competitive - for Full Cost Attribution

It is important to note that Clause 3(4) requires four specific actions only (corporatisation, TERs, debt guarantees and regulatory neutrality). The minimum requirements in Clause 3(4) do not extend to neutrality in terms of:

- direct and indirect subsidies and exemptions affecting input costs and output prices including the need to pay the opportunity cost of land utilised;
- local government rates and charges; and
- dividends payable to shareholders.

As outlined below, in none of the four States examined (NSW, Victoria, Western Australia and Tasmania) is there parity or neutrality between public native forests and plantations in the payment of subsidies, local government rates and charges or dividends.

2.3.3. REGULATORY NEUTRALITY

On the other side of the coin, private wood growers can and sometimes do have a competitive advantage over SFAs and the native forest sector, especially with respect to the environmental regulation of the industry. As is discussed further below, in some States, there is almost no environmental regulation of private plantations and the farm forest sector.

Only in the case of Tasmania are logging operators on private land subject to the same code of practice.

2.3.4. SIGNIFICANT BUSINESS ACTIVITIES

Clause 3(5) of the CPA applies similar requirements to significant business activities, i.e., significant activities undertaken either in legally distinct enterprises, but which are

not listed in the classification, or which are undertaken within other structures including departmental structures.

Clause 3(5) allows a choice between:

- meeting the three requirements outlined in 3(4)(b); or
- ensuring that prices reflect a full cost attribution and take into account the items listed in 3(4)(b), i.e., a less equivalent regime, debt guarantees and regulatory neutrality.

Clause 3(5) states that

> *Subject to clause (6), where an agency (other than an agency covered by subclause (4)) undertakes significant business activities as part of a broader range of functions, the Parties will, in respect of the business activities:*
>
> *(a) where appropriate, implement the principles outlined in subclause (4); or*
>
> *(b) ensure that the prices charged for goods and services will take account, where appropriate, of the items listed in paragraph 4(b), and reflect full cost attribution for these activities.*

Since State forest activities in New South Wales, Queensland, South Australia, Western Australia and Tasmania are formally classified as a Government Trading Enterprises, or have otherwise been corporatised, it follows that Clause 3(5) applies only to Victoria.

However, the previous Victorian government has not implemented any part of the requirements under Clause 3(5), that is:

- there is no TER applying to NRE's Forests Victoria;
- nor are there debt guarantees;
- nor is there regulatory neutrality;
- nor has Victoria followed the alternative option foreshadowed in Clause 3(5)(b), i.e., to recognise tax equivalent, debt guarantees and regulatory neutrality in prices set by full cost attribution.

  Indeed, the Victorian approach of setting log prices on the basis of calculated residual value after all other parties in the value chain have made a necessary profit appears to be in direct conflict with the requirement for full cost recovery.

The current Victorian government is understood to be re-evaluating the implications of the application of competitive neutrality to its forestry activities.[12]

[12] A review of competitive neutrality and forestry was undertaken by KPMG in 1997. This report has not been publicly released. The 1998 KPMG *National Competition Policy Review of the Forests Act 1958*, refers to this earlier report.

2.4. COMPLIANCE WITH THE OBJECTIVE OF COMPETITIVE NEUTRALITY

As noted, Clause 3(1) extends well beyond the minimum requirements for competitive neutrality specified in Clauses 3(4) and 3(5).

Compliance with the spirit of Clause 3(1) requires a much more comprehensive approach extending beyond the narrow focus in TERs, debt guarantees and regulatory neutrality.

In the case of forestry, the more comprehensive approach must encompass the non-neutrality in:

- the cost of land acquisition or rentals; and
- the cost of local government rates and charges.

Rental or opportunity cost of land

The native hardwood activities of the SFAs cover literally thousands of hectares of high rainfall countryside. This land and associated forests have substantial opportunity costs in terms of alternative uses. While at lower levels of exploitation, alternative uses such as logging and tourism may jointly occur, as exploitation increases, such uses become exclusive. Yet, the SFAs are able to treat these huge areas of land as if they were free.

In contrast, plantations regardless of whether publicly or privately owned, must generally buy land, generally from farmers and graziers. As a result, plantations must face full cost while native hardwoods do not.

This failure in competitive neutrality is common to each of the four States reviewed.

Local government rates

State forest agencies – like government departments and government business entities generally – are (with the exception of South Australia) exempted from the payment of annual rates and charges to local government. In contrast, private plantations and farm forestry activities must pay these costs. Again, this failure in competitive neutrality is common to each of the four States under review.

Private investors in plantations and farm forestry aim to cover the full cost of their investment. Only in the case of Western Australia does the pricing methodology need to set minimum (or floor) prices for logs approach – full cost attribution.

Since logging trucks can cause heavy damage to local needs and the SFAs do not pay local rates, a mismatch is suggested between the sources of road costs in a local area and the source of rate revenue.

However, the fact that South Australia has already introduced a regime whereby State government departments and entities pay either an equivalent charge to local government (or pay a gratuity to local government) indicates that mechanisms are reasonably available to reduce this source of competitive non-neutrality.

Overview

Chart 2-2 provides an overview of the extent of compliance with the objectives of competitive neutrality in the area of native forests.

Failure to pay for the costs of land utilised in public native forests is a common failing in each of the four States reviewed in detail – and in Queensland and South Australia.

Failure to pay local government rates is a second common failing to observe the objective of competitive neutrality between forestry activities based on public native forests and forestry activities based on plantations.

CHART 2-2 : COMPETITIVE NEUTRALITY BETWEEN PUBLIC NATIVE FORESTS AND OTHER SOURCES OF TIMBER

	NSW	VIC	WA	TAS
Specific requirements				
Corporatised form	Yes – in own legislation (Cat. 1 GBE)	No	Yes	Yes
Tax equivalent regime	Yes	No	Yes – Equivalent to the amount payable by the corporation under the Commonwealth Tax Act	Yes – section 67(1) of the GBE Act 1995
Debt guarantee	Yes	No	Yes	
Regulatory neutrality	No	No	No	Yes
Broader requirements				
Dividend regime	Yes	Yes	Yes – section 44 (1) of Forest Products Act 2000	Yes – Part 11, Division 2 of GBE Act 1995
Full cost attribution	No	No	Yes (but diluted)	No
Land acquisition / rental	No	No	No	No
Payment of local rates and charges	No	No	No	No

2.5. IMPLEMENTATION OF COMPETITIVE NEUTRALITY

> *Each party is free to determine its own agenda for the implementation of competitive neutrality principles.*

Compliance with the Competition Principle Agreement will be assessed by the NCC as part of the third tranche assessments.

> *A Party may seek assistance with the implementation of competitive neutrality principles from the Council. The Council may provide such assistance in accordance with the Council's work program.*

As far as we are aware, none has been sought.

In particular, Codes should be universally applied.

> *Each Party will publish a policy statement on competitive neutrality by June 1996. The policy statement will include an implementation timetable and a complaints mechanism.*
>
> *Where a State or Territory becomes a Party at a date later than December 1995, that Party will publish its policy statement within six months of becoming a Party.*
>
> *Each Party will publish an annual report on the implementation of the principles set out in clauses (1), (4) and (5), including allegations of non-compliance.*

Across all States, we are aware of one Competitive Neutrality claim against the Victorian State Forests which was lodged in late 1999. The complainant established the costs for his business to establish and run a forestry operation on his land. He then lodged a complaint with the Victorian Competitive Neutrality Complaints Unit regarding the pricing practices and cost recovery approach for timber sourced in the same region. With the general review of competitive neutrality complaints procedures, all outstanding complaints were put on hold. Following the completion of the review, all complainants were sent revised guidelines in October 2000. Further, NRE in 2001 has commenced a review of forest services. The complainant has been invited to resolve the issue with the Department and also to make a contribution to the review.

2.6. CONCLUSIONS

First, in terms of the specific minimum requirements for competitive neutrality, three of the four States examined, New South Wales, Western Australia and Tasmania, comply wholly or partially with the minimum requirements specified in Clause 3(4).

One area of weakness for these jurisdictions, however, may be the issue of regulatory neutrality.

Second, because in all other States the forest agencies are formally classified as significant business enterprises or have been corporatised, Clause 3(5) applies only to Victoria.

Third, by retaining Forestry Victoria within NRE, Victoria has avoided Clause 3(4) and has not applied Clause 3(5). While State and Territory governments have substantial discretion to exercise judgement in the application of clauses 3(4) and 3(5), the previous Victorian Government chose to make judgements which are fundamentally at variance with those made in all other States and (it would appear) made by independent reviewers.[13]

We conclude that there is a *prima facie* case that with respect to forestry activities, Victoria does not comply with the minimum requirements for competitive neutrality.

Fourth, the objectives and principles of competitive neutrality stated in Clause 3(1) are not limited to the minimum requirements specified in Clauses 3(4) and 3(5).

A significant cause of lack of competitive neutrality between timber operations based in public native forests and private plantation and farm forestry is the treatment of public land as a free gift (i.e., without opportunity cost) to the forest agencies. This cause of non-neutrality is common to all States.

A second and closely related source of non-neutrality is the exemption of State forests from the payment of local government rates and charges in all States other than South Australia.

These two causes of non-neutrality derive fundamentally from the historic notion that State forests are crown land.

There is little to suggest that prices for State forest products reflect the actual or attributable costs that would be faced by a private competitor. This fundamental issue is addressed in Chapter 3.

In this wider and more fundamental sense, none of the States and Territories comply in terms of their forestry activities with Clause 3(1) in ensuring that "*Government business should not enjoy any not competitive advantage simply as a result of their public ownership*".

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[13] Neither the previous nor current Victoria Government has released the independent consulting report on competitive neutrality in forestry. The 1998 KPMG *National Competition Policy Review of the Forests Act 1958*, refers to this earlier report.

3. COMPETITIVE NEUTRALITY & PRICING

3.1. INTRODUCTION

In the jargon of the economist, the level of prices set how much of a commodity is supplied by producers and how much is demanded by customers.

In terms of forestry, low prices for logs and pulp encourage higher exploitation of the available resource and lower investment in future resources. However, higher prices serve to reduce the demand for logs, chips and wood products and make it more attractive to plant new trees in plantations.

Particularly because log prices/stumpage rates are not set directly by the market and are administered, the level and method of pricing of access to the forest resource are contentious. Environmental groups believe that royalties are set too low, encouraging over-logging of native forests and under-development of plantations. Correspondingly, the millers and logging companies believe royalties are set too high.

The pricing of sawlogs, pulpwood and chips from native forests is relevant regardless of whether native forest operations are seen to be monopoly or competitive activities. Even if all of the assumptions of perfect competition were to hold – which they certainly do not – the pricing of these products from native forests directly determines the relative volumes of supply.

The pricing of Australia's forest resources is, therefore, a critical parameter affecting both:

- the efficiency with which the existing forest resource is used and exploited; and
- the attractiveness of investment in farm forestry and in plantations, i.e., pricing policies and methodologies affect competitive neutrality.

3.1.1. THE MARKET PLACE

The State forestry agencies continue to dominate Australian forestry activity. While the agencies compete with private investment in the plantation forestry, they have a monopoly or near monopoly in native forests and therefore in the hardwood market.

> *DNRE is effectively a monopoly supplier of hardwood logs to Victorian-based processors, supplying about 95 per cent of demand. The markets for processed hardwood timber products generally have a greater degree of competition due to the availability of substitutes (softwood and other materials) and imports.*
>
> *In general a fundamental distinction can be made between the markets for … other forest products, where the supply from State forests is not*

> *significant; and the market for hardwood logs, where State forests supply nearly all of market demand.*[14]

At a minimum, the pricing of wood and wood products from Australia's native forests by the SFAs sets the price for the major sources of hardwood supply and likely has a broader impact on the market and will influence prices paid for wood and wood products by final customers.

Moreover, prior to the structural reform, separation of functions and commercialisation/corporatisation of the agencies, marketing managers from each agency met annually to exchange information and learn from each others experience and on occasion to discuss contracting and pricing.[15] In other words, the pricing of the timber resource by the forest agencies was not totally independent of practice in other States.

An independent and transparent process to price determination (as applies to most other government business enterprises) is one potential method for resolving the existing conflicts and misunderstandings relating to pricing, i.e., to stumpage rates, royalties, licence fees and other charges associated with the exploitation of the forest resource.[16]

Nonetheless, an independent and transparent process will not achieve sensible price outcomes unless the underlying methodology is correct.

The pricing of hardwood timber from public native forests is a major issue for competitive neutrality. In a broader sense, competitive neutrality should be concerned not only with the competitive advantages which accrue via lowered costs to government business activities simply as a result of their ownership. It should be concerned with the advantages which accrue because government ownership means that costs are not adequately reflected in prices.

3.2. PRICING AND ROYALTIES

A first issue to be clarified is the purpose of royalties, i.e., what are the millers and logging companies being asked to pay for? The dictionary definition of a royalty is: "*a payment made for royal right as over minerals given by a sovereign to a person or company.*" Based on this definition, the term 'royalty' would appear to be particularly inappropriate as a description of the payments for logging public forests.

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14 KPMG (1999), Forests Act 1958: National Competition Policy Review, p. iv.

15 Discussion between MJA and senior manager forest agencies, August-September, 2000.

16 Care should, however, be taken in making comparisons of prices charged across States because of species-related differences in the end products themselves and the different approaches to the way in which each State approaches its pricing. For example, the Tasmanian stumpage price for eucalypt sawlogs excludes charges for the provision of road access, while these are included in some other States.

There is a contrast between, say, a minerals royalty and the charge made by an SFA for access to trees.[17]

- In the case of minerals, the exploiting company has often discovered the resource, and is likely to be totally in control of it from the ground through to processing through to end sale.

  To a large extent, government is merely allowing access to a common property resource and licensing the exploitation to ensure orderly development.

- In the case of public forests, the resource is in public ownership, managed by the State forest business on behalf of government, with substantial value adding and management activities, including maintaining a balance between conservation and commercial use.

  The State forest business is undertaking a major commercial activity over a full rotation cycle ranging between 15 to 200 years.

The SFA is, therefore, supplying substantial value-added services which are embodied in the logs finally extracted. Moreover, each SFA is a near-monopoly supplier of hardwood timber to loggers and mills.

The arguments for independent price regulation – or alternatively market tests through tenders and auction mechanisms – are therefore stronger than they may initially appear.

In seeking a better framework for pricing the services of the SFAs, the inadequacies of the pricing principles set down in the NFPS need to be recognised.

In terms of the pricing and allocation system, the NFPS advocated that prices should:[18]

- 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.

These principles continue to command wide support. Perhaps this is not surprising since the principle of market-based pricing is amenable to multiple interpretations. Moreover, the internal consistency of the NFPS principles (between some interpretations of market-based pricing and full cost attribution) and their consistency with allocative efficiency and with the general approach to price regulation in other government business enterprises would need to be addressed.

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[17] Hardwood Log Royalty Methodology Review Panel (1998) *Final Report to the Minister for the Environment*, Perth, March.

[18] NFPS (1992), p. 17.

These are major steps from where the forestry industry is currently, but they are steps that have been taken over the past five years or so in the water industry with strongly positive outcomes, including for the environment.

As in any area of debate on pricing policies, there needs to be a clear understanding of the objectives that the pricing system is meant to achieve.

Clarification of Pricing Objectives

Consistent with rational and efficient pricing, the pricing objectives of governments and the State forestry agencies should be limited to:

- ensuring revenue to maintain and regenerate Australia's forest stocks and that each investment in such stock deliver a competitive rate of return to the 'shareholders';
- providing a full return to the community from use of a public resource;
- allowing more efficient loggers and millers to secure more of the resource by bidding more, i.e., allow competition;
- ensuring that there are no subsidies favouring exploitation of native forests over the establishment and harvesting of plantations; and
- ensuring equity in pricing in the sense that equally situated businesses are treated equally, i.e., to ensure horizontal equity. (This does not, however, mean subsidising unprofitable businesses to ensure that they receive the same profits as other businesses).

This tight set of objectives treats forestry like any other Australian industry. For instance, while there may be industry development objectives and desire to maintain the status quo in terms of past employment, such objectives should be explicit and pursued outside the framework of pricing policy.[19]

Similarly, notions of equity which in the peculiar sense of offsetting cost disadvantages and ensuring equal profit regardless of circumstance, do not, and should not, form part of the framework and objectives for efficient pricing of access to the forest resource.

This set of five objectives picks up three of the pricing objectives in the 1992 National Forests Policy Statement, i.e., the need to recover sufficient revenue to maintain the forest being cut, the need to include a fair return on capital, and the need to provide a full and fair return to the community from use of a public resource.[20] However, the set

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[19] The recent WA Government decision to assist in the reopening of the Greenbushes Mill is a good example of using separate policy instruments to achieve employment objectives under a conditional contract. See press release "Government guarantees future for Pemberton mill", October 27, 2000. http://www.mediastatements.wa.gov.au. (December 2000).

[20] Under the National Forest Policy Statement, prices should:

of objectives avoids the ambiguity of the term 'market-based' which appears in the NFPS Principles.[21]

The term 'market-based' is not a clear objective since it is consistent with any number of meanings including:

- competitive tenders and auctions with or without reserve prices; and
- the residual value method of determining stumpage rates/royalties. This 'market-based' method deducts costs incurred in different areas to ensure that all loggers and millers are able to earn the same level of profit – regardless of location or log type.

3.3. CURRENT PRICING METHODS USED IN AUSTRALIAN STATES

Current methods of pricing access and exploitation of native forest resources in the Australian States include:

- **the cost of growing method.** This is essentially a full cost recovery method which provides a return to the community sufficient to pay for the cost of establishing and managing that forest in the first place.

  Western Australia's use of this model has been reviewed several times, with the latest published review (1997) declaring that "*the model is based on current information and provides the most relevant cost background for identifying long run revenue requirements to maintain a viable timber logging industry.*"[22] In terms of practical application, Ministers have tended to intervene to soften the impact of this cost recovery approach.

  The Western Australian timber industry has argued strongly for a cost of replacement approach which would treat the existing forest as a gift to the forestry industry.

  > *The principle, known as the 'cost of replacement', requires that royalties cover the cost of regeneration and management of the forest until a decision to harvest again can be made. The main difference, therefore between the costs of replacement and the cost of growing principles relates to the timing of cashflows. That is, whether major revenues are recognised at the beginning or at the end of the rotation respectively.*

- 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.

[21] This ambiguity may have been essential to obtaining approval by all States to the Principles.

[22] *pers. comm.* M. Wood, Forestry Tasmania.

> *CALM's submission addresses specifically the cost of replacement principle, i.e., beginning with the harvesting of a forest, followed by regeneration and ending with a standing forest. CALM state that if this principle is correct then the forest would have a nil asset value, which is not consistent with net market or net present value approaches.*

- **the residual value method.** This sets the stumpage rate or royalty at the estimated residual value left after the deduction of all relevant harvesting costs including an allowance for normal profits from the selling price of sawn timber.[23] This method means that areas and mills which are at a cost disadvantage in terms of transport and other costs pay a lower stumpage rate/royalty to government.

  The method has been used in Australia and elsewhere since at least the 1940s and is currently applied comprehensively in NSW, in a simplified manner in Victoria and it would appear in part in Tasmania.

  The application of this method in NSW is described in Chart 3-1.

  Like NSW, Victoria uses a stumpage equation system (Chart 3-2). Under this system, "*stumpages are set so that the sum of the stumpage and the transport costs involved in placing a base grade of sawn timber on a defined key market is the same for all processors accessing that market.*"[24] Annual negotiations between the native forest industry and the Forestry Victoria may also affect this State's stumpage rates.

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[23] A. Hanson & A. Leslie (1965) "The Determination of Stumpage", *Australian Forestry*, 29 (2), pp. 96-104. This methodology is extremely complex. It has to deal with a whole range of end-products and determine an averaging system to apply to particular timber grades. It would rely upon a detailed knowledge of market structures, which could well change either suddenly or over time. It would make judgements about acceptable levels of profit, which would be both arbitrary and difficult to calculate. All of this would, of necessity, involve auditing of processors' accounts for part of the required information. The differences between the cost structures and even the scale of processors would somehow need to be taken into account. This complexity would make the Residual Pricing method difficult and expensive to administer.

[24] NRE (2001) *Timber Pricing Review*, Call for Consultancy T009500, p. 3.

CHART 3-1 : NSW HARDWOOD LOG VALUE PRICING SYSTEM

The Hardwood Log Value Pricing System (LVPS) has been used by State Forests of NSW to price hardwood quota quality sawlogs since January 1997.

In NSW the price of logs is set by the "*residual value to a sawlog processing company, after deducting all the reasonable costs of manufacturing, distribution and otherwise conducting a business, including a reasonable level of profit, from the value of the end-products.*"

It "*is intended to result in equity between the purchasers of such logs over the coastal and tableland forests.*" The LVPS derives the relative value of quota quality (graded) sawlogs for all commercial coastal and tableland hardwood species. The system is designed to price individual classes of logs so that their value to the timber industry is equal at the mill door.

The Residual Log Value is an estimate of the value of a class of logs anywhere in the State that has the potential to give customers (i.e., millers) the same commercial return on sale, given the average market price for the products derived from that class of logs with allowances for recovery losses and less logging and production costs and freight to market, i.e.,

		Average market price of logs
Less	……..	Profit (as a fixed %)
Less	……..	Freight to market
Less	……..	Cost of production
Convert to mill door log value by applying recovery %		
Less	……..	Logging costs
Gives	……..	Residual log value

Factors which are commonly applied to assess the changes in value of sawlogs under a periodic review are:

- movements in the prices of end-products which are produced or are capable of being produced from sawlogs;
- prices of comparable sawlogs sold in other markets; and
- changes in industry costs of producing its end-products.

State Forests collects information about movements in the prices of end-products from available sources. One source of information which has been used in price reviews over the past several years is the State Forests Timber Market Survey.

State forests, in association with other east coast forestry agencies, conducts a 'Timber Market Survey' each year. The survey measures the price movements of timber by type and product. An output of the survey is the weighted average price change of hardwood timber products on the east coast.

Source: State Forests of NSW (2000) *The Hardwood Log Value Pricing System*

CHART 3-2 : VICTORIAN PRICING

The price of hardwood logs from public native forests in Victoria is currently determined by the Royalty Equation System (RES). The RES was introduced in the 1950s and last revised in 1991, and has been used since then to review log prices.

The RES is an administered pricing system within a residual approach to log pricing. Its functions are to:

- equitably distribute the State's total log royalty bill between licensees, and
- be an administrative mechanism to set the total amount of revenue to be achieved from sawlog sales.

The RES reflects differences in the market value of sawlogs of different qualities, from different parts of Victoria.

The value of a sawlog to industry is assumed to depend on the amount and quality of products that can be cut from it, and the cost of putting sawn timber on the market. The RES aims to reflect these two aspects of sawlog value, however the way the RES considers them is complex.

Victoria's hardwood log pricing methodology is described in document *The Royalty Equation System for Pricing Sawlogs from Victorian State Forests*.[25]

- **auctions and tenders for access to logs and timber**. Auctions and tenders can be combined with a reserve price or without. Unless a reserve price equivalent to the cost of establishing and managing that forest is included, then the community will not receive an adequate return on the use of the public resource and the forest will not be regenerated. Auction and tenders with reserve prices have been widely used overseas, for instance, the US Forest Service introduced such an approach in the 1940s.[26]

  New South Wales first began to tender the supply of logs from native forests in 1984. In the last three years, 12 tenders have been commissioned for native forest logs in that State. The tenders cover the lower grade logs, with all sawlogs and some salvage logs covered by term agreements under the Forestry Act. This means that 75% of the total timber resource (by volume) taken from native forests in New South Wales is covered by term agreements and the residual value pricing approach. The New South Wales timber industry is not in favour of tendering because of the uncertainty associated with this process.[27]

  In Victoria, the supply of logs from native forests first went to tender in the 1980s. Between 1998 and 2000, approximately 60 tenders were released in that State.[28] As in New South Wales, Victorian tenders cover the lower grade residual logs. Of the 2.5 million m^3 of residual logs allocated each year,

[25] The contribution of others in pulling together this material is acknowledged.

[26] Admittedly, the US Forest Service merely sets the reserve price at the residual value.

[27] State Forests of NSW, pers. comm. (December 2000).

[28] This includes a large number of small, one-year tenders.

500,000 m^3 is allocated to AMCOR under a Forestry Agreement Act, another 1 million m^3 is under licence and the remaining 1 million m^3 is open to tender.[29]

Tasmania first tendered the supply of native forest logs in 1992. Over the past 3 years, some 164 tenders have been put out for sawlogs only. Currently, 30,000 m^3 of the 3.5 million m^3 of timber logged in the State is put out to tender. In a total reverse of the New South Wales and Victorian position, only sawlogs are tendered in Tasmania.

Auctions and tenders for access to the forest by different sets of users, i.e., which would allow loggers to bid against apiarists, tourism operators and others have been proposed but have not been implemented.

Cost and demand reflectivity The debate on log pricing has tended to see the cost of production approach as in total conflict with the residual value approach, i.e., that it is a choice between one or the other. This is incorrect.

In economic terms, the residual value approach describes an estimate of the demand schedule showing how much millers are prepared to pay for logs of different grades and in different locations. The cost of production approach shows the supply cost of different qualities of logs in different locations. As in any market, prices should be both cost and demand reflective. Both approaches therefore have a joint role in setting log prices. Thus, the role of cost of production is to set a minimum reserve price in auctions, tenders and contract negotiations. This dual approach is reported in Tasmania.

Forestry Tasmania negotiates stumpage prices with each customer. In most cases, price adjustments are directly linked to movements in an agreed market price index. (The tendency is towards automatically indexed price adjustments, with a five yearly negotiation about the overall basis for pricing, on a customer-by-customer basis.) In other cases, price adjustments are negotiated separately. The effect of Forestry Tasmania's pricing policy is, however, similar to that of the residual value pricing method employed in New South Wales and Victoria, since more distant wood (or wood that is more expensive to harvest) tends to attract a lower stumpage price.[30]

Forestry Tasmania currently sells 40 per cent of product at mill door and is involved in commercial negotiations with each of its customers on an individual basis. There is therefore, no single uniform pricing formula or description.

> *It is an economic fact of course that the value of our products necessarily reflects the prices in final markets, and the costs necessarily incurred in getting that product to that market. For that reason, location of a forest in respect of topography, roads, ports etc is*

[29] A recent exception to this was the tendering of sawlogs brought on by the forfeiting of a licence. All other sawlogs are, however, currently under licence.

[30] Forestry Tasmania, pers. comm. (December 2000)

> *an economic fact of life in stumpage values. That is why any plantation investor will seek to find land close to roads and ports, on reasonable topography so as to maximise returns. The same applies to every economic activity. However, at least for Forestry Tasmania, that does not translate into a fixed 'royalty equation' system. While that was an approach used commonly in previous times, it has not been the case for many years in Tasmania.*
>
> *… [we] negotiate to best effect on a commercial customer basis, depending upon the quality of the product supplied, the contracts, terms, etc. All of this of course within a context of making a return on the assets we have employed, returns on investment, and the expectations of our shareholder*[31]

Forestry Tasmania reports that it continually reassesses the costs of production that it must cover in each area in order to meet its commercial objectives and as a result will rezone (i.e., withdraw) areas from tender/negotiation where cost recovery cannot be achieved.[32] In other words, Forestry Tasmania appears to effectively use reserve prices based on production cost.

These implicit reserve prices are not formally calculated, published nor audited. This means that public confidence in the Tasmanian arrangements is not as high as it ought to be. Greater transparency would likely reduce conflict and distrust over forest operations. As noted above, calculated costs must be sufficient to ensure an on-going forestry business and therefore cover costs of producing the timber, providing for shareholder returns and ensure future investment.

3.4. CRITIQUE OF RESIDUAL VALUE METHOD

Because the residual value log pricing method is used by the two largest States, it is important to examine this approach in some detail.

In effect, the residual value method of pricing logs provides a variable subsidy.[33] The resulting charge varies below the cost of generating that forest according to the level of cost disabilities in each particular area (and for each log type). The method aims to ensure that the same profit is guaranteed regardless of log type and location. In logic, this is equivalent to guaranteeing banana growers in the Antarctic the same profits as banana growers in more suitable natural climates such as Coffs Harbour. Recent analysis of underpricing of logs is shown in Chart 3-3.

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31 Drielsma, Hans, General Manager Forestry Tasmania, e-mail 20 March 2001.

32 *ibid*

33 The residual pricing method starts with a price calculated from averaging of end-product prices and by deducting processing costs and profit margins, leaves a residual amount available for the payment of royalties/licence fee.

CHART 3-3 : UNDERPRICING OF LOGS

Repeated independent reviews have drawn attention to the underpricing of logs:

> *…a number of studies have found that, in most states, the prices of wood from public forests and plantations have in the past often been below those that a competitive market would achieve… To the extent that logs are underpriced, the activities of the forests products industries are subsidized by taxpayers.*[34]

A KPMG investigation of the market value of licences in Victoria, for instance, found that current prices are between 30 to 60 per cent below what they would be under a commercial approach to pricing.[35]

IMPLICIT PRICE PREMIUM ON TRADED LICENCES

REMAINING LICENCE PERIOD	DISCOUNT RATE	
	4%	8%
5 years	$\$17.97/m^3$	$\$20.03/m^3$
10 years	$\$9.86/m^3$	$\$11.92/m^3$

Source: KPMG review, p. 66

Similarly in WA, a recent royalty review found that an increase in royalty rates of 14.11% for karri products and 19.35% for jarrah products was needed to ensure the long-term commercial viability of timber growing.[36]

The obvious question is why this underpricing is occurring. A major reason is to facilitate continuing regional employment in native hardwood forestry.

> *It could be argued that low prices for sawlogs assist with Government objectives relating to employment, industry and export growth and stability in regional communities. Sawmilling businesses would probably experience difficulty adjusting to significantly higher log prices. There would appear to be some potential for an adverse impact on profitability of sawmill and further processing operations, with adverse consequences for investment and employment.*[37]

This rationale has not, however, been made explicit by any of the State agencies or their commercialised counterparts.

In terms of industry policy, the residual value method is therefore equivalent to a tailor-made tariff against imports which is set at a level to offset the precise cost disability of the particular domestic industry or commodity. Australian governments

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34 *ibid*.

35 Australian Bureau of Agricultural and Resource Economics (1991) *Pricing and Allocation of Logs in Australia*, AGPS, Canberra, p. 23.

36 Arthur Andersen (1997) *General Review of Hardwood Timber Royalties*, report prepared for the Minister for the Environment, p.7.

37 *ibid*., p.70.

abandoned tailor-made tariffs in the 1970s. The residual value method takes the logic to a further level by seeking to guarantee the same profits regardless of location.

Since the residual value method results in licence charges set at levels precisely tailored to the situation of individual loggers and areas, this method commands strong support from the industry.[38] Not surprisingly, "*while the* [NSW] *Government may become involved in price determination, there are very few instances of such action over the past 15 years.*"

By subsidising the native forest dependent industry for the use of the forests, the practice adversely affects:

- the commercial performance of the suppliers of the forest, the SFAs, since it decreases their profits;
- alternative suppliers of hardwoods and suppliers of substitutes for hardwoods whose operating costs are considerably higher than those of the native forest dependent industry; and
- the value of the forest for other uses (e.g. conservation, water production and tourism) since the approach distorts the value of the forest for these purposes.

The application of the residual value pricing method thereby increases the rate at which native forests are logged, especially in remote areas. This would not happen under a fully commercial arrangement since the prices for timber that would be charged by a commercial enterprise would more closely reflect the costs of supply so that more remote forest resources would not be subject to utilisation.

> *A further problem for this method is that if the return to the public purse slips below what provides a reasonable return to the public purse, public policy may indicate that the resource should not be harvested until market conditions can provide a satisfactory return. The Residual Pricing method sets the royalty post-facto, which would mean action to reduce supply because royalties are too low also would only be possible post-facto.*[39]

[38] It is the industry's preferred method because it does reflect their ability to pay. The industry points to the notion of economic rent, saying that in the absence of free market price determination, a residual price system is perhaps the only way to determine the maximum economic rent which can accrue to the resource. This means, in theory, that residual pricing could result in higher royalties in a strong end-product market situation. The end product market is, however, more often characterised by strong competition, which means the method would more often result in lower royalties.

[39] *ibid*, p. 64.

The costs to the community associated with the use of the residual value method are therefore high:

> *… perhaps the most coherent objection to the residual pricing method is that the public return comes last, after all other interests have been satisfied. In this situation, the Residual pricing method would be hard to present as being in the public interest.*

3.5. OPTIONS FOR INDEPENDENT PRICES OVERSIGHT UNDER NCP

Under a fully corporatised model and in which the government imposed all appropriate charges (for land, local rates), expected a return on its investment and did not provide explicit subsidies, we would expect the prices charged by the corporatised entity to cover the cost of growing/production and to respond to changes in demand. However, until the body is corporatised, transitional measures must be considered.

One option for achieving compliance with this competitive neutrality issue would be to expose log pricing to the transparent process of independent prices oversight. To promote greater public confidence in the pricing mechanism, the governments should use an external body. This body may be the State's pricing or competition regulator (IPART or the ORG), consultants[40] or a Commonwealth body, such as the Productivity Commission.

This option is consistent with the role of the SFAs as monopoly suppliers of hardwood logs as inputs into subsequent and progressively more competitive markets. This option would therefore meet the commitments of each State and Territory to independent prices oversight of all significant government business enterprises which are monopoly or bear monopoly suppliers (Chart 3-4).

A profit maximising monopolist will restrict output in order to gain a higher price.

The fact that SFAs have not typically sought to maximise profits does not alter the fact that they can and do exert market power by charging prices which are not cost reflective and that these prices have a major influence in the markets in which their own products are sold and in other markets.

Despite their monopoly status and focus, none of the State forest businesses has to date been subject to independent prices oversight. (The Carr Government had foreshadowed such a review by Independent Pricing and Regulatory Tribunal but has not proceeded with this proposal. In Victoria, a forest produce pricing consultancy was announced by the Bracks Government and tendered in early 2001.)

[40] Preferably chosen by Treasury to reduce the ability of the Department to 'shop' for favourable consultants.

CHART 3-4 : NCP REQUIREMENTS FOR PRICE REGULATION

The CPA provides a generic definition of what is meant by independent prices oversight.

2.(4) An independent source of prices oversight advice should have the following characteristics:

(a) *it should be **independent** from the government business enterprise whose prices are being assessed;*

(b) *its prime objective should be one of **efficient resource allocation**, but with regard to any explicitly identified and defined CSOs imposed on a business enterprise by the government…*

(c) *it should apply to **all significant government business enterprises** that are monopoly, or near monopoly suppliers of goods or services (or both);*

(d) *it should permit **submissions** by interested persons; and*

(e) *its pricing **recommendations**, and the **reasons** for them, should be **published**.*[1] [bolding added]

The key phrase is the first, that the prices oversight should be "*independent from the government business enterprise*". This does not require that the price setting should be independent from Ministerial direction or responsibility. In other words, independent price regulation can be defined in a minimal form as independent from the business enterprise or, more comprehensively and expansively. The CPA adopts the minimal definition

Prima facie, the management and exploitation of native forests controlled by the State agencies is a government business activity falling with the ambit of Clause 2 of the CPA, i.e., within the ambit of the requirements for independent prices oversight.

As a signatory to the CPA, each State has committed under Clause 2 to consider independent prices oversight of State and Territory government business enterprises.

Either the pricing methodologies and levels set by the State agencies should be independently reviewed or some other demonstrably better method should be introduced.

3.6. CONCLUSIONS AND RECOMMENDATIONS

The pricing of logs from public native forests raises major concerns in terms of competitive neutrality. There is *prima facie* evidence from ABARE and independent consultants that logs are underpriced.

To comply with competitive neutrality, a framework of principles for log pricing needs to be adopted. The need for a pricing framework is especially evident in New South Wales and Victoria where pricing continues to be based on the residual value approach

with its attendant cross-subsidies and disregard of underlying costs. While commercial pricing must be undertaken by the commercial entity, the principles used need to be subject to independent review.

In seeking a better framework for pricing the services of the State forest businesses, the 'pricing principles' set down in the National Forest Policy Statement (NFPS) will need to be strengthened. This strengthening requires that the existing loose reference to market-based pricing should be cast aside. The ambiguity of the 'market-based' principles has allowed each State to pursue its own methodology and the deleterious consequences of the residual value method to be sustained in New South Wales and Victoria.

Pricing principles for licensed logging in native forests include:

- the form and duration of licences need to provide adequate resource security to allow loggers and millers to invest;
- log prices and licence fees should be set at no less than the full cost of production of that forest and timber;
- cost of production estimates should be independently and transparently derived in processes at arms length from the forest agencies, i.e., in accord with the principles of independent prices oversight;
- licence fees and log prices may be set above this level to allow the community to share in the benefit of the exploitation of a public resource and, where relevant, recognise the opportunity cost of other uses and values; and
- tenders and auctions with minimum reserve prices set at no less than the cost of production should be used to allocate licences in new areas.

One option for achieving compliance with this competitive neutrality issue would be to expose log pricing to the transparent process of independent prices oversight.

This option is consistent with the role of the SFAs as monopoly suppliers of hardwood logs as inputs into subsequent and progressively more competitive markets. This option would therefore meet the commitments of each State and Territory to independent prices oversight of all significant government business enterprises which are monopoly or near monopoly suppliers.

For foresters and others committed to sustaining the available forest resource and running a commercial business, the options of either independent prices oversight or auctions with a cost-based reserve price set by an independently endorsed methodology should be attractive.

Both potentially offer the frameworks and disciplines which can assist in resolving increasing pressures and tensions. These pressures include, of course, increasing

conservation demands, a dwindling resource base for logging and exploitation, increasing constraints on management discretion plus the desire the sustain jobs in rural electorates.

Such pressures threaten to push down log prices below the cost of generating that forest and to destroy any notion of sustainability.

One of the arguments against independent prices oversight of access to the forest resource is that the SFAs face competition from imports either directly or down stream. The fallacy of this argument is illustrated in Attachment E in a stylised description of the market place. We show that even if imports and plantation timber were perfect substitutes (i.e., timber were a pure commodity) the price level for timber from native hardwood forest still has the direct effect of setting the volume of timber obtained from the native forests controlled by the State agencies. Conversely, it also impacts on how much is grown in Australian plantations. Concerns over the level of exploitation of the forest resource and the shift to recognise more fully other competing values and uses means that underpricing of the forest resource is the key issue rather than overpricing.

Auctions with reserve prices established through independent prices oversight and independent monitoring of code compliance and certification are methods of combating these pressures and ensuring that the community receives a return on the use of its forests and that there is certainty that this use is sustainable.

Overall:

- prices should be subsidy-free and recognise the full cost of production including the price of alternative uses;
- auctions and open competitive tenders should be applied to all licences for saw logs and pulp;
- logging licences should be contestable by all natural persons; and
- the full cost of production of timber for State forests agencies should be defined and measured to remove any advantages or disadvantages stemming from the public ownership of the business, ie., in accord with the principles of competitive neutrality.

4. STRUCTURAL REFORM

4.1. INTRODUCTION

Structural reform of monopolies is a prerequisite of State compliance with National Competition Policy. Through Clause 4 of the CPA, State Governments have signed a contract with the Commonwealth Government in which they agree to undertake certain actions when they introduce competition to a sector traditionally supplied by a public monopoly.

In this Chapter, we first confirm that Clause 4 of the CPA is directly applicable to the forestry industry and the SFAs. The current structure of the forestry industry in all four States is then examined in the context of Clause 4. We then identify what we believe to be the key objectives of structural reform of forestry, drawing upon some principles established by the NCC. These objectives provide, in turn, the basis for an assessment of compliance by the States to the major sections of Clause 4 of the CPA.

The NCC's framework for the third tranche assessment reported:[41]

- **New South Wales**

  New South Wales will also need to show that it has met its competitive neutrality commitments in relation to State Forests of New South Wales.

- **Victoria**

  The sale of the Victorian Plantations Corporation and establishment of Forests Victoria raises structural reform obligations and regulatory neutrality issues under clauses 4 and 3 of the CPA, respectively. The Government will need to demonstrate that its approach to, and the outcomes of, these institutional changes are consistent with its CPA obligations.

- **Western Australia**

  The Government will also need to demonstrate that any structural reform obligations (clause 4) arising from the establishment of the Conservation Commission of Western Australia and the Forest Products Commission have been met.

- **Tasmania**

  Tasmania will need to provide information on the application of competitive neutrality to forestry and confirm that its approach meets its competitive neutrality obligations.

[41] NCC (2001) *op. cit.*, pp. 14.5-14.14.

4.2. APPLICABILITY OF CLAUSE 4

Before assessing compliance of State-based forestry industries to Clause 4 of the CPA, we must firstly examine whether Clause 4 does in fact apply to State Forestry Agencies.

Section 1 of Clause 4 states that:

> *(1) Each Party is free to determine its own agenda for the reform of public monopolies.*

Furthermore, Section 2 specifies certain actions where a Party:

> *(2) … introduces competition to a sector traditionally supplied by a public monopoly …*

The specified actions of separation of regulatory from commercial functions, separation of monopoly from competitive functions, and so on are generic requirements of competition reform, reflecting well-established and broadly applied principles.[42] They also have specific applicability to forestry.

Forestry activities in Australia have traditionally been dominated in most States by State forestry commissions/agencies. These agencies operated as integrated monopolies undertaking virtually the entire suite of functions ranging from forest policy to scientific research to setting log prices to day-to-day operations. This bundling of functions within a single agency was very much in keeping with the responsibilities of most public resource management agencies established in Australia, North America and the UK in the late nineteenth century and first half of the twentieth century. These agencies were established to ensure the 'wise use' of resources for the betterment of society, based on a paternalistic view that all aspects of resource management were best left in the hands of the professionals who ran the agencies.

Over a long period, governments (and market forces) have progressively introduced competition into the forestry sector, for instance, by

- withdrawing from direct logging and milling of native hardwoods;
- establishing softwood plantations to demonstrate the commercial viability plantations and acceptance of softwood in place of hardwood in major markets;
- promoting private investment in softwood plantations through programs such as the Commonwealth/State 'Vision 2020';
- introducing tenders/auctions for selected hardwood logs and forest produce (albeit on very limited bases outside Tasmania);

[42] The principles were at addressed at length in Steering Committee on Government Trading Enterprises (1988) *A Policy Framework for Improving the Performance of Government Trading Enterprises,* report to the NSW Government.

- promoting farm forestry as a method of revegetating catchments to slow the spread of dryland salinity;
- recognising, at the policy level, competition between alternative values and objectives for use of the forest resource; and
- increasing the areas of formal reserves and national parks particularly under the Regional Forest Agreements (RFAs) and other decisions over the past decade. With essentially finite hardwood resource on public lands, the increases in formal reserves has had the effect of reducing the resource available for exploitation and hence has increased competition for that resource and in many areas, the intensity of that exploitation.

In each of the four States reviewed here (New South Wales, Victoria, Western Australia and Tasmania), the forestry sector was traditionally controlled and supplied by a public monopoly. In each State, governments have progressively introduced and increased competition. This has not been the result of a single decision or event. Rather it has been progressive and is continuing. Changes in market forces have also contributed to this increased competition.

As a result, we conclude that Clause 4 of the CPA applies both generically and specifically to the forestry activities of governments in each of the four States. We would be surprised if there were any serious disagreement with this conclusion. (Indeed, all four States have made some structural reforms.) Rather the more interesting questions are: what structural reforms have been introduced in each State and how adequate or inadequate are these in terms of the principles contained within Clause 4. We review these questions below.

4.3. OVERVIEW OF STRUCTURAL ARRANGEMENTS IN EACH STATE

Chart 4-1 below provides an overview of the current institutional arrangements for the forestry industry, including the division of responsibilities between and within SFAs and the other departments and agencies involved in forestry management. It is accompanied by a state-by-state description and assessment of current (March 2001) arrangements.

4.3.1. NEW SOUTH WALES

In 1992, the Forestry Commission of NSW began trading as State Forests of NSW, a corporatised[43] Government Trading Enterprise (GTE) with a board of Directors

[43] A commercialised organisation basically operates on profit principles but still generally operates either within a departmental structure or under a Ministry. Corporatisation involves a distinct separation of the Government Business Enterprise (GBE) functions from the Government, with the establishment of a Board whose prime responsibility is the management of the GBE. The GBE is either constituted under the Corporations Law as a limited liability company, or as with State Forests of NSW, by its own corporate form in legislation. In contrast to commercialised entities,

responsible to the Minister for Forests. State Forests of NSW is physically and operationally separated from the Department of Land and Water Conservation (DLWC), although currently sharing the same departmental head.

While commercial operations are a major activity for State Forests, the organisation also has responsibility for policy development and forest management, including regulatory and research functions. In 1998/99, State Forests spent $15.7m on these functions.

The **objectives** of State Forests of NSW are:

- conservation of biodiversity, soil and water, heritage value and productivity of State forests;
- increase the area of hardwood and softwood plantations to meet market opportunities;
- meet financial targets with the NSW Government;
- a focus on the needs of customers and open up new markets, and product or service opportunities for State Forests and the products industry;
- ensure the organisation is structured and staff are suitably qualified and experienced, to deliver the objectives of this Plan;
- publicly report against objective indicators of the environmental management performance of State Forests;
- foster a capable and skilled workforce with positive attitude, committed to the achievement of State Forests objectives; and
- achieve a safety and rehabilitation record which is the best in the Australian forest industry.[44]

State Forests face two of the minimum requirements under **competitive neutrality**:

- tax equivalent regime;
- debt guarantee fees; but
- it is not subject to regulatory neutrality.

In terms of the broader principles, State Forests does **not**:

- pay land costs; nor
- local government rates.

corporatised GBEs, while still owned by Government and serving a public purpose, are more autonomous in day-to-day decisions regarding investment, revenue and expenditure, and strategy. A GBE primarily has a commercial focus but could have secondary non-commercial objectives.

[44] State Forests of NSW, *op. cit.*, p. 4.

CHART 4-1 : OVERVIEW OF STRUCTURAL ARRANGEMENTS FOR THE FORESTRY SECTOR

FUNCTION	DEPARTMENT/AGENCY RESPONSIBLE FOR FUNCTION			
	NSW	VICTORIA	TASMANIA	WA
Policy				
Sectoral policy objectives	Department of Urban Affairs and Planning (DUAP)/ Resource and Conservation Assessment Council	Department of Natural Resources and Environment (NRE)	Department of Infrastructure, Energy and Resources (DIER)	Department of Conservation and Land Management (CALM)
Forest management plans (including sustainable yields, reserves and licensing)	DUAP/RACAC/ State Forests of NSW (SF)/EPA/ NSW Fisheries/NPWS	Forests Service, NRE (FS)	Forestry Tasmania	Conservation Commission (CC) /CALM/FPC
Forest practice codes	SF	FS	Forest Practices Board (FPB)	CALM
Regional industry policy	Dep't of Information Technology and Management (DITM)/Dep't of State and Regional Development (DSRD)	Department of State and Regional Development (DSRD)/FS	DIER	Forest Products Commission (FPC)/Forest Industries Advisory Board
Pricing policy	SF	Forestry Victoria, NRE (FV)	Forestry Tasmania	FPC/CC
Operations				
Logging and milling	Private	Private	Private	Private
Forest management (implementation of plans and codes)	SF	FV	Forestry Tasmania	CALM
Letting of logging (contracts/ auction)	SF	FV	Forestry Tasmania	FPC
Public plantations management	SF	Now privatised (Hancock Timber)	Forestry Tasmania	CALM
Private plantations promotion	Office of Private Forestry, DITM/SF	FV/ Private Forestry Council	Private Forests Tasmania (PFT)	FPC
Regulation				
Monitoring of plan compliance	SF/DUAP/EPA/ NPWS/NSWF	FS	Forestry Tasmania/DPIW	CC
Monitoring of code compliance	SF	FS	Industry/FPB	CC

Policy development and planning on State forest land involves several departments and agencies, which makes the institutional structure of forestry in New South Wales arguably more complex, although not necessarily more independent than in other States:

- Forestry sector policy objectives are essentially the responsibility of the Resource and Conservation Division of DUAP. DUAP services the Resource and Conservation Assessment Council (RACAC), an independent advisory council comprising industry, union and environmental non-government organisation (NGO) representatives.
- Forest management plans are also the responsibility of DUAP and RACAC, although State Forests of NSW and regulatory agencies, including the EPA, NSW Fisheries and the NPWS, have significant input into the plans.[45]
- The Department of State and Regional Development (DSRD) oversees regional industry policy but policy in relation to structural reform of the industry, is coordinated by the Forest Policy Unit of the Department of Information, Technology and Management (DITM).[46]
- Pricing of the native forest resource continues to be undertaken by State Forests of NSW despite its effective monopoly status in controlling the hardwood resource. The entity sets prices for native forest products sold in New South Wales, generally using residual value pricing methodologies (see Chapter 3 for further discussion). It also sets the price for plantation products from State owned plantation land.

The **operational/commercial** aspects of the forestry sector are overseen by State Forests of NSW through its business units:

- Forest management and logging contracts from public forests are the responsibility of the Native Forest Division.
- Management of plantations and contractual arrangements for plantations, both on public and private land, are handled by the Softwood Plantations and Hardwood Plantations Divisions.
- Promotion of plantations on private land is now coordinated by the Office of Private Forestry (OPF), which has recently been established within DITM. The OPF still reports to the Minister for Forestry and State Forests of NSW is also

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[45] Since 1995, RACAC and DUAP have been responsible for overseeing the development and implementation of NSW Forest Agreements under the NSW Forestry and National Park Estate Act 1998. Forest Agreements have to date been reached for three regions: Upper North East, Lower North East, and South East (Eden). Draft management plans covering issues such as sustainable yields, protected areas and monitoring and reporting frameworks have been prepared for these regions. The operational aspects of the Forest Agreements are implemented through Integrated Forestry Operations Approvals (IFOA) which include license conditions.

[46] The FISAP program is administered by the Forest Structural Adjustment Committee (FSAC), FSAC Government Appeals and Review Panel (GARP), the Business Exit Assistance/Industry Development Assistance Working Group and the Worker Assistance Working Group.

involved in plantation investment on private land. Private plantations are also being supported through the Plantations and Reafforestation Act 1999, administered by DLWC.

Monitoring and enforcement of codes of forest practice and management plans remains largely unseparated from day-to-day operations. Logging operations in NSW are regulated by Codes of Forest Practice, State Forest Licence conditions, Codes of Procedure and Harvesting Plans.[47] Logging supervisors from State Forests of NSW oversee logging operations on a day-to-day basis and Regional Operation Managers also conduct random checks. The Internal Audit and Review team also undertakes random audits of a selection of operations in each District.

The NSW Environment Protection Authority (EPA), the NSW Department of National Parks and Wildlife Service (NPWS) and NSW Fisheries are involved in the regulation of some of the licence conditions established under the Integrated Forestry Operations Approvals (IFOA) – e.g., on threatened species, soil erosion. The agencies occasionally undertake random audits of State Forest sites for compliance with licence conditions.[48]

State Forests must, like private operators, comply with the Native Vegetation Act, administered by the DLWC, when purchasing land on which to establish plantations. On the other hand, codes of forest practice do not apply to the management and harvesting of forests on private land.

In summary, achievements and shortcomings with respect to structural reform of forestry management in NSW are as follows:

- State Forests of NSW now has independent legal status, a Board of Directors and a commercial focus. The NSW Government currently applies tax equivalence and debt guarantee to State Forests.
- There has been separation of some aspects of policy development and regulation from commercial and operational functions, notably through the independent role of the RACAC. However, there is a lack of independent monitoring of compliance with codes and standards for native hardwood logging, with State Forests still having a significant role in this area. Furthermore, there is no independent monitoring of compliance with codes and standards for plantations.

[47] The Code of Logging Practice specifies State-wide procedures for licensing, operations etc. The licence conditions establish procedures to be followed by individual operators. The Codes of Procedure aim to ensure that revenue is collected for all material removed from the forest and that the logs are used for the highest value products. Harvesting plans are site specific documents which specify when, where and how the operation will take place. Each harvesting plan must be consistent with a local Management Plan which sets out the overall objectives for a particular area.

[48] Available online at: http://www.forest.nsw.gov.au/Frames/f_manage.htm (September 2000)

- There is no independent assessment of pricing rules for native hardwoods and plantation products. (As noted in Chapter 3, this is a major concern in terms of compliance with NSW commitments to competitive neutrality under clause 3.)
- There has been partial separation of responsibility for the promotion of native forest logging from promotion of private plantations, through the creation of the Office of Private Forestry.

4.3.2. VICTORIA

Prior to July 1999, the Forest Services section of the Department of Natural Resources and Environment (NRE) was responsible for all aspects of public forestry in Victoria. From that date, Forestry Victoria has been responsible for commercial forestry operations in that State. Forestry Victoria is a State service unit within NRE. Although it produces annual accounts, Forestry Victoria has no separate legal status, i.e. it is not a statutory authority, nor is it corporatised. At best, it is only lightly commercialised.

As seen in Chart 4-2, the Director of Forestry Victoria reports through the Deputy Secretary Operations, NRE and Departmental Secretary to the Minister for Environment and Conservation. The Director of Forests Service, NRE also reports to the Departmental Secretary. This means that conflicts are generally resolved internally within the Department and non-transparently, other than through the cabinet process. As discussed in section 4.4.2, this situation raises a major question mark over the adequacy of separation of the regulatory and operational functions of the industry. *Prima facie*, Victoria fails the clause 4 test for separation of functions.

The **objectives** of Forestry Victoria are to:

- improve the efficiency and effectiveness of operating Victoria's State forests;
- improve the scope and quality of services to meet customer expectations;
- achieve a commercial rate of return and dividend acceptable to the Government;
- regenerate commercial native forests to maximise productivity;
- market and sell forest management expertise; and
- position to bid competitively for the provision of forestry services.[49]

The Victorian Government appears to define public trading enterprises more narrowly than other jurisdictions. It therefore has fewer corporatised entities.[50]

Forestry Victoria's status as a commercialised entity within NRE means that the Victorian Government does not apply the specific requirements of clause 3(4)

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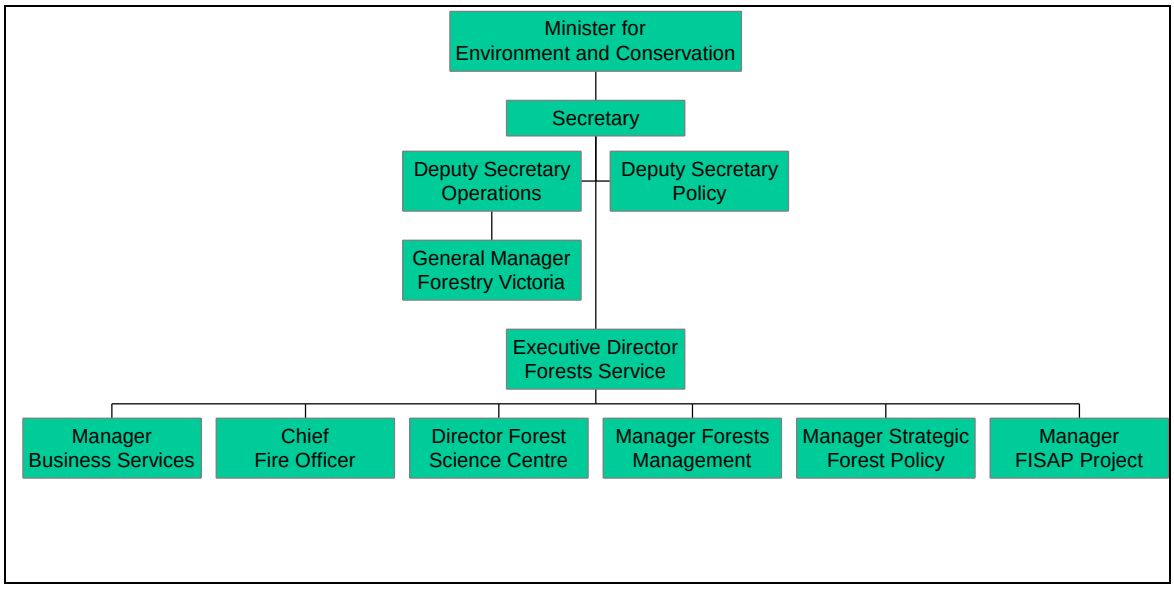
[49] Available online at: http://www.nre.vic.gov.au/web/root/domino/cm_da/nrenfor.nsf/frameset/NRE+Forestry?OpenDocument

[50] It also has fewer due to earlier privatisations of corporatised entities.

(**competitive neutrality**), viz tax equivalent regime, debt guarantee fees and regulatory neutrality. It has also currently failed to apply the equivalent regime under clause 3(5) for significant business entities. Further:

- Forestry Victoria does not pay land costs; and
- Forestry Victoria does not pay local government rates.

CHART 4-2 : SIMPLIFIED ORGANISATIONAL CHART - NRE FORESTRY



Source: Derived from NRE organisational chart, available online at:http://www.nre.vic.gov.au/web/root/domino/cm_da/nrencor.nsf/frameset/NRE+Corporate?OpenDocument

Policy development and planning for forestry is virtually all undertaken within DNRE including setting of sectoral policy objectives. The Forests Service unit within DNRE is responsible for performing most of these policy functions including:

- Forest Management Plans[51], which are produced by the Forest Management Branch of Forests Service. They are developed in accordance with the Code of Forest Practices for Timber Production.
- research and development; and
- regional industry policy.

Pricing policy for the native forest resource, including the setting of stumpage rates, is however the responsibility of Forestry Victoria, despite its effective monopoly status in controlling the hardwood resource. Like State Forests of New South Wales, Forestry Victoria sets prices for all native forest resources sold in the State, principally using residual value pricing methodology (see Chapter 3 for further discussion).

[51] These plans address biodiversity conservation, stream and catchment protection, timber production and recreation and cultural heritage.

The operational/commercial aspects of the forestry sector are principally also the responsibility of Forestry Victoria including forest management in native forests and logging contracts.

The management of plantations is now in private hands, however. Plantations Victoria, which was responsible for all publicly owned plantations in Victoria, was briefly corporatised before being privatised through a trade sale to Hancock Timber.

The promotion of private plantations is now the responsibility of Forestry Victoria and the Private Forestry Council, a semi-autonomous representative council serviced by Forestry Victoria. The Council has produced a private forestry strategy '*Private Forestry in Victoria: Strategy Towards 2020*'.

Monitoring and enforcement of codes of forest practice and standards is undertaken by NRE's Forests Service, to the extent that it is separated from Forestry Victoria, NRE. Certainly, there is no independent board, as in Tasmania, to oversee the regulatory process.

Monitoring and reporting of compliance with management plans is also the responsibility of Forests Service. As previously noted however, the independence of Forests Service in carrying out these regulatory functions is not adequate given its location within NRE.

Compliance with the Code of Forest Practices is monitored on public land by NRE employees.[52] On private land, monitoring of the code is essentially the province of local government. From an environmental perspective, neither approach appears satisfactory.

In summary, achievements and concerns with respect to structural reform of the forestry industry in Victoria are as follows:

- Forestry Victoria has no separate legal status being neither a statutory authority nor corporatised.
- None of the specific requirements of competitive neutrality currently have been applied to Forestry Victoria.
- At best, there is only partial separation of the policy and regulatory from commercial functions of the industry. Although there has been separation within NRE of the policy and regulatory functions from commercial functions, Forestry Victoria and Forests Services:

[52] The Auditor General has previously noted problems with this system, namely that there is a strong disincentive for departmental officers to reprimand negligent contractors given the close rural communities in which the officers and contractors reside. The Tasmanian approach to regulation may overcome this 'proximity' issue to some extent. In any case, though, it is a concern that is independent of the extent and adequacy of structural separation.

  - are in the same department and have the same departmental head;
  - have the same minister; and
  - have policy, commercial and regulatory decision-making processes that are not transparent.

- One consequence of this situation is that policy development, including the development of management plans and setting of licence arrangements, is not sufficiently independent of commercial operations.
- Another consequence is that there is no independent monitoring of compliance with codes and standards for timber harvesting in native forests.[53]
- A further consequence is that there is no independent assessment of pricing for either native hardwoods or plantation products.
- There are also concerns about the ability of local government to adequately monitor the Code of Forest Practices on private land.[54]
- Development of a Private Forestry Strategy by the Private Forestry Council and Forestry Victoria has led to a partial separation of responsibilities for the promotion of native forest logging from plantations in Victoria.

4.3.3. TASMANIA

Before 1994 nearly all of the policy, operational and regulatory functions of forestry in Tasmania were the domain of the State Forestry Commission. In 1994, following the corporatisation of the Commission, Forestry Tasmania and Private Forests Tasmania came into being.

Forestry Tasmania is a GBE, with a Board of Directors, which is directly responsible to the Minister for Infrastructure, Energy and Resources. It has a clearly defined vision, mission and set of objectives. In most cases, these objectives have specific strategies, targets and outcomes tied to them and are reported against in the annual report. The **objectives** of Forestry Tasmania are to:

- *Improve profit performance and returns to shareholders*
- *Develop a world competitive hardwood and softwood forest resource which is sustainably managed and meets all statutory environmental standards*

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[53] An example of what can happen when monitoring and enforcement of regulations is not independent of operational functions has recently been publicised in Victoria. An example relates to the ringbarking and poisoning by NRE officers of 100 ecologically and culturally significant trees in the Cobboboonee state forest, in breach of a State Government moratorium on the practice [see Miller, C. (2001), 'Anger at culled trees', *The Age*, 17 March].

[54] The State Government has recently allocated $800,000 over four years to help implement the Code of Forest Practices on private land, in accordance with recommendations made by the Private Forestry Council [see Hopkins, P (2001) 'Bracks code governs private land', *The Age*, 19 March]. It is too early yet to assess whether these changes will overcome the institutional deficiencies with monitoring on private land.

- *Meet customer requirements and expand the customer base in domestic and international markets*
- *Enjoy the broad support of the Tasmanian community for State forest management.*[55]

Forestry Tasmania is alone amongst SFAs reviewed here in that it meets all specific **competitive neutrality** requirements under clause 3(4). However:

- it does not pay land costs; and
- it does not pay local government rates.

Responsibility for **forest policy** in Tasmania is segmented, with a number of departments and agencies having a policy role:

- Sectoral policy objectives are developed through the Department of Infrastructure, Energy and Resources (DIER). DIER is also responsible for industry policy.
- District Forest Management Plans have been developed by Forestry Tasmania, with some input from relevant regulatory agencies such as the Department of Primary Industries, Water and Environment. The Plans cover wood production (in both native forests and plantations), biodiversity conservation, other productive uses of the forests and relevant legislation and licence conditions.
- Forest Practice Plans and Codes are produced by the Forest Practices Board. The Board is an independent statutory body that has responsibilities for fostering a cooperative approach towards policy development and management of the forest practices system outlined in the Forest Practices Act. These responsibilities include the regulation and monitoring of day to day forestry operations in Tasmania. Under the Forest Practices Act, Forest Practice Plans are required for most forest operations.[56] These must be developed in accordance with the Forest Practices Code that specifies how forest operations should be planned and conducted.[57]
- Pricing rules for native forest products in Tasmania are not independently set. Although auctioning or tendering processes are often used by Forestry Tasmania for the sale of sawlogs, the rules by which reserve prices are set by Forestry Tasmania are not transparent (see Chapter 3 for a further discussion).

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55 Forestry Tasmania, *op cit*, p. 5.

56 Including the establishment of forests, the harvesting of timber and the construction of roads and the use of quarries in connection with forest operations. The plans will include details on the location of roads, planned harvesting system, reforestation provisions and stocking standards, and measures for the protection of soils, water and other natural and cultural values. http://www.fpb.tas.gov.au/fpb/docs/plans_main.htm.

57 The Code covers the establishment and maintenance of forests, including the stocking or restocking of land with trees, the harvesting of timber and the construction of roads and other works. Information obtained online. http://www.fpb.gov.au/fpb/docs/code_main.htm (September 2000).

The **operational functions** of forestry on public land, including native forest and plantations management and logging contracts, are all undertaken by Forestry Tasmania.

Promotion of private forestry investment and development is undertaken by a separate, government funded authority. This authority, Private Forests Tasmania, assists the private forest sector to manage native forests and also encourages the expansion of plantations and the use and value of trees in land management. Like Forestry Tasmania, Private Forests Tasmania has a board of directors who are responsible to the Minister for Infrastructure, Energy and Resources.[58]

Monitoring and enforcement responsibilities in Tasmania are shared:

- Monitoring of District Forest Management Plans is coordinated by Forestry Tasmania, although regulatory agencies can enforce relevant licence conditions.
- Monitoring and enforcement of forest practice plans and codes are coordinated by the Forest Practices Board. According to the Board, "*Tasmania's forest practices system is primarily delivered under self-regulatory processes backed up by independent monitoring and enforcement by the Forest Practices Board.*"[59] Forest Practices Officers are employed directly by the forestry companies to plan and supervise forestry operations. This self-regulatory process is then underpinned by independent audits of operations undertaken by independent forest practices officers together with specialist staff of the Board.[60] In 1998-99, the Board undertook a random sample covering 15 per cent of annual timber harvesting operations on private property and State forest in Tasmania.[61]

  Appeals in relation to applications for private timber reserves, timber harvesting plans and three-year plans can be lodged with the Forest Practices Tribunal but there are no provisions in the Act for third party appeals.

In summary, achievements and concerns with respect to structural reform of the forestry industry in Tasmania are as follows:

- Forestry Tasmania has now been corporatised and has a strong commercial focus. It meets the minimum requirements under competitive neutrality.
- There is now a clear and transparent separation of some of the policy and regulatory/monitoring and commercial functions between the different forestry institutions, each of which has an independent legal status and board. This separation has been achieved through:

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58 http://www.privateforests.tas.gov.au (September 2000)

59 http://www.fpb.tas.gov.au/fpb/docs/regulations_main.htm

60 These results are published in the Board's annual report which is tabled before Parliament.

61 Forest Practices Board (1999), *Annual Report 1998-99*, Forest Practices Board, Hobart.

  - creation and operation of the Forest Practices Board; and
  - creation of Private Forests Tasmania.

- The independence of monitoring operations is greater than in Victoria.
- The separation of some of the policy and regulatory processes has been achieved at the institution level. However, as there is a lack of separation at the ministerial level, with all three forestry bodies reporting to the one Minister, Tasmania has not instituted a strong model of separation (see section 4.4.2).
- There is no independent assessment of pricing rules for native forest products.

4.3.4. WESTERN AUSTRALIA

The management of forestry in Western Australia was substantially restructured in late 2000 with enactment of the *Forests Products Act 2000* and the *Conservation and Land Management Amendment Act 2000*. Whereas the Department of Conservation Land Management (CALM) was previously responsible for virtually all policy, operational and regulatory functions associated with forestry, these functions are now split between CALM and two new bodies, the Forest Products Commission and the CC.

The Forests Products Commission (FPC) was established through the *Forest Products Act 2000*, with responsibility for commercial activities in native forest and plantations. The seven-member FPC will operate as a statutory authority reporting to the Minister for Forest Products. It will develop an annual strategic development plan and an annual statement of corporate intent for the approval of the Minister for Forest Products and the Treasurer. It will operate on a commercial basis, paying a dividend to the Government after deduction of costs. The **mission and objectives** of the FPC are:

> *To contribute to Western Australia's economic and regional growth by:*
>
> - *developing the sustainable use of the State's native and plantation timber resources;*
> - *promoting local value adding for these resources; and*
> - *achieving appropriate returns to the State for the use of publicly-owned and FPC-managed timber resources*[62]

The Forest Products Commission meets two of the minimum specific requirements of **competitive neutrality** under clause 3(4): it makes tax equivalent payments and pays debt guarantee fees. It does not face regulatory neutrality. In terms of the broader competitive neutrality objectives, the FPC:

- does not pay land costs;
- does not pay local government rates.

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[62] http://www.fpc.wa.gov.au/about.html

The CC was established through the *Conservation and Land Management Amendment Act 2000*. It is a statutory authority with a permanent Secretariat, and will report to the Minister for the Environment. The Commission will be the vesting body for all conservation lands including national parks, nature reserves, conservation parks, State forests and timber reserves. The Commission includes an auditing section that will oversee CALM's implementation of management plans as well as the harvesting activities of the Forest Products Commission.

Forest policy in Western Australia is now principally the responsibility of the CC, although both CALM and the FPC have significant input into this area:

- Forest management plans for State forests are ultimately the responsibility of the CC. CALM still has a responsibility for preparation of the management plans, but they must be approved by both the CC before they can be implemented. Furthermore, under section 27 (2) of the CALM Amendment Act 2000, the Minister for Forest Products must also agree to the sections of a management plan relevant to its operations (e.g., sustainable yields and changes to timber reserve boundaries) before the management plan can be finalised.
- Development and implementation of forest practice codes is still the responsibility of CALM.
- Industry policy responsibilities are shared between the Forest Products Commission and the Forest Industry Advisory Board, which has been established to advise the Minister for Forest Products on native hardwood timber industry policy.
- Pricing responsibilities are shared between the CC and the Forest Products Commission. The CC provides advice to the Minister on the appropriate level of native forest royalties, however it is the Forest Products Commission that ultimately sets the prices for timber products.

The **operational functions** of forestry are shared between CALM and the Forest Products Commission. The FPC is responsible for all aspects of commercial forestry operations of native forests and public plantations including logging contracts and the promotion of public and private plantations. The primary responsibility of CALM is now supervision of the production of timber under contract to the Forests Products Commission. It is also responsible for other aspects of implementation of the management plans, both in native forests and public plantations, including nature conservation, tourism, sustainable levels of timber production and regeneration.

Responsibility for the **audit and monitoring of compliance** with management plans and codes of forest practice rests with the CC.

In summary, achievements and concerns with respect to structural reform of the forestry industry in Western Australia are as follows:

- FPC has been created as statutory authority, with an independent board and with a strong commercial focus. However, a number of key principles of competitive neutrality are still not being applied to the body.
- Forest operations are quite strongly separated from forest policy and regulation, with the FPC and CC having separate legal status from CALM.
- However, the process for establishing pricing rules for native forest products, although nominally independent, is still significantly influenced by the commercially focussed FPC.
- Furthermore, there is no separation of responsibility for the promotion of native forest logging from promotion of plantations in Western Australia.

4.3.5. SUMMARY

The review of the structural and institutional arrangements for forestry in each of the four States shows a considerable range of arrangements. At one extreme, Western Australia (and to a lesser extent Tasmania) has applied the principles summarised in clause 4 to a greater extent. At the other extreme, Victorian arrangements do show in particular weaker separation. We examine now the requirements for the major components of clause 4.

4.4. SEPARATION OF FUNCTIONS

4.4.1. FORESTRY SECTOR FUNCTIONS

The native forests timber industry today faces a very different scenario to the one it faced in the past. Increased community concern for environmental protection has led to pressures to create forest reserves and ensure that forests outside of reserves are managed in a sustainable manner. At the same time, due to international competition and competition from alternative domestic sources of wood products, such as plantations, the industry has had to undergo structural change. This change, combined with regional communities' concerns to maintain or boost employment in their regions, has led to pressures to over-harvest remaining native forests and/or underprice forest products.

Pressure to over-harvest also comes from other features identified in this report as well as institutional failure on the part of the existing agencies (institutional failure is not addressed in this report). Changes to reduce systemic failure should reduce institutional failure (in part at least) on one hand and market failures on the other (completely). The extent to which institutional failure is completely reduced will depend on the tightness with which requirements for being 'efficient' are applied.

The forestry sector now entails a multiplicity of functions including:

- developing management plans and licensing frameworks so as to achieve the sustainable management of forests including preservation of high conservation-value forests and sustainable rates of logging;
- developing codes of practice for the harvesting of commercial forests ;
- setting pricing rules to ensure cost-reflective pricing of timber products and an adequate return from public resources;
- promoting a viable forestry industry, including plantations and farm forestry;
- effective day-to-day management of public and private forests including implementation of management plans and codes;
- efficient commercial forestry operations including logging, milling and letting of contracts for logging; and
- regulating and enforcing compliance with management plans and codes of conduct.

There is a general recognition now that to successfully deal with these increasingly competitive objectives for forest use requires a new structural framework for management of the industry. This framework requires the responsibility for oversight of the policy, operational and regulatory aspects of the industry to be unbundled. It should also ensure that the multiple objectives can be dealt with in an effective, independent and transparent manner and to build public confidence in forestry decision-making processes.

A key principle, perhaps the key principle arising from of Clause 4 of the CPA in relation to the forestry industry is separation of responsibilities for undertaking these different functions. The concern with respect to application of this principle is not so much whether there is separation of functions within State-based forestry operations but how adequate is the level of separation.

4.4.2. SEPARATION OF REGULATORY AND COMMERCIAL FUNCTIONS

The principle of adequate separation applies most strongly to the separation of responsibilities for regulation of the industry from the commercial functions of the industry. Section 2 of Clause 4 states that:

> *Before a Party introduces competition to a sector traditionally supplied by a public monopoly, it will remove from the public monopoly any responsibilities for industry regulation. The Party will re-locate industry regulation functions so as to prevent the former monopolist enjoying a regulatory advantage over its (existing and potential) rivals.*

The rationale for this requirement is clearly one of competitive neutrality. Indeed, Section 3 (d) of Clause 4 states that a Party will undertake a review into:

> *the most effective means of separating regulatory functions from commercial functions of the public monopoly.*

This same point has been made by the former Industry Commission, which argues that "*(forestry) enterprises should not be both an umpire and a player*".[63]

There is little debate over the reasons for seeking a separation of regulatory and commercial functions. The National Competition Council notes that where there is unclear or incomplete separation between responsibilities for service provision and regulation:

- there is an overlap in various functions and obligations and this provides an environment for conflicts of interest;
- there is a divided focus between the commercial imperatives of the service provider and the duties and responsibilities of the regulators; and
- there is an incentive for regulation to favour the government service provider over other actual or potential providers (for example, non-government or local government).[64]

The matter of debate is not whether to separate commercial and regulatory functions but what constitutes adequate separation. Where there is an inadequate degree of separation, other participants in the industry – private forestry companies, landholders pursuing farm forestry and so on – may doubt whether the regulator treats them in the same manner as State Forestry Agencies. Furthermore, environmental advocates, business organisations and others will raise concerns about the transparency of decision making and question the independence of regulatory decisions. The NCC has addressed these issues most explicitly in the context of the water industry – but the issues are common and the principles apply to all sectors where governments have previously bundled all or most functions of a sector under a government owned monopoly.

Forestry has multiple and disparate objectives. The level of distrust between the parties is high. The need for independence and transparency in forestry decision making is therefore, if anything, higher than in water and other sectors. At a minimum, therefore, the principles and concerns discussed by the NCC in relation to water apply to adequate separation of regulatory and service functions within the forestry industry.

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63 Industry Commission (1993) *Adding Value to Australia's Forest Products*, Industry Commission, Canberra, p. 115.

64 NCC *Institutional reform issues in the water industry*, p.3, :http://www.ncc.gov.au/nationalcompet/assessments/water%20background%20papers/Institutional%20reform%20issues

It is essential, for example, that SFAs do not enjoy a regulatory advantage or perceived regulatory advantage over the private suppliers of plantation timber. Furthermore, it is essential that decision making on regulation of the forestry industry is independent and transparent. This outcome can best be achieved by separating the execution of responsibilities for standard setting and regulatory enforcement from commercial operations and distancing them from the immediacy of the political system.

To this end, NCC provides guidance as to the most effective means of effecting separation of the regulatory and commercial functions of an industry. In its paper on institutional reform of the water industry, the NCC states that

> *Many of the concerns that arise where the state is the primary service provider can be addressed by separating out conflicting Ministerial responsibilities…Ministerial separation is a solid foundation on which sound institutional arrangements can be built.*[65]

In addition, the NCC suggests that institutional separation will be assisted by:

- regular public reporting, particularly by the regulator to Parliament;
- empowering the regulator to make decisions that are binding on the Minister;
- corporatisation of the service provider, particularly where several Ministers have responsibility for the provider; and
- Ministers absenting themselves from discussions when there are perceived conflicts between their regulatory and service responsibilities.[66]

Based on these principles, a **strong model of separation** of the regulatory and commercial functions of the forestry industry would be one where:

- responsibilities for the regulatory and commercial functions are fully separated at both the ministerial and agency levels;
- the service provider agency is corporatised, with an independent board;
- the powers of the regulator are well defined; and
- monitoring and reporting processes are independent and transparent.

Separation of responsibilities for the regulatory and commercial functions at the agency level but not the ministerial level could be regarded as a **minimal model of separation**, provided the service provider is corporatised.

Separation of responsibilities at neither the agency level nor at the ministerial level is likely to be **inadequate** for the purposes of complying with Clause 4 of the CPA.

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65 *ibid*, p. 4.

66 *ibid*, pp. 4-5.

A second issue is what functions should be separated. Drawing upon the principles above, the following key objectives should be sought from structural reform of the forestry sector consistent with Clause 4 of the CPA:

- separation of forestry policy and regulatory functions from commercial functions of the industry, both at the agency and ministerial level;
- independent and transparent setting, monitoring and enforcement of forest management plans, standards and codes of practice; and
- independent and transparent setting of reserve prices to be applied in contract negotiations and/or for auctions/tenders.

The extent to which these objectives have been achieved varies from State to State. Drawing from the detailed assessment of the States in section 2.5 the following summary is provided:

- In Western Australia, recent reforms in that State have moved much of the responsibility for standards setting and enforcement to an independent Conservation Commission (CC), with commercial functions being principally the responsibility of the Forest Products Commission (FPC), a commercialised statutory authority. However, the Department of Conservation and Land Management (CALM) still plays a significant role in the development of Forest Management Plans and the Minister for Forest Products can veto a plan under certain circumstances;
- Tasmania and NSW have achieved partial separation of responsibilities. In Tasmania, some of the industry regulatory functions are the responsibility of an independent Forest Practices Board and in NSW they are the responsibility of a number of departments, coordinated by the Department of Urban Affairs and Planning (DUAP). There is no independent setting of reserve prices in either State; and
- In Victoria, separation is even less complete. Although NRE's Forests Service section now has responsibility for industry regulation, Forests Service is in the same department and has the same minister as NRE's Forestry Victoria, which is responsible for the commercial functions of the industry. Forestry Victoria does not have separate legal status, being neither a statutory authority nor corporatised.

In terms of framework and structure then, Western Australia goes furthest towards meeting the strong separation test. The State goes some way to meeting the strong model of separation, having established separate institutions, with separate ministers, to deal with policy, commercial and regulatory functions.

The level of separation of functions within Tasmania and NSW is less adequate. In their favour, the agencies responsible for commercial operations in the two States,

Forestry Tasmania and State Forests of NSW respectively, have separate legal status. However, these two agencies also have a role in the policy and regulatory functions in their respective States. Furthermore, in Tasmania the same minister is responsible for both Forestry Tasmania and the Forest Practices Board.

Separation of policy and operational from regulatory functions in Victoria is clearly not adequate. Not only are all of the functions under the same minister but they are all undertaken in the same department. There is no independent board for operations and no independent, transparent processes for standards setting, monitoring and enforcement.

Importantly, in performing its regulatory function, agencies must take into account other values outside of commercial logging, such as environmental goals.

4.4.3. SEPARATION OF COMPETITIVE ELEMENTS WITHIN THE FORESTRY INDUSTRY

The principle of separation also applies to the separation of potentially competitive elements within an industry. Sections 3 (b) and 3 (c) of the CPA state that a Party, before introducing competition to a market traditionally supplied by a public monopoly, will undertake a review into:

> *(b) the merits of separating any natural monopoly elements from potentially competitive elements of the public monopoly;*
>
> *(c) the merits of separating potentially competitive elements of the public monopoly;*

It is important that the monopoly elements of SFAs are distinguished from their competitive elements. There is a case for arguing that natural monopoly elements, such as the day-to-day management and commercial operations of public native forests, should remain with the SFAs. The same argument cannot be advanced in relation to the promotion of plantations, especially plantations on private land. For this reason, we believe that another key objective of structural reform of the forestry industry is:

- separation of responsibility for the promotion of native forest logging from promotion of plantations.

The extent to which this objective has been pursued by the States also varies from state-to-state. Drawing from the detailed assessment of the States in section 2.5, the following summary is provided:

- In Tasmania, Private Forests Tasmania is a statutory authority responsible for the promotion of private plantations.
- The situation is similar in NSW where an Office of Private Forestry (OFP) has responsibility for the promotion of private plantations.

- In Victoria, responsibility for the promotion of plantations resides jointly with a Private Forestry Council (serviced by Forestry Victoria) and Forestry Victoria itself.
- In Western Australia, the FPC has responsibility for the promotion of both native forest logging and private plantations.

In conclusion, Tasmania most clearly meets the separation test with respect to the promotional functions of the forestry industry. In NSW, the level of separation is adequate, although the OFP does not enjoy separate legal status. In Victoria and Western Australia, the level of separation is not adequate.

4.4.4. FURTHER REQUIREMENTS FOR SEPARATION OF FORESTRY INDUSTRY FUNCTIONS

Experience with reform of other sectors suggests that in implementing structural reform of the forestry sector, a number of important organisational criteria need to be met. These include:

- clarity of objectives for each of the agencies/authorities involved in the sector;
- accountability;
- performance monitoring of the agencies against financial and non-financial indicators; and
- financial viability of the industry.

In addition, processes for structural reform should be:

- transparent; and include
- strong public consultation.

4.5. COMPLIANCE WITH OTHER ELEMENTS OF CLAUSE 4

4.5.1. COMMERCIAL OBJECTIVES AND COMMUNITY SERVICE OBLIGATIONS

Another important principle arising from Clause 4 of the CPA is that public monopolies responsible for the operational/commercial aspects of an industry should operate commercially. Sections 3 (a), (f) and (h) of Clause 4 state that before a Party introduces competition to a market traditionally supplied by a public monopoly, it will undertake a review into:

> *(a) the appropriate commercial objectives for the public monopoly*
>
> *(f) the merits of any community service obligations* [CSO] *undertaken by the public monopoly and the best means of funding and delivering any mandated community service obligations;*

> *(h) the appropriate financial relationships between the owner of the public monopoly and the public monopoly, including the rate of return targets, dividends and capital structure.*

The Industry Commission has made a similar point, recommending that public enterprises should "*vest management in a commercial board accountable to Parliament through a minister*" and that they should "*provide clear and non-conflicting objectives that relate to commercial performance only*"[67]. State Forestry Agencies should have separate legal status, with an independent board and adopt and have commercial targets, including for rates of return and dividends payable to the government.

To argue that subsidies in the price of timber from public native forests automatically represents a CSO towards the regional communities is drawing a long bow in our view.

In 1994, the Steering Committee on National Performance Monitoring of Government Trading Enterprises stated that a CSO

> *…arises when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs which it would not elect to do on a commercial basis, and which the government does not require other businesses in the public or private sectors to generally undertake, or which it would only do commercially at higher prices.*[68]

By the same token, the objective of competitive neutrality is the elimination of resource allocation distortions arising out of the public ownership of government business enterprises. Clearly, therefore, any argument for subsidies for 'timber towns' reliant on public native forests (for example) must also be weighed against the ensuing need for similar subsidies in private sector plantations and farm forestry disadvantaged by these subsidies.

An examination of the structure and objectives of the State Forestry Agencies (detailed in section 4.4) reveals that to a greater or lesser extent they now have a commercial focus:

- Forestry Tasmania is a fully corporatised Government Business Enterprise with a suite of mainly commercially related objectives including to "improve profit performance and returns to shareholders". It reports against a general series of revenue and profitability targets. Its annual report also contains a detailed series of financial statements, including information on tax equivalent expenditure.[69]

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67 Industry Commission, op. cit.

68 Steering Committee on national Performance Monitoring of Government Trading Enterprises (1994) *Community Service Obligations: Some definitional, costing and funding issues*, April, p. xi.

69 Forestry Tasmania (1999), *Annual Report 1998-99*, Forestry Tasmania, Hobart, p. 5.

- The Forests Products Commission (FPC) of Western Australia is a commercialised statutory authority. Its objectives are commercially focussed including an objective of "*achieving appropriate returns to the State for the use of publicly-owned and FPC-managed timber resources*".[70] Since the FPC has only just commenced operations, the validity of this objective cannot yet be assessed.
- State Forests of NSW is also a statutory authority, operating as a commercialised Government Trading Enterprise. Its objectives are a mix of non-commercial and commercial objectives including to "*meet financial targets agreed with the NSW Government*".[71] These targets are detailed in the annual report which includes details of income tax and dividends provided.
- Forestry Victoria, is a service unit of NRE and is, at best, only lightly commercialised.[72] Its objectives include achieving a commercial rate of return and dividend which is '*acceptable to the Government*'[73], however details of dividends provided to government are not available in the agency's financial statements.

It might be inferred that with the corporatisation and/or commercialisation of SFAs in Western Australia, Tasmania and NSW, any subsidies in the forestry sector would now be transparent in those States. However, in at least one of those States, NSW, there are, *prima facie,* a number of subsidies being met by State Forests that are not detailed in the latest annual report. These include:

- residual value pricing (see Chapter 3 for further discussion); and
- subsidised shipping of logs to mills in other regions.[74]

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70 Available online at: http://www.fpc.wa.gov.au/about.html

71 State Forests of New South Wales (2000) *Annual Report 1998/99*, Sydney, p. 4.

72 While the term 'commercialised' has a range of meanings, Forestry Victoria is not commercialised in the same manner as, say, Victoria's non-metro urban water authorities which, while lacking distinct and separate legal status, have independent, skills-based boards of directors and operate at arms length from the department.

73 Information available online at: www.nre.vic.gov.au/web/root/domino/cm_da/nrenfor.nsf/frameset/*NRE+Forestry?OpenDocument*. (Accessed February 2001).

74 This subsidy has come through the NSW Forest Industry Structural Adjustment Package (FISAP). The FISAP is administered by the Forestry Structural Adjustment Unit of the Department of Information, Technology and Management. It has been developed in response to the Comprehensive Regional Assessment (CRA) process, which led to new areas of forest being set aside as reserves, particularly in the North East of the State. An outcome of this process has been to shift the geographic centre of the native forests logging industry further south.

One element of FISAP is a 'Long Haul Subsidy Program', which subsidizes freight costs of logs to mills (particularly in the North East) that have been effected by the changes resulting from the CRA process. The Long Haul Subsidy Program is a five-year program that is designed to provide time for subsidized mills to relocate. If the program is indeed relatively short term, with a sunset clause then, it is not a major concern with respect to non-commercial objectives. If however, it is one of a series of ongoing subsidy programs that provide long term industry support, then we are concerned that this amounts to a CSO that is not explicit.

In Victoria, where Forestry Victoria is not yet commercialised, both the nature and extent of subsidies remains unclear. As in NSW though, residual value pricing is used and it would appear that subsidies, including unpaid royalties, are being used to keep a number of non-viable mills open.

In conclusion, Tasmania and (subject to future operations) Western Australia, are the States which most convincingly meet the commercial objectives test of Clause 4. In NSW, the provision of subsidies remains at odds with the apparent commercial focus of State Forests of NSW. In Victoria, subsidies and the failure of Forestry Victoria to achieve separate legal status raise serious question marks against its commercial intent.

4.5.2. COMPETITIVE NEUTRALITY

Implementation of competitive neutrality principles is another requirement of Clause 4 of the CPA. Section 3 (e) of Clause 4 states that before a Party introduces competition to a market traditionally supplied by a public monopoly it will review:

> *the most effective means of implementing the competitive neutrality principles set out in this Agreement*

As discussed in depth in Chapter 2 of this report, there are a number of major requirements for competitive neutrality to be achieved in forestry. These include:

- payment of land purchase or rent costs by SFAs;
- payment of local government rates by the Agencies;
- regulatory neutrality; and
- application of tax equivalent regimes to SFAs.

All States are to a greater or lesser extent deficient with regards to these requirements, with Victoria being particularly deficient:

- SFAs do not pay land costs in any of the States;
- nor do any of the SFAs pay local government rates;
- only in Tasmania, where both Forestry Tasmania and Private Forestry Tasmania are subject to Forest Practice Codes, is there full regulatory neutrality; and
- tax equivalent regimes are applied to the SFAs in NSW, Tasmania and Western Australia but not in Victoria, where the 'shielding' of Forestry Victoria within the structure of NRE enables it to avoid tax equivalence.

  TER status is not relevant where the SFA is not a profit-making enterprise.

Sources: Department of Information, Technology and Management (2000) *DITM Annual Report 1999/2000*, DITM, Sydney. State Forests of NSW pers.com.

4.5.3. PRICE AND SERVICE REGULATIONS

Section 3 (g) of Clause 4 states that before a Party introduces competition to a market traditionally supplied by a public monopoly it will review:

> *the price and service regulations to be applied to the industry.*

Price regulations are meant to ensure that certain minimum requirements are met including the need:

- for a reserve price to be set in logging contract negotiations and auctions; and
- to set reserve prices at levels that at least recover the full costs of production.

Across the States reviewed, Western Australia has examined price regulation twice while Victoria is currently undertaking a review of timber pricing. Neither NSW nor Tasmania have undertaken public reviews of pricing regulations for forestry.

Service regulations relevant to the forestry industry are generally covered in the forest management plans and forestry codes of practice. The aim of these plans and codes is to ensure that the forest management responsibilities of the SFAs and the harvesting operations of private logging companies are undertaken according to a range of legislated[75] and other criteria covering:

- sustainable yields for rates of harvesting;
- protection of biodiversity;
- protection of water quality and soils; and
- safety standards.

There are two aspects to the issue of price and service regulations. First is the question of **adequacy** of the price and service regulations applied to the forestry sector in each State are in fact adequate. With respect to service regulations, the question is beyond the scope of this report, however we do discuss the adequacy of price regulations in some depth in Chapter 3.

Second, and of more immediate relevance, is the question of the **process** by which the price and service regulations have been reviewed and established. As discussed in section 4.4.2, two of the key objectives of structural reform of SFAs are:

- independent and transparent setting, monitoring and enforcement of forest management plans, standards and codes of practice; and
- independent and transparent setting of reserve prices to be applied in contract negotiations and/or for auctions/tenders.

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[75] Note, the specific requirements of relevant legislation are usually set out as terms or conditions of licenses.

A state-by-state examination of the application of these objectives gives, at best, mixed results, with no State having fully independent and transparent processes for setting price and service regulations.

Western Australia

In Western Australia the CC, an independent statutory authority, is now ostensibly responsible for the development, monitoring and enforcement of management plans and codes. However, the process by which plans and codes are being developed is not fully independent or transparent with CALM and the Minister for Forest Products having a significant say in the drafting of Forest Management Plans. Furthermore, the process by which prices have been established in Western Australia is neither independent nor fully transparent. Although the CC advises the Government on royalties, it is the commercially focussed Forest Products Commission and the Minister for Forest Products who have ultimate responsibility for setting prices.

Tasmania

The partial separation of regulatory and commercial functions in Tasmania has lead to the development and monitoring of some, but not all, environmental and resource management regulations by the independent Forest Practices Board. Processes for the development of regional management plans by Forestry Tasmania are not fully transparent. Tasmania now relies heavily on auctions for the sale of sawlogs but the process for setting reserve prices by Forestry Tasmania is not transparent nor independent.

New South Wales

In NSW, the process for the development of management plans, through the Resource and Conservation Assessment Council (RACAC), is more transparent than in the other States. However, the commercially focussed State Forests of NSW still plays a significant role in monitoring and enforcing these plans and in the development of forest codes of practice. State Forests is also responsible for pricing policy in NSW. The Hardwood Log Value Pricing System[76] utilises independent market surveys for pricing sawlogs but is overseen by State Forests and therefore the pricing process cannot be regarded as fully independent. The process is reasonably transparent however.

Victoria

In Victoria, the responsibility for developing and setting policy and regulations ostensibly resides with the Forests Service section of Natural Resources and Environment. As previously discussed, the separation of Forests Service from Forestry Victoria is not adequate, with the result that the independence of policy and regulatory

[76] See Chapter 3 for a discussion of this system.

processes is questionable.[77] Furthermore, processes for developing and reviewing policies and regulations lack transparency. For example, even though the development of management plans involves some public consultation, the decision-making processes on the contents and implementation of the plans is unclear. Less independent and transparent still are the processes by which prices are set and licences issued. For example, information on the individuals and sections who issue the logging tenders is not readily available. Details of the residual value pricing system used in Victoria are also difficult to obtain. It is to be hoped that the current review by the Victorian Government into timber pricing will recommend reforms that lead to greater independence and transparency in pricing policy.

4.6. ASSESSMENT OF STATE COMPLIANCE WITH CLAUSE 4

What then is our assessment of compliance by the States to Clause 4 of the CPA in relation to the forestry sector?

As discussed in sections 4.4 and 4.5, the key objectives or outcomes sought from structural reform of State Forestry Agencies are as follows:

- separation of policy from the regulatory and commercial functions of the industry;
- independent and transparent setting, monitoring and enforcement of plans, standards and codes;
- independent and transparent setting of reserve prices;
- separation of responsibility for the promotion of native forest logging from promotion of plantations;
- commercial focus of State Forestry Agencies;
- competitive neutrality of State Forestry Agencies.

It is apparent from our overview, in section 2.5, of institutional arrangements for forestry, that the nature and extent of reforms to SFAs has varied greatly from state-to-state. It is also apparent that the level of compliance of the States to the objectives listed above, as a result of reforms undertaken, varies considerably from State to State. Chart 4-3 following summarises our assessment of compliance by each State with these objectives.

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[77] A recent example of what can happen when policy/regulatory development and monitoring are not independent of commercial operations relates to the reported practice of overcutting in Victoria's native forests. This practice apparently stems from miscalculations by NRE of sustainable yields in a number of the areas designated for timber harvesting. The Minister for Environment and Conservation has now set up an 'independent expert group' to investigate the extent of overcutting. The investigation was only set up however, following complaints about the situation by environmental organisations and the timber industry [see Hopkins, P (2001), 'Experts to assess forest overcutting', *The Age*, 19 March 2001].

CHART 4-3 : LEVEL OF COMPLIANCE WITH KEY OBJECTIVES OF STRUCTURAL REFORM

STRUCTURAL REFORM KEY OBJECTIVE	NSW	VIC	TAS	WA
Separation of policy and regulatory from commercial functions	❍	✗	❍	✓
Independent and transparent monitoring and enforcement of plans, codes and standards	❍	✗	❍	❍
Independent and transparent setting of reserve prices	✗	✗	✗	❍
Separation of native forest logging from the promotion of private plantations	❍	❍	✓	✗
Commercial focus of SFA	❍	✗	✓	✓
Competitive neutrality				
TER etc	❍	✗	❍	❍
Regulatory neutrality	✗	✗	❍	✗
Land / rates / full cost recovery	✗	✗	✗	✗

Key: ✓= full compliance; ❍ = minimally compliant; ✗ = non-compliant

New South Wales has made some tentative steps towards structural reform, establishing an Office of Forest Products and removing some aspects of forestry policy and regulation away from State Forests of NSW. However, even on the most favourable reading separation of the policy and regulatory from commercial functions of the industry is, at best, barely minimal. A similar conclusion is reached with respect to the independence of monitoring and enforcement of codes and standards. NSW does not comply with major components of the competitive neutrality test of Clause 4 of the CPA.

In **Victoria**, non-compliance with key objectives of Clause 4 of the CPA is apparent virtually across the board. Forestry Victoria is not a separate legal entity and clearly fails compliance tests with respect to both commercial focus and competitive neutrality. Although policy and regulatory functions are now undertaken by the Forests Service section of NRE, separation of Forests Service from Forestry Victoria is clearly inadequate in terms of the key principles of agency and ministerial separation. For similar reasons, Victoria is also non-compliant with respect to the tests for independent monitoring and enforcement of standards and codes and independent setting of pricing rules.

Furthermore, Victoria's failure to undertake a review of the structural arrangements of its public forestry sector prior to the reorganisation of NRE contravenes Clause 4, sections 2 and 3 of the National CPA. This breach is due to the fact that the split of NRE's regulatory and commercial operations was undertaken after the privatisation of the Victorian Plantations Corporation.

In **Tasmania**, the corporatisation of Forestry Tasmania has provided the body with a clear commercial focus. However, compliance of Forestry Tasmania with the

competitive neutrality test is only partial. It still does not pay local government rates or land costs. Although significant reforms have been undertaken to the structure of the forestry industry in Tasmania, including through creation of the Forest Practices Board, separation of the policy and regulatory from commercial functions of the industry is still, at best, only minimally compliant. For example, both bodies still report to the same minister. Similarly, the independence of the process for developing and monitoring codes and management plans is also only minimally compliant, since Forestry Tasmania and private industry play, arguably, a significant role in policy development and regulation.

In **Western Australia**, structural reforms undertaken in 2000 have achieved considerable advances towards an appropriate industry structure in terms of the separation of the policy, regulatory and commercial functions of the industry. However, processes for the development, monitoring and enforcement of management plans and codes of conduct, while ostensibly the responsibility of the independent CC, can still be heavily influenced by CALM and the Minister for Forest Products. The FPC is an independent statutory authority with a strong commercial focus. Nevertheless, it fails the important elements of the competitive neutrality test. Furthermore, separation of responsibilities for the promotion of native forest logging and promotion of private plantations has not been achieved with reforms in Western Australia.

Recommendation

Victoria should review the operations and arrangements for Forestry Victoria to ensure that it complies with the specific requirements of Clause 4 of the Competition Principles Agreement.

5. LEGISLATIVE REVIEW

5.1. BACKGROUND

Clause 5 (3) of the competition principles agreement stipulates that:

> *… each Party will develop a timetable … for the review, and where appropriate, reform of all existing legislation that restricts competition by the year 2000.*

Forestry is one of the sectors covered by this requirement.

Forestry related activities in each State and Territory are subject to extensive legislation and regulation, as they are in all jurisdictions. The base legislation in each State is:

- NSW - *Forestry Act 1916*;
- Victoria - *Forests Act 1958*;
- Tasmania - *Forestry Act 1920;* and
- Western Australia - *Forest Products Act 2000*.

In addition to these Acts, there are numerous other pieces of legislation that are relevant to forestry in each State. For example, in Tasmania there are at least 17 State Acts, administered by six government departments/trading enterprises, which regulate the management and administration of its forests. These include the *Private Forests Act 1994* and the *Forests Practices Act 1985*. Similarly, in Western Australia the management and administration of State forests is regulated through a range of legislation including the *Conservation and Land Management Act 1984* and the *Conservation and Land Management Amendment Act 2000*.

In this Chapter, we provide an indication of the requirements of Clause 5 of the CPA in relation to forestry sector. We examine the guiding principles and key questions to be addressed in the review of forestry legislation and provide an indicative assessment of potential compliance issues to be addressed by each State.

5.2. GUIDING PRINCIPLES

The object of NCP is to "*accelerate the microeconomic reform process, recognising the benefits from sustained economic and employment growth.*"[78]

Legislation review is an obligation for each State and Territory under the CPA entered into on 11 April 1995.

[78] National Competition Council (1998) *Compendium of National Competition Policy Agreements*, 2nd edition, AGPS, Canberra, p. 11.

> *The guiding principle is that legislation (including Acts, enactments, Ordinances or regulations) should not restrict competition unless it can be demonstrated that:*
>
> *(a) the benefits of the restriction to the community as a whole outweigh the costs; and*
>
> *(b) the objectives of the legislation can only be achieved by restricting competition*[79]

and

> *The guiding principle established under National Competition Policy places the onus of proof on governments to demonstrate a public interest case for the enactment or retention of statutory restrictions.*[80]

The guiding principles are, therefore, pro-competitive, i.e., the onus is on each government to demonstrate the case for retaining any competitive restrictions identified. On the other hand, the CPA also makes it clear that competition is not sought for its own sake, but rather to improve efficiency. As a result, the issue is not whether the legislation underpinning existing forestry activities restricts competition, but rather, whether those restrictions can be justified in public interest terms.

The essential question for any NCP review of forestry legislation is, can the restrictions be justified? More precisely, are there net social and economic benefits from any anti-competitive arrangements identified in the forestry legislation?

5.3. KEY QUESTIONS IN LEGISLATION REVIEW

NCP identifies five basic questions that should be addressed in review of legislation:

- clarify the objectives of the legislation;
- identify the nature of the restriction on competition;
- analyse the likely effect of the restriction on competition and on the economy generally;
- consider alternative means for achieving the same result including non-legislative approaches; and
- assess and balance the costs and benefits of the restriction.[81]

These questions can be addressed in terms of a step-by-step examination of each of the individual Acts and regulations associated with forestry related activities and how this

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[79] *Competition Principles Agreement*, Clause 5 (1). The requirement to review legislation is contained in Clause 5.

[80] Government of Victoria (1997) *NCP Guidelines for Legislation Review.*

[81] *Competition Principles Agreement*, Clause 5 (9).

legislation fits with broader legislation on national resource management and government business activities. However, it is also possible to take an overview of the total framework, how it has developed over the last several decades and the challenges and changes that the framework and objectives must address.

5.4. PROGRESS TO DATE

Victoria, Tasmania and Western Australia have all completed legislation reviews of the main pieces of forestry legislation in their respective States, but only Victoria has published the review with a Government response.[82,83]

The KPMG review of the Victorian *Forests Act 1958* made several recommendations, including that the Victorian Government:

- include a specific objective in the Act to provide guidance on the balance intended to be struck between the potentially conflicting activities;
- amend the Act to allow the option of a purchaser/provider type arrangement;
- clarify sustainable yield provisions to ensure that NRE does not have to supply logs up to the sustainable yield regardless of demand; and
- specify broad criteria or guidelines for licences relating to rights to commercially exploit forest produce.

The Victorian Government is understood to be reconsidering the report and a new response.

New South Wales has not listed the *Forestry Act 1916* in its inventory of review. *Prima facie*, this is a breach of sub-clause 5(3) of the CPA, which states that all Parties should have reviewed 'legislation restricting competition' by the year 2000.[84] However, the NSW Government argues that it has been engaged in an ongoing review of forestry legislation for some years, separate from national competition policy process. Full details of the NSW Government's reasoning for the approach it is taking to reviewing forestry legislation are to be provided in its annual report to the NCC in 2001.[85] It is

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82 The legislation reviews so far undertaken include - Victoria: *Forests Act 1958* and Regulations, *Forestry Rights Act 1996*; Western Australia: *Conservation and Land Management Act 1984*, *Conservation and Land Management Amendment Act 2000, Forest Products Act 2000*; Tasmania: *Forestry Act 1920.*

83 Department of Natural Resources and Environment (2000) *Financial Report 1999/2000*, Department of Natural Resources and Environment, Melbourne, p. 74.

84 The New South Wales *Forestry Act 1916* may fall in this category due to the similarities between it and the Victorian Act, which was found to include significant restrictions on competition that are not in the public interest. Many of the critical comments made in the Victorian review related to pricing. These adverse comments would equally apply to New South Wales since State Forests of NSW also uses a residual value approach to setting log prices.

85 NSW Office of Cabinet, pers. com., 23 March 2001.

important that the NCC ensures that any review of forestry legislation being undertaken by NSW fully addresses clause 5.

This review has not been able to obtain a copy of the Tasmanian review report. However, consultants appointed by the NCC have stated that:

> *The review of the Forestry Act 1920 was completed by an external consultant in 1998. The Act has since been substantially simplified and removed the perception of Forestry Tasmania as an industry regulator by removing policing powers.*
>
> *The review essentially recommended the simplification of the Act and the removal of several sections and did not make explicit recommendations on restrictions to competition, except that certain conditions on wood supply agreements be deleted, and comments that minimum supply restrictions are anticompetitive.*[86]

In its framework for its third tranche assessment, the NCC examined each jurisdiction. It reported[87] for:

- **New South Wales**

  The New South Wales legislation appears to contain restrictions on competition similar to those in other jurisdictions (market entry and production controls) which are under NCP review.

  The New South Wales Government will need to provide details about the process it is undertaking in relation to forestry and its outcomes. Further, as the Acts are not scheduled on the State's NCP review program, New South Wales will need to demonstrate that the process it is undertaking in relation to its forestry legislation is consistent with NCP principles, or explain why the legislation should not be subject to review.

- **Victoria**

  The Government will need to report on its response to the review of the Forests Act, including demonstrating a net public benefit case for the retention of restrictions on competition.

  The contractual nature of agreement Acts means that amending them, even where anti-competitive provisions are identified, prior to their expiration can potentially impose significant costs on government. Consequently, the Council encourages the Victorian Government to establish a process whereby the agreement Acts are examined against the NCP principles prior to renewal or renegotiation.

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86 Centre for International Economics (2000) "Review of fisheries and forestry legislation", prepared for the National Competition Council, August 2000, p.

87 NCC (2001) *op. cit.*, pp 14.5-14.14.

- **Western Australia**

  The Government will need to show that its forestry regulation reviews and their outcomes are consistent with the NCP principles, and report on progress with the various legislative amendments under consideration.

- **Tasmania**

  *The Tasmanian Government will need to report on **progress** with its review and reform of forestry legislation and demonstrate that its approach to forestry regulation meets the fundamental CPA requirement. In particular, the Council seeks evidence that restrictions contained in the Forestry Act were appropriately assessed against the NCP principles and have been retained only where they provide a net public benefit.*

5.5. CLARIFICATION OF OBJECTIVES AND FRAMEWORK

5.5.1. OBJECTIVES FRAMEWORK

National Competition Policy requires clarification of the objectives of legislation. These objectives may be explicit in the legislation itself, spelt out in second reading speeches and other relevant documentation, or implicit. In reviewing legislation in terms of its objectives and impact on competition, it is important to understand the nature of the market(s) and why the Government is involved.

Forests and forestry activity exhibit a number of special features that suggest a role for government:

- First, forests provide a renewable, easily exploited resource with a long renewal period. Therefore, they can be over exploited and mistakes in policy or in practice cannot be remedied quickly.
- Second, forests contain a number of potentially significant values that are distinct from the value derived from their use for timber production. These include:
  - ecological values such as biodiversity protection;
  - water production;
  - carbon sequestration and storage;
  - apiary;
  - wilderness preservation; and
  - recreation and tourism.

  At low levels of production, timber exploitation will arguably not compete with these other uses and values. However, as the intensity of exploitation increases (e.g., clear felling or unsustainable selective logging) most of these other uses become directly competitive and, in the case of wilderness preservation, mutually exclusive.

- Third, because the presence of logging (either clear felling or selective) potentially threatens biodiversity protection, it threatens major benefits to future generations that the current generation of forest owners cannot readily capture. These impacts fall outside of the market price mechanism because there are no private rights to the biodiversity of a forest and are therefore major negative externalities.
- Fourth, notwithstanding the increasingly capital intensive nature of the timber industry and the increasing importance of plantations, the exploitation of public native forests is still regarded in many rural and regional communities and by governments as a critical source of employment and therefore of importance to the social fabric of those communities.

In economic terms, forest exploitation therefore causes some positive, but primarily negative externalities or spillovers. Typically, governments react to negative externalities by prohibiting or constraining access to the activity, by imposing a tax to cover the costs of the negative side-effect, or by imposing minimum standards under which the activity may be conducted. Conversely, governments seek to preserve the positive externalities by guaranteeing resource security, providing industry structural adjustment assistance and encouraging alternatives to the exploitation of native forests, such as plantations.

The legislative intervention in forestry related markets should be seen therefore, as a response to the need to create and control markets and to mitigate or control negative side effects that arise from the market activity. This perspective drives the objectives of forestry legislation.

5.5.2. CLARIFICATION OF OBJECTIVES

Clause 5(9) of the CPA states that without limiting the terms of reference of a legislative review, a review should:

> *(a) clarify the objectives of the legislation.*

In the context of forestry, there are two sets of objectives:

- Clear objectives for government involvement in the forestry sector.

  While these objectives are not required to be in the Act itself, the Act provides the best means for the government to articulate and preserve the objectives. It is notable that in no State does the major State forestry legislation contain objectives for government involvement in the forestry sector.
- Clear objectives for the major institution(s) described in the legislation. For the SFAs these objectives should have a commercial focus, except where they include specific reference to CSOs being provided and the need for sustainable

resource management. The objectives should also be consistent with the operational objectives of the SFAs, as set out in their mission statements etc.

Of the four States, the Tasmanian forestry legislation contains the clearest institutional objectives. The objectives of the forestry corporation, as set out in the *Forestry Act 1920*, are as follows:

> *As a manager of forest land with a commitment to multiple use, the objectives of the corporation are to optimise -*
>
> *(a) the economic returns from its wood production activities; and*
>
> *(b) the benefits to the public and the State of the non-wood values of forests.*

These objectives are supported by a more detailed set of corporate functions.

The institutional objectives in the NSW *Forestry Act 1916* are quite general:

(a) *to conserve and utilise the timber Crown-timber lands …. to the best advantage of the State;*

(b) *to provide adequate supplies of timber from Crown timber lands …;*

(c) *to preserve and improve, in accordance with good forestry practice, the soil resources and water catchment capabilities of Crown timber lands …;*

(d) *to encourage the use of timber derived from trees grown in the State;*

- *(i)? to promote and encourage their use as a recreation, and*
- *(ii)? to conserve birds and animals thereon; and*

(e) *to provide natural resource environmental services.*

These objectives are not entirely consistent with the more explicit objectives of State Forests of NSW that are set out in its annual reports. In particular, they lack a clear commercial element. Furthermore, they make no reference to the subsidies currently being provided through State Forests.[88]

The *Forest Products Act 2000* of Western Australia contains a comprehensive list of institutional functions and objectives that are bundled together under the generic heading of 'Functions of the Commission'. As a result of this bundling, the overriding objectives of the Forest Products Commission are difficult to ascertain. The 'functions' include non-commercial objectives such as "*... to promote employment in …and development of the forest products industry*" (s.10(1)(i)) and "*... ensuring that any stockpile of forest products is kept to a minimum…*" (s.10.(1)(k)).

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[88] Neither the legislation nor the operational objectives of State Forests of NSW include specific reference to industry and employment subsidies. Current intervention in support of industry employment in some regions would be better treated as a CSO. This is discussed in more detail in section 2.4.1 of the report.

The Victorian *Forests Act 1958* does not contain institutional objectives per se but section 18 of the Act does set out the general powers and duties of the Secretary of the Department. They are very general and broad, including the control and management of:

> *(a) State forests and plantations, nurseries, forest schools and industrial undertakings carried on under this Act …; and*
>
> *(b) The establishment, maintenance, improvement and renewal of forest plantations and tree-nurseries and the distribution of trees there from …*

Forestry legislation in most States has either been redrafted or has undergone substantial amendments over the last ten years or so. The lack of clear objectives in the legislation of most States might be surprising, although we note that all governments in Australia have had difficulty in reconciling the competing objectives for forests over that period. The absence of clear objectives may therefore be a reflection of the difficulties which governments have faced. Nonetheless, independent reviewers of State forestry legislation and the NCC should seek to have clear objectives - both for governments and forestry institutions - inserted into the legislation.

5.6. RESTRICTIONS ON COMPETITION

Clause 5(9) of the CPA also states that without limiting the terms of reference of a legislative review, a review should:

> *(a) identify the nature of the restriction on competition;*
>
> *(b) analyse the likely effect of the restriction on competition and on the economy generally;*
>
> *(c) assess and balance the costs and benefits of the restriction; and*
>
> *(d) consider alternative means for achieving the same result including non-legislative approaches.*

To illustrate the application of these sub-clauses we will consider them together.

5.6.1. POTENTIAL RESTRICTIONS ON COMPETITION

State forestry acts contain many elements that are potential restrictions on competition. These include:

- Setting quotas or maximum sustainable yields.
- Allocating licences for use or exploitation of a forest.
- Setting licence conditions which:
  - exclude non-exploitative activities;
  - require compliance with management plans and codes of conduct;

  - require compliance with safety and other standards; and
  - include performance criteria (especially input regulations).
- Conferring preferred supplier/customer status.
- Limiting participation in licences on the basis of:
  - ownership (eg. excluding overseas or interstate participants);
  - size;
  - legal form/status (eg. excluding cooperatives); or
  - previous activity.
- Subsidising particular operators:
  - on the basis of ownership/size/legal form/previous activity; or
  - by setting minimum or maximum prices.
- Exclusive monopoly arrangements.

There are some instances where potential restrictions on competition are in the public interest and where community welfare is better served by the retention of these restrictions. The CPA contains a two-part test of these public interest elements. The first part, a generic test, is set out at sub-clause 1(3) of the CPA:

> *Without limiting the matters that may be taken into account, where this Agreement calls:*
>
> *(a) for the benefits of a particular policy or course of action to be balanced against the costs of the policy or course of action; or*
>
> *(b) for the merits or appropriateness of a particular policy or course of action to be determined; or*
>
> *(c) for an assessment of the most effective means of achieving a policy objective;*
>
> *The following matters shall, where relevant, be taken into account:*
>
> *(a) government legislation and policies relating to ecologically sustainable development;*
>
> *(b) social welfare and equity considerations, including community service obligations;*
>
> *(c) government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;*
>
> *(d) economic and regional development, including employment and investment growth;*
>
> *(e) the interests of consumers generally or of a class of consumers;*
>
> *(f) the competitiveness of Australian businesses; and*
>
> *(g) the efficient allocation of resources.*

In relation to the legislation review requirement, the test is then refined at Clause 5(1):

> *The guiding principle is that legislation (including Acts, enactments, Ordinances or regulations) should not restrict competition unless it can be demonstrated that:*
>
> *(a) the benefits of the restriction to the community as a whole outweigh the costs; and*
>
> *(b) the objectives of the legislation can only be achieved by restricting competition.*

On this basis, many of the potential restrictions listed above may be justifiable in terms of public interest. These include the imposition of quotas to ensure sustainable yields and licence conditions that require compliance with management plans, codes of conduct and safety standards. There are some restrictions though which, *prima facie*, do not appear to be justifiable in terms of the test and raise compliance issues in relation to Clause 5 of the CPA. These are:

- licences mandating exploitation;
- restrictions on entry to logging and milling;
- restrictions on entry to forest management;
- subsidised pricing; and
- minimum sustainable yield.

5.6.2. LICENCES MANDATING EXPLOITATION

The most common form of property rights, such as land and water, allow the owner to use the resource as desired. For example, owners of land can build on or otherwise work it or they can leave it totally vacant or undisturbed. Similarly, water rights give permission to the owner of those rights to extract water under specified conditions but do not require that the water actually be extracted or used for irrigation or other consumptive purposes.

In contrast, logging licences generally require certain areas of forest to be logged or they restrict access to the 'timber reserves' for other uses. For example:

- In NSW, under section 27A (1) of the *Forestry Act 1916*, a timber licence authorises the holder "*… to take timber, or such class or description of timber as is specified in the licence, on Crown-timber lands*". In practice, this means that the licence holder is required to take the timber, subject to other conditions.
- In Victoria, section 52(1)(a)(iii) of the *Forests Act 1958* allows for the granting of a licence or permit in Crown land, reserved forests for the purpose of occupying an area of not more than 2000 hectares for the "*... exclusive cutting of timber*".

- The *Tasmanian Forestry Act 1920* is even more explicit. Under section 25 of the Act a forest permit may "*confer on the holder exclusive rights over the land therein defined for all purposes connected with the obtaining, conversion, and removal of such forest produce as is specified therein*".

Since the licences in practice require evidence of intent and capability to log, persons or other entities wishing to purchase logging licences in order to enjoy the forest for other purposes in general cannot do so. In other words, under the arrangements outlined above, a consortium of say apiarists, environmentalists and tourism operators could not bid for a timber licence, pay the required royalties and then **not** cut the forest. Furthermore, they could not preserve the forests through, say, purchasing the land, since the forests are on Crown land.

This potential restriction on competition raises significant compliance issues.

5.6.3. RESTRICTIONS ON ENTRY TO LOGGING AND MILLING ACTIVITIES

Logging and milling licences in NSW, Victoria and Western Australia are negotiated for up to 20 years, without recourse to open tenders. The reliance on negotiated contracts rather than tenders reflects, in part, concerns over employment in traditional forestry, ownership of fixed capital and, in some States, the desire to increase value adding in the industry.

Nevertheless, the use of negotiated logging and milling licences and the increasing conditionality attached to the licences has the potential to restrict competition and to benefit incumbent operators. In all three States mentioned, provisions of the forestry legislation regarding allocation of licences or contracts are very generally expressed.[89] This means that although the provisions do not of themselves restrict competition, the generality of the provisions means that the relevant agencies have considerable discretion in the design and the operation of the licensing system. Thus, even though the legislation in Victoria, Western Australia and Tasmania provides for the option of licences being issues through auctions or tenders, in practice only Tasmania has applied this option to quality sawlogs on a regular basis.

As outlined in section 5.2, a key guiding principle of legislation is that it should not restrict competition unless it can be demonstrated that:

> *(b) the objectives of the legislation can only be achieved by restricting competition.*

There is no doubt that long-term, negotiated contracts for logging and milling represent restrictions to competition. These restrictions may be justified in terms of the multiple

[89] The relevant provisions are: NSW, *Forestry Act 1916, section 27A; Victoria, Forests Act 1958,* section 52; Western Australia, *Forest Products Act 2000*, sections 55-57.

objectives of government forest policy, including for example, resource security. However, the NCC, governments and independent reviewers of forestry legislation need to examine whether less restrictive alternatives to long term contracts can be found that still meet the objectives of the legislation.

5.6.4. RESTRICTIONS ON ENTRY TO FOREST MANAGEMENT

Forestry legislation in Victoria and Tasmania vests exclusive control and management of the policy, regulatory and commercial functions of the forest to a single agency or corporation. For example:

- the Victorian *Forests Act 1958* provides that the Secretary shall have

  5.(1)…exclusive control and management of -

  (a) all matters of forest policy;

  (b) the granting issuing and enforcing of all leases licences permits or authorities under this Act …;

  (c) the collection and recovery of all rents fees royalties charges and revenue under this Act …; and

  (d) the administration generally of this Act.

- Similarly, in Tasmania section 8 of the *Forestry Act 1920* provides for the corporation to control and deliver "*land use policy for State forest ….; …forest management and forest produce policy…; commercial policy of the corporation*"; and

  …exclusive management and control of:

  - *all State forest …;*
  - *all forest products on State forest …;*
  - *the establishment and tending of forests, and all forest operations on State forests …; and*
  - *the granting of all permits, licences, forest leases and other occupation rights and the making of all contracts of sale under this Act.*

By contrast, forest management provisions in the relevant legislation in NSW and Western Australia (the *Forestry Act 1916* and the *Conservation and Land Management Act 1984* respectively), although broadly expressed, do not give exclusive control of all policy, management and commercial functions to the relevant agency/department.

The independent reviewers of the *Victorian Forests Act 1958*, indicated their concern regarding the implications of the term 'exclusive control and management' for competition in the potential market for commercial forestry management services. Specifically, they questioned whether exclusivity might extend to the performance of policy, regulatory and commercial functions and whether it might "*…preclude arrangements whereby DNRE* (the department with responsibility for management)

engaged a contractor to carry out the types of functions provided for in the Act, along the lines of 'purchaser/provider' models of service provision." [90]

The reviewers concluded that it is desirable for the issue to be clarified by amending the Act to allow for the possibility of the provision of commercial forestry services by entities other than the department administering the Act.[91] We concur and recommend that similar amendments be made to the Tasmanian legislation.

5.6.5. SUBSIDISED PRICING

As discussed in depth in Chapter 3, prices for sawlogs and pulpwood from native forests could well be underpriced in a number of the States. Underpricing encourages higher exploitation of the available resource and lower investment in future resources. It also constitutes a restriction on potential and actual competition from suppliers of alternatives to native hardwoods.

Log prices/stumpage rates from native forests are not set directly by the market but are administered by SFAs through their forestry Acts and related regulations. In Western Australia, section 59 of the *Forest Products Act 2000* details a number of components that must be taken into account in setting a contract price. These include:

- costs of managing or harvesting the forest products;
- costs of services and advice provide by CALM;
- full recovery of the costs incurred by CALM in relation to managing forest products and managing and protecting departmental land;
- the Commission's operating costs in relation to the forest products; and
- a component representing a profit from the exploitation of the forest products.

In the other States, the provisions in the forestry acts relating to pricing are brief and broadly expressed, giving the SFAs wide discretion in the methodologies used and levels at which prices are set.[92] Given the general nature of these pricing provisions, they do not in themselves restrict competition. Nevertheless, there is little doubt that the lack of specificity in the legislation has contributed to a lack of transparency, independence and consequently, public confidence in pricing, particularly in NSW and Victoria, as identified in Chapter 3.

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90 KPMG Consulting Pty Ltd (1998), *Forests Act 1958: National Competition Policy Review & Government Response*, report for the Department of Natural Resources and Environment, 24 April 1998, p. 47.

91 KPMG, *op. cit*., p.51.

92 The relevant provisions are: NSW, *Forestry Act 1916, section 30B;* Victoria, *Forests Act 1958*, sections 5 (1) (c) and 21 (2); Tasmania, *Forestry Act 1920*, section 29 (3).

5.6.6. MINIMUM SUSTAINABLE YIELD

Section 52A of the Victorian *Forests Act 1958* provides that the Secretary must ensure that, for each timber supply period,

(1) *…the total hardwood sawlog supply levels from State forest in a forest management area equals or is within the permitted margin of the total of the sustainable yield rates for that area during that period;* and that

(2) *… the permitted margin for a forest management area in relation to a timber supply period is 2% above or below the total of the sustainable yield rates for that area during that period.*

The independent reviewers of the Act[93] noted concerns that have been raised about the permitted margin of sawlog supply of two per cent below the sustainable yield rates. The concerns are that this provision could be interpreted as legal obligation on NRE to set a **minimum** sustainable yield, i.e., that NRE must cut timber to the sustainable yield level regardless of the demand for timber.

A legislative sustainable yield limitation on the total amount of timber taken in a forest management area would meet the 'public interest' test and therefore not raise Clause 5 compliance concerns **provided** the sustainable yield operates only as a maximum level of supply. If, however, it operated as a minimum level also, then compliance concerns do arise, since setting a minimum supply level could artificially depress prices and impact on the competitiveness of competing log suppliers such as plantation owners. Furthermore, if a sustainable yield rate operates as a minimum rate, it allows no 'margin of safety' for an incorrect over calculation of the sustainable yield - cutting to the minimum required level might actually be at an unsustainable level. This potential for this eventuality is illustrated by the recent evidence of overcutting in areas of Victoria's native forests, due to possible miscalculations by NRE of sustainable yields.[94]

The independent reviewers of the Victorian Forests Act note that NRE claims not to require licensees to take the authorised volume of timber regardless of demand.[95] Nevertheless, the Victorian legislation should be amended to exclude that possibility.

Forestry legislation in other States do not contain provisions that could be interpreted as minimum sustainable yields. Section 17 (1) of the NSW *Forestry Act 1916* does however, require State Forests to ensure that there is maintained in NSW "*an area of not less than 3,250,000 hectares dedicated as State forests*". This provision too could be interpreted as a requirement to maintain minimum supply levels.

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93 KPMG, *op. cit.*, p. 55.

94 Hopkins, *op. cit.*

95 KPMG, *op. cit.*, p. 55.

5.7. AGREEMENT ACTS

Agreement Acts are Acts of Parliament that provide "legislative backing to contractual agreements entered into by the Government with the private sector." These Acts have been used in many business areas.

Agreement Acts are not immune from NCP consideration. The Victorian State Government's *Timetable for Review of Legislative Restrictions on Competition* states:

> *By their nature these Acts often restrict entry to particular markets for the period of the agreements. As such, they will involve a legislative restriction on competition which falls within the requirement for review under the Competition Principles Agreement.*
>
> *To balance the requirement for review against the limitation imposed by existing private right and obligations, reviews will initially need to identify the scope for change while preserving existing private rights and obligations and, where there is scope for change, proceed within those parameters.*[96]

In Western Australia, where there are a proportionately large number of Agreement Acts (particularly related to mining), the NCC has agreed with the Western Australian Government's proposal to review an accepted sample of these Acts for their impact on competition. This approach may be taken with forestry.

Forestry Agreement Acts typically specify the amount, and conditions under which, the Government will supply timber to a particular company. Acts related to the supply of native hardwoods raise a number of issues worthy of further attention.[97]

First, the Agreements can extend for much longer than other forest licences. This gives the company named in the Agreement a significant advantage over other competitors who do not enjoy the same resource security. For example, the *Forestry (Wood Pulp Agreement) Act 1996*, which sets an agreement between the State Government of Victoria and AMCOR Ltd for the supply of pulpwood, extends to the year 2030, whereas ordinary logging licences in Victoria only extend for 15 years at the most.

Second, while the Agreements do not provide an exclusive right of access to a particular Forest Area, they nonetheless restrict competition across the entire State since they entitle the named company to a significant proportion of the overall volume of timber available for felling in a particular year. Other companies are therefore unable to compete for this timber. For example, under the *Forestry (Wood Pulp Agreement) Act*

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96 Victorian Government (1996) *Victorian Government Timetable for Review of Legislative Restrictions on Competition*, June, s.10.

97 It is beyond the scope of this review to examine all Agreements Acts. The Victorian *Forests (Wood Pulp Agreement) Act 1996* is therefore discussed as a case study in relation to these issues.

1996, AMCOR's guaranteed supply of pulpwood accounts for nearly 25% of the total volume of timber logged in Victoria each year.[98] This effectively means that other companies must compete for the remaining 75% of the resource, while AMCOR does not have to compete at all, a problem that would come to the fore if Victorian yields proved to be unsustainable.

Third, the Agreements sometimes include provisions that waive the payment of licence fees which, to the best of our knowledge, all other companies have to pay. For example under *Forestry (Wood Pulp Agreement) Act 1996*, payment of licence fees by AMCOR is waived.[99]

In addition to these more generic concerns with Agreement Acts, there are some specific concerns in relation to the *Forestry (Wood Pulp Agreement) Act 1996* that are worth examining. First, the Act explicitly requires that:

> *In using its powers and applying its discretions whether under this Agreement or the Act or the Forests Act the Minister and the Secretary shall give full recognition to the fact that the Company is engaged in a competitive business and so far as the interests of forest management allow the Secretary … shall so act in every reasonable way as to enable the Company to carry on the industry in an economic manner.*

Thus the Act appears to provide for substantial competitive benefits to be conferred on the company on the basis of ministerial discretion.

Of further interest is the timing of the Act in relation to two other important processes that were occurring at the time. The first of these is the CPA and the subsidiary legislation review process; the second, the Regional Forest Agreement process.

In relation to the National Competition Policy process, the timing of the Act is of concern given the Governments above-mentioned acknowledgement that Agreement Acts constitute a legislative restriction on competition and therefore need to be included in the NCP legislation review process. This issue should therefore have been at the forefront of the Government's mind when dealing with AMCOR about the Act. It appears however, that the issue was not dealt with, and ergo that the Act was not subject to the benefits test associated – which, if true, constitutes a breach of the CPA. This can be inferred from the fact that the Act along with all other Victorian forestry Agreement Acts were scheduled for review either by 1 December 1998 for those Act relating to the provision of softwoods and 1 December 1999 for those relating to the

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98 In 1998/99, 2.1 m^3 of timber was taken from Victoria's native forests. Of this, 500,000 m^3 was supplied to AMCOR under the *Forests (Wood Pulp Agreement) Act 1996*.

99 Section 6 states:

A licence fee may be waived in whole or in part in accordance with the Agreement despite anything to the contrary in the *Forests Act 1958* or regulations under that Act.

provision of hardwoods. Of further concern is that all forestry Agreement Acts have since been withdrawn from review, as they cannot be amended without the consent of both parties. If this is the case, then the Victorian State Government, with respect to the AMCOR agreement, has put itself in a position where it need not have been.

In relation to the RFA process, the timing of the Act is also of concern given that in 1996, the Victorian State Government and native forest timber industry were deeply involved in the RFA process, a process which was intended to provide, amongst other things, resource security for the native timber industry. For some reason, however, the State Government chose to negotiate separately with AMCOR and to provide it with an agreement that would extend its resource security longer than that of any other company in the State which would be subject to the 20 year RFAs. This situation therefore appears to conflict with the NCP directive at Clause 5(1) that legislation should not restrict competition unless it can be demonstrated that the objectives of the legislation can only be achieved by restricting competition, as there was clearly another process which was designed to achieve this resource security. Of further concern is the fact that whereas the RFAs were based on quite extensive research and public consultation, the Agreement with AMCOR had an unknown, but likely lesser amount of the former, and definitely none of the latter.

5.8. OVERVIEW AND RECOMMENDATIONS

Chart 5.1 provides an overview of compliance issues in each State relevant to Clause 5. In all States, there are aspects of the forestry legislation and/or review process which raise questions about non-compliance with Clause 5. These concerns are particularly evident with respect to the legislation in NSW and Victoria.

CHART 5-1: POTENTIAL COMPLIANCE ISSUES WITH CLAUSE 5: REVIEW OF FORESTRY LEGISLATION

Compliance Issue	NSW	Vic	Tas	WA
Reviewed or scheduled for review	Unclear	Yes completed	Yes completed	Yes completed
Clear objectives				
Legislative objectives	No	No	No	No
Institutional objectives	Yes but unclear	Yes but unclear	Yes	Yes but unclear
Significant restrictions				
Licence mandates exploitation	Yes	Yes	Yes	Yes
Restricts access to logging licences	Unclear	Unclear	No	Unclear
Restricts entry to forest management	No	Yes	Yes	No
Allows for subsidised pricing	Yes	Yes	Yes	No
Minimum sustainable yield/supply specified	Unclear	Unclear	No	No

Recommendations

In considering legislation reviews under clause 5, the National Competition Council needs to pay particular attention to clarifying the objectives of the relevant legislation and the institution responsible for administering the legislation for each State. The NCC should ensure that all States review or re-review their forestry legislation to ensure full compliance with Clause 5 of the CPA.

Each State should also pay attention to the potential restrictions in their legislation to competition from activities not related to timber production and potential restrictions on entry to forest management.

Victoria, NSW and Tasmania should amend the pricing provisions of their respective State legislation to reduce the discretionary nature of pricing policy and explicitly establish the need for full cost recovery.

A EMPLOYMENT AND INVESTMENT

A.1 INTRODUCTION

At the policy and political level, there is a strong focus on maintaining employment in remote communities – and that has meant forestry and milling based on timber from native forests. For instance, speaking about the RFA process in south-west Western Australia (and the Court Government's decision to change some of the outcomes of the RFA), the current Federal Minister, the Hon. Wilson Tuckey stated that:

> *the objective was to achieve job security for timber workers in the timber towns of the south west who rely on the industry for their economic and social well-being.*[100]

He went on to say that:

> *the decision today by the WA Government to renege on the signed agreement has effectively destroyed the job security for timber workers which was so important at the time the WA RFA was signed by both governments.*

The Minister's commitment to native timber industry employment can also be seen in his statement to a group of concerned timber workers in the Ballarat region of Victoria:

> *I am happy to reinforce with timber workers and their families that I am the 'Minister for Forestry'.*

Against this background, successive governments have placed particular emphasis on retaining employment in the native forest industry, particularly in logging and sawmilling. The Prime Minister and Victorian Premier, for example, promised that there would be no net job losses because of the implementation of the Victorian RFAs.[101]

However, the employment issue is overstated – if not misstated – since employment in plantations and based on plantation-based timbers is rapidly growing.

If employment in traditional forestry is a policy objective then we ought to define and measure it with necessary accuracy. The existing statistical base is so poor that we cannot tell how much employment is being generated by 'new forestry' in the form of plantations and how much by traditional forestry. Nor can we tell how much the subsidisation of logging in the remote areas of NSW and Victoria damages plantation-based employment.

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[100] The Hon. Wilson Tuckey (1999) "WA Government's Unilateral review of the RFA a blow to regional towns and jobs", Media Release AFFA A99/87TU, 27 July. http://www.affa.gov.au/ministers/tuckey/releases/99/99_87tu.html

[101] See 'RFA process completed in Victoria', Media release from the Office of the Premier and Treasurer, March 31, 2000. See also http://www.rfa/vic/gipps/index.html

A.2 EMPLOYMENT

Employment in forest-based industries is estimated to be between 75 to 80 thousand persons according to the ABS Labour Force statistics (Chart A-1).

CHART A-1: LEVELS OF EMPLOYMENT IN WOOD-RELATED INDUSTRIES

	Forestry and Logging	Log Sawmilling and Timber Dressing	Other Wood Product Manufacturing	Paper and Paper Product Manufacturing	Total
Average for year to June			No. of jobs ('000)		
1998	14.0	15.0	28.3	20.2	*77.5*
1999	14.1	17.0	26.2	21.9	*79.2*
2000	8.8	18.5	30.6	20.1	*78.0*

Source: ABS Labour Force statistics (ABS Cat. No. 6203.0, various)

Across the States and Territories, employment in wood-related industries represents around one per cent of total employment in all States, except Tasmania where it represents three per cent, and less than half a per cent in the Territories (Chart A-2).

CHART A-2: EMPLOYMENT IN WOOD-RELATED INDUSTRIES: STATES AND TERRITORIES

	Total Number '000	Proportion of State/ Territory Employment		Total Number '000	Proportion of State/ Territory Employment
New South Wales			Western Australia		
1998	23.1	0.8%	1998	6.9	0.8%
1999	23.3	0.8%	1999	8.5	1.0%
2000	24.6	0.8%	2000	7.6	0.8%
Victoria			Tasmania		
1998	19.3	0.9%	1998	5.6	2.9%
1999	21.4	1.0%	1999	6.6	3.4%
2000	19.0	0.9%	2000	5.4	2.7%
Queensland			Northern Territory		
1998	15.1	1.0%	1998	0.3	0.3%
1999	11.1	0.7%	1999	0.2	0.2%
2000	12.0	0.7%	2000	0.4	0.4%
South Australia			Australian Capital Territory		
1998	7.3	1.1%	1998	0.8	0.5%
1999	7.8	1.2%	1999	0.5	0.3%
2000	8.7	1.3%	2000	0.5	0.3%

Source: ABS Labour Force statistics (ABS Cat. No. 6203.0, various)

The Australian Bureau of Statistics undertakes two[102] surveys that show employment levels for forestry related industries: the household survey (of respondents in 30,000

[102] The Survey of Employment and Earnings (SEE) obtains information each quarter from 10,000 employers on its business register. The information provides estimates of wage and salary earner employment (and therefore omits self-employed and employers) by industry and public and private. It does not however, include estimates for private Agriculture, forestry and fishing employment. Employees are classified according to the primary activity of the business. The ABS also notes that there is a large number of mainly small private businesses that are not on the register.

dwellings Australia-wide) and the Manufacturing Survey/Census (a quinquennial census, supplemented by annual surveys of around 17,000 manufacturers).

In the case of the household survey, respondents currently allocate themselves to an industry.[103] In the case of the manufacturing survey, the business is allocated to an industry category.

An alternative source for employment data is the RFA process. The regions, however, "*cover only part of the forest estate and thus only aggregate to a subset of the national aggregate.*"[104] As part of the RFA process, the NSW regions drew on 1996 census data.

With more than half of Australia's sawlog production now coming from plantation softwood and the area of hardwood plantations now expanding rapidly, strong employment growth in plantation-based activities while unobservable, appears to be a logical inevitability.

Regrettably, the available statistics do not mirror or illuminate the policy debate since:

- they do not draw the relevant distinctions. The industry sectors used by the ABS are based on industry sectors rather than products. Forestry-related employment and output is spread across Primary Industry (growing and harvesting of trees), Secondary Industry (manufacturing processes transforming timber) and Tertiary Industry (importantly transport for logged trees, but also other services such as sales and servicing of logging equipment). Details for forestry-related employment are not extractable for Tertiary Industry. These classifications do not take account of the source of the trees.

  While environmental and community concerns focus on the exploitation of native forests and the potential to substitute plantations for native forests, the ABS employment data on forestry and logging fail to distinguish between either plantation-based and native forest-based activities or between hardwood and softwood-based activities.

  Similarly, the ABS manufacturing survey fails to separate investment, employment and other indicators for sawmills processing hardwood and softwood or based on native forest or plantation timber.

The ABS notes that the Labour Force is the preferred source of total and State employment figures while the SEE obtains better industry and sector estimates.

[103] In earlier surveys some allocation was undertaken by cross-referencing each respondent's employer with the business register.

[104] Dargavel, J, Conley, K, Proctor, W. Ferguson, I and Bhati, U (1998) *Direct and Indirect Employment in the Forest Sector and Forest Sector Employment as a Proportion of Total Employment*, Final Report for AFFA, Montreal Process Project 6.5a, p. ix. While this report was concerned with employment associated with forests and not solely with employment in timber extraction and downstream processing, the latter received most of its attention.

- confidence in the survey data is too low for the data to be useful. There can be reasonable confidence in the employment data on sawmilling and other timber-based manufacturing activities, where they are sourced from the manufacturing survey. However, employment data on forestry and logging activities can only be sourced from the ABS Labour Force (household survey) statistics which has very large standard errors in percentage terms.[105] Given few people are employed in this sector and they are spread throughout non-metropolitan Australia, it would be incredibly expensive to survey sufficient households to obtain reliable estimates.

  As a result, the available ABS estimates on forestry and logging activities can not be used to measure short-run changes in employment nor to make regional comparisons;

- the definitions and bases for collecting the data are inconsistent. A particular problem is that particular occupations may or may not be included across different surveys. In the case of haulage operators, whether they are counted within Forestry and logging depends on:
  - in the manufacturing survey, where they are employed by the sawmill they are included in the category but if they are sub-contactors they are not;
  - in the household survey, it is up to the respondent to nominate the industry.

There is a further negative conclusion. Since there is little confidence in the basic ABS Labour Force data on forestry and logging employment, it follows that analyses based on these data are likely to be – at a minimum – similarly imprecise. For instance,

- Clark (1995) uses the volume of plantation production, plus assumptions on labour productivity to derive estimates of forestry and logging employment in plantations. Unavoidably, even if Clark's productivity assumptions were accurate in representing the actual (but unobservable) real world, her estimates can not be more reliable than the underlying ABS data; and

- our attempts to use the data directly assembled on milling and processing employment dependent upon native forests covered by the RFAs suggest that different concepts and definitions are being applied in the ABS manufacturing survey and the RFA processes.

The centrality of employment to the public policy debate over the logging of public native forests necessitates good quality data on employment in the native forest, plantations and farm forest sectors. Unfortunately however, none of the ABS, ABARE and the BRS can currently identify those whose employment is associated with either plantation or native forests, despite what appear to be very real opportunities to do so through existing programs, e.g., National Forest Inventory or ABARE forestry work.

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[105] Relative standard errors for the Manufacturing Survey for industry sub-division by State are almost entirely less than three per cent.

CHART A-3: MOVEMENTS IN NATIONAL FORESTRY MANUFACTURING EMPLOYMENT: MANUFACTURING SURVEY VS HOUSEHOLD SURVEY

	1997-98	1998-99	Change
		('000)	
Log sawmilling and timber dressing			
Household survey	15.0	17.0	+2.0
Manufacturing survey	15.3	12.5	–2.8
Other wood product manufacturing			
Household survey	28.3	26.2	–2.1
Manufacturing survey	30.1	30.9	+0.8
Paper and paper product manufacturing			
Household survey	20.2	21.9	+1.7
Manufacturing survey	17.2	17.3	+0.1
Total			
Household survey	63.5	65.1	+1.6
Manufacturing survey	62.6	60.7	–1.9

Source: ABS (2000) *Labour Force*, unpublished data, ABARE (2000)

The impact of this lack of data is to hide the growing importance of the plantation sector from the native forest-based logging. Moreover, there is a concern that the existing data, by default, have tended to inflate estimates of employment in the native forest sector, implying a higher economic and social contribution to regional areas.

This, in turn, has affected the analysis of the role of this industry vis-à-vis other regional industries (e.g., tourism, conservation and beekeeping). The existing employment data have also hidden the growing economic and social significance of the plantation sector and the need for governments to re-focus on this expanding industry.

We examine below the details of this mismatch between policy focus and useable statistics and then report the little that can be said with confidence about employment levels and trends.

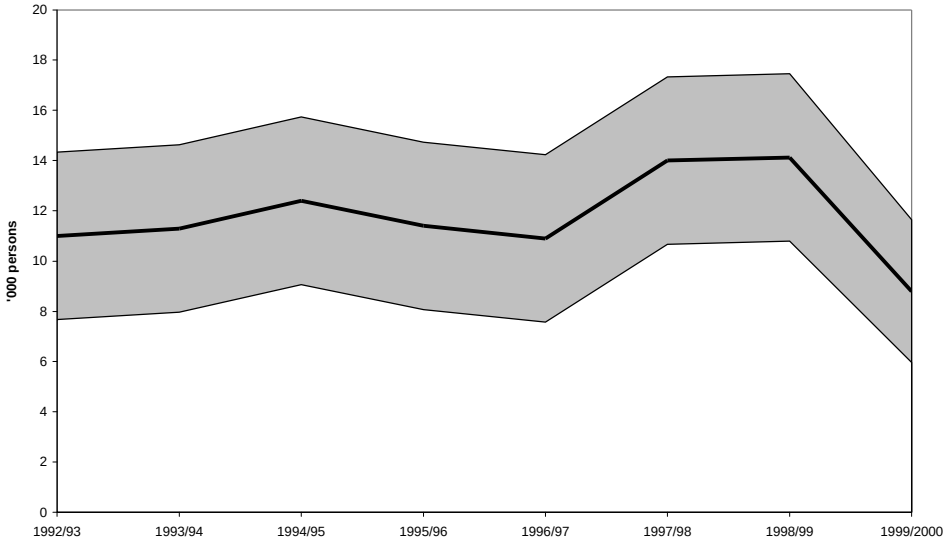
A.2.1. Overview on Forestry-based Employment

While the political focus is directed to maintaining forestry logging and milling jobs in remote communities, the ABS estimates have high relative standard errors which makes early discernment of trends and actual numbers difficult. For instance, the point estimates for forestry and logging suggest that employment fell sharply in the past year (after rising significantly in the previous two years). However, each of these estimates is within the 95 per cent confidence interval for the estimates for the previous five years. From this view, it is not clear if there has been any change in employment.

A striking feature of the NFPS and subsequent RFAs is the emphasis on industry development in an industry which across Australia in 1997 directly employed only

around 11,000 persons in forestry and logging and a 19,000 in log sawmilling dressing.[106]

CHART A-4: EMPLOYMENT IN FORESTRY AND LOGGING – SPREAD OF ESTIMATES



Source: ABS (2000) *Labour Force, Australia*, and ABARE (2000) *Australian Forest Products Statistics*

In a decade when industry assistance has been substantially dismantled, forestry is one of the few remaining industries where there is a strong commitment to the industry in its own right and where significant funds have been provided by the Commonwealth. This is due in part to the historical regional nature of the employment and the major structural pressures facing the industry, especially as a result of the downsizing of the available resource.

The magnitude of the restructuring funds invites comparison with the dairy industry.[107] However, the dairy industry deregulation will primarily change who produces a level of output which is relatively stable at the national level. In contrast, the significant increase in forest reserves should lead to a reduction in logging output.

A.2.2. Employment Subsidies

In most States, there is a strong political objective to maintain native forest-based employment in remote areas. This objective is assisted by subsidies provided through:

- the residual value pricing in the major forestry States of sawlogs, chips and residues which may mean that timber from remote areas is sold at a lower return. Moreover, this is likely to be less than production cost (see Chapter 3);

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106 National Forest Inventory (1998) *Australia's State of the Forests Report 1998*, BRS, Canberra.

107 In fact, the dairy industry package is equivalent to $30,000 per employee and only around $10,000 per employee in the forestry industry.

- special one-off agreements to restructure and boost employment, for example at the Greenbushes Mill in WA or Swifts Creek in Victoria; and
- special arrangements with the SFAs to maintain logging activity or milling activity by shipping logs over substantial distances.

In addition, the RFA's Forestry Industry Structural Program (FISAP) will provide some $101 million to assist in restructuring of the forest industry in RFA areas (Chart A-5).

CHART A-5: FOREST INDUSTRIES STRUCTURAL ADJUSTMENT PROGRAM

As part of the RFA agreements, Commonwealth and State Governments have provided substantial funding for:

- industry development;
- rescheduling assistance;
- business exit assistance and
- labour adjustment/worker assistance.

The worker assistance program provides assistance for workers who have or will lose their jobs as a results of the RFA processes.[108] The type of assistance provided includes:

- training assistance;
- relocation assistance;
- wage subsidies for new employers; and
- assistance for employers directly impacted by a Regional Forest Agreement to run programs assisting workers.

Regional Forest Agreement	Funding program	Commonwealth contribution	State contribution	Total
Tasmanian	One-off payment	$110m over 3 years		$110m
Victorian	Victorian FISAP	$18.8m	$23.8m	$42.6m
South-West WA	WA FISAP	$15m (+ additional $5m tourism related exp.)	$23.5m	$38.5m $5.0m
NSW	NSW FISAP	$60m [1]	$60m	$120m

1. NSW FISAP funding currently suspended

Source: *pers. comm.* Agriculture, Fisheries & Forestry Australia, August 2000. See also http//www.rfa.gov.au

The overall Commonwealth funding available through the FISAP program is $101 million spread over the years 1996 to 2003. This equates to a one-off capital grant of $11,500 over that period for every person employed in the logging and sawmilling sectors – this implicit subsidy to native forestry is higher as funds are not available for those employed in the plantations or farm forest parts of the industry.

108 Obtained Online. Available HTTP: http://www.nre.vic.gov.au (November 2000)

A.3 PLANTINGS AND INVESTMENT

Investment in Australia's forest industries includes:

- additions to the existing estate of softwood and hardwood plantations;
- replanting of native forest which has been clearfelled plus other investment in forestry and logging needs, infrastructure and equipment; and
- investment in new milling and processing facilities and the upgrading of existing facilities .

The make-up of Australia's timber industry has changed quite significantly over the past decade, largely due to the increase in the plantation estate over this period which has been assisted by Government commitment to treble the 1996 effective area of Australia's plantations by 2020.[109]

A.3.1. Investment in Plantations

Australia's plantation estate increased substantially in the 1960s but particularly from the 1970s. Rates of softwood planting peaked in the second half of the 1970s, plateaued in 1980 and fell in the 1990s. In sharp contrast, hardwood plantings which had been negligible previously rose exponentially in the 1990s (Chart A-6).

As a result of the heavy plantings of softwoods in the 1960s and 1970s, by 1992 "*45 per cent of saw logs harvested in Australia* [were] *supplied from coniferous plantations.*"[110]

In 2000, plantations are supplying over half Australia's domestic timber needs.[111] Some commentators estimate that Australia is rapidly approaching the point where woodchip exports could be sourced from existing and planned plantations.[112] On the other hand, the quality, durability and commercial relevance of parts of the older softwood estate is by no means uniform.

In 1999, 94,812 ha of new plantations were established, which represented a 44 per cent increase on the total area of new plantations established in 1998. A further 155,000 ha were intended to be established in 2000.[113] This suggests that investment in plantations

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109 "*In July 1996 the Ministerial Council on Forestry, Fisheries and Aquaculture endorsed the plantation industry's target of trebling the plantation estate by the year 2020*" Plantations 2020 Vision Implementation Committee (1997) *Plantations for Australia – The 2020 Vision*.

110 Industry Commission (1993) *Adding Value to Australia's Forest Products*, Inquiry Report No. 32, September, p. 304

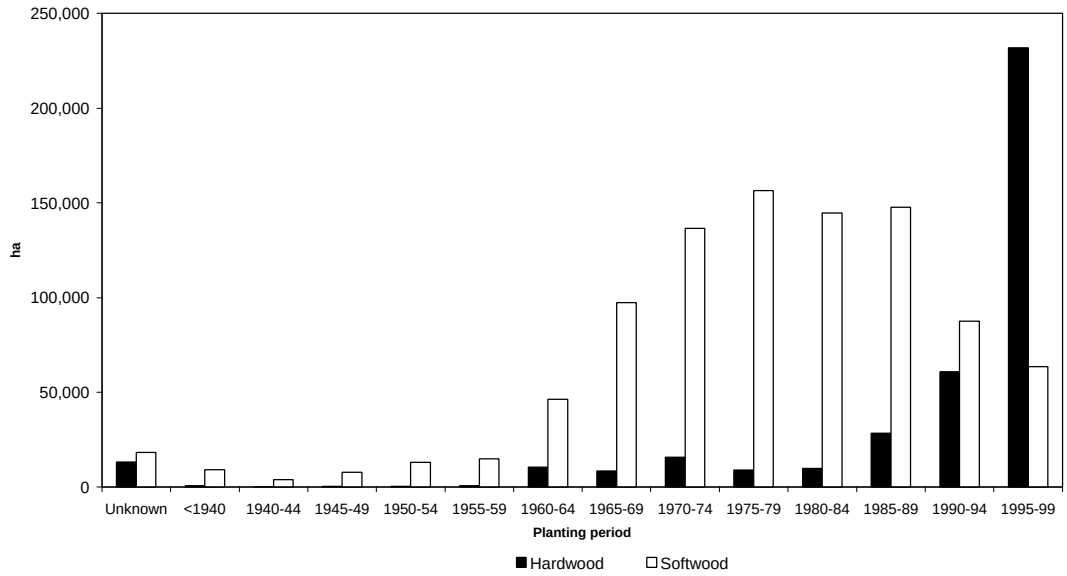
111 Department of Foreign Affairs and Trade (2000) "Australia's Forest Industry", Australia 2000 series. http://www.dfat.gov.au/australia2000/forests.html , November.

112 For instance, James Duggie briefing (2000) *Chiplog supply from Australia's existing eucalypt plantations*, July, reviewed Judy Clark's projections for the sector. She found that Western Australia would meet Australia's current export hardwood woodchip volumes by 2005 [p. 8].

113 National Forest Inventory (2000) *National Plantation Inventory Tabular Report – March 2000*, Bureau of Rural Sciences, Canberra.

was between $100m and $160m in 1999 and is expected to be between $155m and $260m in 2000.[114] Most of this investment is private.

CHART A-6: PLANTATION PLANTING PERIOD: 1994 & SUBSEQUENT ANNUAL PLANTINGS



Note: For all years prior to 1995, the planted areas are net of any areas of plantations which may have been turned over to other purposes up to and including 1994.

In the 1960-64 planting period, the softwood and hardwood figures include areas from the Western Australia region which were planted prior to 1962. Thus, the national total figure for the 1960-64 period is inflated by 32 per cent and 60 per cent respectively.

Source: NFI (1997) *National Plantation Inventory of Australia*, p. 10 and BRS (2000) *National Forest Inventory*, March, BRS (1999) *National Plantation Inventory of Australia*.

In contrast, reflecting the dominance of government agencies in softwood planting in the past, most of Australia's plantation estate is currently under public ownership, although there is an equal split in the ownership of the trees. In 1998, 75 per cent of all new plantations were established on private land. In 1999, this proportion had risen to 90 per cent (see Chart A-7 for ownership by area and Chart A-8 for tree ownership). Moreover, the BRS expects that there will be "*an increase by the private sector, both through the transfer of public ownership of trees to private ownership of trees, and the expansion of privately owned trees on both public and private land.*"[115]

[114] The Victorian Department of Natural Resources provides estimates for 1997 of the investment costs for new plantations "*The direct cost of establishing rain-fed plantations varies from $1,000 to $1,700 per hectare (excluding land and any borrowing costs).*: DNRE (1997) *Investing in Victoria – Trade and Investment: Private Forestry*, www.nre.vic.gov.au November 2000.

[115] National Plantation Inventory (2000) *National Plantation Inventory Tabular Report – March*, BRS

CHART A-7: NEW AREAS PLANTED TO HARDWOOD AND SOFTWOOD PLANTATION IN 1998 AND 1999 BY LAND OWNERSHIP

	1998				*1999*			
	Public Land		*Private Land*		*Public Land*		*Private Land*	
	Hard	*Soft*	*Hard*	*Soft*	*Hard*	*Soft*	*Hard*	*Soft*
NSW	7,426	3,612	232	1,436	2,000	1,200	2,375	1,482
VIC	101	673	8,298	624	10	358	25,316	483
QLD	0	352	1,989	195	135	15	2,378	91
SA	3	461	2,000	308	3	255	8,000	222
WA	0	0	823,400	2,050	0	300	27,500	3,400
TAS	2,499	1,225	7,900	833	3,423	2,224	13,044	150
NT	0	0	8	0	0	0	448	0
ACT	0	0	0	0	0	0	0	0
Total	10,029	6,323	43,827	5,446	5,571	452	79,061	5,828
TOTAL	**16,352**		**49,272**		**9,923**		**84,889**	

Notes: Data obtained at September each year.

Source: National Forest Inventory (2000) *National Plantation Inventory – March 2000*, Bureau of Rural Sciences.

CHART A-8: NEW AREAS PLANTED TO HARDWOOD AND SOFTWOOD PLANTATION IN 1998 AND 1999 BY TREE OWNERSHIP

	Public trees		**Private trees**		**Joint Venture**	
	Hard	**Soft**	**Hard**	**Soft**	**Hard**	**Soft**
1998						
NSW	7,426,	3,612	232	1,232	0	204
VIC	0	155	8,399	1,142	0	0
QLD	0	352	1,665	110	324	85
SA	3	461	2,000	308	0	0
WA	0	0	23,300	70	100	1,980
TAS	1,747	832	7,900	500	752	726
NT	0	0	8	0	0	0
ACT	0	0	0	0	0	0
Total	9,176	5,412	43,504	3,362	1,176	2,995
Total	**14,588**		**46,865**		**4,171**	
1999						
NSW	2,000	1,200	446	1,074	1,929	408
VIC	0	0	25,326	841	0	0
QLD	135	15	2,077	6	301	85
SA	3	255	8,000	222	0	0
WA	0	300	27,500	0	0	3,400
TAS	2,880	0	12,910	150	677	2,224
NT	0	0	440	0	8	0
ACT	0	0	0	0	0	0
Total	5,018	1,770	76,699	2,293	2,915	6,117
Total	**6,788**		**78,992**		**9,032**	

Source: Bureau of Rural Sciences (2000) *National Plantation Inventory – March 2000.*

The current constraint in plantation production is not the volumes of logs available for cutting and processing, but rather, the capacity to mill and process those logs. For instance, during the 1990s in Tasmania, over one-third of Tasmania's exports of plantation roundwood timber was not processed (Chart A-9).

CHART A-9: ACTUAL AND PROJECTED TASMANIAN PLANTATION WOOD SUPPLY (M^3 ROUNDWOOD PER ANNUM)

Log grade	*Domestically processed 1994/5*	*Unprocessed exports 1994/5*	*Total 1994/95*	*2000*	*2005*
Softwood sawlog	302,000	95,000 (24%)	397,000	736,000	780,000
Softwood veneer logs	2,000	Unknown but included in sawlogs	2,000	30,000a	30,000a
Softwood Chiplog	370,000	Est. 268,000 (42%)	638,000	467,000	467,000
Softwood other	19,000		19,000	poles and posts incl in chiplog	poles and posts incl in chiplog
Softwood total	**693,000**	**363,000**	**1,056,000**	**1,233,000**	**1,277,000**
Eucalypt Chiplog	0	0[b]	0	1,000,000	1,000,000
Total plantation	**693,000**	**363,000**	**1,056,000**	**2,233,000**	**2,277,000**

Source: A. Banks & J. Clark (1997) *Tasmania's Plantation Processing Industry: Job opportunities now and in the future*, report prepared for Australian Greens Senator Bob Brown, July, p. 3.

Banks and Clark estimate that an additional 790 new jobs could be created in Tasmania through the processing of plantation wood, the supply of which was projected to double over the period from 1997–2000. They currently estimate that plantation-based employment accounts for 42 per cent of jobs in Tasmania's wood products industry and that the plantation industry creates nearly three times as many manufacturing jobs per m^3 of wood harvested than the native forest industry.[116] This is due to the fact that whereas 70 per cent of plantation wood harvested in Tasmania is processed into sawntimber, paper and other wood products, only 25 per cent of wood harvested from native forests is so processed – the remainder ends up as woodchips. According to Banks and Clark,

> *The export of an average 112 000m^3 of whole plantation sawlogs annually (25% of production) represents approximately 140 jobs lost in softwood sawmilling and further processing into products such as joinery, mouldings, and furniture components.*[117]

Clark concluded that:

> *Australia wide plantations remain unharvested for lack of processing facilities. A major plantation sawlog stockpile exists. In Western Australia the sawlog*

[116] Banks and Clark (1997) *Tasmania's Plantation Processing Industry: Job opportunities now and in the future*, report prepared for Australian Greens Senator Bob Brown, July, p. i.

[117] Banks & Clark (1997) p. 5.

stockpile is estimated to total 1.2 million m^3. This is four times Western Australia's current annual plantation sawlog cut.[118]

For the environment movement, an important question is when and under what conditions can imports, plantations and farm forestry meet Australia's wood needs. This raises questions about competitive neutrality and pricing reform which are addressed in preceding Chapters.

A.3.2. Investment in Native Forests

In discussing investment, we first must define what we mean by the term. There is a methodological question as to what should be defined as investment in native forests. From a national accounts perspective, for example:

- should replacement of felled trees be included;
- the UN System of National Accounts recommends that natural growth in crops be included as 'work-in-progress' or 'investment'. The ABS has rejected this recommendation;
- for the purposes of estimating investment, does it include the acquisition of forests and any planting costs;
- improvements to land and other capital costs are included.[119]

In terms of the national perspective, we would agree with the ABS' approach which is to include only net increases in area or quality of forests managed. Such increases would be recognised within the investment figures for forestry.

As discussed earlier under employment, there are no separate ABS figures for native forests. Any figures would be included with other (non-native) forestry figures.

Alternatively, preparation and planting costs may be considered investment (although not recorded as such within official data). The National Forest Inventory estimated that

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[118] J. Clark (1998) *Investment in plantation processing – the over-riding goal for the wood & wood products industry*, prepared for the National Trust of Australia (WA) Symposium: The Regional Forest Agreement – A Question of Balance, Murdoch University, 13 June.

[119] "[s. 15.11] *The acquisition of non-reproducible tangible assets such as land, subsoil assets and natural timber tracts is not included in gross fixed capital formation. However, capital costs associated with the extension or development of these assets are included, as are outlays on land reclamation and improvement.*"

However, the UN's system of national accounts (SNA93) "[s. A2.6] *recommends that cultivated natural growth be included in output as work-in-progress or gross fixed capital formation over the entire period of the growth process. This recommendation covers growth of agricultural crops, livestock, cultivated fish and crustacea, vineyards, orchards and timber tracts. In SNA68, only growth in livestock and fishstock were treated in this way, although the recommended treatment was not adopted in the ASNA. The existing ASNA treatment is to include crops and forest products in output when harvested, but to follow SNA93 recommendations for major categories of livestock (i.e. beef and dairy cattle and sheep*" ABS (2000) *Australian National Accounts: Concepts, Sources and Methods.*

around 110,000ha is logged in a year.[120] Estimates of costs for native forests are not readily obtainable. By way of comparison, Private Forests Tasmania provides estimates for the cost of establishing plantations of the order of $1,200 to 1,500 per hectare.[121]

A.3.3. Investment in Mills and Processing

During the 1990s, there has been significant investment in new and upgraded mills and processing facilities (Chart A-10). Again, these figures show investment in manufacturing processes irrespective of the original of the wood – native forest, plantation or imports.

Over the five years to 1998-99, total investment in forestry and wood-based industries averaged over $800,000,000 per annum. Within this total, investment in sawmilling averaged around 3% only of the total.[122]

CHART A-10: CAPITAL EXPENDITURE IN FOREST PRODUCT MANUFACTURING INDUSTRIES ($m)

	1996/97	1997/98	1998/99
Wood and wood products			
Log sawmilling	28.1	11.9	31.7
Resawn & dressed timber	62.7	66.5	57.1
Hardwood woodchips	9.5	16.8	14.0
Plywood & veneer mfg	15.5	16.9	9.6
Fabricated wood mfg	307.6	109.6	32.3
Wooden structural fittings & joinery	44.6	41.2	70.9
Wood products nec	29.2	4.3	50.8
Total	497.2	267.2	266.4
Paper & paper products			
Pulp, paper & paperboard	170.1	182.7	86.2
Paper bags incl sack mfg	17.4	29.5	16.9
Solid paperboard containers	50.1	28.1	23.8
Corrugated paperboard containers	86.5	150.8	210.7
Paper products nec	39.8	51.2	50.5
Total	*363.9*	*442.3*	*388.1*
TOTAL CAPITAL EXPENDITURE	**861.1**	**709.5**	**654.5**

Source: ABARE (2000) *Australian Forest Products Statistics, June quarter 2000*, p. 73.

[120] National Forest Inventory Australia (1999) *State of the Forests Report 1998*, http://www.affa.gov.au/docs/rural_science/nfi/activities/sofr/uses.html

[121] Private Forests Tasmania *Plantation Establishment – Labour & Costs*, http://www.privateforests.tas.gov.au/infosheets/6labour&costs.htm

[122] ABS Manufacturing Survey.

B COMPETITION PRINCIPLES AGREEMENT

The text of the Competition Principles Agreement is reproduced from the National Competition Commission (1998) *Compendium of National Competition Policy Agreements*, second edition

Competition Principles Agreement – 11 April 1995

WHEREAS the Council of Australian Governments at its meeting in Hobart on 25 February 1994 agreed to the principles of competition policy articulated in the report of the *National Competition Policy Review*;

AND WHEREAS the Parties intend to achieve and maintain constant and complementary competition laws and policies which will apply to all businesses in Australia regardless of ownership;

THE COMMONWEALTH OF AUSTRALIA

THE STATE OF NEW SOUTH WALES

THE STATE OF VICTORIA

THE STATE OF QUEENSLAND

THE STATE OF WESTERN AUSTRALIA

THE STATE OF SOUTH AUSTRALIA

THE STATE OF TASMANIA

THE AUSTRALIAN CAPITAL TERRITORY, AND

THE NORTHERN TERRITORY OF AUSTRALIA agree as follows:

Interpretation

1.(1) In this Agreement, unless the context indicates otherwise:

"Commission" means the Australian Competition and Consumer Commission established by the Trade Practices Act;

"Commonwealth Minister" means the Commonwealth Minister responsible for competition policy;

"constitutional trade or commerce" means:

(a) trade or commerce among the States;

(b) trade or commerce between a State and a Territory or between two Territories; or

(c) trade or commerce between Australia and a place outside Australia;

"Council" means the National Competition Council established by the Trade Practices Act;

"jurisdiction" means the Commonwealth, a State, the Australian Capital Territory or the Northern Territory of Australia;

"Party" means a jurisdiction that has executed, and has not withdrawn from, this Agreement;

"Trade Practices Act" means the *Trade Practices Act 1974*.

(2) Where this Agreement refers to a provision in legislation which has not been enacted at the date of commencement of this Agreement, or to an entity which has not been established at the date of commencement of this Agreement, this Agreement will apply in respect of the provision or entity from the date when the provision or entity commences operation.

(3) Without limiting the matters that may be taken into account, where this Agreement calls:

(a) for the benefits of a particular policy or course of action to be balanced against the costs of the policy or course of action; or

(b) for the merits or appropriateness of a particular policy or course of action to be determined; or

(c) for an assessment of the most effective means of achieving a policy objective;

the following matters shall, where relevant, be taken into account:

(d) government legislation and policies relating to ecologically sustainable development;

(e) social welfare and equity considerations, including community service obligations;

(f) government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;

(g) economic and regional development, including employment and investment growth;

(h) the interests of consumers generally or of a class of consumers;

(i) the competitiveness of Australian businesses; and

(j) the efficient allocation of resources.

(4) It is not intended that the matters set out in subclause (3) should affect the interpretation of "public benefit" for the purposes of authorisations under the Trade Practices Act.

(5) This Agreement is neutral with respect to the nature and form of ownership of business enterprises. It is not intended to promote public or private ownership.

Prices Oversight of Government Business Enterprises

2.(1) Prices oversight of State and Territory government business enterprises is primarily the responsibility of the State or Territory that owns the enterprise.

(2) The Parties will work cooperatively to examine issues associated with prices oversight of government business enterprises and may seek assistance in this regard from the Council. The Council may provide such assistance in accordance with the Council's work program.

(3) In accordance with these principles, State and Territory Parties will consider establishing independent sources of price oversight where these do not exist.

(4) An independent source of price oversight advice should have the following characteristics:

(a) it should be independent from the government business enterprise whose prices are being assessed;

(b) its prime objective should be one of efficient resource allocation, but with regard to any explicitly identified and defined community service obligations imposed on a business enterprise by the government or legislature of the jurisdiction that owns the enterprise;

(c) it should apply to all significant government business enterprises that are monopoly, or near monopoly, suppliers of goods or services (or both);

(d) it should permit submissions by interested persons; and

(e) its pricing recommendations, and the reasons for them, should be published.

(5) A Party may generally or on a case-by-case basis:

(a) with the agreement of the Commonwealth, subject its government business enterprises to a prices oversight mechanism administered by the Commission; or

(b) with the agreement of another jurisdiction, subject its government business enterprises to the pricing oversight process of that jurisdiction.

(6) In the absence of the consent of the Party that owns the enterprise, a State or Territory government business enterprise will only be subject to a prices oversight mechanism administered by the Commission if:

(a) the enterprise is not already subject to a source of price oversight advice which is independent in terms of the principles set out in subclause (4);

(b) a jurisdiction which considers that it is adversely affected by the lack of price oversight (an "affected jurisdiction") has consulted the Party that owns the enterprise, and the matter is not resolved to the satisfaction of the affected jurisdiction;

(c) the affected jurisdiction has then brought the matter to the attention of the Council and the Council has decided:

(i) that the condition in paragraph (a) exists; and

(ii) that the pricing of the enterprise has a significant direct or indirect impact on constitutional trade or commerce;

(d) the Council has recommended that the Commonwealth Minister declare the enterprise for price surveillance by the Commission; and

(e) the Commonwealth Minister has consulted the Party that owns the enterprise.

Competitive Neutrality Policy and Principles

3.(1) The objective of competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. These principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities.

(2) Each Party is free to determine its own agenda for the implementation of competitive neutrality principles.

(3) A Party may seek assistance with the implementation of competitive neutrality principles from the Council. The Council may provide such assistance in accordance with the Council's work program.

(4) Subject to subclause (6), for significant government business enterprises which are classified as "Public Trading Enterprises" and "Public Financial Enterprises" under the Government Financial Statistics Classification:

(a) the Parties will, where appropriate, adopt a corporatisation model for these government business enterprises (noting that a possible approach to corporatisation is the model developed by the inter-governmental committee responsible for GTE National Performance Monitoring; and

(b) the Parties will impose on the Government business enterprise:

(i) full Commonwealth, State and Territory taxes or tax equivalent systems;

(ii) debt guarantee fees directed towards offsetting the competitive advantages provided by government guarantees; and

(iii) those regulations to which private sector businesses are normally subject, such as those relating to the protection of the environment, and planning and approval processes, on an equivalent basis to private sector competitors.

(5) Subject to subclause (6), where an agency (other than an agency covered by subclause (4)) undertakes significant business activities as part of a broader range of functions, the Parties will, in respect of the business activities:

(a) where appropriate, implement the principles outlined in subclause (4); or

(b) ensure that the prices charged for goods and services will take account, where appropriate, of the items listed in paragraph 4(b), and reflect full cost attribution for these activities.

(6) Subclauses (4) and (5) only require the Parties to implement the principles specified in those subclauses to the extent that the benefits to be realised from implementation outweigh the costs.

(7) Subparagraph (4)(b)(iii) shall not be interpreted to require the removal of regulation which applies to a Government business enterprise or agency (but which does not apply to the private sector) where the Party responsible for the regulation considers the regulation to be appropriate.

(8) Each Party will publish a policy statement on competitive neutrality by June 1996. The policy statement will include an implementation timetable and a complaints mechanism.

(9) Where a State or Territory becomes a Party at a date later than December 1995, that Party will publish its policy statement within six months of becoming a Party.

(10) Each Party will publish an annual report on the implementation of the principles set out in subclauses (1), (4) and (5), including allegations of non-compliance.

Structural Reform of Public Monopolies

4.(1) Each Party is free to determine its own agenda for the reform of public monopolies.

(2) Before a Party introduces competition to a sector traditionally supplied by a public monopoly, it will remove from the public monopoly any responsibilities for industry regulation. The Party will re-locate industry regulation functions so as to prevent the former monopolist enjoying a regulatory advantage over its (existing and potential) rivals.

(3) Before a Party introduces competition to a market traditionally supplied by a public monopoly, and before a Party privatises a public monopoly, it will undertake a review into:

(a) the appropriate commercial objectives for the public monopoly;

(b) the merits of separating any natural monopoly elements from potentially competitive elements of the public monopoly;

(c) the merits of separating potentially competitive elements of the public monopoly;

(d) the most effective means of separating regulatory functions from commercial functions of the public monopoly;

(e) the most effective means of implementing the competitive neutrality principles set out in this Agreement;

(f) the merits of any community service obligations undertaken by the public monopoly and the best means of funding and delivering any mandated community service obligations;

(g) the price and service regulations to be applied to the industry; and

(h) the appropriate financial relationships between the owner of the public monopoly and the public monopoly, including the rate of return targets, dividends and capital structure.

(4) A Party may seek assistance with such a review from the Council. The Council may provide such assistance in accordance with the Council's work program.

Legislation Review

5.(1) The guiding principle is that legislation (including Acts, enactments, Ordinances or regulations) should not restrict competition unless it can be demonstrated that:

(a) the benefits of the restriction to the community as a whole outweigh the costs; and

(b) the objectives of the legislation can only be achieved by restricting competition.

(2) Subject to subclause (3), each Party is free to determine its own agenda for the reform of legislation that restricts competition.

(3) Subject to subclause (4) each Party will develop a timetable by June 1996 for the review, and where appropriate, reform of all existing legislation that restricts competition by the year 2000.

(4) Where a State or Territory becomes a Party at a date later than December 1995, that Party will develop its timetable within six months of becoming a Party.

(5) Each Party will require proposals for new legislation that restricts competition to be accompanied by evidence that the legislation is consistent with the principle set out in subclause (1).

(6) Once a Party has reviewed legislation that restricts competition under the principles set out in subclauses (3) and (5), the Party will systematically review the legislation at least once every ten years.

(7) Where a review issue has a national dimension or effect on competition (or both), the Party responsible for the review will consider whether the review should be a national review. If the Party determines a national review is appropriate, before determining the terms of reference for, and the appropriate body to conduct the national review, it will consult Parties that may have an interest in those matters.

(8) Where a Party determines a review should be a national review, the Party may request the Council to undertake the review. The Council may undertake the review in accordance with the Council's work program.

(9) Without limiting the terms of reference of a review, a review should:

(a) clarify the objectives of the legislation;

(b) identify the nature of the restriction on competition;

(c) analyse the likely effect of the restriction on competition and on the economy generally;

(d) assess and balance the costs and benefits of the restriction; and

(e) consider alternative means for achieving the same result including non-legislative approaches.

(10) Each Party will publish an annual report on its progress towards achieving the objective set out in subclause (3). The Council will publish an annual report consolidating the reports of each Party.

Access to Services Provided by Means of Significant Infrastructure Facilities

6.(1) Subject to subclause (2), the Commonwealth will put forward legislation to establish a regime for third party access to services provided by means of significant infrastructure facilities where:

(a) it would not be economically feasible to duplicate the facility;

(b) access to the service is necessary in order to permit effective competition in a downstream or upstream market;

(c) the facility is of national significance having regard to the size of the facility, its importance to constitutional trade or commerce or its importance to the national economy; and

(d) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist.

(2) The regime to be established by Commonwealth legislation is not intended to cover a service provided by means of a facility where the State or Territory Party in whose jurisdiction the facility is situated has in place an access regime which covers the facility and conforms to the principles set out in this clause unless:

(a) the Council determines that the regime is ineffective having regard to the influence of the facility beyond the jurisdictional boundary of the State or Territory; or

(b) substantial difficulties arise from the facility being situated in more than one jurisdiction.

(3) For a State or Territory access regime to conform to the principles set out in this clause, it should:

(a) apply to services provided by means of significant infrastructure facilities where:

(i) it would not be economically feasible to duplicate the facility;

(ii) access to the service is necessary in order to permit effective competition in a downstream or upstream market; and

(iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist; and

(b) incorporate the principles referred to in subclause (4).

(4) A State or Territory access regime should incorporate the following principles:

(a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.

(b) Where such agreement cannot be reached, Governments should establish a right for persons to negotiate access to a service provided by means of a facility.

(c) Any right to negotiate access should provide for an enforcement process.

(d) Any right to negotiate access should include a date after which the right would lapse unless reviewed and subsequently extended; however, existing contractual rights and obligations should not be automatically revoked.

(e) The owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access.

(f) Access to a service for persons seeking access need not be on exactly the same terms and conditions.

(g) Where the owner and a person seeking access cannot agree on terms and conditions for access to the service, they should be required to appoint and fund an independent body to resolve the dispute, if they have not already done so.

(h) The decisions of the dispute resolution body should bind the parties; however, rights of appeal under existing legislative provisions should be preserved.

(i) In deciding on the terms and conditions for access, the dispute resolution body should take into account:

  (i) the owner's legitimate business interests and investment in the facility;

  (ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;

  (iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;

  (iv) the interests of all persons holding contracts for use of the facility;

  (v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility;

(vi) the operational and technical requirements necessary for the safe and reliable operation of the facility;

(vii) the eonomically efficient operation of the facility; and

(viii) the benefit to the public from having competitive markets.

(j) The owner may be required to extend, or to permit extension of, the facility that is used to provide a service if necessary but this would be subject to:

(i) such extension being technically and economically feasible and consistent with the safe and reliable operation of the facility;

(ii) the owner's legitimate business interests in the facility being protected; and

(iii) the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.

(k) If there has been a material change in circumstances, the parties should be able to apply for a revocation or modification of the access arrangement which was made at the conclusion of the dispute resolution process.

(l) The dispute resolution body should only impede the existing right of a person to use a facility where the dispute resolution body has considered whether there is a case for compensation of that person and, if appropriate, determined such compensation.

(m) The owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.

(n) Separate accounting arrangements should be required for the elements of a business which are covered by the access regime.

(o) The dispute resolution body, or relevant authority where provided for under specific legislation, should have access to financial statements and other accounting information pertaining to a service.

(p) Where more than one State or Territory regime applies to a service, those regimes should be consistent and, by means of vested jurisdiction or other cooperative legislative scheme,provide for a single process for

persons to seek access to the service, a single body to resolve disputes about any aspect of access and a single forum for enforcement of access arrangements.

Application of the Principles to Local Government

7.(1) The principles set out in this Agreement will apply to local government, even though local governments are not Parties to this Agreement. Each State and Territory Party is responsible for applying those principles to local government.

(2) Subject to subclause (3), where clauses 3, 4 and 5 permit each Party to determine its own agenda for the implementation of the principles set out in those clauses, each State and Territory Party will publish a statement by June 1996:

(a) which is prepared in consultation with local government; and

(b) which specifies the application of the principles to particular local government activities and functions.

(3) Where a State or Territory becomes a Party at a date later than December 1995, that Party will publish its statement within six months of becoming a Party.

Funding of the Council

8. The Commonwealth will be responsible for funding the Council.

Appointments to the Council

9.(1) When the Commonwealth proposes that a vacancy in the office of Council President or Councillor of the Council be filled, it will send written notice to the States and Territories that are Parties inviting suggestions as to suitable persons to fill the vacancy. The Commonwealth will allow those Parties a period of thirty five days from the date on which the notice was sent to make suggestions before sending a notice of the type referred to in subclause (2).

(2) The Commonwealth will send to the States and Territories that are Parties written notice of persons whom it desires to put forward to the Governor-General for appointment as Council President or Councillor of the Council.

(3) Within thirty five days from the date on which the Commonwealth sends a notice of the type referred to in subclause (2), the Party to whom the

Commonwealth sends a notice will notify the Commonwealth Minister in writing as to whether the Party supports the proposed appointment. If the Party does not notify the Commonwealth Minister in writing within that period, the Party will be taken to support the proposed appointment.

(4) The Commonwealth will not put forward to the Governor-General a person for appointment as a Council President or Councillor of the Council unless a majority of the States and Territories that are Parties support, or pursuant to this clause are taken to support, the appointment.

Work Program of the Council, and Referral of Matters to the Council

10.(1) The work of the Council (other than work relating to a function under Part IIIA of the Trade Practices Act or under the *Prices Surveillance Act 1983)* will be the subject of a work program which is determined by the Parties.

(2) Each Party will refer proposals for the Council to undertake work (other than work relating to a function under Part IIIA of the *Trade Practices Act* or under the *Prices Surveillance Act 1983)* to the Parties for possible inclusion in the work program.

(3) A Party will not put forward legislation conferring additional functions on the Council unless the Parties have determined that the Council should undertake those functions as part of its work program.

(4) Questions as to whether a matter should be included in the work program will be determined by the agreement of a majority of the Parties. In the event that the Parties are evenly divided on a question of agreeing to the inclusion of a matter in the work program, the Commonwealth shall determine the outcome.

(5) The Commonwealth Minister will only refer matters to the Council pursuant to subsection 29B(1) of the Trade Practices Act in accordance with the work program.

(6) The work program of the Council shall be taken to include a request by the Commonwealth for the Council to examine and report on the matters specified in subclause 2(2) of the Conduct Code Agreement.

Review of the Council

11. The Parties will review the need for, and the operation of, the Council after it has been in existence for five years.

Consultation

12. Where this Agreement requires consultation between the Parties or some of them, the Party initiating the consultation will:

    (a) send to the Parties that must be consulted a written notice setting out the matters on which consultation is to occur;

    (b) allow those Parties a period of three months from the date on which the notice was sent to respond to the matters set out in the notice; and

    (c) where requested by one or more of those Parties, convene a meeting between it and those Parties to discuss the matters set out in the notice and the responses, if any, of those Parties.

New Parties and Withdrawal of Parties

13.(1) A jurisdiction that is not a Party at the date of this Agreement commences operation may become a Party by sending written notice to all the Parties.

(2) A Party may withdraw from this Agreement by sending written notice to all other Parties. The withdrawal will become effective six months after the notice was sent.

(3) If a Party withdraws from this Agreement, this Agreement will continue in force with respect to the remaining Parties.

Sending of Notices

14. A notice is sent to a Party by sending it to the Minister responsible for the competition legislation of that Party.

Review of this Agreement

15. Once this Agreement has operated for five years, the Parties will review its operation and terms.

Commencement of this Agreement

16. This Agreement commences once the Commonwealth and at least three other jurisdictions have executed it.

C THIRD TRANCHE FRAMEWORK FOR FORESTRY

Attached is an extract from the National Competition Council (2001) *Framework for the Third Tranche Assessment of Governments' Progress with Implementing National Competition Policy and Related Reforms,* AusInfo, Canberra, 5 February dealing with forestry.

14 Forestry and fisheries

Australia's forests and fisheries provide a plentiful and varied bounty of food, paper, and building materials as well as generating valuable export dollars. In 1998-99, forestry and fisheries activities accounted for approximately $1.2 billion of Australia's gross domestic product (ABARE 1999).

In 1998-99, Australia exported 8 000 kilotonnes of wood and wood products worth some $3.3 billion (ABARE 1999). Woodchips accounted for some 99 per cent of the total volume of wood product exports and represented 46 per cent of the total value of wood product exports. In the same year, Australia imported wood and wood products valued at $3.3 billion, more than half of which was paper and paper products.

Australia produced some 200 kilotonnes of fisheries products, in 1998-99 including prawns, rock lobsters, abalone, scallops, oysters and fish (ABARE 1999). This productions was valued at $1.5 billion. In the same year, Australia exported fish and fish products worth $1.2 billion and imported $640 million worth of fish and fish products.

Forests and fisheries are renewable, but not limitless, resources. For both industries, governments regulate access to and the use of these resources to manage, conserve and protect them. Balance is a key element of forest and fisheries policy and regulation: balancing the competing demands of different users of the resource, particularly commercial and recreational users, and balancing today's needs with the needs of future generations.

In examining the approach and effect of forestry and fisheries regulation from the perspective of NCP the questions which need to be answered are:

- does regulation deliver a net public benefit to society as a whole; and
- is the current regulatory approach the best way to achieve the outcomes society desires?

Forestry

Forests are a renewable resource. However, this does not mean that forests are a limitless resource that can be exploited without due regard for management or planning for future sustainability.

Those who support existing forestry legislation argue that without government intervention, forestry resources would be utilised at an unsustainable rate with little or no consideration of environmental issues such as preserving biodiversity, management of greenhouse gas emissions, inter-generational issues, or competing uses such as recreation. They also argue that it is necessary to recognise in legislation that there are

different considerations relating to the regulation of old growth forests versus new growth forests, and hardwood versus softwood forests or plantations.

State governments are responsible for forestry regulation. Typically, regulation involves restricting market entry and conduct through licensing, permit, lease and other access arrangements, restrictions and prohibitions on activities undertaken in State forests and quantity restrictions on the harvesting of forests.

The Commonwealth has no jurisdiction to regulate in relation to the management of forests. However, it imposes controls over the export of forest products under its export legislation and has worked with State governments and interest groups to develop a series of Regional Forest Agreements (RFAs). The RFAs are 20 year agreements between the Commonwealth and State governments which set out objectives and policies for the management of Australia's old growth forests. They are designed to take account of and balance social, economic, environmental and cultural heritage values of native forests.

Competitive neutrality

Under clause 3 of the CPA, governments have agreed to ensure that, where appropriate, their significant business activities do not enjoy any net advantage over their competitors simply as a result of their public ownership. The NCP competitive neutrality principles and their application are discussed in Chapter 3.

The key competitive neutrality issue for forestry is that in some instances the prices charged for logs by government forestry businesses may not fully reflect the costs associated with their production as required by the CPA. The effect of under pricing logs is to give public sector forestry operators a competitive advantage over private sector operators. The under pricing of logs and related forest products may distort forest management decisions, such as those relating to the volume of logs harvested and the use of the forest for other purposes, and potentially may deter the establishment of private sector forestry businesses.

The Productivity Commission is currently investigating the application of competitive neutrality in the forestry sector. All jurisdictions are participating. The Productivity Commission research is expected to be completed in mid-2001.

Structural reform

Clause 4 of the CPA requires, amongst other things, that commercial and regulatory functions held by a public monopoly be relocated prior to the privatisation of the public monopoly or the introduction of competition into a market traditionally supplied by the public monopoly. Historically,

many public forestry entities exercised both commercial and regulatory functions. The relocation of regulatory functions is designed to ensure that publicly-owned forest enterprises do not face potential conflicts between their commercial and regulatory obligations.

This separation is also important to the implementation of competitive neutrality under clause 3 of the CPA. One of the principles of competitive neutrality is that government business enterprises are subject to regulations to which private sector businesses are normally subject. This is the notion of regulatory neutrality. Separation of commercial and regulatory functions is designed to remove any advantage that a government business might have over its competitors, arising from its exercise of regulatory functions.

Water reform

Forests and their management also have implications for the NCP water reform program. Trees trap water in their roots thereby reducing run-off into waterways. Therefore, policies encouraging large scale planting of trees to deal with problems such as soil erosion, salinity and greenhouse gas emissions also have implications for water management policies. This highlights the need for integrated catchment management. The NCP water reform program is discussed in Chapter 8.

The Council's approach to assessing progress generally

It is only since the second tranche assessment in June 1999 that the Council has started to examine progress with applying NCP to forestry regulation and management. For the third tranche assessment, the Council will be examining jurisdictions' forestry regulation and their approaches to its review (clause 5). The Council will also, where relevant, look at the application of competitive neutrality (clause 3) and structural reform (clause 4) obligations.

Governments will need to report on progress with the review and reform of forestry regulation and the application of, and compliance with, competitive neutrality and structural reform commitments.

Status of review and reform

Commonwealth

The principal Commonwealth forestry legislation includes the *Export Control Act 1982*,[1] Export Control (Unprocessed Wood) Regulations 1986,

[1] A discussion of the Export Control Act and its review is included in Chapter 13, Agriculture and related activities.

Export Control (Hardwood Wood Chips) Regulations 1997 and Export Control (Regional Forests Agreements) Regulations 1997.

While not governing the forestry sector per se, several other Commonwealth Acts can, under certain circumstances, apply to forestry activities. These include, the *Environment Protection and Biodiversity Conservation Act 1999*, the *Australian Heritage Commission Act 1975*, and the *Administrative Appeals Tribunal Act 1975*.

Hardwood wood chip regulations

The export of hardwood wood chips is prohibited without a licence[2] which is granted by the relevant Commonwealth Minister. The Act applies to those areas not covered by a RFA.

The stated purpose of the Export Control (Hardwood Chips) Regulations 1997 is to provide a system for the granting of licences to export hardwood wood chips that:

- ensures native hardwood wood chips for export are derived from forests which are covered by a RFA;
- imposes a national ceiling on exports of native hardwood wood chips from forests not covered by a RFA;
- ensures that harvesting of native hardwood is conducted in a manner that preserves the national forest reserve system, minimises environmental impacts, and encourages value-added investment in forest industries;
- ensures the total mass of authorised wood chips export each year from all licences does not exceed a maximum prescribed level as determined by the RFAs; and
- takes account of possible economic and social impacts of a decision to grant or refuse a licence.

Additionally, the Minister may grant:

- a restricted shipment licence for the purpose of developing a new market or analysing woodchips for processing suitability; or
- a transitional licence which prescribes the authorised export mass for each year of the licence subject to the provisions of the relevant RFA.

[2] A licence is not required if the volume of wood chips exported is less than two tonnes.

Unprocessed wood regulations

The Export Control (Unprocessed Wood) Regulations 1986 allow for the granting of licences to export prescribed goods, and for the Minister to regulate the conditions under which a licence is issued.

As with hardwood wood chips, exports of prescribed unprocessed wood products are prohibited without a licence.

Review status

All forestry related export control regulations are currently under review by the Commonwealth Department of Agriculture, Fisheries and Forestry Australia. Submissions have been called for and the review is expected to be completed in mid-2001.

The Council's approach to assessing progress

For the third tranche assessment, the Commonwealth will need to report on progress with its review process and any actions arising, and demonstrate a net public benefit case in support of restrictions on competition.

New South Wales

Forestry legislation in New South Wales includes the *Forests Act 1916*, *Plantations and Reafforestation Act 1999*, *Threatened Species Conservation Act 1995*, and *Forestry and National Park Estate Act 1998*. Restrictions on competition contained in these Acts include licensing and the prohibition of activities that are deemed incompatible with ecological sustainability and biodiversity.

None of the above Acts is formally scheduled for review under NCP. New South Wales is running a parallel reform process whereby various forestry reforms are being considered and implemented to improve the efficiency and sustainability of the forestry sector in the State.

The Council's approach to assessing progress

The New South Wales legislation appears to contain restrictions on competition similar to those in other jurisdictions (market entry and production controls) which are under NCP review.

The New South Wales Government will need to provide details about the process it is undertaking in relation to forestry and its outcomes. Further, as the Acts are not scheduled on the State's NCP review program, New South Wales will need to demonstrate that the process it is undertaking in relation to its forestry legislation is consistent with NCP principles, or explain why the legislation should not be subjected to review. New South

Wales will also need to show that it has met its competitive neutrality commitments in relation to State Forests of New South Wales.

Victoria

Victoria's forestry legislation includes the *Forests Act 1958*, *Forests Rights Act 1996*, and *Forests (Wood Pulp Agreement) Act 1996*. Victorian officials have advised that the *Forestry Pulp and Paper Company's Afforestation Contracts Act 1949* is not in use.

The purpose of the *Forests Act 1958* is: to protect State forests; control the use of forest land and the exploitation of forest produce; ensure the sustainability of supply of timber and other forest produce; reduce fire hazards; protect the ecological condition of native forests; and facilitate public recreation in State forests.

The Department of Natural Resources and Environment has exclusive control and management of the Victorian State forests in all matters of forest policy, the granting of leases and licences, the collection of fees and royalties, and the compulsory acquisition of land for forestry purposes. Licences may be sold by auction or tender. Long term (15 year) licences are available which may be rolled over after the fifth year for a further 15 years.

The Forests Act imposes restrictions on timber harvest. Therefore, it affects log supply through provisions on sustainable yield (that is, the number, size and type of trees which can be felled in a given area), and (indirectly) through the allocation of hardwood sawlogs via licensing.

Review status

The review of the *Forests Act 1958* and regulations was completed in April 1998. Recommendations arising from the review were to:

- include a specific objective in the Act to provide guidance on the balance among potentially conflicting functions;
- clarify reference to exclusive control and management and clearly allow for the option of a purchaser/provider type structure;
- clarify sustainable yield provisions to ensure that they do not require a minimum level of logging regardless of the demand for timber;
- specify guidelines for the allocation of rights to commercially utilise forest produce, to facilitate transparent allocation and pricing processes;
- consider a more 'pro-competition' approach to formulating provisions in the Act to enhance competition and efficiency in the utilisation of forest produce;

- assess the cost and benefits of corporatisation of Commercial Forestry and clearly separate policy, regulatory and commercial functions to enhance competitive neutrality;

- review the present system of administered log allocation and pricing to develop more market-based processes to improve allocative efficiency and enhance competitive neutrality; and

- reform minor forest product licences and permit practices to enhance transparency.

In July 1999, Forests Victoria was established as a service agency. By July 2000, it was ring-fenced for accounting purposes to separate the regulatory and commercial arms of forestry management in Victoria.

The Victorian Government is currently considering its response to the review recommendations.

Forestry rights

The purpose of the *Forestry Rights Act 1996* is to create forestry property rights.

The Act allows a land owner to enter into an agreement with a person to develop, maintain and harvest forest property on their land, vest ownership of the forest property to that person, and permit forestry activities on the property.

There were a range of forest agreements listed on Victoria's 1996 legislation review timetable. However, they have been withdrawn from review as some have been repealed following the sale of the Victorian Plantations Corporation, while others cannot be amended without agreement of the other (private) party to the agreement.

For example, the *Forests (Wood Pulpwood Agreement) Act 1996* ratifies an agreement between the Minister and AMCOR Ltd with respect to the supply of pulpwood for the manufacture of wood pulp and for other purposes. The Act specifies:

- quantities of annual supply to the company between 1996 and 2029;

- the terms of supply and acceptance of supply;

- payment of a licence fee and the method of calculation of that fee; and

- payment of royalties and the method of calculation of royalties.

The Act reflects a commercial negotiation between the Victorian Government and AMCOR Ltd. Victoria withdrew it from review arguing

that it cannot be amended without the agreement of both parties, otherwise the State may be liable to pay compensation.

The Council's approach to assessing progress

The Government will need to report on its response to the review of the Forests Act, including demonstrating a net public benefit case for the retention of restrictions on competition.

The sale of the Victorian Plantations Corporation and establishment of Forests Victoria raises structural reform obligations and regulatory neutrality issues under clauses 4 and 3 of the CPA, respectively. The Government will need to demonstrate that its approach to, and the outcomes of, these institutional changes are consistent with its CPA obligations.

The contractual nature of agreement Acts means that amending them, even where anti-competitive provisions are identified, prior to their expiration can potentially impose significant costs on government. Consequently, the Council encourages the Victorian Government to establish a process whereby the agreement Acts are examined against the NCP principles prior to renewal or renegotiation.

Queensland

Forestry legislation in Queensland includes the *Forestry Act 1959*, *Sawmills Licensing Act 1936* and *Integrated Planning Act 1997*.

The Forestry Act

The *Forestry Act 1959* provides for forest reservations, the management and protection of State forests. It also provides for the sale and disposal of forest products and quarry material.

The Act allows for the Department of Primary Industries (DPI) to carry out all matters of forest policy, and have control over forest products and quarry material which is the property of the Crown.

DPI grants timber collection licences, which it can issue via auction, tender, or any other means as appropriate, and collects associated fees and royalties. The Act provides for the collection of a levy to fund the Timber Research and Development Advisory Council.

DPI determines the maximum quantities of forest products which may be removed from State forests. The *Forestry Act 1959* establishes a Crown forest sawlog allocation system under which DPI can sell and allocate native forest sawlogs. DPI can determine the sustainable yield of sawlogs in various zones, set permit conditions for specific areas, prescribe the minimum tree harvest size permitted, and set prices payable for harvested logs.

Sawmill licensing

The stated purpose of the *Sawmills Licensing Act 1936* is to stabilise the timber industry by licensing sawmills and veneer and plywood mills. The licences prescribe the maximum productive capacity of each mill.

DPI administers the licensing process. It has absolute discretion to grant or refuse any application for a licence and may impose any terms and conditions. Licences are transferable on approval from DPI. Certificates of exemption from licensing can be issued under specified conditions, including if output is not intended for sale.

Integrated planning

The scope of the *Integrated Planning Act 1997* is considerably broader than forestry policy but can affect the management of forests. The purpose of the Act is to achieve ecological sustainability by coordinating and integrating planning at the local, regional and State levels, managing the development process, and managing the environmental impacts of development. The Act also controls the establishment of plantations, so affecting market entry thereby potentially restricting competition.

Review status

The NCP review of the *Forestry Act 1959* was completed in April 1999. The report has not been publicly released but is understood to have supported the retention of the existing allocation system. An amendment to the Act, via the *Forestry Amendment Act 1999* extended an exemption over the allocation system from the trade practices law until 2009. Compulsory funding of the Timber Research and Development Advisory Council by statutory stumpage payments was removed in January 2000.

The review of the *Sawmill Licensing Act 1936* is currently underway. A draft report is now being considered by the Government.

The Integrated Planning Act replaced the *Local Government (Planning and Environment) Act 1990*. The new Act was to be assessed against the NCP principles during its development and is not scheduled for further review.

The Council's approach to assessing progress

For the third tranche assessment, Queensland will need to report on progress with the reviews of the Forestry and Sawmill Licensing Acts. In particular, it will need to show that there is a public interest justification in support of the retention of any restrictions on competition.

Queensland will also need to demonstrate that any restrictions contained in the Integrated Planning Act are consistent with its NCP commitments.

Western Australia

The key piece of forestry legislation in Western Australia is the *Conservation and Land Management Act 1984*. Related legislation includes the *Sandalwood Act 1929*, the *Town Planning and Development Act 1928*, and the *Soil and Land Conservation Act 1945*.

Western Australian forestry regulation is in a period of change. There are several Bills reforming the State's forestry arrangements currently before the Parliament, including the Conservation and Land Management (CALM) Amendment Bill 2000, and the Forest Products Bill 1999. Local government approval of plantations, as governed by the *Town Planning and Development Act 1928*, will change as a (draft) State Farm Forestry Policy is enacted by each local government. Also, the State Government has prepared the Tree Plantation Agreements Bill 2000 to circumvent any restriction on harvesting under the *Soil and Land Conservation Act 1945*.

Conservation and Land Management Act 1984

The key objective of the *Conservation and Land Management Act 1984* is to ensure that lands reserved for the purposes of nature reserves, national and marine parks, conservation and recreation, and State forest and timber reserves are available for those purposes.

The Act gives the State exclusive control of land and marine areas in State forests, parks and reserves. The (new) Department of Conservation (the Department) controls access to and the use of land, timber and other resources on land under its control, and can levy royalties or fees for access to these resources. Under the Act, the State can compulsorily acquire land for a State forest, timber reserve, national park, nature reserve, marine nature reserve or marine park.

Timber workers engaging in the harvest or transport of timber from State forests or timber reserves must be registered. There are also restrictions on the sale of State forest produce or products, the export of timber, and on mining activities undertaken in State forests.

Amendments to the Act have been prepared which will change the institutional forestry arrangements in the State. The Conservation and Land Management Amendment Bill 2000 will establish a new conservation body to be known as the Conservation Commission of Western Australia. National parks, nature reserves, conservation parks, State forests and timber reserves will be vested in the Conservation Commission.

The functions of the Department will be amended, including removing the Department's ability to contract for the harvest of forest products from public land and timber sharefarm land, and for the sale of those products. These functions will be undertaken by the Forests Products Commission, as provided by the Forest Products Bill 1999.

Forest Products Bill 1999

The Forest Products Bill 1999 will establish the Forest Products Commission as a commercial statutory authority which will be responsible for contracting for the harvesting of forest products on public land and for selling those products. The objectives of the Forest Products Commission will be to ensure the long term viability of the forest products industry and the ecologically sustainable management of indigenous forest products located on public land, while maintaining profits from forest products.

Review status

The review of the *Conservation and Land Management Act 1984* was conducted by an independent consultant in 1998-99. To a large extent, this review has been taken over by events concerning the establishment of the Department of Conservation and the Forest Products Commission.

The Government has commissioned a consultant to review the Conservation and Land Management Amendment Bill and the Forest Products Bill, which are currently before Parliament. The public consultation period for the review has finished and the review is expected to be completed before the Western Australian Parliament debates the Bills.

Other legislation and relevant reviews

The review of the *Sandalwood Act 1929* is complete. The Western Australian Cabinet endorsed the sole recommendation, to remove the restriction on the proportion of the annual sandalwood harvest that may be taken from private land. The amendment is yet to be introduced.

Competitive neutrality

Under the Conservation Land Management Act, the Department can, amongst other things, extract profit from timber plantations developed under share-farming agreements and raise credit by borrowing from the State Treasurer or other sources guaranteed by the State Treasurer. This means the Department may be involved in business undertakings and commercial activities, potentially in competition with the private sector. This raises issues of competitive neutrality.

In 1999, consultants reviewed the Department's plantation business in accordance with competitive neutrality principles. The review recommended that the plantation business unit be corporatised and given a single commercial objective. However, the review also recommended a number of constraints be imposed upon the new corporation, including that:

- the business be confined to plantations and supply to mill gate;

- non-declining yields be achieved;
- the pine land base be maintained;
- the level of export of logs be limited; and
- the level of debt be limited but not such as to preclude attracting equity partners for plantation expansion.

The main thrust of the reforms recommended by the review will be achieved by the establishment of the Forest Products Commission as the State's commercial forest agency.

The Council's approach to assessing progress

The Government will need to show that its forestry regulation reviews and their outcomes are consistent with the NCP principles, and report on progress with the various legislative amendments under consideration.

Western Australia will need to report on its adoption of the recommendations of the competitive neutrality review and show that its approach is consistent with its competitive neutrality obligations (clause 3) in relation to the corporatisation of the Department's plantation business unit. The Government will also need to demonstrate that any structural reform obligations (clause 4) arising from the establishment of the Conservation Commission of Western Australia and the Forest Products Commission have been met.

South Australia

There is negligible forestry legislation in South Australia, as the State has almost no native forestry activities.

The *Sandalwood Act 1930* specifies the amount of sandalwood which may be taken each year throughout the State, and provides for the amount to be allocated via licences. The Act was reviewed in 1999.

The clearing of trees is covered by the *Native Vegetation Act 1991*, which is a conservation Act containing prohibitions on the use and taking of vegetation. The Act was reviewed in 1999.

Local councils develop planning schemes under the *Planning Act 1982*. This Act gives rise to development plans for a range of activities including forestry, and limits the establishment of forests in various areas. The Act regards plantations as general farming activity, and plantations face the same restrictions as all other land uses.

The limited native forest activity which is undertaken is the responsibility of Forests SA. In its 1999 Annual NCP Report, South Australia advised that it intended to corporatise Forests SA and apply the full range of

private sector equivalence measures in order to met its competitive neutrality commitments. Subject to the passage of legislation, Forests SA was expected to commence operating as a corporatised entity from July 2000.

The Council's approach to assessing progress

The Council seeks advice on the recommendations and actions arising from the 1999 reviews of the Sandalwood Act and Native Vegetation Act. The Council also seeks confirmation from South Australia that there is no other relevant forestry legislation which should be considered for NCP review. Further, confirmation is sought as to the implementation of the corporatisation of Forests SA.

Tasmania

The *Forestry Act 1920* and the *Forest Practices Act 1985* are the principal pieces of forestry legislation in Tasmania. The *Land Use Planning and Approvals Act 1997* is also relevant.

Forestry Act 1920

The *Forestry Act 1920* establishes the Forestry Corporation (the Corporation) which is responsible for optimising the economic returns from its wood production activities and the benefits to the public and the State of the non-wood values of forests. The Corporation has exclusive management and control of State forests and the forest products derived from them.

The Corporation is required to prepare forest management plans for the State forests. These plans may restrict access to the relevant land at various times and for certain purposes.

The Corporation is also required to make available for the veneer and sawmilling industries an annual minimum quantity (300 000 cubic metres) of eucalypt veneer logs and eucalypt sawlogs.

Forest Practices Act 1985

The *Forest Practices Act 1985* establishes the Forest Practices Board (the Board) which is responsible for ensuring the sustainable management of Crown and private forests with due care for the environment.

While focussing on self-regulation, the Act:

- requires forest practice plans to be prepared before forest operations commence;
- provides for the establishment of the Forest Practices Code (the Code);

- requires the rehabilitation of land in cases where the Code is contravened; and

- provides for the declaration of private timber reserves so that private land holders are able to ensure the security of their forest resources.

The Board issues and maintains the Code which is designed to protect the environment by establishing and maintaining forests. It does this by setting standards for: re-stocking trees; harvesting timber; and constructing roads and other works connected with establishing, growing or harvesting forests.

Forest practice plans may also restrict the conduct of market participants. The Board can accept, reject or amend a forest practice plan as it deems appropriate.

Forest operators who harvest more than 100 000 tonnes of timber per annum in Tasmania must submit a three-year plan to the Board. Plans must show the location(s) of land from which timber is intended to be harvested, volumes of timber to be harvested, routes intended to transport timber out of each location, and proposed measures for reafforestation in each of the three years. Producers harvesting small quantities are not subject to these requirements.

Review status

The review of the *Forestry Act 1920* was completed by an external consultant in 1998. The Review recommended simplification of the Act, but did not make explicit recommendations on competitive restrictions contained in the Act. The Review did recognise that minimum supply restrictions are anti-competitive. The Act has since been substantially simplified and amended to remove the policing powers of Forestry Tasmania so that it does not conduct regulatory functions.

The review of the *Forest Practices Act 1985* was undertaken in 1998 by the Forest Practices Advisory Council and recommended no changes. The restrictions contained in the Act were considered to be 'in the public interest and represent the minimum level [of regulation] necessary'.

The Council's approach to assessing progress

The Tasmanian Government will need to report on progress with its review and reform of forestry legislation and demonstrate that its approach to forestry regulation meets the fundamental CPA requirement. In particular, the Council seeks evidence that restrictions contained in the Forestry Act were appropriately assessed against the NCP principles and have been retained only where they provide a net public benefit.

Tasmania will need to provide information on the application of competitive neutrality to forestry and confirm that its approach meets its competitive neutrality obligations.

ACT

There is no legislation that specifically governs forestry in the ACT.

ACT Forests manages plantations in the Territory. ACT Forests is the forestry business arm of the Department of Urban Services and acts under executive authority from the Department.

The Council's approach to assessing progress

The ACT will need to show that ACT Forests applies appropriate competitive neutrality arrangements.

Northern Territory

There is currently no forestry legislation in the Northern Territory. However, Codes of Practice for the forestry industry are currently being prepared.

Following Cyclone Tracey in 1974, much of the industry was wiped out and, because of termites and future cyclones, houses in the Northern Territory are usually made of steel rather than wood.

The Council's approach to assessing progress

The Northern Territory Government will need to advise of the legislative basis, if any, for the development of the Code of Practice and demonstrate that NCP principles were appropriately taken in account in the preparation of the Code.

Table 14.1: Forestry regulation review and reform activity

Jurisdiction	Legislation	Review activity	Reform activity
Commonwealth	*Export Control Act 1982*	Completed in 2000.	Focused on food products (see Related legislation section).
	Export Control (Hardwood Wood Chips) Regulations 1997	Underway.	
	Export control (Unprocessed Wood) Regulations 1986	Underway.	
	Export Control (Regional Forest Agreements) Regulations 1997	Underway.	
New South Wales	*Forestry Act 1916*	Not scheduled for review – non-NCP process underway.	
	Plantations and Reafforestation Act 1999	Not scheduled for review – non-NCP process underway.	
	Threatened Species Conversation Act 1995	Not scheduled for review – non-NCP process underway.	
	Forestry and National Park Estate Act 1998	Not scheduled for review – non-NCP process underway.	
Victoria	*Forests Act 1958*	Completed in 1998.	Recommendations under consideration. In 1999 Forests Victoria established.
	Forests Rights Act 1996	Not scheduled.	
	Forests (Wood Pulp Agreement) Act 1996	Withdrawn from review.	

Jurisdiction	Legislation	Review activity	Reform activity
Queensland	*Forests Act 1959*	Completed in 1998 – report not available.	TPA exemption for allocation system extended and compulsory funding of the Timber Research and Development Authority removed in January 2000.
	Sawmills Licensing Act 1936	Underway.	
	Integrated Planning Act 1997	Not scheduled for review.	
Western Australia	*Conservation and Land Management Act 1984*	Review completed in 1999.	Overtaken by work on two Bills listed below.
	Conservation and Land Management (CALM) Amendment Bill 1999	Before Parliament.	To establish the Conservation Commission of Western Australia.
	Forest Products Bill 1999	Before Parliament.	To establish the Forest Products Commission.
	Sandalwood Act 1929	Completed in 1998.	Amendment in 2000 to remove arbitrary quota on harvesting on private land.
	Town Planning and Development Act 1928	Na	To be replaced by a State Farm Forestry Policy.
	Soil and Land Conservation Act 1945	Na	To be amended by the *Tree Plantation Agreements Bill 2000.*
South Australia	*Sandalwood Act 1930*	Review completed.	
Tasmania	*Forestry Act 1920*	Completed in 1998.	Simplification of the Act and removal of perception of Forestry Tasmania as an industry regulator.
	Forest Practices Act 1985	Completed in 1998.	Nil.
	Land Use Planing and Approvals Act 1997	Underway.	

There is no forest legislation scheduled for review in either the ACT or the Northern Territory.

D STYLISED DESCRIPTION OF AUSTRALIAN SUPPLY AND DEMAND

The importance of correctly pricing licences to exploit native forests can be illustrated by a stylised description of the Australian forestry market.

The supply of wood and wood products to meet Australian demand can be sourced locally from native forests or plantations or imported. Locally produced wood and wood products can also be exported.[123]

The international prices of wood products therefore have an important influence on the Australian market and tend to set the domestic price for any particular type of wood product.

In terms of the supply of domestic wood and wood products from native forests, as volumes harvested increase, forestry and logging needs to be undertaken in more remote, less productive areas. Moreover, with the increased area of reserves, the ability to increase volumes requires higher intensity and a change in forest practices toward plantation management. As a result, additional volumes of bulk hardwood timber and products to the Australian market entail higher long term costs of supply.

As a result, international prices drive the price of commodity woods and wood products in the domestic market, variations in the supply costs of Australian hardwood timbers and products and the supply costs of softwoods tend, therefore, to determine respective market shares. In this model, domestic costs do not set the price to customers.

The international (import) price sets the market price but the relative costs and efficiency of hardwood and softwood production in Australia set their market shares in domestic production and the domestic/import share.

This stylised description is, of course, a simplification. It ignores, for instance, the fact that:

- wood is not a perfectly uniform commodity (Radiata is not a direct substitute for Jarrah and native hardwoods are an imperfect substitute for Oregon). and that Australian hardwoods are not perfect substitutes for either Australian softwoods or imported timbers; and
- wood chips are both a by-product of, and a substitute for, sawn logs.

[123] Residues are a by-product of sawn timber and wood chipping is therefore an effective method of obtaining value from residues. However, woodchipping can substitute for sawn timber by downgrading the logs. That is, woodchipping is a potentially competitive demand for wood products.

These simplifications do not alter the essential point that Australian timber prices to final users are primarily driven by international prices and that the price of Australian products primarily sets their market shares. The fact that the SFAs still retain a dominant market position in terms of the prices charged for hardwoods does not therefore raise concerns about monopoly pricing and exploitation of consumers.

On the contrary, the concerns are that by charging too little for the hardwood resource that they control and therefore retain too high a market share and that Australia is exploiting too much of the available forest resource.

This concern is heightened by the fact that:

- the NSW and Victorian SFAs in their native forest operations do not recognise the cost of production in log prices, do not pay rates on that land to local government and benefit from GST exemptions on stumpage rates and other charges for their services;
- both NSW and Victorian pricing policies reduce the royalty/stumpage charge to logging operators to offset higher transport costs in remote areas; and
- do not use the cost of production/supply as a reserve price in either their auctions/tenders or their negotiations.

However, as recognised explicitly in the CPA, the prices oversight of government business enterprises, "*prime objective should be one of efficient resource allocation*". It is not directly dependent upon monopoly status or the protection of customers.

Prima facie, the lack of competitive neutrality and the pricing policies in the four States examined in this report means that there must be strong concerns for the efficiency with which Australia's forest and timber resources are being used and managed.

Importantly, this level of concern arises on narrow efficiency grounds and does not depend upon ascribing forests with any environmental values. At this level, the concern is purely a question of economic efficiency.