

1990 - 91

Parliament of New South Wales

**Public Accounts Committee
of the
Forty-Ninth Parliament**

Fifty-Second Report

Inquiry pursuant to Section 57(1) of the Public Finance and
Audit Act 1983, concerning the Forestry Commission

(Transcripts of Proceedings are printed in a separate volume to this Report)

December 1990

Public Accounts Committee
Parliament of New South Wales

10/12/90
C0157

**Report on the
Forestry Commission**

Members of the Public Accounts Committee

The Members of the Public Accounts Committee of the Forty-Ninth Parliament are:

Mr Phillip Smiles, LL.B., B.Ec., M.B.A., Dip. Ed., M.P., Chairman

Phillip Smiles was elected Member for Mosman in March 1984. A management and marketing consultant since 1974, Phillip Smiles has been involved with entrepreneurial business activities since his teens. Since entering Parliament he has been actively interested in areas of small business, emergency services, welfare and financial analysis. He was appointed a Member of the Public Accounts Committee in 1984 and was elected Chairman in 1988.

Mr George Souris, B.Ec., Dip. Fin. Mangt., F.A.I.M., F.A.S.A., C.P.A., M.P., Vice Chairman*

George Souris was elected Member for Upper Hunter in 1988. An accountant in public practice for 12 years, George Souris also served as a Shire Councillor in Singleton for seven years, four of which were as Deputy President. At university he was a Rugby Blue, represented NSW Country, Australian Universities and Australian Colts rugby teams. He is the NSW Parliament's appointed Member of the University of Newcastle Council. George Souris has experience in taxation and business management and an interest in financial analysis. He is a member of Rotary and other community organisations.

Mr John Murray, B.A., M.P.

John Murray, formerly a teacher, was elected Member for Drummoyne in April, 1982. An Alderman on Drummoyne Council for three terms, John Murray was Mayor of the Council for five years and served four years as Councillor on Sydney County Council. He has served as a member of the Prostitution Committee and the House Committee, and is a former Chairman of the Public Accounts Committee.

Mr Allan Walsh, B.A.(Hons), Dip. Ed., M.P.

Allan Walsh was elected Member for Maitland in September, 1981. Following eight years as a Mirage fighter pilot with the R.A.A.F., he was involved in business management. Allan Walsh has also taught industrial relations, management and history at technical colleges.

Mr Terry Griffiths, M.P.

Terry Griffiths was elected Member for Georges River in 1988. Prior to being elected to Parliament he was the Chief Executive of the Scout Association of Australia. Before this he was an Army Officer. He is a graduate of the Officer Cadet School Portsea, a graduate of the School of Military Engineering and a Fellow of the Australian Institute of Management. He has been actively involved in Lions, Rotary and other community organisations.

* Mr George Souris, M.P., Member for Upper Hunter, was appointed to the Committee on 23 February 1989, and elected Vice-Chairman on 2 March 1989. Mr Souris replaced Miss W. Machin, M.P., who was appointed to the position of Chairman of Committees on 23 February 1989.

Secretariat

Victoria Walker, M.A., Director

Tom Benjamin, B.A., M.O.A., M.Psych., Dip. S.I.A.,
Senior Project Officer

Bernadette Gurr, Clerk

Norma Rice, Secretary/Word Processor Operator

Rebecca Turrell, B.A. (Visual Arts)
Secretary/Word Processor Operator

Consultant

Michael Smart, B.A. (Magna Cum Laude) (Harvard)

Reader

Dr John Dargavel, B. Sc., M. Sc., Ph.D.

Advisors on Eucalypt Plantations

Dr Joe Landsberg, M. Sc., Ph.D.

Paul Jones, B. Sc. (For)

NSW Public Accounts Committee

Parliament House
Macquarie Street
SYDNEY NSW 2000

Telephone: (02) 230 2631
Fax: (02) 230 2831

Report on the Forestry Commission

CONTENTS

	Page
Chairman's Foreword	ix
Executive Summary	xi
Summary of Recommendations	xvii
1. Introduction	1
Terms of reference	
Method of investigation	
Background to the Inquiry	
2. Background to Forestry Commission	5
History of forestry in NSW	
Role and objectives	
Structure and staffing	
Operational activities	
3. Accounting Processes	13
Failure of accounting mechanisms to provide information they are thought to	
Growing stock valuation	
Accounting resources	
Allocation of labour expenses	
Important data not brought to account	

	Page
4. Finance	25
Resource rental tax	
Notional income tax	
Local government rates	
Interest on loans incurred prior to 1988	
Dividends	
How Commission subsidies benefit industry	
Royalties discounted for haulage costs	
Industry's public road cost subsidy	
Summary	
5. Efficiency, Economy, Effectiveness	37
Air wing	
Other plant and equipment	
Privatisation of road construction	
Mapping branch	
6. Production Controls	55
Estimating sustainable quotas	
Enforcing the quotas	
Is sustained yield occurring?	
Planning and production controls	
Changing character of native forests	
7. Pricing	65
Plantation Radiata pine pricing	
Native Eucalypt pricing	
8. Marketing	81
9. Pine Plantations	89

	Page
10. Eucalypt Plantations	93
11. Valuation and Rate of Return	107
12. Research	115
13. Corporate Structure, Aims, and Incentives	123
Clarity of objectives	
Managerial authority	
Performance evaluation	
Rewards and sanctions	
Competitive neutrality	
Political control	
14. Amenity Nurseries	137
15. Consistency of Activities with Charter	145
16. Policy Impact on the Community	155

List of Appendices

1. Call for Submissions	167
2. Call for Submissions	168
3. Submissions and Correspondence Received	169
4. Witnesses at Public Hearings	171

CHAIRMAN'S FOREWORD

This Report follows a comprehensive examination of every aspect of the New South Wales Forestry Commission. It provides detailed evidence of an organisation locked in a time warp and in consequence displaying a management structure, commitment to productivity and ethos which one would normally associate with a British colonial bureaucracy of the 1950s.

Factors contributing to the Forestry Commission's problems include inexperienced management, the Commission's determination to solve its own problems without outside help or interference and the Commission's concentration on recruiting foresters and thereafter promoting such recruits into positions more appropriate for economists, market researchers, ecologists, civil engineers and other professional specialists.

The most public evidence of this 1950s' mentality is the bitter controversy and conflict that has existed between conservation groups and the Commission over the last 10 to 15 years. This controversy is not dissimilar to that which has existed in many other parts of the world. However, the New South Wales Forestry Commission has largely focused on serving the specialist interests of sectors of the timber industry in this State and has not sought to effectively replace this confrontation with meaningful consultation.

During the course of this Inquiry fellow Committee Members and I were fortunate to inspect government involvement in forest management in the other States of Australia and New Zealand. I inspected approaches taken in Malaysia, the Philippines, Canada, and the USA. While no government necessarily offered the ideal solution, it nevertheless remains an indictment of the New South Wales Forestry Commission that no apparent attempt has been made to study and draw on the experience of overseas colleagues. In consequence the Commission has become the victim of an isolationist policy. Yet there were many lessons to be learned, particularly from the state of Oregon, USA, from British Columbia, Canada, and from New Zealand. If those lessons had been learned the Commission would be a much more effective organisation than it is today.

Report on the Forestry Commission

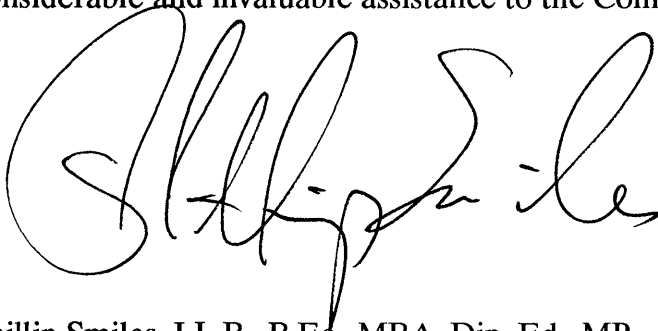
The absence of a clear mandate for public consultation, the inability of the Commission to recognise the significance of its existing and potential business operations and the inordinate size of the Head Office is unacceptable given the importance of forest products to the New South Wales economy.

I hope that this Report will provide an opportunity for the Forestry Commission to be restructured into the effective organisation it must become in order to properly serve the people of New South Wales in this decade and beyond.

The opportunity for effective internal auditing, the adoption of a market value approach to valuing market and stock assets, the recognition of the importance of both commercial activities and the 'public good' component, each with its associated costs, the development of an inventory of all forest assets under Commission control and the rationalisation of Head Office with devolution of management to the field must be seen as absolutely critical in the Commission's path to corporatisation. Until such is realised the Commission will not be efficient, will not be economical and will not be effective.

Notwithstanding the critical nature of this Report, I acknowledge the tremendous dedication of the Forestry Commission officers, their total and generous co-operation with the Committee and their obvious concern to do things better on behalf of the Commission and the people of New South Wales. I am convinced that the Forestry Commission already has much of the necessary talent and ability, particularly in the field, to implement the recommendations contained in this Report.

In conclusion, I wish to thank my fellow Committee Members for their continuing tremendous devotion and commitment to increasing efficiency, effectiveness and accountability in the public sector, Ms Victoria Walker, Committee Director, for her professional input and Mr Michael Smart, Management Consultant, who provided very considerable and invaluable assistance to the Committee.



Phillip Smiles, LL.B., B.Ec., MBA, Dip. Ed., MP
Chairman

EXECUTIVE SUMMARY

In line with its policy commitment to commercialisation of some public sector entities, the NSW Government transferred a number of organizations, including the Forestry Commission, from the Consolidated Fund to operate on a self-funding basis on 1 July, 1988. Thus the Commission took its first steps toward corporatisation with the formal separation of its "commercial" and "non-commercial" operations, and the assumption by Treasury of the Commission's debt burden (which exceeded \$100 M) in exchange for an equity stake. The first year's commercial results seemed favourable in that a surplus of \$28.1 M was recorded on revenues of \$76.4 M.

This result in pure accountancy terms is misleading because the Commission benefited from several significant subsidies which it would not have enjoyed if fully corporatised. These subsidies include: 1) nonpayment during 1988-89 of dividends to Treasury, 2) nonpayment of lease fees for the commercial exploitation of Crown Lands, 3) nonpayment of local council rates and charges, and 4) nonpayment of "notional income tax" on the commercial surplus. Although it is difficult to estimate the monetary value of these and other subsidies, the Committee believes a conservative estimate would place it well above the \$28.1 M surplus.

The Committee notes that the move toward corporatisation did not see any change to the Commission's organization chart or any significant change to staffing levels. More importantly, the separation between commercial and non-commercial operations is not reflected in the organization chart, with individual members of staff sharing their time between commercial and non-commercial activities.

Commercial operations of the Commission can be divided into two principal income areas which together account for 88.4% of revenue: softwood plantation harvesting and native forest harvesting. Because of geographical, biological, and technological factors, the production of timber from these two types of forest require different expertise, methods, equipment, and infrastructure. However, this fundamental difference is nowhere reflected in the Commission's organization chart, and the Committee understands that at the head office level, individual staff members share their time between softwood plantation and native forest related activities.

In an enterprise such as forest management where the logistics make decentralization necessary, it is alarming to find that the head office consumes 26.8% of the Commission's commercial expenditure. Having made comparisons with similar

organizations overseas and interstate, the Committee believes the top-heavy bureaucracy in the NSW Commission has contributed to its troubles in competing even in its own home timber product markets, let alone export markets.

The need for such a large head office would be greatly reduced if the Commission placed greater emphasis on those management and staff practices current in the private sector. To this end there should be a greater reliance on tendering out such services as plant hire and maintenance, road construction and maintenance, fleet maintenance, and aircraft hire. By replacing fixed cost items such as workshops, capital equipment, and permanent staff with contract services the Commission would create the right incentives for high productivity in these areas.

Particular areas in which the Commission could economise its head office expenditure without sacrificing performance include the research division, engineering branches, purchasing and stores, fleet maintenance and workshops, and cartography. The cost-benefits of the anticipated move into the \$18 M new head office at Pennant Hills seem highly questionable in light of the obvious need to reduce head office staff numbers. The need for the Commission to own prime commercial real estate in urban areas such as Coff's Harbour and Port Macquarie is also questionable from a forest management point of view.

The failure of NSW forest product industries to develop export markets boils down to problems in marketing and pricing. Customers of the Commission perceive its inflexibility on pricing, its reactive approach to market opportunities, and its defensive attitude toward the status quo as being the source of major problems in the industry. The lack of qualified marketing and economics professionals within the Commission's marketing division is disconcerting. In fact, a bachelor of science in forestry is the only professional qualification which is strongly represented in the upper ranks of the Commission, even though the broad spectrum of its activities make multidisciplinary expertise essential.

From a management point of view, the Committee believes that the Commission's principal problem is a lack of focus. This lack of focus is ingrained in the corporate culture and justified under the title "multiple-use forest management". It is further exacerbated by the fact that foresters are engaged in a diverse set of specialized tasks for which their training and experience do not always adequately prepare them. As one regional forester put it, "foresters are jacks of all trades". The clear implication is that they are masters of none except forestry. The lack of focus is built into the Commission's organizational structure with commercial and non-commercial work,

plantation and native forestry occurring within individual units, and often within the daily routine of individual employees. Under these circumstances, the Committee wonders how the Commission can possibly achieve the level of excellence which is necessary to compete internationally against highly focused professional organizations.

The Committee feels that these problems could be addressed if the Commission's first tentative steps toward corporatisation were extended and accelerated with the aim of complete corporatisation and the phased removal of all subsidies over a five year period. A dramatic reworking of the Commission's organizational structure is essential, which would include at least a division of the staff and facilities into commercial and non-commercial units, and a further division of commercial units into a plantation softwood product line and a native hardwood product line, each with responsibility for their own profitability.

By dividing the Commission into units which have single objectives (e.g. profit maximisation for each product line, conservation of non-wood values for the non-commercial sector), the Committee believes the present inefficiencies and conflicts of interest which hinder the Commission in its performance, and require high levels of administrative staff, and which have caused much public disaffection with the Commission would be significantly reduced.

Modern management ethos dictates that the research functions currently undertaken by the Commission should be shifted to the commercial unit, and the direction and funding of future research must be determined on the basis of its commercial value to either the plantation pine program or the native forest timber program. Research of a non-commercial nature should be undertaken by outside organizations such as CSIRO, the Universities, and other commercial organizations.

The removal of subsidies, which in the case of dividends has already been recommended by Treasury and in the case of council rates has been recommended by the Committee of Inquiry into Local Government Rating (April 1990), is essential to the economically efficient functioning of the commercial product lines. In large measure, it has been the subsidies which have allowed the bureaucracy of the Commission to grow substantially and go unchallenged. The "bottom line" has looked good because the subsidies have not been brought to account.

Naturally, a sudden removal of subsidies would create short-term upheavals in the timber processing industries, so it is necessary in the Committee's view to phase out

subsidies over a five-year period, giving all Commission customers adequate indication of future log price movements.

A rise in plantation softwood royalties would probably be unacceptable to the Commission's customers, since there is strong evidence to suggest that softwood pulp logs are already the most costly in the Pacific Rim, and the softwood product market is subject to considerable price competition from interstate and international suppliers. By creating a distinct division for plantation softwoods and focusing on running a lean organization, the Commission can emulate its competitors. Like the successful radiata growers in New Zealand, South Australia, and South America, the Commission should be able to gain market share by good management, unhindered by confused objectives, over-heavy bureaucracy, or environmental criticism.

Without subsidies, increased royalties on native hardwood seem inevitable. Unlike radiata pine, native timber faces no direct competition from overseas, and the unique properties of eucalypt timber provide scope for realizing greater value than is currently obtained from each log. A rise in native hardwood royalties will mean a reduced annual cut (for reasons of decreasing demand by millers). To derive as much or more revenue from less raw material, processing industries will face the necessary challenge of focusing on higher value end-products for eucalypt timber.

It is important to note that raising hardwood royalties would have a number of beneficial effects for the State. Firstly, it would impose an economic limit on the annual timber harvest, which would complement the regulatory limit (the quotas). There would be less incentive to cheat on the quotas, and correspondingly less strain on the Commission's regulatory mechanisms.

Secondly, pricing provides a mechanism to remove some State Forest areas from timber production without creating the industry backlash generated by "locking up" forests. The divisive debate over logging "old growth" forests would become less intense because logging operations would be forced to be more selective and operate on a smaller scale, on purely economic grounds.

Thirdly, it would force the eucalypt processing industries to concentrate on added value by enhancing the unique characteristics of NSW eucalypt timber. The present situation sees these high-value trees being used predominantly for house framing, fence palings, and pallets in competition with radiata pine, generally regarded as a superior product for these uses.

Fourthly, the economics of competing with plantation pine dictate that ever increasing volumes of native timber must be harvested and processed at ever decreasing prices. However, it is well known that there is an upper limit to the availability of native timber in NSW. Current quotas are already set at the Commission's estimates of sustainable yields for most districts. There is some debate as to whether sustained yield is actually achieved in all districts. While the Committee spent a considerable period of time examining the silvicultural methods of the Commission, it is not fully equipped to evaluate these arguments. Nevertheless, there appears to be sufficient doubt about the quantity and qualities of future native timber yields in a number of areas to warrant caution and restraint in logging the possibly diminishing and degrading State timber resource. Therefore, the restraint which higher native timber royalties would bring about appears welcome in terms of the long-term viability of the resource.

Finally, higher prices for eucalypt timber would improve the economic viability of hardwood plantations in NSW. Significant plantation programs are underway in Tasmania and Western Australia. The Committee acknowledges that circumstances differ from state to state and that doubts exist over the biological and economic viability of a hardwood plantation program in NSW, however the strategic importance of a successful plantation program justifies a genuine and concerted effort to test its feasibility with continued annual plantings on a scale similar to those undertaken by other states. The Committee feels that the Forestry Commission has not given such a program a fair chance to succeed.

SUMMARY OF RECOMMENDATIONS

Accounting Processes

Recommendation 1

It is recommended that the Forestry Commission strengthen its internal financial audit function, by placing it in the hands of qualified professional accountants, emphasising performance monitoring, and separating the internal audit function from management influence.

Chapter 3

Recommendation 2

It is recommended that the Forestry Commission immediately move to adopt a market-value based approach to valuing growing stock assets, following the example of South Australia's Woods and Forests Department. The Committee to review progress in one year.

Chapter 3

Recommendation 3

It is recommended that the Forestry Commission make sufficient resources available to:

- the general accounting area to cope with the workload;
- train district and regional staff in the use of newly installed computer equipment for accounting functions;
- speed the transition to computerized general ledger accounting whilst adhering strictly to the Spectrum Methodology.

Chapter 3

Recommendation 4

It is recommended that ALL Forestry Commission staff and executives who work in both commercial and noncommercial activities keep daily diaries indicating the allocation of their time.

Chapter 3

Recommendation 5

It is recommended that the Forestry Commission annually estimate the value added by its management of the native forest estate for commercial timber production, with the details of the value added (or subtracted) annually included in its annual financial statements and Annual Report. The Committee to review progress in one year.

Chapter 3

Recommendation 6

It is recommended that the Forestry Commission add a financial dimension to its inventory of all forest assets under Commission control. The Committee to review progress in one year.

Chapter 3

Recommendation 7

It is recommended that the Forestry Commission convene a committee with sunset provisions composed of third parties which may include the Department of Planning, Ministry of Environment, National Parks and Wildlife Service, community groups, and industry groups to establish a range of non-wood values for the forests under the Commission's control, and publish the results of these discussions in the Commission's Annual Report.

Chapter 3

Recommendation 8

It is recommended that the Forestry Commission quantify all subsidies which it enjoys by virtue of its being a government body, and include estimates of such subsidies in the yearly audited financial statements. The Committee to review progress in one year.

Chapter 3

Finance

Recommendation 9

It is recommended that the Forestry Commission pay the State Government rental on all native forest which it manages for timber production.

Chapter 4

Recommendation 10

It is recommended that this rental payment comprise a relatively small annuity per hectare of gross state forest less dedicated reserves, and a considerably larger fee payable upon timber harvesting.

Chapter 4

Recommendation 11

It is recommended that, consistent with State Government policy, the Forestry Commission be levied local government rates and charges.

Chapter 4

Recommendation 12

It is recommended that the Forestry Commission draw up a list of non-productive assets for disposal, including office buildings, other real-estate holdings, and under-utilized non-essential plant and equipment, which are not actively used for timber production. The Committee to review progress in one year.

Chapter 4

Recommendation 13

It is recommended that the Forestry Commission dispose of the surplus assets identified above in an orderly fashion and within a time frame which allows the Commission to obtain good sale prices.

Chapter 4

Recommendation 14

It is recommended that the proceeds of these asset sales be employed to fund the Forestry Commission's future capital works programs.

Chapter 4

Recommendation 15

It is recommended that, over the useful life of existing mills (with a maximum term of 15 years for newer mills and average term of 5 years for older mills), the Forestry Commission phase out the compensation for long haulage distances from forest to mill which is built into its current royalty structure.

Chapter 4

Recommendation 16

It is recommended that the Forestry Commission phase in a system which specifies the log price "at the log dump" which depends upon the quality and type of timber, without reference to transportation costs. The Committee to review progress in one year.

Chapter 4

Recommendation 17

It is recommended that the Forestry Commission ensure that its senior officers are aware of the existence and magnitude of government subsidies to the Commission, and of the likely necessity of managing without them in the near future.

Chapter 4

Recommendation 18

It is recommended that the Forestry Commission prepare strategic financial, marketing, and operational plans to implement, over approximately a five-year period, a phased removal of all major subsidies, including but not limited to payment of a sub-market dividend to Treasury, nonpayment of resource rental for exploitation of native forests, nonpayment of notional income tax, and nonpayment of local government rates and charges. The Committee to review progress in one year.

Chapter 4

Efficiency, Economy, Effectiveness

Recommendation 19

It is recommended that the Forestry Commission immediately reconsider the justification for the head office move to Pennant Hills, with a view to selling the office complex when it is economically prudent to do so, and subletting office space in the meantime.

Chapter 5

Recommendation 20

It is recommended that the Forestry Commission consider relocating the head office to a more strategic location, where the cost of accommodation for Commission officers would not be as onerous as in Sydney.

Chapter 5

Recommendation 21

It is recommended that the Forestry Commission amalgamate each regional office with one of its district offices, but otherwise make no immediate changes to staffing at district and regional offices.

Chapter 5

Recommendation 22

It is recommended that the Forestry Commission undertake a phased reduction of head office staff numbers aimed at achieving a 50% or greater reduction within 3 years, with the intention of concentrating head office activity on policy setting and centralized provision of certain services which cannot be provided either at the regional level or by the private sector. The Committee to review progress in one year.

Chapter 5

Recommendation 23

It is recommended that the Office of Public Management be invited to begin a comprehensive review of Forestry Commission head office staff functions in light of the guide-lines and imperatives outlined in this report.

Chapter 5

Recommendation 24

It is recommended that the Forestry Commission make near-term plans to sell its two passenger aircraft (Cessna 421's), and contract for an external professional review of the justification for owning all three of the remaining fixed-wing aircraft in light of the very low annual number of flying hours.

Chapter 5

Recommendation 25

It is recommended that the Forestry Commission eliminate the mechanical engineering branch, purchasing, stores, workshops, and the plant hire account in a phased and orderly fashion.

Chapter 5

Recommendation 26

It is recommended that services formerly provided by the Forestry Commission's mechanical engineering branch, purchasing, stores, workshops, and the plant hire account be obtained from the private sector, and that plant items other than fire tankers and other essential equipment be sold. The Committee to review progress in one year.

Chapter 5

Recommendation 27

It is recommended that the Forestry Commission considerably reduce the resources allocated to mapping branch, civil engineering branch, and other head office Forest Operations branches (with the exception of fire-fighting). The Committee to review progress in one year.

Chapter 5

Production Controls

Recommendation 28

It is recommended that the Forestry Commission provide detailed information to the public on the current status of sustained yield policy in each management area and current plans, if any, to modify quotas. The Committee to review progress in one year.

Chapter 6

Pricing

Recommendation 29

It is recommended that the Forestry Commission discontinue its present method of setting royalties based on recovery of visible costs and employ instead a method based primarily on the market's willingness to pay.

Chapter 7

Recommendation 30

It is recommended that the Forestry Commission hire professional economists to perform the analytical groundwork for pricing decisions. The Committee to review progress in one year.

Chapter 7

Recommendation 31

It is recommended that the Forestry Commission make much greater use of econometric techniques to analyze price sensitivities and other characteristics of all timber markets.

Chapter 7

Recommendation 32

It is recommended that the Forestry Commission work towards a market pricing computer model which could be employed to adjust pricing in a market-sensitive way more than once or twice a year, if necessary.

Chapter 7

Recommendation 33

It is recommended that the Forestry Commission adopt a more market-oriented approach to pricing plantation pine products, including the monitoring of market conditions for customers' products, and heavy discounting when strategic objectives justify it.

Chapter 7

Recommendation 34

It is recommended that the Forestry Commission continue to regulate the price of native timber, using a policy of raising pricing to the point of indifference as a policy tool to complement the use of regulatory tools for controlling annual harvesting of timber.

Chapter 7

Recommendation 35

It is recommended that the Forestry Commission raise prices on eucalypt sawlogs and pulplogs above the CPI, over a five year period.

Chapter 7

Marketing

Recommendation 36

It is recommended that the Forestry Commission review its market direction and devote significant resources to the development of new markets, for example:

- assisting customers to penetrate export markets;
- providing price and volume incentives to value-adding customers;
- re-orienting wood-technology research toward assisting industry to develop new value-added timber products. The Committee to review progress in one year.

Chapter 8

Recommendation 37

It is recommended that the Forestry Commission conduct its own market research, and not rely so heavily on market projections done by organizations such as FAFPIC and ABARE whose objectives differ from the Forestry Commission's. The Committee to review progress in one year.

Chapter 8

Recommendation 38

It is recommended that the Forestry Commission hire marketing professionals and economics professionals with specific marketing orientation in preference to foresters for marketing positions. The Committee to review progress in one year.

Chapter 8

Recommendation 39

It is recommended that the Forestry Commission put significant resources into strategic planning for timber sources and markets over a range of time horizons. The Committee to review progress in one year.

Chapter 8

Recommendation 40

It is recommended that the Forestry Commission back up any new production initiative with a professional marketing plan which is subjected to scrutiny by outside directors, before resources are committed to production.

Chapter 8

Eucalypt Plantations

Recommendation 41

It is recommended that to the greatest extent possible, the Forestry Commission employ alternatives to land purchase in initiating eucalypt plantation schemes, drawing upon interstate expertise and experience wherever possible.

Chapter 10

Recommendation 42

It is recommended that the Forestry Commission plan to situate most plantations within practical distances from existing woodchipping facilities, while leaving scope for the establishment of plantations in locations which will serve future strategic mills.

Chapter 10

Recommendation 43

It is recommended that the Forestry Commission make a decisive commitment to a research program aimed at boosting yields and preventing losses from hardwood plantations.

Chapter 10

Recommendation 44

It is recommended that the Forestry Commission formulate and circulate for public comment a 30-year plan for the introduction of plantation eucalypt timber as a major alternative supply of pulpwood.

Chapter 10

Recommendation 45

It is recommended that the Forestry Commission give a strong commitment to the creation of and participation in an Australia-wide eucalypt plantation program.

Chapter 10

Recommendation 46

It is recommended that the Forestry Commission make a decisive commitment to an ongoing program of annual eucalypt plantings without clearing forests, with the short to medium-term intention of providing a supplementary supply of hardwood pulp logs.

Chapter 10

Recommendation 47

It is recommended that the Forestry Commission make information on growth and financial performance for new and existing plantations freely available for scrutiny by the scientific community and the public.

Chapter 10

Valuation and Rate of Return

Recommendation 48

It is recommended that those Forestry Commission managers responsible for commercial activities adopt a bottom-line orientation to setting and achieving goals.

Chapter 11

Recommendation 49

It is recommended that, in goal-setting, the Forestry Commission use rate of return on assets managed as the performance indicator, calculating return on market-valued assets by bringing subsidies to account.

Chapter 11

Research

Recommendation 50

It is recommended that, for forest research, the Forestry Commission move toward a research funding system in which managers of commercial units within the Commission (and in outside organizations) pay for specific research which they intend to exploit commercially.

Chapter 12

Recommendation 51

It is recommended that the Forestry Commission liaise with industry to a much greater extent in framing its wood technology research projects, with the specific intention of assisting industrial customers to develop and market value-added timber products.

Chapter 12

Recommendation 52

It is recommended that the Forestry Commission significantly scale down its basic science research activities, relying on the universities and CSIRO to a greater extent.

Chapter 12

Corporate Structure, Aims, and Incentives

Recommendation 53

It is recommended that the Forestry Commission be restructured into at least four principal divisions which have different objectives:

- regulation of the native forest resource;
- provision of "public good" services;
- long-term profitable running of the pine plantations;
- long-term profitable production of timber from native forests. The Committee to review progress in one year.

Chapter 13

Recommendation 54

It is recommended that the Forestry Commission's new proposed divisions have no common head-office staff or facilities.

Chapter 13

Recommendation 55

It is recommended that one set of Forestry Commission field officers be given responsibility for executing forest management in an integrated manner which produces both private and public goods in each area.

Chapter 13

Recommendation 56

It is recommended that a distinct set of Forestry Commission field officers be given responsibility for regulating uses of the native forest resources.

Chapter 13

Recommendation 57

It is recommended that the proposed indigenous forest regulatory division be given control over the soon to be established environmental assessment unit, which will take responsibility for environmental impact assessments for both the proposed commercial indigenous forest division and the proposed indigenous forest public-good division.

Chapter 13

Recommendation 58

It is recommended that the Forestry Commission immediately implement a policy of facilitating the lateral entry of non-foresters into senior management roles.

Chapter 13

Recommendation 59

It is recommended that the Forestry Commission devolve greater managerial authority to regional and district foresters, for example the ability to hire and fire staff and increased budgetary authorization limits. The Committee to review progress in one year.

Chapter 13

Recommendation 60

It is recommended that the Forestry Commission redirect sufficient resources to the internal audit function along with a specific mandate to conduct performance monitoring to an acceptable corporate standard. The Committee to review progress in one year.

Chapter 13

Recommendation 61

It is recommended that the Forestry Commission implement rewards and sanctions at the operational level by replacing permanent staff wherever possible with outside contractors who are on reward-for-performance contracts. The Committee to review progress in one year.

Chapter 13

Recommendation 62

It is recommended that the Treasury assist the Forestry Commission in achieving competitive neutrality, particularly including the phasing out of all subsidies. The Committee to review progress in one year.

Chapter 13

Recommendation 63

It is recommended that during a transition period of approximately five years the Forestry Commission be readied for the step to corporatisation, in which period the five principles of corporatisation

- clarity of objectives;
- managerial authority;
- performance monitoring;
- rewards and sanctions;
- competitive neutrality;

should be put into place. The Committee to review progress in one year.

Chapter 13

Recommendation 64

It is recommended that the State Government retain ministerial control over the Forestry Commission until such time as its performance merits State-Owned Corporation status.

Chapter 13

Amenity Nurseries

Recommendation 65

It is recommended that the Forestry Commission adopt a pricing policy/management approach for the amenity nurseries which establishes cost targets by deducting an appropriate profit margin from market prices.

Chapter 14

Recommendation 66

It is recommended that the Forestry Commission's amenity nurseries continue the important work of rural reforestation, mining rehabilitation, public native tree planting, and public utility works.

Chapter 14

Recommendation 67

It is recommended that the Forestry Commission reconsider its domestic retail sales policy for amenity nurseries, with a view to selling only products which are consistent with the core business of large-scale revegetation programs.

Chapter 14

Recommendation 68

It is recommended that the Forestry Commission place greater emphasis on larger, centralized production nurseries, which are necessary to improve output and quality, and to reduce unit costs.

Chapter 14

Consistency of Activities with Charter

Recommendation 69

It is recommended that the Forestry Act be amended to remove clauses which might unduly prevent the Forestry Commission from adopting a fully corporate organizational structure.

Chapter 15

Recommendation 70

It is recommended that section 9B of the Forestry Act be repealed and in its place provisions inserted which aim to achieve:

- a clear statement of the powers, functions, and duties of the Inspectorate;
- inclusion of field inspections and enforcement of forest management regulations in those duties;
- creation of genuine independence of the Inspectorate from the commercial operations of the Commission.

Chapter 15

Recommendation 71

It is recommended that section 8A(2) of the Forestry Act, 1916, be amended to be consistent with the Environmental Planning and Assessment Act, 1979.

Chapter 15

Recommendation 72

It is recommended that the Forestry Act be amended to include provisions for formal public participation in the management planning process.

Chapter 15

Recommendation 73

It is recommended that the Forestry Commission accept that logging and roading are significant effects under the Environmental Planning and Assessment Act, 1979, and take immediate steps to gear up for efficient, professional, routine production of environmental impact statements.

Chapter 15

Recommendation 74

It is recommended that the Forestry Commission ensure that all its staff are thoroughly briefed on their obligations under the Environmental Planning and Assessment Act, 1979, with particular care to explain what course of action is dictated by law when an apparent conflict arises between the Forestry and Environmental Planning and Assessment Acts.

Chapter 15

Recommendation 75

It is recommended that the Forestry Commission update its Indigenous Forest Policy document to reflect the Environmental Planning and Assessment Act requirements, research results, and industrial realities which have emerged since 1976.

Chapter 15

Recommendation 76

It is recommended that the Forestry Commission separately monitor its expenses in preparing environmental impact statements and its expenses in fighting environmental actions in court, including these figures in its Annual Reports.

Chapter 15

Policy Impact on the Community

Recommendation 77

It is recommended that the Forestry Commission urgently address the need for public participation in its planning processes generally, and in its preparation of Indigenous Forest Policy Documents, Management Plans, and Preferred Management Priority Classification documents specifically.

Chapter 16

Recommendation 78

It is recommended that the Forestry Commission initiate a working party composed of Commission, industry, conservation, and government representatives to consider how tripartite agreements could feasibly be implemented in the New South Wales context.

Chapter 16

1. Introduction

Terms of reference

1.1 On 28 March, 1990, the Hon. Ian Causley, M.P., the Minister for Natural Resources, requested that the Public Accounts Committee conduct an inquiry into the Forestry Commission with the following terms of reference:

1.2 To inquire and report upon the Forestry Commission of NSW, with particular reference to the following matters:

- * The accounting processes of the Forestry Commission;.
- * The performance of the Commission with respect to:-
 - efficiency
 - economy
 - effectiveness
 - marketing and pricing policies
 - production controls
 - finance and administration
 - procedures and controls;
- * The extent to which the functions and activities are in accordance with the charter of the Commission;
- * The functions and activities of the amenity nurseries;.
- * Any other matter which imparts on the accountability efficiency and effectiveness of the Forestry Commission.

Method of investigation

1.3 The Committee conducted its inquiry between April and November, 1990, concurrent with a number of other inquiries and activities pursuant to Section 57 of the Public Finance and Audit Act 1983. The method of investigation

included:

- * a review of submissions and correspondence received in response to advertisements issued in the press;
- * inspections of state government forestry bodies, commercial timber growing and processing firms, and environmental groups within and outside Australia;
- * inspections of Forestry Commission regional and district offices and industrial sites in New South Wales;
- * inspections of the Forestry Commission's head office, research facility, and amenity nurseries;
- * public hearings;
- * letters to officers of the Forestry Commission and analysis of their replies;
- * informal discussions with environmental lobbyists, interstate foresters, and industry lobbyists.

Background to the Inquiry

1.4 The Public Accounts Committee received a reference from the Minister for Forests to inquire into several aspects of the Forestry Commission's operations. Particular matters were brought to the Committee's attention by both industry and environmental lobby groups. Pricing policies emerged as a key theme in the criticisms of the Commission. The conservation movement maintains that by selling sawlogs and pulplogs at unnecessarily low prices, the Forestry Commission contributes to wasteful uses of these resources and renders it impractical to take steps which must be taken to ensure long-term resource availability. Industry lobby groups also express dissatisfaction with the Commission's pricing policies which is couched in terms of an insensitivity to prevailing market conditions. The actual mechanism by which prices are set remains mysterious to both conservation and industry lobbyists.

- 1.5 A second major theme in criticisms of the Forestry Commission is its "*closed door*" approach to decision-making. The Forestry Act of 1916 permits the Commission to plan and operate rather autonomously from public interest groups. In contrast, the National Parks and Wildlife Service is required to conduct a lengthy public consultation before plans are approved. The upper echelon of the Forestry Commission is composed almost entirely of foresters. The Commission's bureaucrats generally come up through the ranks and often remain with the Commission for their entire careers. Critics wonder whether this decision-making group would arrive at different conclusions if it included professionals in marketing, economics, land-use planning, public relations, and other fields of expertise.
- 1.6 The narrow focus of this institution and the relative isolation it enjoys have led to bitter controversy and conflict in the past decade. The Commission has failed to keep pace with rapidly changing community expectations about the uses of forests. A string of adverse findings in the Land and Environment Court between 1978 and 1983 seems to have strengthened the Commission's resolve to operate in secrecy. The general public finds it nearly impossible to get some information regarding economic studies, intended operations, or financial estimates. Construction of logging roads has sometimes commenced prior to completion of an environmental impact statement, effectively pre-empting the result. This pre-emptive tactic backfired in the case of the Upper Wilson Creek Road in Nullum State Forest, which became the subject of an investigation by the Ombudsman in 1985. In a similar instance, a gravel road built through rainforest at Washpool was subsequently dismantled.
- 1.7 During this inquiry the Committee became aware of questionable policies and actions falling into five main areas:
- marketing and pricing policies;
 - impact on private firms in forest industries;
 - formulation and execution of long-term plans;
 - efficacy of practices which risk conflict; and
 - treatment of critics.

2. Background to Forestry Commission

History of forestry in NSW

- 2.1 The first European settlers in New South Wales cleared millions of hectares of forest to make way for agriculture. Early Governors issued edicts requiring licenses to fell timber on Crown lands, however there was no restraint on logging of private land. By the mid nineteenth century, the rate of clearing of forests began to cause concern. In 1871, the Government set aside the first timber-production reserves. By 1882 there were 460 reserves encompassing more than one million hectares. The creation of these reserves sparked land-use controversy even then.
- 2.2 The Forestry Commission traces its origins to the creation, on March 1, 1882, of the Forest Conservation Branch. In the following three decades control of forestry passed from public service administrators to professional foresters. The Forestry Act of 1916 brought the Forestry Commission into being in its present form. Although numerous amendments to the Act have been enacted over the past 74 years, it is this 1916 piece of legislation which largely determines the structure, activities, and objectives of the present Commission. Principal among these objectives was the conservation and utilization of the State's timber resources.
- 2.3 According to Mr. J.F. Yarwood, the then Secretary to the Forestry Commission, in a letter to the Australian Financial Review published January 23, 1990, "*Over-cutting [of forests] did occur in the immediate post-war period, in response to prevailing economic pressures ...*". This conclusion was possible only in hindsight. In fact, it was not until the 1960's, when the Commission was acquiring enough information to understand the nature and extent of its forests, that it could assess growth and timber yields accurately. During this period the rate of timber getting slowed as the Forestry Commission's officers realized that yield levels were not sustainable.
- 2.4 Plantations of radiata pine, which had been initiated in South Australia in 1881, were commenced in New South Wales in the 1940's. Significant

amounts of second rotation radiata pine did not come on stream in New South Wales until the 1970's. Significant private pine plantings did not occur until the late 1970's.

- 2.5 It was in the late 1970's and the 1980's that the public began to perceive the Forestry Commission as an exploiter, rather than a conserver of State Forests. The Environmental Planning and Assessment Act was used successfully by environmental lobby groups to challenge the Commission on its decisions to build roads and log in environmentally sensitive areas. This shift in public perceptions was hurtful to the Commission, which had always perceived itself as foremost among the conservers of the State's forests.
- 2.6 As the 1980's wore on and the Commission was under ever-increasing pressure to deliver a commercial profit, a genuine conflict of interest developed. On the one hand was the statutory obligation to conserve the timber resource. But on the other hand, the requirement to be profitable was driving the Commission closer to the forest products industry, whose survival depended on timber-getting access to areas of high conservation value.
- 2.7 In the present day, this conflict of interest is unresolved. The Commission's attitude to criticisms from the environmental lobby that it is destroying forests, and to criticisms from industry that it is not permitting enough logging is that professional foresters know best. Consequently, very little information is provided to outsiders which might allow them to second-guess the Commission's decisions.
- 2.8 Two aspects of the history of New South Wales forestry should be emphasized. Firstly, it is important to understand that forestry is a long-term venture. Today's seedlings may not be mature for one or more centuries. A majority of the trees harvested today for sawing or woodchipping are older than the Forestry Act itself. For example, the Assistant Commissioner for Forests, Mr. P.A. Fisher, in a letter to the Committee dated 29 August, 1990, stated that the average age of eucalypts woodchipped at Eden is 100-200 years.
- 2.9 Secondly, the profession of forestry has only existed in Australia since the turn of this century, and measurements of growth rates and forest inventories have only been done on a significant scale since the 1960's. The experience base of forest science in the New South Wales context covers a short time period compared to the maturation cycle of natural forests.

Role and Objectives

2.10 The Forestry Act of 1916 sets out the objects of the Forestry Commission in subsection 8A (1) :

- a) *to conserve and utilise the timber on Crown-timber lands to the best advantage of the State;*
- b) *to provide adequate supplies of timber from Crown-timber lands for building, commercial, industrial, agricultural, mining and domestic purposes;*
- 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; and*
- e) *consistent with the use of State forests for the purposes of forestry and of Flora Reserves for the preservation of the native flora thereon -*
 - i) *to promote and encourage their use as a recreation; and*
 - ii) *to conserve birds and animals thereon.*

2.11 The Commission states in its 1988-89 Annual Report¹ that to assist in achieving its objects, it is committed to:

- *multiple purpose forest management;*
- *creation and maintenance of an efficient and effective organization to implement its policies;*
- *effective use of those public funds invested in Crown-timber lands in New South Wales with the objective of achieving overall profitability of commercial operations in the long term;*

1 1988-89 Annual Report of the Forestry Commission of NSW, p. 21

- *stable employment, safe and healthy working conditions and opportunity for personal development for all employed by the Commission;*
- *maximisation of community benefit from the forest estate subject to maintenance and protection of the forests in a healthy and vigorous condition at all times;*
- *provision of stable wood supply conditions to wood-using industries, commensurate with the capacity of the forests to maintain supplies;*
- *provision of a source of technical knowledge for use in the interests of the State in matters pertaining to forestry and forest products and their utilisation; and*
- *protection of the community interest insofar as certain timber marketing practices are concerned.*

Structure and staffing

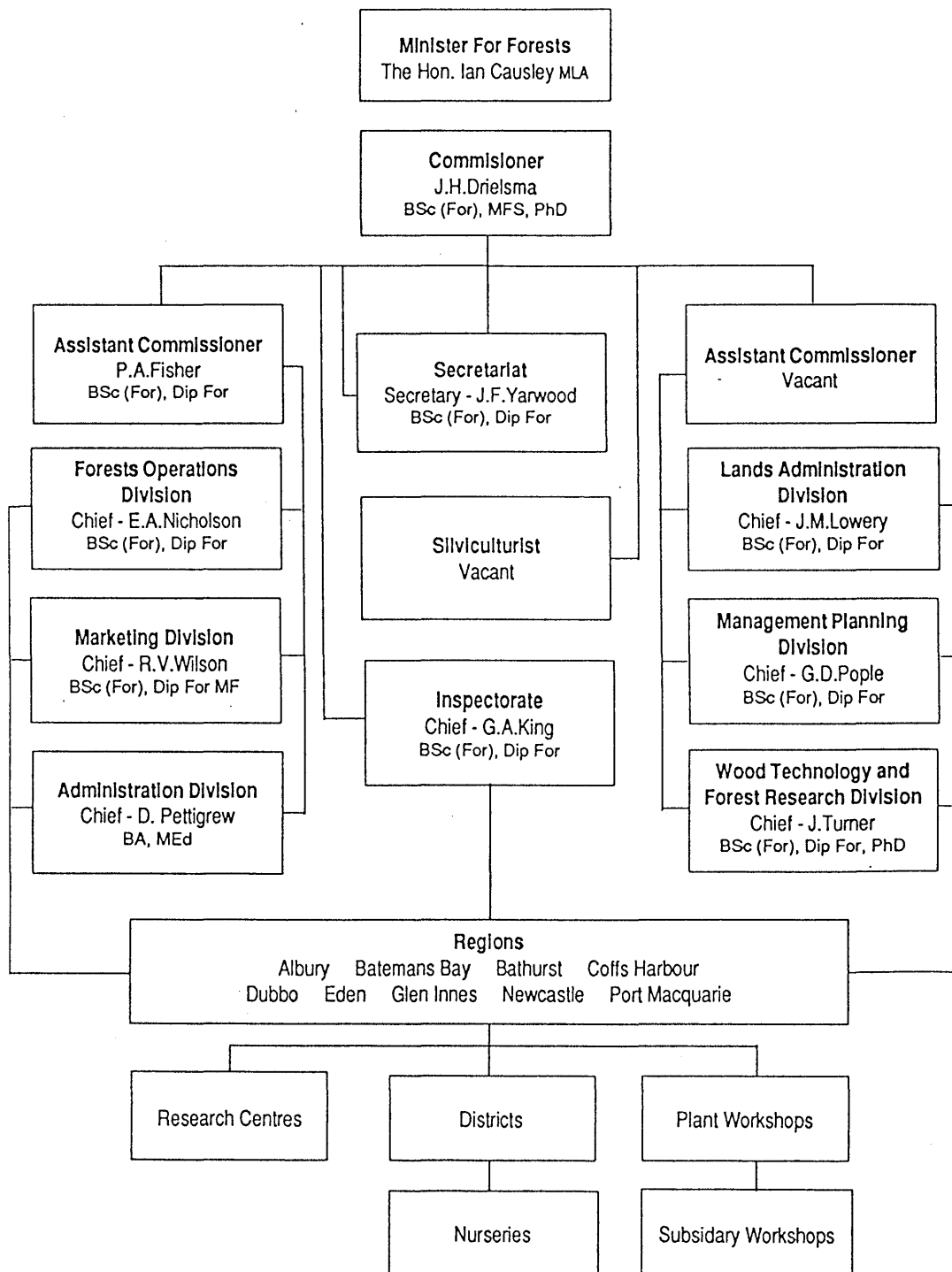
2.12 The Forestry Commission is subject in all respects to the direction of the responsible Minister. The Commissioner for Forests is the organization's chief executive officer. Two Assistant Commissioners report to the Commissioner, each overseeing three divisions. The Forest Operations Division, Marketing Division, and the Administration Division report to one Assistant Commissioner. The Lands Administration Division, Management Planning Division, and the Wood Technology and Forest Research Division report to the other Assistant Commissioner. The Secretariat, the Silviculturist, and the Inspectorate also report to the Commissioner.

2.13 Beneath the head office organization outlined above, the Forestry Commission divides its field operations into nine regions. According to the Commission's Annual Report for 1988-89², "[The Commission's administrative structure] is composed of a Head Office directing decentralised Regional Offices, which in turn administer district offices, research centres, mechanical workshops, tree nurseries, etc." (see diagram)

2 1988-89 Annual Report of the Forestry Commission of NSW, p. 21

Organisation Chart

as at 30 June 1990



- 2.14 The Commission's staff at August 30, 1990 consisted of 688 public servants, of which 284 were located in Sydney, and 1082 "Section 10" (wages) employees, of which 33 were located in Sydney. Taking account of the fact that a number of established positions were vacant at the time, these numbers are broadly consistent with staff levels at June 30, 1989, at which time there were 742 public servants, and 1100 section 10 employees. Between June 30, 1985 and June 30, 1989, the staff levels had been relatively constant, varying from a low of 1,802 in 1987, to the high point of 1,842 in 1989.
- 2.15 At June 1990, figures for established staff positions (both filled and vacant) indicate that of 770 public service positions, 189 were foresters. At head office, foresters represent 45 of 340 public service positions. In the field, foresters represent 144 of 430 public servants.
- 2.16 Finally, prior to Dr. J.H. Drielsma's appointment on May 23, 1990, the Commissioner's position had been vacant for nearly one year since June 19, 1989, when the late Dr. S.W. Gentle commenced sick leave.

Operational activities

- 2.17 Six principal areas of activity engage the Commission: forest management, services to the community, forest production and marketing, support services, research, and administration.
- 2.18 Forest management consists of preparing forest management plans, wood production, environmental management, providing for recreation, water catchment, flora and fauna conservation, heritage values, National Estate areas, and native forest preservation, and control of fire, forest insects, and forest diseases.
- 2.19 Community services include advisory services, timber inspection, public relations, publicity, public education, demonstration forests, the Hunter Valley coal mine rehabilitation program, revegetation of freeway verges, joint programs (such as the National Afforestation program) with Federal Government, tree and shrub nurseries, co-operation with local government, and the Oberon Rural Community Development Study.

- 2.20 Forest production and marketing consists of studying marketing conditions for timber, timber pricing, liaising with primary wood-based industries, operating production nurseries, and fostering other commercial uses of State Forests.
- 2.21 Support services include road construction and maintenance, surveying, provision and maintenance of equipment for forest management (such as aircraft, bulldozers, tractors, tankers, etc.), air photo interpretation, communications, forest inventory, and provision and maintenance of computing facilities.
- 2.22 Research consists broadly of research into management of pine plantations, research into management of native forests, forest product research, and laboratory testing services. Administration encompasses personnel, staff development and training, and maintenance of library services, legal branch, and safety policy.

3. Accounting Processes

3.1 Although they have been accepted by the Auditor General, the published accounts for 1988-89 do not adequately reflect the true financial position of the Commission because important data for management purposes is not brought to account and because the accounting mechanisms in place do not always provide the information which they are thought to.

3.2 A head office circular submitted to the Committee entitled "*The Accounting Processes of the Forestry Commission*" explains the processes in broad terms. This circular notes the distinction between public good activities and commercial activities. It notes the move to the Outer Budget Sector in 1988, and the resultant onus on the Commission to manage its own finances. It also notes that 1974 marked the beginning of separate accounting for commercial and non-commercial activity, as well as the introduction of profit and loss statements for commercial operations.

3.3 Management accounts, according to the circular, perform the following functions:

- enable costing of timber production, which assists in determining royalties;
- monitor financial performance of projects;
- show relative financial performance of management areas and practices;
- aid expenditure and revenue control;
- aid capital investment decisions;
- provide a sound financial information basis.

3.4 In the management accounts, the Commission's expenditure is disaggregated by species grouping and by geographic areas (equivalent to profit centres).

The profit centres correspond to one or more management plan areas. There are 109 separate profit centres, each with its own income and expenditure statement, and balance sheet.

- 3.5 The Committee notes that the New South Wales Forestry Commission was in the forefront of introducing commercial accounting principles into forestry in Australia, and is still advanced relative to many other states.

Failure of accounting mechanisms to provide information they are thought to

- 3.6 The Committee in its investigations has had to rely heavily on the accounting information provided by the Forestry Commission. As is so often the case in the forestry field, there are few alternative sources of information. A priori, the Committee held some concerns that vital information from the field might suffer from non-uniform methods of data collection or from the relative lack of staff availability or experience. For reasons which will be discussed later, the Committee felt that the internal auditing function allocated to the Inspectorate was not an adequate safeguard.
- 3.7 The Auditor General's office has informed the Committee that the audited 1989-90 accounts have been returned to the Commission for corrections owing to the large number of anomalies. While the Forestry Commission is not the only State Government body to have suffered this fate, it does point up some serious shortcomings with the Commission's accounting processes.
- 3.8 The Commission's financial controller, Mr. W.J. Vanooi, explained some of the difficulties under the title *"Limitations of the Existing Accounting System"* in a submission to the Committee relating to another Public Accounts Committee enquiry.

"Although the Forestry Commission prepares commercial accounts at the end of the financial year, it does so by converting information held in a Visual Record Computer (V.R.C.) system into a double entry system, using a series of internally developed computer programs. Much of this information is provided on returns from country offices and/or has to undergo extensive

manipulation before it is entered into the computer system. To summarise we do not have a general ledger, or debtors and creditors ledgers normally found in commercial accounting packages.”¹

- 3.9 Amplifying and expanding upon these acknowledged limitations, the Auditor General’s office noted the following deficiencies. The accounting system was developed in the early 1970’s, well before the Outer Budget move, and is now nearly obsolete. Detailed revenue and expenditure information is available only at the district and regional levels. No attempt is made to aggregate this information on a Commission-wide basis into detailed revenue and expenditure categories until the end of the year. Management accounts, useful as they are, are only up-to-date at the end of the year.
-

Recommendation 1

It is recommended that the Forestry Commission strengthen its internal financial audit function, by placing it in the hands of qualified professional accountants, emphasising performance monitoring, and separating the internal audit function from management influence.

- 3.10 Following its review of the 1988-89 financial statements, the Auditor General’s office made a number of recommendations to the Commission with the aim of improving internal control systems and methods of compiling financial statements. At the time, the Commission agreed to implement these recommendations. However, some of the most important suggestions, relating to the construction of financial statements, were only implemented after the June 1990 statements were returned to the Commission for correction. These suggestions included submitting all accounts schedules to the Financial Controller for checking prior to their inclusion in the consolidated accounts, formalising the consolidation process onto a spreadsheet, and adopting a structured approach to developing consolidated accounts starting from management account figures and updating them on a journal style basis as the

¹ Attachment 1, submission from the NSW Forestry Commission to the Public Accounts Committee’s Inquiry into Prompt Payments, 18 September, 1990.

Head Office Overheads, Plant Account Asset Schedules, and other values are determined.²

Growing stock valuation

- 3.11 A significant shortcoming noted by the Auditor General is the failure to adequately address the issue of revaluation of growing stock. The Commission's policy for valuing the growing stock asset in plantation, broadleaf and cypress pine forests is outlined in Note 1. (II) (a) and (b) to the 1988-89 Accounts³. The Commission's reliance on the CPI to inflate the previously capitalised historical costs seems to the Committee to be whimsical at best, and thoroughly misleading at worst. This procedure bears no relationship whatsoever to the market values realizable from the forest resources, and fails to take account of very significant factors affecting growth (such as timeliness of thinning operations, for instance).
- 3.12 The Committee understands that the Australian Accounting Research Foundation has undertaken a research project concerning external financial reporting for self-generating and regenerating assets, such as productive forests, started in May 1990. While waiting for these results, the Committee believes that the Commission could do worse than to consider the models used by the South Australian Woods and Forests Department, the New Zealand Forestry Corporation, or some of the private forestry corporations in New Zealand - at least as far as valuing their pine plantation assets.

Recommendation 2

It is recommended that the Forestry Commission immediately move to adopt a market-value based approach to valuing growing stock assets, following the example of South Australia's Woods and Forests Department. The Committee to review progress in one year.

² Management Letter, 19 December, 1989, from Senior Audit Manager, Auditor General's Office to the Commissioner of Forests, Appendix, p. 3

³ 1988-89 Annual Report of the Forestry Commission of NSW, p. 95

- 3.13 Continuing to probe the *"inventory"* problem (valuation of growing stock), the Committee feels that with so much of the Commission's commercial asset base in the form of standing trees it is imperative the Commission do more to understand firstly the extent of those assets, and secondly how their operations affect the value of those assets. The acknowledged fact that behind-schedule thinning of the plantations at Oberon diminishes their commercial value is nowhere reflected in the accounts. This and other important details are completely glossed over by the curious accounting treatment which applies a CPI adjustment to historical costs. Under the presumed existence of sustainable yield in native forestry, (which the Committee questions in the chapter on Production Controls) the commercial value of the native forests is assumed to be constant in real terms, even though there is evidence (discussed in the Production Controls chapter) to suggest that the commercial value is diminishing in real terms.

Accounting resources

- 3.14 In its inspections of field offices of the Commission, notably at Coff's Harbour and Oberon, the Committee observed that office computer equipment was lying unused for want of any staff training. The Committee understands that this situation has prevailed over several months at least. Given the Commission's intention to invite tenders in October 1990 for a full commercial accounting system, of which these district satellite computers will no doubt form a part, the Committee cannot help but wonder how well the implementation of the new accounting system has been planned. Additionally, the Committee understands that the Commission had employed the Spectrum Methodology for specifying the new accounting system, but that subsequent departures from that methodology have caused some problems. Overall, the Committee gets the clear impression that the transition to a new accounting system is unfolding slowly (and apparently not smoothly) in part because insufficient or inappropriate resources are being applied to the problem. In particular, the small head office accounting staff seems to be carrying an excessive workload.

Recommendation 3

It is recommended that the Forestry Commission make sufficient resources available to:

- the general accounting area to cope with the workload,
 - train district and regional staff in the use of newly installed computer equipment for accounting functions,
 - speed the transition to computerized general ledger accounting whilst adhering strictly to the Spectrum Methodology.
-

Allocation of labour expenses

3.15 A final area of concern to the Committee with regard to possibly inaccurate statements in the accounts, is the allocation of labour expenses to commercial versus non-commercial activities. This concern arose because almost all Commission employees are engaged in a mixture of commercial and public-good activities. In fact, only the research officers engaged in Silviculture and Soils and Nutrition research are entirely commercial. No officers are entirely non-commercial. Under this situation, (which is not entirely desirable, as is explained in the chapter on Corporate Structure), the Committee felt that there may be opportunities for commercial labour expenses to be charged to the public good.

3.16 The Committee's concerns deepened when Assistant Commissioner Fisher admitted to a degree of uncertainty in assigning costs.

Mr. Fisher: "The government pays us about \$14 million for this so-called public good thing, but we are still trying to get a better handle on that cost."

Committee: "That's a figure plucked out of the air, isn't it?"

Mr. Fisher: "No, it is a figure which has been achieved by generalising officer time and expenditure on that aspect, on making arbitrary estimates of the time and effort spent on that aspect of forestry activities." ⁴

3.17 In reply to the Committee's request, the Director of Corporate Services submitted an explanation of how these costs are allocated on 28 September, 1990. Some, but not all officers are required to use diaries to break up their daily time into Public Good and Commercial Programs. These include all field staff, some other regional staff, all staff in Community Affairs Branch and Civil Engineering Branch, all timber inspection staff, and some officers in Lands Administration Division. From these primary records, district, regional, and divisional average apportionments of time are obtained by the following processes:

- * The apportionment of officer time in a District determines the average for all staff in the District.
- * The apportionment of officer time in Districts plus that of field and any other designated staff in the Regional Office determines the average for the Region.
- * The apportionment of designated officers time in each Division determines the average for all staff in that Division.

3.18 Checks that diaries seem plausible are made monthly by reviewing officers. At present, there are no plans to alter this method of accounting for time.

3.19 The Committee was disturbed to learn that this vital accounting distinction - between commercial activities and the public good component was being made in such a casual, ad hoc, and virtually unverifiable way. Numerous opportunities exist to misrepresent commercial expenses as public good, thereby boosting the reported commercial surplus. On the other side of the

⁴ Minutes of Evidence, 19 June, 1990, p. 181

coin, the timber industry could potentially take hold of this system and, questioning whether commercial profits were subsidising non-commercial activities, argue that royalties should be lower.

- 3.20 It is absolutely vital that a clear and credible allocation of expenses be made between commercial and public good components. While the Committee was not presented any evidence which demonstrated that abuses of the system have occurred, it feels that this system is totally inadequate to make this key distinction. The only workable solution, in the Committee's view, is to form, to the greatest extent possible, separate divisions for commercial and non-commercial activities, with distinct staff and facilities. This concept is developed further in the chapter on Corporate Structure, Aims, and Incentives.

Recommendation 4

It is recommended that ALL Forestry Commission staff and executives who work in both commercial and noncommercial activities keep daily diaries indicating the allocation of their time.

-
- 3.21 The question has been raised as to whether keeping daily diaries would be an onerous, time-consuming chore. In reply, the Committee notes that it is common practice in legal, engineering, consulting, and other firms to require all professionals to account for their time. Not even partners or managing directors are exempt from this requirement. It is perceived as the only possible method of accurately billing multiple clients, and also as a powerful time-management tool.

Important data not brought to account

- 3.22 Thus far, the Committee has emphasised information presented in the accounts which, for various reasons, may not accurately depict the conditions and processes which they are intended to depict. The Committee also harbours concerns about information which is not brought to account, but

which is absolutely essential to a proper understanding of the Commission's custodianship of the State's forest resources. To summarize these points, native forest asset valuations really only consider exploitation costs and fail to consider replacement costs, a satisfactory inventory of native forests is lacking, there is no accounting for the non-timber values inherent in the native forest, very little indication is given in the 1988-89 accounts of the impending necessity of the Commission paying a dividend to Treasury, and numerous subsidies enjoyed by the Commission (as detailed in the chapter on Finance) are not quantified in the accounts.

- 3.23 The Committee does appreciate that until now the Commission has not been required to bring these figures to account, and furthermore that some of these figures would be difficult to estimate. Nevertheless, rational management of the native forests and full public accountability can only be achieved if these types of factors are exposed to public scrutiny and debate.

Recommendation 5

It is recommended that the Forestry Commission annually estimate the value added by its management of the native forest estate for commercial timber production, with the details of the value added (or subtracted) annually included in its annual financial statements and Annual Report. The Committee to review progress in one year.

- 3.24 Native forest asset valuations are based essentially on the procedure specified in the Notes to the Accounts⁵. The Commissioner has submitted rate of return on asset calculations which place the net assets at June 1989 in pine plantations at \$406.1 M and broadleaf forest assets at \$98.0 M⁶. These figures are derived from historical capital expenditure. The pine plantation asset is distributed over 180,000 hectares of net forested area, while the broadleaf forest asset is distributed over 2,700,000 hectares⁷. Investment intensity, in

5 1988-89 Annual Report of the Forestry Commission of NSW, p. 95

6 Reply from the Commissioner to the Committee's question, submitted 26 September, 1990

7 1988-89 Annual Report of the Forestry Commission of NSW, p. 8

terms of net asset worth per hectare, is \$2,256 for pine plantations and \$36 for broadleaf forests, using the above figures.

- 3.25 The Committee understands that the pine plantation figure is akin to a replacement cost figure, since almost all establishment costs are capitalised in the asset figure. The native forest figure, on the other hand, is understood to be only the capitalised cost of man-made "*improvements*" to the broadleaf forests which consist in the main of road construction and minimal silvicultural treatment. On this basis, the Committee concludes that this valuation is really only representative of "*exploitation*" costs, and does not begin to approach a "*replacement*" cost figure. To put it another way, the native forest asset value stated in the accounts does not include the value of the trees.
- 3.26 An inventory of the State's native forest trees is not yet sufficiently advanced to warrant inclusion in the accounts. The Commissioner stated in his testimony that the Commission does have a comprehensive set of data on its own state forests, although he expressed some misgivings about the currency and precision of that information.⁸
- 3.27 The real problem arises, as the Committee understands it, in attaching a financial value to the stock of growing trees. Some approaches to this problem are discussed in the chapter on Valuation and Rate of Return, however it is worthwhile to note here that the Committee understands there is no generally accepted method for valuing natural forests anywhere in the world. Notwithstanding that fact, the Committee believes it is better to begin by using some method and refining it in future years than to delay the attempt until an ideal method becomes available.

Recommendation 6

It is recommended that the Forestry Commission add a financial dimension to its inventory of all forest assets under Commission control. The Committee to review progress in one year.

⁸ Minutes of Evidence, 18 June, 1990, pp. 12, 13

- 3.28 When the Committee questioned the Commissioner and others involved in the inventory project about the accounting for non-wood values, it was met with a chorus of chuckles, from which the Committee inferred that that question was in the *"too hard basket"*.
-

Recommendation 7

It is recommended that the Forestry Commission convene a committee with sunset provisions composed of third parties which may include the Department of Planning, Ministry of Environment, National Parks and Wildlife Service, community groups, and industry groups to establish a range of non-wood values for forests under the Commission's control, and publish the results of these discussions in the Commission's Annual Report.

- 3.29 Moving on to the dividend policy, the Committee's concern is that the Commission has been trumpeting its large retained commercial surplus for 1987-88, and larger retained surplus for 1988-89 without making it plain that the retained surpluses were substantially larger than they would have been had the Commission paid a Treasury dividend in those years. The message received by the casual reader of the accounts is that the Commission has had two wonderfully successful years. The Committee hopes that in 1989-90, when a dividend is to be paid, and in subsequent years, this euphoric presentation to the public will be tempered with a proper account of the Commission's financial responsibilities.
- 3.30 The issue of presenting and quantifying subsidies in the accounts will be taken up in detail in the chapter on Finance. Suffice to say here that by not bringing these subsidies to account, the Commission fails to afford the public a true and fair picture of how it receives and employs funding.

Recommendation 8

It is recommended that the Forestry Commission quantify all subsidies which it enjoys by virtue of its being a government body, and include estimates of such subsidies in the yearly audited financial statements. The Committee to review progress in one year.

4. Finance

- 4.1 The entire timber industry in New South Wales revolves around a system of substantial public subsidies. The Committee believes the Commission's finances have been boosted since the Forestry Amendment Bill, 1988, introduced additional subsidies. The Committee perceives that what subsidies the Commission does not consume in its inefficient bureaucracy it passes on to its customers in the form of lower timber prices.
- 4.2 The Committee does not wish to imply that these subsidies are improperly obtained. All are supported by current legislation. However, the way in which these subsidies are recorded (and sometimes not recorded) in the Commission's financial accounts does not work in the interests of public accountability. More seriously, the Commission's internal lack of awareness of these subsidies has led, in the Committee's view, to a consistent pattern of questionable management decisions which work to the short-term advantage of industry, but may have extremely detrimental long-term effects.

Resource rental tax

- 4.3 One of the most important long-standing subsidies is the nonpayment of fees to government for the commercial exploitation of native forests. Native timber is free of charge to the Forestry Commission. For this reason primarily, the Commission can charge extremely low royalties and still cover their costs. Industry has successfully used this low cost argument to press the Commission for inappropriately low prices on native logs. Therefore the nonpayment of any rental on Crown Lands by the Commission is a net transfer of public equity to the timber processing industry. Before the Commission was moved to the outer budget sector, this nonpayment was understandable - though counter productive. However, now that the Commission is operating on a commercial basis and reporting "*profit*", the Committee feels that this subsidy is unjustifiable.

Recommendation 9

It is recommended that the Forestry Commission pay the State Government rental on all native forest which it manages for timber production.

Recommendation 10

It is recommended that this rental payment comprise a relatively small annuity per hectare of gross state forest less dedicated reserves, and a considerably larger fee payable upon timber harvesting.

Notional income tax

4.4 The government's corporatisation program for statutory authorities has identified the Forestry Commission as a candidate for corporatisation in the near future. As a state-owned corporation, the Commission would be obliged to pay, in addition to dividends, a notional income tax on its commercial net income. The potentially devastating effect of this requirement on the Commission's bullish commercial results was acknowledged by Assistant Commissioner Fisher. *"We would be in difficulty if we had to pay tax."*¹

Local government rates

4.5 Some subsidies enjoyed by the Commission in common with other government departments and statutory authorities are the nonpayment of local government rates, and exemption from sales tax on motor vehicles, plant and equipment. Considering the overall prospect of removing subsidies, the Chief

¹ Minutes of Evidence, 19 June, 1990, p. 180.

of Marketing Division stated, *"If we were a private sector company we would toss in the towel."*²

Recommendation 11

It is recommended that, consistent with State Government policy, the Forestry Commission be levied local government rates and charges.

Interest on loans incurred prior to 1988

- 4.6 The Forestry Commission had for years failed to cover its costs with operating revenue. The commercial deficit was \$1.34 M in 1985-86, and \$3.68 M in 1986-87³. In 1987-88, with the passage of the Forestry Amendment Bill, a commercial surplus was reported. In 1988-89 the commercial surplus increased substantially. The reason for this dramatic turnaround is that the subsidies enjoyed by the Forestry Commission were substantially increased by the Forestry Amendment Bill. Dr. S.W. Gentle acknowledged this point in the Commissioner's Review⁴, *"The net effect of restructuring finances has been to bring the Commission's commercial operations into surplus at \$11.4 million net of extraordinaries."*
- 4.7 The main new subsidy granted by the Forestry Amendment Bill was relief from the Commission's interest burden (interest had been payable on debts in excess of \$100 M). The intention had been to swap debt for equity, thereby making dividends payable to Treasury in place of interest to commercial creditors. However, the Commission did not pay any dividend to Treasury in either 1987-88 or 1988-89. Conservatively assuming a borrowing rate of 13% on loans totalling \$109.7 M, loan interest of \$14.2 M would have been payable in 1988-89.⁵ The subject of Treasury dividends will be taken up in detail below, but for the moment suffice to say that this nonpayment of either

2 Minutes of Evidence, 19 June, 1990, p. 148.

3 1986-87 Annual Report of the Forestry Commission of NSW.

4 1987-88 Annual Report of the Forestry Commission of NSW.

5 Loan amount stated in 1988-89 Annual Report of the Forestry Commission of NSW, p. 100.

interest or dividend amounts to a significant subsidy in 1988-89, when a large commercial surplus was reported.

- 4.8 The Committee believes that this interest relief has a distorting effect on the Commission's decisions regarding the disposal of surplus assets. In the Commissioner's Review 1987-88, Dr. Gentle comments, *"For 1987-88 the primary effects [of the Forestry Amendment Bill] are to relieve the Commission of its notional interest burden, which is not directly related to any aspect of forest management."*⁶
- 4.9 The Committee finds it astonishing that a state forestry service could have generated a debt burden in excess of \$100 M which was not related to forest management. From the former Commissioner's statement, the Committee has concluded that this debt burden must have arisen, at least partly, from the acquisition of non-forestry assets. A case in point is the Commission's regional office at Coff's Harbour. The Commission's informal valuation of this prime commercial office site is \$3 M⁷. The Commission has provided no rationale for the ownership of an expensive urban office which oversees rural operations. The Committee believes that the interest relief granted the Commission in 1988 has removed the incentive for the Commission to take the economically rational step of selling this and other non-productive assets.
-

Recommendation 12

It is recommended that the Forestry Commission draw up a list of non-productive assets for disposal, including office buildings, other real-estate holdings, and under-utilized non-essential plant and equipment, which are not actively used for timber production. The Committee to review progress in one year.

⁶ 1987-88 Annual Report of the Forestry Commission of NSW.

⁷ Minutes of Evidence, 19 June, 1990, p. 239.

Recommendation 13

It is recommended that the Forestry Commission dispose of the surplus assets identified above in an orderly fashion and within a time frame which allows the Commission to obtain good sale prices.

Recommendation 14

It is recommended that the proceeds of these asset sales be employed to fund the Commission's future capital works programs.

Dividends

4.10 The Commissioner laid out the background to dividend payments in reply to the Committee's questions:

"Since 1988, when the Commission was moved to the outer budget sector, the notional loan interest is not charged and all previous loans and government grants have been accumulated into a formation cost of the Commission at \$461 M. This amount has been apportioned to the 3 programs as follows:

<i>Softwood plantations</i>	<i>\$ 355.51 M</i>
<i>Broadleaf forests</i>	<i>\$ 91.21 M</i>
<i>Cypress forests</i>	<i>\$ 14.53 M "</i> ⁸

4.11 As noted above, the Commission did not pay any dividend to Treasury in either 1987/88 or 1988/89. Treasury had determined initial targets for

⁸ Reply from the Commissioner to the Committee's June, 1990 questions, submitted 26 September, 1990.

dividend payments of \$14.5 M in 1989/90, \$16 M in 1990/91, and \$22 M in 1991/92. The Commission negotiated with Treasury to reduce the 1989/90 dividend to \$10 M due to its poor cash position. The Committee notes that even the relatively high proposed dividend of \$22 M for 1991/92 is below the \$23 M figure which would represent a 5 percent nominal return on the formation capital. The \$10 M dividend payment for this year represents a nominal rate of return of 3.1 percent. This rate of return on assets is far below the earnings before interest and taxation typically achieved by private sector forestry firms.

- 4.12 The Government Trading Enterprises Monitoring Unit (GTEMU) of the Treasury retained Ernst and Young in March 1990 to examine the Commission's financial position. Ernst and Young's report indicated that, in their opinion, the Forestry Commission will not be able to pay any dividend for 1989/90 to 1991/92, because all the projected profits and retained earnings will be transferred to the Capital Reserve to fund the re-stocking program.
- 4.13 The GTEMU did not accept Ernst and Young's view because their report did not address critically either the rationale behind the huge transfer (\$112 M over three years) to the Capital Reserve or the projected rate of return of the capital investment funded by the capital transfer. Since the Commission's debt/equity ratio is approximately 4% (in comparison to listed forestry companies which are in the range 50% to 150%), the GTEMU concluded that the Commission has great scope for the funding of dividends by running down cash reserves and increasing debt. The GTEMU considered that an efficient use of debt funding should be encouraged and a commercial rate of return target adopted.⁹
- 4.14 The Committee agrees with the GTEMU that a commercial rate of return target is appropriate for dividend payments. However, it has grave reservations as to whether the Commission's present degree of financial discipline renders it capable of meeting large loan repayments.

⁹ Background paper to a letter dated 11 August, 1990 from the Treasurer to the Minister for Tourism, Lands and Forests.

How Commission subsidies benefit industry

- 4.15 The State's timber processing industry is heavily subsidised by the public sector. Chief among the subsidies are under priced raw materials (in the case of Eucalypt logs), and failure to bear the full costs of road construction and maintenance which are attributable to the industry's operations. As a result of these subsidies, sawmilling businesses which would be marginal or non-viable in their present form are able to continue operating and to continue resisting the pressures to change their inefficient methods of operation.
- 4.16 It has been widely acknowledged by the Commission that their principal aim in price-setting is to recover costs of production. It follows that any cost savings achieved by the Commission will be passed on to their customers. In fact, as the Chief of Marketing Division testified, *"We have had to go to our customers - we chose to go to our customers and justify what we were doing, to tell them exactly what we were doing, that we were lifting prices to levels which would cover the cost of production as we assessed the cost of production."*¹⁰ The Committee perceives clearly that whatever public subsidy is afforded to the Commission will be passed on directly to its customers in the form of lower raw material prices.

Royalties discounted for haulage costs

- 4.17 Transport infrastructure for logging operations consists both of public roads and roads which are built and maintained by the Forestry Commission. Forestry Commission roading is a very significant cost item. Construction of roads and bridges cost \$6.35 M and maintenance cost \$6.26 M in 1988-89. Costs for the two prior years were comparable.¹¹
- 4.18 The Commission does not apply a *"user-pays"* system to roading costs, preferring to amalgamate them by district and region, and seek to recover them from overall royalty revenue. Because the Commission's quota system rigidly allocates timber from specific forests to specific customers, it would be possible to charge individual customers more if they require expensive roading. Instead, the Commission has adopted the unacceptable notion that

10 Minutes of Evidence, 19 June, 1990, p. 137.

11 1988-89 Annual Report of the Forestry Commission of NSW.

customers whose mills are remote from the forests which supply them should be compensated for the higher haulage expense which they incur. This compensation takes the form of reduced royalty, the aim of which is to level the combined costs of royalty and haulage to the mill door between all customers.

4.19 This philosophy reached its highest expression in the *"appraisal"* or *"residual stumpage"* system of royalty determination which is still being phased out in 1990. The appraisal system was a labyrinthine intellectual construction which attempted to identify the prices in consumer markets of timber-derived products and to identify all costs involved in transforming a standing tree into these products. After removing all costs from the consumer price and allowing for reasonable profit margins for all firms in the chain, the residue was thought to be the standing tree's commercial worth. When it was discovered that some standing timber was highly sought after even at prices which far exceeded the residual value, questions arose about the validity of this system.

4.20 In the present day, the appraisal system has been replaced in most areas by the *"gross measure"* royalty system, which is simpler to administer, but which retains the haulage cost compensation. By approaching the transportation cost problem in this manner, the Commission has introduced two troubling elements of economic irrationality. Firstly, it has removed the incentive for industry to locate their activities close to the resource base. Secondly, it is subsidising inappropriately situated mills by discounting for the haulage cost. Under these circumstances, the Committee finds it hardly surprising that *"N.S.W. has the longest log hauls and most difficult logging conditions on average."*¹²

12 Reply from Mr. R. Wilson to the Committee's question, submitted 29 August, 1990.

Recommendation 15

It is recommended that, over the useful life of existing mills (with a maximum term of 15 years for newer mills and average term of 5 years for older mills), the Forestry Commission phase out the compensation for long haulage distances from forest to mill which is built into its current royalty structure.

Recommendation 16

It is recommended that the Forestry Commission phase in a system which specifies the log price "at the log dump" which depends upon the quality and type of timber, without reference to transportation costs. The Committee to review progress in one year.

Industry's public road cost subsidy

4.21 Considering the use of public roads by logging trucks, it is frequently asserted that motor vehicle taxes, registration charges, and fuel taxes pay for the damage inflicted on public roads. However, a submission by Dr. P.G. Laird of the University of Wollongong makes the convincing case that there is a significant under-recovery of road system costs from these and other sources of revenue. Under-recovery may be conservatively estimated at above one million dollars per year considering only truck traffic related to woodchip exports from NSW.¹³

"Some factors relevant to the Eden woodchip operation are now given, where the local woodchip industry (Final EIS 1986, p. 74) notes total payments to the public sector from woodchip operations of \$20.32 million for 1985/86 and claims that there is

¹³ Letter from Dr. P.G. Laird submitted 21 June, 1990.

*no evidence of any element of 'subsidy' being provided to the Eden export project. However, no mention is made of any payment to local government for the use of council roads by logging trucks."*¹⁴

*"Fully costed estimates of the total external cost of road freight of timber are now given as at least 4 cents per net tonne kilometre. Data is given in Page 15 of broad estimates of the freight task of haulage of timber to Eden for woodchip exports along public roads some 39 million tonne km for 1985-86. With a unit cost of 4 cents per net tonne km, the full external cost (i.e. that not paid by the woodchip company) of all this timber on public roads is \$1.56 million for that year. Accounting also for other timber hauled from NSW to other ports (e.g. Newcastle) for export gives an annual freight task broadly estimated at 75 million tonne km. With a unit cost of 4 cents per net tonne km, the external costs are some \$3 million a year. There is also additional external costs in the haulage of fuel, and equipment, along public roads to gain access to logging operations. Similarly, when private contractors of the Forestry Commission construct roads in forests, the haulage of road making equipment (and the fuel to power it) along public roads incurs a hidden subsidy."*¹⁵

- 4.22 The Committee recognizes that this under-recovery of road damage costs applies to trucking associated with all industry in the State. While deserving of attention, this issue should not be used to single out the timber industry.

Summary

- 4.23 To achieve a crude understanding of the magnitude of subsidies, if the interest burden of \$14.2 M was subtracted from the 1988-89 commercial surplus of \$27.3 M, and a 39% rate of notional taxation applied to the remainder, the notional tax bill would have been \$5.1 M. In combination, interest and

14 "External Costs of Road Transport of Bulk Exports Through New South Wales Ports", Philip Laird, CRES Working Paper 1988/12, ANU Centre for Resource and Environmental Studies, pp. 14,15.

15 Dr. Laird's August, 1990 update of his earlier submission.

taxation would have cost \$19.3 M had they been paid by the Commission. In addition to this quantifiable \$19.3 M subsidy, the unpaid resource rental tax and local government rates are likely to have completely swallowed up the commercial surplus.

- 4.24 A quick calculation for the 1989-90 year, based on the un-audited annual accounts submitted by the Commission on October 18, 1990, reveals that despite its pledge to pay a \$10 M dividend, the Commission still receives a tremendous subsidy. The 1989-90 commercial surplus of \$37.7 M would have given rise to a notional tax bill of \$14.7 M (assuming a 39% tax rate). A further \$11.5 M would be payable to Treasury if 50% of the post-tax surplus were earmarked for dividend payment. Thus in 1989-90, the notional tax and dividend charges would have been \$26.2 M. Subtracting the \$10 M dividend payment agreed to by the Commission, it is clear that the quantifiable component of subsidies is still \$16.2 M.
- 4.25 Once again, the Committee wishes to stress that the subsidies in respect of resource rental tax and local government rates are not insignificant. If the resource rental were only \$1 per hectare per year for native State forest areas being cultivated for timber production this bill would come to \$3.1 M annually.¹⁶
- 4.26 To summarize, the Committee is aware that the Commission has been the recipient of a number of public subsidies whose combined magnitude looms very large compared to the operating surpluses reported in 1987-88 and 1988-89. Although these subsidies are supported by current legislation, their presence gives a misleading impression to the public of the Commission's financial position. Additionally, the subsidies have introduced many strands of economic irrationality into the Commission's decision-making. Finally, the subsidies are either consumed by the Commission's inefficient bureaucracy or passed on to the timber processing industry, which benefits from a substantial public subsidy package.
- 4.27 It is the Committee's view that these subsidies should be phased out entirely over time. Of course this phase-out must be done with full advance warning to the Commission's customers and accompanied by a realistic appraisal of the likely impact on raw materials prices. The Commission itself will have to

¹⁶ Figure derived from combining net forested areas for native eucalypt and cypress pine forests reported in the 1988-89 Annual Report of the Forestry Commission of NSW, p. 8.

undertake much more comprehensive financial forward planning than has been in evidence so far to accomplish this difficult transition with minimum disruption to the forest resources, the state government's finances, and the timber industry.

Recommendation 17

It is recommended that the Forestry Commission ensure that its senior officers are aware of the existence and magnitude of government subsidies to the Commission, and of the likely necessity of managing without them in the near future.

Recommendation 18

It is recommended that the Forestry Commission prepare strategic financial, marketing, and operational plans to implement, over approximately a five-year period, a phased removal of all major subsidies, including but not limited to payment of a sub-market dividend to Treasury, nonpayment of resource rental for exploitation of native forests, nonpayment of notional income tax, and nonpayment of local government rates and charges. The Committee to review progress in one year.

5. Efficiency, Economy, Effectiveness

- 5.1 When the Committee approached the question of efficiency, Commissioner Drielsma asserted that the previous year's healthy "*bottom line*" demonstrated that performance was not a problem.¹ The Forestry Commission's Annual Report for 1988-89 does give the impression that the Commission is operating profitably in its commercial activities. However, when one takes into account the significant subsidies (as outlined in the chapter on Finance) upon which this bottom line is predicated, it becomes questionable as to whether true costs are even being met. It becomes clear that the "*bottom line*" could and definitely should be improved by considering ways to gain more value for money spent on administration.
- 5.2 Administration consumes 42.8% of the commercial expenditure, of which head office management and administration is the largest part (26.8% of commercial expenditure).² This high allocation of expenses to head office seemed disproportionate to the Committee, considering that almost all the Commission's work is done at the field level. Head office is understood to provide policy direction and centralised services. But the Committee wonders whether these services could be more economically provided under some other arrangement.
- 5.3 The Commission employs a total of approximately 1,770 people, including 770 full-time public service staff positions and approximately 1000 Section 10 employees³, generating a total turnover of \$91 M consisting both of commercial forestry income and government payments.⁴ The Commission is administered by a head office staff of 340 full-time public service positions.⁵
- 5.4 The Committee is cognizant of the fact that efficiency can be difficult to measure when public goods are produced because of the difficulties in

1 Informal discussion during a visit by the Committee to Head Office, on 14 June, 1990.

2 1988-89 Annual Report of the Forestry Commission of NSW, p. 83.

3 At June 1990, Reply from Mr. Graeme King to the Committee's question.

4 1988-89 Annual Report of the Forestry Commission of NSW, pp. 82, 84.

5 Op. Cit. G. King.

quantifying public good outputs. However, in the commercial sphere, efficiency is far more cut and dried, and more comparable between organizations.

- 5.5 The Committee sought to arrive at an impression of the Commission's efficiency in the commercial sector of its operations. Lacking a clear separation between commercial and non-commercial staff, the Committee has had to rely on financial information to infer the basic efficiency parameters. Of the 340 head office staff, 84 are engaged in research, which should perhaps be treated separately (although the Committee notes that research does draw on the commercial budget for much of its funding).
- 5.6 It is true to say that the remaining 256 head office staff all participate in administering the commercial operations of the Commission, although very few, if any, work exclusively on commercial activities. As a rough guide, the Committee used the proportion of expenditure allocated to commercial activities to estimate the number of "full-time equivalent" employees engaged in commercial work at head office. Of the Commission's \$58.5 M total expenditure in 1988-89, \$45.4 M, or 78%, was commercial.⁶ 78% of the 256 non-research head office staff represents 200 full-time equivalent staff positions. 78% of the 1,770 total Commission employees represents 1,381 full-time equivalents.
- 5.7 Given that forestry essentially occurs in the forest, the Committee wondered how appropriate it is for a forestry organization to employ 200 staff in York Street to manage a commercial operation employing only 1,381 staff altogether, and enjoying an annual turnover of only \$73.0 M.⁷
- 5.8 Any commercial business, particularly a tree-growing one, must be structured appropriately for its type of business. The Committee believes that head office staff numbers in New South Wales testify to the managerial and administrative inefficiencies which hinder the Forestry Commission.
- 5.9 The Committee was not dissuaded from this view by a report on an efficiency audit conducted in November 1986 by the Public Service Board, which was forwarded to the Committee by the Commissioner. This report, under the terms of reference "to determine the extent to which the administrative support

6 1988-89 Annual Report of the Forestry Commission of NSW.

7 1988-89 Annual Report of the Forestry Commission of NSW.

*services are conducted in an efficient, economic, and proper manner*⁸, stated that most administrative support services were found to be efficient and effective, and that there were no major deficiencies found.⁹ The executive digest concludes with the statement that, *"There appears to be little further opportunity to reduce administrative support staffing below the current levels and this is a matter which is under constant review by the Commission in any case."*¹⁰

- 5.10 The audit methodology considered the four criteria: cost, timeliness, volume, and quality of support services. Unfortunately, the cost comparisons were limited to comparisons with other state government departments. On page 15, where the report specifically looks at the proportion of expenditure allocated to head office management and administration, the trends are considered favourable compared to the Queensland Forestry Department. This procedure may have had some validity when the Commission was in the inner budget sector, but now that it is on the brink of corporatisation the relevant comparison is to commercial firms or successfully corporatised government organizations.
- 5.11 Apart from this problem with making meaningful cost comparisons, the efficiency audit also failed to critically examine the question of whether management could restructure the present administration to yield more productivity. In the Committee's view, one of the Commission's greatest failings is in this area. Certainly the head office staff manage to remain busy, but it seems highly probable, based on overseas and interstate examples, that under a different structure the Commission's objectives could be satisfied equally well or better with far less effort.
- 5.12 Regardless of the efficiency audit's generally favourable outlook, it did raise the following points of concern to the Committee:
- The favourable finding for mapping branch and cartography staff mentioned only regional and district staff, not head office.
 - The report was highly critical of staff development and training.

8 "A report on an efficiency audit of administrative support services in the Forestry Commission of N.S.W.", Public Service Board of New South Wales, November, 1986, p. 1.

9 Ibid., p. 2.

10 Ibid., p. 3.

Report on the Forestry Commission

- The incidence of internal-only advertising for vacant positions was 25% higher for the Commission than the average for other public service departments.
- Although great progress had been made in the previous two years, there were important areas of Equal Employment Opportunity implementation still to be addressed.
- In purchasing, there were significant departures noted from Treasury and Commission procedures, and the Commission's Administration Manual is imprecise.
- The communications system lacked policy, planning, and review.
- The system for replying to Ministerial correspondence was inadequate.
- Public relations policies and guide-lines were needed.
- Internal auditing had a 30 percent shortfall in the statutory requirement of three year coverage of each District, Region, workshop and Head Office division. Internal auditing did not include efficiency or effectiveness reviews.
- An urgent need for training of Regional and District staff in the use of the already installed terminals for the network inventory, pay-roll and costing central systems was highlighted.
- It was noted that the fixed wing air fleet consisted of four aircraft but only two pilots.
- It was admitted that the audit on legal branch was conducted over too short a time period to assess the workload, and that the auditors were unable to assess the importance and priority of each matter.
- The number of fleet items per head office staff was above average compared to other government departments.

- It was recommended that workloads and staffing of workshops be reviewed.
- The district staff felt the efficiency of maintenance and repair provided by the workshops to be fair.
- The auditors noted that responsibility was fragmented in the personnel area.

5.13 Finally, and of great concern to the Committee, in the section on licensing, the audit found instances of:

- *commencement of operations before the issue of authorising documents,*
- *absence of agreed variation statements from documents,*
- *lack of adequate materials measurement criteria.”¹¹*

5.14 The efficiency audit did not attach great importance to these deficiencies, labelling them instances of “*sub-standard issue*” of licenses. However, the Committee is well aware that in the present climate of forestry debate, errors of this sort may impinge directly on the Commission’s accountability and credibility in controversial logging operations, and in their own claims that sustainable yield is taking place.

5.15 It has been reported in the press¹² that the Commission intends to relocate its head office to a new, specially constructed office at Pennant Hills, which will cost the Commission \$18 M over three years. Following this development, the Committee asked for and received a copy of the feasibility study which led the Commission to decide to make this move.¹³ Rather paradoxically, this study appears to recommend against the move to West Pennant Hills. In the conclusion it states:

“The West Pennant Hills option is the most marginal in economic terms of all the options examined. It is not favoured

11 Ibid., p. 33.

12 The Australian Financial Review, January 19, 1990.

13 “Economic Evaluation of Forestry Commission Accommodation.”, Travers Morgan, Pty. Ltd., September 1988.

by the majority of staff. The benefits to the timber industry of an all timber building may improve its economic worth, but it is unlikely that the benefits could be great enough to make it comparable to the best of the other options.”¹⁴

- 5.16 Examining the robustness of their conclusion, Travers Morgan studied the sensitivity of the results to changes in the following factors: discount rate, rent savings, land and building costs, and employee travel costs. Most significantly however, Travers Morgan did not consider the sensitivity of results to diminishing head office staff levels. Even a cursory examination of the cost-benefit methodology makes it clear that if head office staff were to be reduced, the entire rationale for the move would disappear.
- 5.17 In the Committee’s view there is a clear need for a drastic downsizing of the Forestry Commission’s head office. For this reason, the proposed head office move seems to be poorly motivated on economic grounds. If the Commission is not irrevocably committed to the move, the Committee recommends that the move be cancelled, and that any rent savings which can be achieved by contraction of head office be utilized. If, however, the Commission is committed to the move, the Committee recommends that the Commission begin planning immediately to sublet or strata title surplus space.

Recommendation 19

It is recommended that the Forestry Commission immediately reconsider the justification for the head office move to Pennant Hills, with a view to selling the office complex when it is economically prudent to do so, and subletting office space in the meantime.

- 5.18 The Committee agrees in principle that the Sydney CBD may not be the ideal location for the Commission’s head office. However, a move to the suburban fringe of Sydney appears not to provide the primary benefits of relocation: greatly reduced accommodation expenses and proximity to forestry activities.

¹⁴ Ibid., p. 36.

Instead, the Committee believes the Commission should give consideration to relocating head office to a more strategic rural area.

Recommendation 20

It is recommended that the Forestry Commission consider relocating the head office to a more strategic location, where the cost of accommodation for Commission officers would not be as onerous as in Sydney.

- 5.19 Having reached the general conclusion that the Commission is not efficient, economical, or effective in relation to the head office activities, the Committee went on to consider in which areas staff reductions could realistically be made at the head office level. In this consideration, the Committee was very mindful of the fact that care must be taken not to disrupt operations in the regions and districts because of the detrimental effect it might have on industry and the rural communities.
- 5.20 In general terms, the Commission's field performance seemed to be much more highly aligned to the Commission's primary objectives of forest management than its head office performance. Overall, the Committee was impressed with the regional and district foresters it met. However the practice of maintaining a regional office separate from the office for the district it occupies, seemed to the Committee to be quite inefficient and wasteful. When questioned on the motivation for this practice, field officers explained, rather lamely, that if the regional office were combined with a district office then people would pester the regional forester on matters which should be handled by the district forester. The Committee feels that the savings from eliminating duplicated accommodation and staff would easily offset the expense of training reception staff to refer visitors to the district forester.

Recommendation 21

It is recommended that the Forestry Commission amalgamate each regional office with one of its district offices, but otherwise make no immediate changes to staffing at district and regional offices.

- 5.21 Apart from the amalgamation of each regional office with one of its district offices, the Committee feels that the most prudent course of action would be to reorganize head office along sound organization lines, placing due emphasis on objectives, structure, and incentives, and to allow the revamped management to pursue its own program of regional efficiency at a later date.
- 5.22 The Committee proposes that an organization such as the Office of Public Management be called in to critically examine the Commission's use of staff and facilities at head office with a view to drastically curtailing expenditure in these areas. So as to avoid the trap which the Public Service Board Efficiency Audit appears to have fallen into, it would be necessary firstly to make cost comparisons with commercial organizations (not with government departments), and secondly to continually question the rationale for the very existence of most head office units. The Committee feels that head office properly should provide only policy direction and a limited range of essential centralised services. The guiding principle should be that head office should provide only those services which cannot be provided by private enterprise and which offer great economies of scale relative to regional services.

Recommendation 22

It is recommended that the Forestry Commission undertake a phased reduction of head office staff numbers aimed at achieving a 50% or greater reduction within 3 years, with the intention of concentrating head office activity on policy setting and centralized provision of certain services which cannot be provided either at the regional level or by the private sector. The Committee to review progress in one year.

Recommendation 23

It is recommended that the Office of Public Management be invited to begin a comprehensive review of Forestry Commission head office staff functions in light of the guide-lines and imperatives outlined in this report.

- 5.23 Before such a detailed examination of head office takes place, the Committee wishes to highlight several areas, by no means a complete list, which seem to offer great scope for rationalization. These include the entire Wood Technology and Forest Research Division (which is discussed in a separate chapter on Research), the legal branch (which, as is discussed in the chapter on Consistency of Activities with the Charter, would have a substantially reduced workload if the Commission were to adopt a less litigious approach to environmental issues), the mapping branch within the Lands Administration Division, purchasing and stores, the rural workshops, the plant hire scheme, and the Commission's air wing within the Forest Operations Division.
- 5.24 Aside from these highlighted sections, which are discussed in this report, the Committee has serious reservations about the necessity of employing 59 head office staff members in the Administration Division when each region and district has its own administrative officer. Similar misgivings are held about the need to employ 44 head office staff in the Secretariat, the primary function

of which appears to be convening a multitude of committees and task-forces.¹⁵ In general terms, the Public Accounts Committee is also concerned that the \$9.3 M¹⁶ expenditure planned on computerization is not offset or recouped with reductions in staff numbers under any plans presented to the Committee. It seems to the Committee ironic that the two divisions which hold the most legitimate claim to a strong head office presence due to their policy orientation, namely marketing and management planning, are the smallest in terms of staff numbers.

- 5.25 The irony of employing 54 head office personnel in "*Forest Operations*" was not lost on the Committee. This irony is partly explained by the Forest Operations Division's decision to purchase goods centrally, to maintain plant and equipment at its own permanent workshops, and to own rather than hire most plant and equipment. The Committee accepts that there are circumstances in which it is essential to own equipment in order to provide a permanent standby capability (fire tankers are a prime example). However, owning plant is usually less advantageous than hiring it if the plant experiences high percentages of idle time.

Air wing

- 5.26 This problem is illustrated nowhere more graphically than in the case of the Commission's air wing. As of January, 1990, the Commission possessed five fixed-wing aircraft, and one helicopter, and leased a Turbo Commander. Earlier in this chapter, the Committee recorded its concern that in 1986 the Commission employed only two fixed-wing pilots to fly its then fleet of four fixed-wing aircraft. In itself, this fact suggests that the aircraft enjoy relatively low rates of use (that is few flying hours compared to hours on the ground). Information received from the Commissioner on aircraft usage confirms this suspicion.
- 5.27 The fleet of six aircraft was flown for a total of 2,020 hours in 1989. Of the 2,020 hours actually flown, 477 hours were spent on outside charter work, 702 hours were spent transporting Commission staff, and 119 hours were spent on

15 Minutes of Evidence, 18 June, 1990, p. 4.

16 Reply from Acting Secretary King to the Committee's question, submitted 12 December 1990. The \$9.3 M will be expended over three years.

pilot training. The residue consists of aerial photography - 93 hours, fire detection and burning - 182 hours, district reconnaissance - 327 hours, and plantation cultural work - 120 hours. In total, these more essential usage items amount to 722 hours per year.¹⁷

- 5.28 The Committee understands from sources within the charter aviation profession that 1,000 or more hours of annual service are readily achievable from each of the types of aircraft possessed by the Commission, even allowing for standard maintenance and overhaul. The only limiting factors would be the availability of flight crew and, of course, demand. Within normal commercial usage parameters, a fleet such as the Commission possesses should be capable of flying 5,000 or more hours per year. Therefore, it seems impossible to avoid the conclusion that the Commission's air wing is considerably under-utilized.
- 5.29 A point which has been stressed often by the Commission is that its air wing is required for strategic reasons relating to fire control, timely aerial fertilization of plantations, and essential aerial photography. The Committee has obtained a document entitled "*Information for Customers when Planning Travel with 'F.C. Air'*", dated January, 1990. This document describes the Commission's air fleet, consisting of two Cessna 421's (7-passenger pressurized aircraft), one Cessna 402 (6 passenger unpressurized craft suitable for aerial photography), two Cessna 337's (3-4 passenger unpressurized aircraft, suitable primarily for aerial observation and photography) and one leased Turbo Commander (a 6-7 passenger pressurized twin-engine plane).
- 5.30 Having made enquiries within the ranks of aviation professionals, the Committee understands that the Turbo Commander and the two Cessna 421's, being suitable mainly for transportation of passengers, contribute nothing to the Commission's strategic needs in terms of either silviculture, aerial photography, or fire control.
- 5.31 Beyond the obvious inappropriateness of owning the two Cessna 421's and leasing the Turbo Commander, the Committee wonders if the argument is strong, under the circumstances, for maintaining a fleet of more than one fixed-wing aircraft and one helicopter. Even such a reduced fleet would be under utilized in terms of the "*essential*" aerial tasks quantified above,

¹⁷ Figures from Reply by the Commissioner to the Committee's question, submitted 26 September, 1990.

however the Committee realizes that further reductions might compromise the vital permanent standby capability.

5.32 Incidentally, it seems noteworthy that since 1986, the Commission's air wing has increased in size from four to five (or six, including the Turbo Commander on lease) fixed-wing aircraft and that the Commission has a new terminal in Avro Street, Bankstown Airport which is equipped with a waiting lounge and passenger amenities. During the June 4, 1990 visit to Commission head office, staff informed the Committee that air charter services were providing much needed revenue to offset the costs of operating aircraft. The Committee responded to this information by wondering whether the Commission was running a timber business or an airline.

5.33 An inventory of NSW public sector air services conducted by the Office of Public Management in December 1989, disclosed the facts that, while the Forestry Commission's air wing was just earning sufficient revenue to cover operating costs, its fixed wing fleet enjoyed the lowest average number of flying hours per aircraft (290 hours per year) of the seven departments included in the report. The Department of Lands was the next lowest, with only 550 hours per year, and the Department of Health was the highest, with 947 hours per year.¹⁸

Recommendation 24

It is recommended that the Forestry Commission make near-term plans to sell its two passenger aircraft (Cessna 421's), and contract for an external professional review of the justification for owning all three of the remaining fixed-wing aircraft in light of the very low annual number of flying hours.

¹⁸ "An Inventory of N.S.W. Public Sector Air Services", Office of Public Management, December, 1989, p. 9.

Other plant and equipment

- 5.34 If, as seems probable based on views privately expressed by Commission staff in the field, this gross under utilization of plant and equipment is typical, then tremendous savings could be made by managing this aspect of forest operations differently. The depreciated value of plant and equipment owned by the Commission is placed at \$31.7 M.¹⁹ Members of the mechanical engineering branch, which administers the plant hire scheme, informed the Committee that it requires an average of one staff member to administer 80 fleet vehicles (which, as the Public Service Board's 1986 report noted, is higher than average staffing for the public service generally). A total of 138.2 full time equivalent employees are engaged at the Commission's workshops.²⁰
- 5.35 The Committee understands that there is some dissatisfaction at the field level with service provided by central purchasing and stores, the plant hire scheme, and particularly the service provided by the workshops. Considerable support appears to be present, in the field at least, for an entirely decentralised approach to purchasing of small items, plant hire and maintenance. If such an approach were used, as it has been with great success by New Zealand's private and public timber producers, the rationale for the existence of the mechanical engineering branch would virtually disappear.

Recommendation 25

It is recommended that the Forestry Commission eliminate the mechanical engineering branch, purchasing, stores, workshops, and the plant hire account in a phased and orderly fashion.

¹⁹ 1988-89 Annual Report of the Forestry Commission of NSW, p. 91.

²⁰ Staffing figure supplied by Commission's purchasing staff during the Committee's June 4, 1990 visit to head office.

Recommendation 26

It is recommended that services formerly provided by the Forestry Commission's mechanical engineering branch, purchasing, stores, workshops, and the plant hire account be obtained from the private sector, and that plant items other than fire tankers and other essential equipment be sold. The Committee to review progress in one year.

Privatisation of road construction

5.36 Dr. Bill Hurditch, Executive Director of the New South Wales Forest Products Association expressed to the Committee his association's view that road construction and maintenance tasks undertaken by the Commission should be privatised. Dr. Hurditch's point of view has been echoed by haulage contractors who have pointed out to the Committee that the current royalty scheme provides no incentive for the Commission to maintain forest roads to a high standard. While the Committee agrees in principle, it recognizes the need for a body such as the Forestry Commission at least to oversee roading operations to ensure that adequate standards are maintained. Nevertheless, the Committee appreciates the enormous expense to the Commission of constructing and maintaining roads, not the least of which is the cost of maintaining permanent staff (such as those in the civil engineering branch) whose functions relate to roading. It would be worthwhile, in the Committee's view to investigate alternatives for reducing costs to the Commission and improving the quality of forest roads.

5.37 Considering briefly the fire-management section, its small head office presence yet effective liaison with the field officers struck the Committee as exemplary. This section, in contrast to so many of the Forest Operations Division sections, seemed to strike an appropriate balance between head office and field. In the Committee's view, other centralised service units within the head office would do well to model themselves on this section.

Recommendation 27

It is recommended that the Forestry Commission considerably reduce the resources allocated to mapping branch, civil engineering branch, and other head office Forest Operations branches (with the exception of fire-fighting). The Committee to review progress in one year.

Mapping branch

- 5.38 The mapping branch, which employs 15 cartographers in head office and a further 8 in the field, provided the Committee with an illustration of how management choices can render the best efforts of a section inefficient. The conclusion of a January 1989 performance review of the mapping branch by the Chief Cartographer brings out many of the key points.

*"In 1977, there were 25 cartographers and tracers in the Branch; now there are 17. Despite this reduction in numbers and the addition of new functions (SAP and Management Plan maps) since then, the Branch has improved both its products and productivity. Because it is a service Branch, subject to client demands, its effectiveness must be judged by the client's acceptance of its services. By this measure, the Branch is effective."*²¹

- 5.39 The Committee wondered whether it was possible that the work of 25, subsequently done by 17, and now by 15, could be done by even fewer staff members. Mr. John Lowery, Chief of the Lands Administration Division, which oversees the mapping branch, indicated to the Committee that the necessity to have a large in-house capability arises in large part because mapping work is often required urgently to meet strict deadlines.

Committee: "Why such tight deadlines, I mean, the trees aren't going to go away so - -?"

21 "Mapping Branch - Performance Review", 12 January, 1989, p. 14.

*Mr. Lowery: "You see, ours is a service division, we don't set the deadlines, we have to work to them. Various other authorities including the Commission itself, are involved in the determination of the deadlines. It comes to us as a requirement, you need all that species typing done by such and such a date and then it comes to us to work out the best means of achieving it."*²²

Committee: "What are we talking about then?"

Mr. Lowery: "We are talking about the production of maps and diagrams for environmental impact statement documents and similar type documents - -"

Committee: "Just stop there, they have produced from memory five EISs and they have another seven to go or in the pipeline, you would know which seven were to come and what preparatory work has to be done for those EISs?"

*Mr. Lowery: "We know at a certain stage what they are but some of them have been imposed on us, if that is the right word to use, at relatively short notice. You would be aware that there has been difference of opinion as to whether in fact an EIS is required or not."*²³

²² Minutes of Evidence, 19 June, 1990, p. 224.

²³ Minutes of Evidence, 19 June, 1990, p. 224.

- 5.40 In this example, the Committee found a classic illustration of how the Commission's slowness to act on its obligations under the Environmental Planning and Assessment Act, 1979 caused it to incur hidden costs in the form of an overstaffed mapping branch. Staff levels are based on the peak load, and consequently are under utilized for much of the time. It is the Commission's management practices, more than anything else, which create the need in this case and across the entire organization to provide for peak load situations.

6. Production Controls

6.1 In the course of its inquiry, the Committee has concluded that there are some serious question-marks over whether production controls are designed in such a way as to achieve sustainable harvesting of the native forest resource, and whether production controls are enforced effectively.

6.2 Fears for the future of the State's forests were among the prime motivations for the creation of the Forestry Commission. In the 1907 Royal Commission of Inquiry on Forestry, the Commissioners had stated:

*"It is obvious, therefore, that, at the present rate of consumption, the quantity of hardwood timber suitable for commercial purposes it is estimated to be at present standing on the Forest reserves and other Crown-lands of the State will not last more than about 36 years, and that our supply of softwoods will be consumed in little more than 20 years."*¹

6.3 Fortunately, the Forestry Commission was able to avert that potential catastrophe due to its system of production controls. The principle of sustainable yield - only harvesting the annual increment of forest growth - is the keystone of all production controls. Drawing an analogy to banking, the sustainable harvesting of forests allows the Commission to "live off the interest" on its forest asset. Over harvesting would be tantamount to "spending the capital"; a pattern which is unsustainable in the long term. Armed with an estimate of the annual growth increment for each forest area, the Commission is able to set harvesting targets or annual quotas. Providing that the targets are set correctly and that logging operations adhere to them, sustainable yield is thereby assured.

6.4 The Committee notes parenthetically that sustainable yield is an economic, rather than ecological principle. It should not be presumed that the nature, character, or flora species composition of a forest is constant even though sustained yield may be occurring in that area. The conservation movement

1 Quoted in P. Prineas, "The NSW Forestry Act, A review with suggestions for reform", 1985, p. 7.

has raised serious concerns particularly regarding fauna conservation in forest areas harvested under the sustained yield philosophy.

- 6.5 Concerns about the future of the native forest estate are once again being trumpeted in the media. In view of the grave allegations regarding the unsustainability of present harvesting regimes, the Committee sought to establish how quotas are calculated, how they are enforced, whether sustained yield is occurring, what role planning plays in the Commission's production controls, and to what extent the character of the State Forests is changing.

Estimating sustainable quotas

- 6.6 From a practical point of view, it is not always straightforward to set correct targets or to ensure they are met. The annual growth increment must be calculated for each area, and these increments vary enormously over the State. This calculation relies on data gathered from small sample plots located within each management area, on historic yield figures, and upon mathematical growth models. The data are used to establish initial values and parameters used by the model, but it is the model results which form the basis of estimated annual growth increments. The Committee understands that the Commission generally employs "*stand-table projection*", and (for regrowth forests in the Eden region) a single-tree, distance-independent growth model named "*StandSim*" to derive its estimates of growth increments.
- 6.7 The Committee understands that precision of growth estimates is not particularly high because of many factors, including uncertainties in inventory, growth modelling, and utilization of the standing timber. Growth models have been applied to plantation forests with greater success than native forests due to the comparative ease of taking an accurate inventory of growing stock and of predicting growth for single-species, even-aged stands. Mixed-species, uneven-age stands typically encountered in native forests continue to present problems for growth modelling experts.
- 6.8 Where the imprecision of growth predictions results in an overestimate, the consequences are severe. The Committee recognizes that the science of forestry in general and growth modelling in particular are incomparably far advanced now in relation to the post-World War II period. Nevertheless, the belated discovery in the 1960's that overcutting had been occurring in the post-

World War II period, and a natural scepticism of mathematical models, lead the Committee to wonder whether it will be discovered in twenty years' time that present harvesting prescriptions are based on overly optimistic growth estimates.

Enforcing the quotas

- 6.9 With the best of intentions it is possible to make serious mistakes in determining and administering sustainable timber yields. However, the profit motive can also lead to mistakes of this sort. The economics of running a sawmill or woodchip mill provide a strong imperative to process as much timber as possible as quickly as possible. In the long-term, sustainable harvesting is in industry's best interest, but in the short-term many mills would prefer to process tomorrow's timber today, gaining tomorrow's profit today, then relocate once the resource is too degraded to be useful. Under these circumstances, it would be naive not to recognize that short-term economics is in direct conflict with regulation and the principle of sustained yield.
- 6.10 Regional and district foresters are responsible for enforcing the quota system. Prior to the bulk measure system, felled trees were measured and tallied by the "*marketing foreman*" at either the log dump or the mill, the quota account was debited, and the mill was billed at the end of the accounting period. Each log was required to bear the imprint of the forester's hammer. In case the mill manager or the harvesting contractor breached the conditions of his license, the Commission held guarantees amounting to two months' royalty payments (in the case of the mills) which could be forfeited by the offender. The threat of cancelling or suspending licenses is felt by the Commission to be a sufficient deterrent to deliberate infringements.
- 6.11 Despite all these safeguards, the former Commissioner, Dr. S.W. Gentle commented to the Commission's senior officers in 1981, that,

"there has been a hardening line towards over-cutting, particularly in the last 12 months. We have had too many of our big management areas where the data and the statistics that come out of the Management Planning Division indicate that without a doubt they are being over-cut. I know that statistics lie. They are not good perhaps within plus or minus 10 per cent

*but when you are looking at plus or minus 100 per cent, at our level here, there is absolutely no argument about the fact that something has got to be pulled back closer to where 'in-line' is. So if you are in any doubt about what you should be doing on the quota side it is definitely to pull things back towards the sustained yield principle which is really the corner-stone of all forestry at the field management level."*²

- 6.12 One problem with the controls is the potential for stockpiling felled timber in the forest before it is tallied by the Commission. Chief forest inspector King referred to this point, *"The sort of area where it can get sloppy is the amount of timber that may be on the ground and not brought to account at the end of a quota year or getting towards the end of the quota year and poor estimates have been made of those sorts of volumes of wood that are on the ground."*³ In theory the district forester is accountable for this type of error, but in practice the system has very few checks in place to make him accountable. The Inspectorate does not involve itself in examining the over-cutting of quotas, according to Chief Inspector King.⁴ The Inspectorate's role is restricted to making sure controls are in place.
- 6.13 Another problem is that sawmills desire logs of particular lengths. The logging contractors, who are engaged by the mills, cut logs to the desired lengths in the forest. A tree which may have been capable of producing a 3.4 m sawlog may be cut for a 2.8 m sawlog. The unused 0.6 m of log would be left in the forest.
- 6.14 To some extent, the Commission takes this factor into account when predicting yields for each coupe. The important point, from the Committee's perspective, is that it is often up to the logger's discretion as to how the standing timber is utilized. Since the Commission is not able to supervise loggers at all times, the strong possibility exists that this discretion will be exercised with commercial objectives in mind. As noted above, commercial objectives may conflict with the forester's regulatory objectives. The sawmiller only pays for the volume of the delivered log. The actual yield for the coupe in terms of wood volume and revenue may be less than the potential yield.

2 Dr. S.W. Gentle, Opening Address to the NSW Forestry Commission Senior Officer's Conference held at Head Office - 4th and 5th June, 1981, pp. 4,5.

3 Minutes of Evidence, June 19, 1990, p. 162.

4 Minutes of Evidence, June 19, 1990, p. 161.

The lack of an audit comparing predicted to actual timber yields is, in the Committee's view, one of the largest "holes" in the production control system.

- 6.15 Documents requested by the Committee from the Chief of the Marketing Division, indicate that overcuts and undercuts of more than 10% routinely occur in the present day. To be fair, overcuts are normally authorized in advance by the Commission to compensate a mill for undercuts in previous years and hence have no negative impact on sustained yield. In some cases, these overcuts are debited against future years' quotas.
- 6.16 On advice from professional foresters outside the Commission, the Committee understands that flexibility in the annual cut is not necessarily deleterious to the forest, and may be desirable for adjusting timber output to market conditions. However, the Committee believes the Commission should guard carefully that this flexibility does not affect the long-term sustained yield, and ensure that debits against future quotas are implemented. Of course it is preferable to allow undercuts to be accumulated prior to overcutting.
- 6.17 The Chief of the Marketing Division stated that, *"There are 60 Management Areas within the State which cover native forests, and to peruse all records to extract a listing of instances where the cut in a given year exceeded the prescribed yield by more than 10% would be very time consuming."*, indicating to the Committee that the Commission does not have complete control over the annual cut.⁵
- 6.18 Recent events have led the Committee to question the Commission's commitment to enforcement of quotas. In its Interlocutory Judgment in the case of *Corkill v. Forestry Commission*, 29 October, 1990, the Land and Environment Court has issued orders restraining the Commission from permitting any logging, roading, or burning in the North Washpool State Forest in recognition of the Commission's history of apparently illegal approvals for the logging of rainforest there.

5 Reply from Mr. R.V. Wilson to the Committee's question, dated 29 August, 1990.

6.19 Justice Hemmings stated in his judgment,

*"In my opinion, the lawfulness of approvals to log rainforest areas which were expressly excluded from the only environmental impact statement prepared for the North Washpool area is a most serious matter for determination at the final hearing. I have no hesitation in determining that there are a number of serious issues raised in these proceedings as to the lawfulness not only of the 1990 approval to resume and subsequent harvesting plan, but also of the previous decisions upon which they were based. I am of the opinion that, subject to the exercise of the Court's discretion, such activities should be restrained pending further orders."*⁶

6.20 Against this backdrop of possible errors in the determination of sustainable yield levels and questionable enforcement of quotas, the Committee was interested to discover whether sustained yield is actually occurring in the State's native forests.

Is sustained yield occurring?

6.21 The Committee's concerns were heightened by testimony from Mr. Jeff Angel, Assistant Director of the Total Environment Centre, which implied that the State's large old trees were being consumed at an unsustainable rate. *"The wood chip quota supplied from state forests, Harris Daishowa is almost completely old growth. 90 percent of the trees logged in the Eden area are old growth and go to the wood chip company."*⁷ Mr. Angel went on to state that these trees are over 100 years old. These ages were confirmed by Assistant Commissioner Fisher, who placed the oldest trees woodchipped at Eden at 200-300 years, the youngest at 35-40 years, and the average at 100-200 years. Mr. Fisher stated that, *"The average age will decrease dramatically in future harvests as a significant part of future pulpwood intake will comprise thinnings from regrowth stands. This source of pulpwood is negligible at present."*⁸

6 Interlocutory Judgment, *Corkill v. Forestry Commission of N.S.W.*, Land and Environment Court of N.S.W., Justice Hemmings, 29 October, 1990, p. 7.

7 Minutes of Evidence, June 18, 1990, p. 87.

8 Reply by Assistant Commissioner Fisher to the Committee's question, dated 29 August, 1990.

- 6.22 Further alarming the Committee was section 1.6.4 of the Management Plan for the Wingham Management Area (1985) which canvasses long-term prospects:

*"If it is assumed that the present level of cut continues and that there is no alteration in the current utilisation standards, the hardwood sawlog resources available from unlogged stands and the relogging of previously logged stands could be exhausted in the period 2005-2010. At this time the oldest significant area of regrowth resulting from earlier logging will be 60-65 years old. With current sawmill technology it is assumed that a rotation of at least 80 years is required to produce sawlogs of suitable size."*⁹

- 6.23 Addressing the Committee's deepening concern over this issue, Assistant Commissioner Fisher explained the current status of sustained yield in the State's native forests:

*"the Commission has what it calls a sustained yield strategy. This is often misunderstood particularly by environmentalists, because what they say is you haven't got sustained yield in some areas, and that in effect is true, but we do have in all areas a sustained yield strategy. In other words, we are heading towards sustained yield."*¹⁰

- 6.24 This point is discussed further in correspondence seen by the Committee from the Hon. Ian Causley, then Minister responsible for forestry, dated April, 1989, which stated that it was correct that not all forest areas are on sustained yield at present, but that strategies in place would bring sawlog production to within 5% of long-term sustained yield within 5 years.

- 6.25 The Committee notes that this prediction of achieving sustained yield in 5 years is contradicted by the statement quoted above from the Wingham Management Plan.

- 6.26 Mr. Causley's letter concludes by observing that one of the principal reasons for the failure to achieve sustainability has been the fact that quotas have not

⁹ Wingham Management Plan, Forestry Commission of NSW, 1985, p. 27.

¹⁰ Minutes of Evidence, June 19, 1990, p. 185.

been reduced as State Forests have been withdrawn from timber production. The Committee has been informed by officers of the Commission that this failure to reduce quotas up until 1990 has stemmed from an undertaking given the timber industry by the previous government. However, the Committee notes the Commission's continuing failure in 1990 to fully address the need to reduce quotas.

Planning and production controls

6.27 In the Committee's view, the entire issue of sustainability and the future of the native forest resource raises very grave doubts about the Commission's ability to plan for the future. The Committee was concerned to learn from Mr. G.D. Pople, Chief of the Management Planning Division that the Commission has no plans which extend over a 40 year or more horizon.¹¹ While acknowledging the importance of very long time horizons in forestry, the Commission has in fact only the Indigenous Forest Policy (last updated in 1976), and the Management Plans (which consider only individual management areas and concentrate on relatively short time-spans) to guide it. There are instances of spectacular failures of plans - such as the predicted boom in mining timber which never eventuated, and the overestimation of demand for pine thinnings in the Oberon district - which are discussed in the chapter on Marketing.

Changing character of native forests

6.28 One could easily obtain the impression from the Commission's public relations efforts that the State's harvested forests retain their basic character and composition despite being logged. The notion of sustained yield is often thought to imply that the forest's essential features do not change in the average, in the long run. However one must be absolutely clear about the fact that sustained yield only means that the same volume of timber can be extracted each rotation, in perpetuity.

6.29 It is a matter of fact that the forest's structure has been changing in the past decades. Dr. J. Turner, Chief of the Research Division testified that,

¹¹ Minutes of Evidence, June 19, 1990, p. 198.

*"if you carry out reasonable prescriptions my comment would be that harvesting would have minimal impact on - the main change that will occur of a detrimental nature in harvesting is appearance and a change in structure of the forest. ... Instead of having a thing 30 metres high it is going to be a bit shorter, and there will be less big trees in it."*¹²

6.30 The point is illustrated graphically in a figure entitled "Stand Tables 1985 and 2010" appearing in appendix 7d of the Urbenville Management Plan. Relative to 1985, the stocking levels in 2010 are higher in the small diameter classes, but lower in the diameter classes 70 cm and above, and virtually nonexistent in the classes above 100 cm diameter (at breast height over bark). In other words, although the volume of harvestable timber may be comparable, in 2010 that volume will be composed of more logs of smaller diameter.

6.31 The late Commissioner, Dr. Gentle referred also to this structural change:

*"If you in the field don't understand that the logs of the past, the logs that were regarded as marginal logs 10 years ago are now Rolls Royces in the chain going into the sawmill, you have missed the whole point. Similarly, if you don't project your thinking 10 years ahead and say that the stuff which is marginal right now because it is too small, is going to be the Rolls Royce in 10 years time, you have also missed the point."*¹³

6.32 Ultimately it is for society to decide how it balances the values of native forest containing large old trees versus additional timber production. However, society should be presented with a candid assessment of the status of sustained yield efforts and a true picture of how the policy affects the other public values of the forest. For example, this trend toward smaller trees is well known to foresters, but not at all well publicized by the Commission.

12 Minutes of Evidence, June 18, 1990, p. 61.

13 Op. Cit., Dr. S.W. Gentle, pp. 16, 17.

Recommendation 28

It is recommended that the Forestry Commission provide detailed information to the public on the current status of sustained yield policy in each management area and current plans, if any, to modify quotas. The Committee to review progress in one year.

7. Pricing

- 7.1 Having examined in detail the important issue of pricing policies, the Committee has found it necessary to consider pricing separately for the Commission's two major species groupings. To summarize the findings, the Commission's method of price setting for plantation pine appears to be market-insensitive, to the possible detriment of the future of the entire product line. For native eucalypt timber, the Commission's policy objective of sustainable yield may be compromised and the State's native forests may risk degradation because the method of price setting leads to inappropriately low price levels.
- 7.2 Because prices play such an important role in determining how resources are used, pricing policies are central to this investigation. From the Committee's point of view it has been essential to question the methods by which marketing and pricing decisions are made. It has also been important to consider the qualifications and experience of the individuals or groups who arrive at these most important decisions.
- 7.3 Early in the investigation, it became clear that the Commission operates in two rather different, if overlapping, markets: native hardwood, and plantation softwood. In fact, the Commission also operates in the cypress pine market. However the relatively small size of the cypress pine program does not justify extensive treatment here. Instead, the Committee has concentrated its attention on the two major forest species groupings.
- 7.4 Perhaps surprisingly, the Commission's commercial position is quite different in each of these markets, and the recommendations from this inquiry differ considerably depending upon whether one considers radiata pine or native eucalypt. This chapter begins with some general comments about pricing and market dynamics, then proceeds to consider plantation pine and native eucalypt pricing issues separately.
- 7.5 Given the centrality of pricing decisions to this inquiry, it is useful to consider the economic consequences of pricing decisions for public resources. In an economy characterised by markets which exhibit perfect competition, prices

are set at the marginal cost of production, and free-market dynamics can be expected to provide an optimal allocation of investments to productive uses.

- 7.6 If interventions in a raw materials market cause prices to be maintained below the free-market price, then investment in producing the raw material will be discouraged at the same time that downstream markets which employ the raw material to produce other goods will demand a larger supply. The Committee believes that this scenario closely matches the present market situation with regard to native hardwoods.
- 7.7 Conversely, if market intervention maintains prices above the free-market price, then investment in production will be encouraged at the same time that downstream markets will demand less due to their cost-driven loss of market share. The Committee believes that this scenario closely matches the present market situation with regard to plantation softwoods.
- 7.8 In a free market, these two departure from equilibrium scenarios would be corrected by the raw material price settling to an equilibrium level. In reality, such a desirable settling is difficult to achieve. The markets for timber are not perfectly competitive. Any attempt to calculate the equivalent of a marginal cost of production for timber would be complex, abstract, and highly contentious. Perhaps most significant for the sensitivity of pricing to market conditions is the fact that pricing must be approved annually by Cabinet.
- 7.9 At present, the high demand for hardwood sawlogs and pulplogs, and for softwood sawlogs (in excess of the quota), and the high profitability Harris Daishowa woodchipping enjoys seems to indicate that pricing is lower than what the market will bear. The oversupply of cypress pine logs and softwood pulplogs seems to indicate that they are over priced.
- 7.10 It is important not to consider pricing in isolation. When supply exceeds demand at a given price, dropping the price is not the only option. There is also the option not to participate in the market at all. If pricing is already at or near the cost level, then non-participation may be the only option. This argument is relevant to conservation demands that extensive harvesting of old native forests be halted.
- 7.11 Pricing of native timber is perceived to be well above the Forestry Commission's direct costs in making it available for milling and woodchipping.

However, if loss of non-wood values in the forest estate due to logging (such as wildlife habitat, genetic diversity, recreational potential, and others) are explicitly included in the costing, pricing may not be above society's costs. This argument has never succeeded in finding an objective footing since the costing of non-wood values is highly contentious. However, the difficulty of estimating the magnitude of non-wood values does not diminish the importance of doing so.

7.12 Despite some differences in approach between species, the overriding consideration in the Commission's price setting appears to be recovery of costs. The Commission does not fell the timber (except in a few limited cases) or haul it to its customers. The Commission's role is simply to "manage" the forests and "market" the products. Broadly speaking, the Commission incurs costs in applying silvicultural treatment to its plantations, providing vehicular access to its forests, supervising harvesting and haulage operations, satisfying various requests from customers, government, and to a much lesser extent the public, fighting and preventing forest fires, and servicing its own organizational needs. The current expense of these activities, more than any market-related factor, is what shapes the Commission's pricing decisions, as will be explained below.

7.13 Forestry Commission prices are administered prices in the sense that they are chosen by the Commission rather than determined by the free market. Prices must be approved annually by the Minister responsible for forests, although some executives of the Commission tend to view Ministerial approval as a "rubber stamp".

"... the Commission decides what its approach will be based on the information given to it by its marketing division. It then approaches the Minister and says, 'Minister, this is what the Commission had decided in relation to royalties. Do you have any comment?'"¹

7.14 In a document entitled "Royalties" the Chief of the Marketing Division states that,

"The Forestry Commission of N.S.W. determines appropriate

1 Minutes of Evidence 19 June, 1990, Assistant Commissioner Fisher, p. 178.

*royalty rates under provisions of the Forestry Act." "In the determination of royalties the Commission is guided by the costs of timber production as revealed in its commercial accounts. Other relevant factors, additional to Government policy, include forest management requirements, market prices, prices and demand for competitive materials, and the rate of inflation."*²

- 7.15 Mr. Wilson's testimony left the Committee with the distinct impression that, although lip service is paid to these other factors, in fact it is cost recovery which drives and motivates all price level decisions.

*"We have a primary objective of at least covering our cost of production. I have a recent period of our history, we have been pushing pretty hard to achieve that and that has been - it has been a cost push driven pricing system."*³

Recommendation 29

It is recommended that the Forestry Commission discontinue its present method of setting royalties based on recovery of visible costs and employ instead a method based primarily on the market's willingness to pay.

- 7.16 The Chief of Marketing Division described the Commission's method of determining the best pricing that the logs can support in the following terms,

*"You push and pull and find out a lot of things. To get - I guess, in the Forestry Commission, we have come from somewhere, we didn't just appear out of the blue. We've had pricing - a history of pricing that goes back a long way so, you know, at any point of time you look at the levels of prices we are getting now and they have come from somewhere. They have been increased because of certain actions."*⁴

2 Reply by the marketing division to the Committee's question on royalty setting, p. R-4(i).

3 Minutes of Evidence, June 19, 1990, p. 137.

4 Minutes of Evidence, June 19, 1990, pp. 135, 136.

7.17 The Committee found this ad hoc policy based partly on the historical status quo and partly on amateurish market analysis to be most disconcerting. Considering the great importance of forest-based industries for rural communities, the balance of trade, and the State generally (an importance which is constantly trumpeted in Forestry Commission publications), this homespun approach to the vital questions of pricing seems less than adequate.

Recommendation 30

It is recommended that the Forestry Commission hire professional economists to perform the analytical groundwork for pricing decisions. The Committee to review progress in one year.

Recommendation 31

It is recommended that the Forestry Commission make much greater use of econometric techniques to analyze price sensitivities and other characteristics of all timber markets.

Recommendation 32

It is recommended that the Forestry Commission work towards a market pricing computer model which could be employed to adjust pricing in a market-sensitive way more than once or twice a year, if necessary.

7.18 The consequences of this cost-driven pricing policy are most unfortunate. In the case of plantation softwoods, the lack of market sensitivity is damaging a potential export industry in pine pulp products such as medium density fibreboard and some grades of paper. In the case of native hardwood forests, the under pricing which results from this *"exploitation cost recovery"* policy may well be causing long-term degradation to our native forest heritage and is certainly forestalling action on vital initiatives to create alternative supplies of hardwood. These points will be taken up in the two sections below.

Plantation Radiata Pine pricing

7.19 Submissions received by the Committee have expressed the opinion that softwood prices are set too low by the Commission. Mr. Robert L. Pritchard, Managing Director of Pritchard Associates (consultants on international trade and investment), and an investor in softwood plantations, stated in his submission that, *"The nub of the problem is that the Commission totally dominates the production and pricing of forest resources in New South Wales. Softwood prices are held at unrealistically LOW levels, thereby discouraging further investment in plantations."* This point of view was echoed to some extent by Dr. M.E.C. Thorpe, President of the New South Wales Chapter of the Australian Forestry Development Institute.

"In fact, I would take this even a stage further, whereby with the paucity of markets for softwood in this state at the current time and the poor development of overseas export markets, the Commission very often has used its expertise and its intelligence and its know-how to get into a monopolistic situation, whereby

they have in fact precluded the private sector from meaningful marketing situations.”⁵

7.20 Dr. Thorpe went on to note the apparent paradox that,

“There is a lot of timber out there which has not yet been harvested and there is a lot of land which could be planted with timber. We are running a \$1.8 billion debt in this country in terms of timber imports. It seems crazy. So that if we are going to do anything about that national debt, we have to look to ways and means of getting greater facility for the use of our product.”⁶

7.21 The Committee noted with interest the subtle difference between Mr. Pritchard’s emphasis on unrealistically low royalties and Dr. Thorpe’s emphasis on the lack of market opportunities as the cause of the problem. At first blush, Mr. Pritchard’s viewpoint appears to contain the inherent contradiction that on one hand softwood prices are maintained at levels which are too low to encourage investment, and on the other imported timber products are defeating the local counterparts on price competition. In reply to the Committee’s specific question on that point, Mr. Pritchard stated

“We have a huge advantage in competing with them because we are an island economy and overseas competitors have to incur the transportation costs in shipping their competing products here.”⁷

7.22 However, Mr. Pritchard’s point of view is contradicted by evidence submitted by CSR Wood Panels Group and Australian Newsprint Mills Limited with regard to softwood pulplog royalties. CSR submitted a graph depicting unit operating costs for a medium density fibreboard plant which compared the types of costs for New Zealand, USA, Chile, Canada, and Australia. Since the market for medium density fibreboard is an international market, the transportation cost component was calculated for distribution to Yokohama, Japan. The graph shows Australia to be the highest cost producer, due primarily to its higher wood cost component. Australian costs were shown to be 20% higher than the next highest cost producer, the USA.

5 Minutes of Evidence, Dr. M.E.C. Thorpe, June 18, 1990, p. 107.

6 Minutes of Evidence, June 18, 1990, p. 108.

7 Minutes of Evidence, August 14, 1990, p. 11.

- 7.23 Mr. N. Humphreys, Wood Production Manager for Australian Newsprint Mills Limited, discussed pulplog pricing policies in his submission.

*"The Commission is required by government to fund its activities from revenue. This is an excellent principle but leads to conflict if the Commission's prices are not market determined. In the case of plantation pulplogs the Commission charges the highest royalties (\$15.33/tonne) in the Pacific Rim at a time when it is unable to sell 70% of its first thinning yield. Its pulplog royalties are over twice those charged in New Zealand and almost 20% more than those charged in Victoria."*⁸

- 7.24 Mr. Pritchard expanded upon the Commission's inability to sell 70% of its first thinning yield.

"I direct the Committee's attention on this to the Forestry Commission's own report in 1987 which is called 'Management Plan for Bathurst Management Area' and in that report there is a section dealing with this problem which appears under the heading 'Commercial Thinning' at pages 32 and 33 of that management plan.

"But essentially what that plan reveals is that as of 1 January 1987 a huge area had been by-passed for what is called first thinning and first thinning is the vital first thinning in a new forest where you go in and take out the smaller specimens that aren't like to reach maturity at saw log stage and remove them in order to revitalise and promote the rate of growth of the remaining trees.

*"That huge area which had been by-passed by the Commission for first thinning, in other words, an area where the Commission couldn't find a market to justify felling the trees totalled 14,586 hectares. The consequences of that is that if those trees are allowed to stand or those forests are allowed to stand unthinned for much longer in a heavy wind they will fall over."*⁹

⁸ Submission from Mr. N. Humphreys, Wood Production Manager, Australian Newsprint Mills Limited, 24 August, 1990, pp. 3, 4.

⁹ Minutes of Evidence, August 14, 1990, p. 9.

- 7.25 During the Committee's visit to Oberon, the district forester, Mr. Colin Roberts, confirmed that the Commission was indeed behind in its thinning schedule, and that this failure to thin to schedule would indeed have a detrimental effect on the plantations' future ability to produce sawlogs at a commercial rate.
- 7.26 Mr. Roberts also noted the industry link in this problem. The CSR medium density fibreboard (MDF) plant has a capacity to consume 380,000 cubic metres of pulpwood annually. However, because of the present world market conditions for MDF, production at the plant is down by 60% on capacity, and only 100,000 cubic metres is consumed per year. Given the emphasis placed on wood costs in CSR's submission to the Committee, one can hardly fail to make the connection between the Commission's high royalties and its inability to sell the thinnings.
- 7.27 Taking all these factors into account, the Committee believes that the market opportunities for New South Wales plantation softwood are poor at present. The view that softwood prices are unnecessarily low appears to contradict the evidence presented to the Committee - at least with regard to softwood pulplogs. In fact, it seems most likely that the excessively high prices for radiata pulpwood are causing two serious strategic problems for the State. Firstly, the price-induced lack of a market for thinnings is causing a depletion of the commercial value of the Commission's pine plantations. In other words, a large long-term cost is being incurred (foregone sawlog revenue) in the name of recovering short-term costs (maximum possible pulplog revenue). Secondly, the high wood factor-cost is damaging the ability of local export products, such as CSR's MDF, to compete internationally, with obvious implications for local employment and the balance of trade.
- 7.28 In light of these serious strategic problems, it seems most puzzling to the Committee that the price administrators at the Commission have not seen fit to address this apparent over pricing problem with radiata pulplogs. Taking a more general view, the Committee questions the wisdom of having an administered price, with major adjustments only occurring every five years¹⁰ for a raw material input into products which are freely traded on an international market.

10 Op. Cit., "Royalties", Mr. R. Wilson, p. R-4(i).

7.29 The submission from Boral Timber Division seems to sum up the problems:

"Royalties for logs are determined by the NSW Forestry Commission according to their method of determining royalty. Their system has considered changes in CPI and weekly earnings, but is also over-ridden by their need to balance budgets and Treasury constraints on rates of return.

"One of the problems in using this method to determine royalty is that it takes no account of the producer's position where:

- *Market price for the finished goods is largely determined by import competition.*
- *The other main items of manufacturing cost are outside the control of the producer; e.g., wages and electricity.*
- *Royalty is determined by the Forestry Commission on parameters that are not properly related to the industry.*
- *Interstate royalties are not considered and other major producers are given significant competitive advantages."*¹¹

Recommendation 33

It is recommended that the Forestry Commission adopt a more market-oriented approach to pricing plantation pine products, including the monitoring of market conditions for customers' products, and heavy discounting when strategic objectives justify it.

¹¹ Submission from Mr. George Day, Operations Manager, Boral Timber Division, 7 September, 1990.

Native Eucalypt pricing

- 7.30 Environmental activism has reinforced the point that in dealing with native forests the Commission is dealing with an entirely different set of problems to those raised by plantation forests. And yet the Commission's rhetoric hardly seems to recognize a difference. Use of the term "*Overmature Forest*" in preference to the term "*Old Growth Forest*" draws a parallel between centuries-old natural forests and the unthinned, deteriorating plantations at Oberon. The connotation is that old growth forests are somehow defective, requiring harvesting for their own well-being. Statements that regrowth forests (following logging operations) are scarcely distinguishable from eucalypt plantations (as detailed in the chapter on Eucalypt Plantations) betray a desire to manage the native forest the way a plantation is managed.
- 7.31 In terms of pricing policy, the Commission seems to apply its overarching cost-recovery methodology equally to plantation and native forest products. While cost estimations are valid for plantations, since establishment and "*replacement*" costs can reasonably be determined, this procedure is most definitely not appropriate for native forests, since it is so difficult to estimate a "*replacement*" cost. When the Commission speaks of recovering costs in its native forest program, it is speaking of what may be called "*exploitation*" costs. The only costs recovered are those shown in the Management Accounts. These relate only to expenditure actually incurred by the Commission in permitting the State Forests to be logged by others. These costs are subsidised, as discussed in the chapter on Finance.
- 7.32 In his presentation to the Committee, the regional forester for Eden made a point of illustrating that logged native forest grows back vigorously with little silvicultural treatment. This claim is tantamount to stating that the "*replacement*" cost for such forest is virtually zero. As the environmental movement has demonstrated, this claim does not apply to the non-timber values inherent in the native forest. Certainly the native forest can be replaced with very little expense to the Commission, but it is replaced by something different. As the chapter on Production Controls shows, the regenerated forest is characterized by a larger number of trees of much smaller diameter classes, which comprises (as far as one can tell from the information provided by the Commission) a roughly equivalent volume of

timber. A strong case has been made that the regenerated forest also contains a smaller number of species of fauna.

- 7.33 In order to obtain a diameter class distribution in the regenerated forest which is comparable to the distribution of the original old growth forest, it would be necessary to increase the logging rotation very significantly, since large diameter trees take many decades to grow. The expression "*time is money*" could well have been coined for forestry. In fact, to replace the old growth forest with a comparable regrowth forest would force the Commission to incur very significant costs in terms of foregone royalties, interest payments, and other charges. Therefore, replacement costs are very substantial for native forests.
- 7.34 Reference has already been made in this chapter to the Commission's thoroughly inadequate methods for gauging what price the market will bear. Occasionally, the Commission auctions odd lots of timber on the spot market to gain an estimate of marginal prices. This procedure has not produced any firm indications that royalties are set at unrealistic prices. The method itself is subject to many confusing influences. One of the key problems is that relatively short economic haulage distances for timber and the geographical spread of state forests result in highly regional markets for logs. As a result, although the Commission may sell timber to hundreds of mills, in any one area the timber market may be characterised by bilateral monopoly. An extreme example is provided by the eucalypt pulpwood market in the State's Southeast. In any parcel auction of pulpwood, Harris Daishowa would be the only bidder.
- 7.35 The Committee believes that there is solid evidence that the market for most classes of native hardwood would be able to sustain higher prices. In making this assertion, the Committee is mindful of the comments made in the previous section about international competitiveness of radiata pine. Very important market distinctions exist between eucalypt and pine products. Radiata pine is grown in many Pacific Rim nations, its uniform qualities making it a standard commodity. Eucalypt is much more specific to Australia, sought after for its unique qualities. Australia's large volume of eucalypt woodchip exports to Japan owes much to the superior quality of the product as well as to the favourable price.

- 7.36 In the Committee's view, the fact that New Zealand softwood timber and paper is flooding the Sydney market does not indicate that eucalypt royalties must be slashed to stave off the trade imbalance. To do so would be absurd. In the eucalypt product market, which is not as well defined as it could be had the Forestry Commission adopted a more enlightened approach to marketing (for detailed explanation, see the chapter on Marketing), there is no serious international competition. The failure of eucalypt products (apart from woodchips) to sell in overseas markets says more about the failure of industry to develop exportable eucalypt products than it does about over pricing of eucalypt logs.
-

Recommendation 34

It is recommended that the Forestry Commission continue to regulate the price of native timber, using a policy of raising pricing to the point of indifference as a policy tool to complement the use of regulatory tools for controlling annual harvesting of timber.

- 7.37 Commenting on the market for eucalypt timber, Mr. Ron Wilson, Chief of Marketing Division, informed the Committee that the Commission sells everything available for sale in the hardwood sawlog area.¹² Dr. Bill Hurditch, Executive Director of the NSW Forest Products Association, while admitting his organization's advocacy of lower prices, indicated to the Committee that hardwood sawlogs were not overpriced.

*"By and large in any private enterprise the system the watchword is to get the best product at the lowest price at the best conditions obviously but in terms of reality the members believe that the products are inappropriately priced. I don't believe overall wood costs - I will speak about that in a minute - overall wood costs may well not be overpriced but individual components within that overall wood price are overpriced."*¹³

¹² Informal discussion during the Committee's visit to head office on June 4, 1990.

¹³ Minutes of Evidence, 18 June, 1990, p. 115.

- 7.38 Dr. Hurditch had indicated in other conversations with the Committee that the overpricing complaint referred particularly to large poles, which are now struggling to compete with concrete poles.
- 7.39 The Committee understands that prices garnered by the Forestry Commission for pulplogs in the Eden region are among the highest obtained in Australia. Nevertheless, the very healthy profits enjoyed by the Harris-Daishowa (Australia) woodchip operation lead the Committee to believe that this operation could remain viable and profitable even if royalties were increased.
- 7.40 Annual returns on file with the Corporate Affairs Commission indicate that in 1989 Harris-Daishowa (Australia) reported operating profit and extraordinary items after income tax of \$9.4 M on total assets of \$42.7 M representing a return on assets of 22% after tax in that year. In 1988 Harris Daishowa reported operating profit and extraordinary items after income tax of \$7.1 M on total assets of \$33.0 M representing a return of 21.5% after tax in that year. The 1989 post-tax operating profit figure is greater than the \$7.5 M nominal share capital issued by the company.¹⁴
- 7.41 The general thrust of this evidence from the marketplace is supported by a submission to the Resource Assessment Commission by the Australian Bureau of Agriculture and Resource Economics (ABARE), according to an article in the Sydney Morning Herald dated July 3, 1990. The conclusion of this article, entitled "Forests 'should make a profit'", states:
- "ABARE's recommendations assume native forests are overexploited and plantation development is retarded because State forests do not face market pressures and private loggers pay a low royalty."*¹⁵
- 7.42 Of course any prospect of a price hike creates an immediate reaction from the sawmilling industry. In an article in the West Australian entitled, "Royalty rise puts firms at risk: Bunning", the chief of the giant Western Australian sawmilling firm Bunnings, Mr. Bob Bunning, is quoted complaining about a contemplated rise in royalties. The article states that, in Mr. Bunning's view, the viability of the timber industry is under threat from the proposed royalty

14 Certified accounts provided by Business and Consumer Affairs, years ended December 1989, and 1988.

15 "Forests 'should make a profit'", Paul Cleary, The Sydney Morning Herald, July 3, 1990.

rise, and that the timber industry could not afford to pay higher royalties for sawlogs.¹⁶

- 7.43 Notwithstanding this argument, the Committee was informed that Mr. Bunnings' firm enjoys substantially lower royalties than any other miller in Western Australia. In a briefing paper offered to the Committee by the Western Australian Department of Conservation and Land Management, it is stated that Bunnings pays only \$29 per cubic metre for premium grade sawlogs, which normally attract royalties on the order of \$70 per cubic metre, and have been auctioned at prices as high as \$80 per cubic metre.¹⁷
- 7.44 Mr. Bunning responded to the issue of the price differential by stating, "*The fact that others in our industry are operating on different terms to ours does not necessarily mean we are getting a good deal. It suggests that others may be paying too much.*" The Committee notes that these others appear to be staying in business despite paying more for their timber than Bunnings.¹⁸
- 7.45 In view of the strong evidence from the marketplace that native timber prices are generally below what the market will bear, the Committee believes that the case for raising prices on native timber is overwhelming, despite protests from sawmilling proprietors.

Recommendation 35

It is recommended that the Forestry Commission raise prices on eucalypt sawlogs and pulplogs above the CPI, over a five year period.

- 7.46 Apart from the obvious improvement in revenue generation, a higher pricing regime for native timber would have a number of beneficial effects for the Commission and for the State. Firstly, it would impose an economic limit on the annual timber harvest, which would complement the regulatory limit.

16 "Royalty rise puts firms at risk: Bunning", Anne Burns, The West Australian, August 29, 1990.

17 Western Australian Department of Conservation And Land Management Briefing Paper 2/90, pp. 2, 3.

18 Op. Cit., The West Australian, August 29, 1990.

- 7.47 Secondly, pricing provides a mechanism to remove some State Forest areas from timber production without creating the industry backlash generated by *"locking up"* forests. The divisive debate over logging *"old growth"* forests would become less intense because logging operations would be forced to be more selective and operate on a smaller scale, on purely economic grounds.
- 7.48 Thirdly, it would force the eucalypt processing industries to concentrate on added value by enhancing the unique characteristics of NSW eucalypt timber. The present situation sees these high-value trees being used predominantly for house framing, fence palings, and pallets in competition with radiata pine, generally regarded as a superior product for these uses.
- 7.49 Fourthly, the economics of competing with plantation pine dictate that ever increasing volumes of native timber must be harvested and processed at ever decreasing prices. However, it is well known that there is an upper limit to the availability of native timber in NSW. Therefore, the restraint which higher native timber royalties would bring about appears welcome in terms of the long-term viability of the resource.
- 7.50 Finally, higher prices for eucalypt timber would improve the economic viability of hardwood plantations in NSW, a strategic initiative of such great importance that the Commission's long failure to seriously address it is nothing short of baffling.

8. Marketing

- 8.1 In the chapter on pricing, the Committee noted its conviction that it was in the State's best interests to raise the price of most native hardwood logs. Certainly the Commission is capable of setting prices at any level it sees fit. However the possibility exists that the Commission could price itself out of its existing markets. (Although it seems likely that present eucalypt markets can bear substantially increased pricing). One potential solution to this dilemma is to follow the example of the New Zealand Forestry Corporation who took positive steps to develop export markets in response to a similar situation.
- 8.2 The New South Wales situation was outlined by Mr. Ron Wilson, Chief of Marketing for the Forestry Commission, in his testimony.

*"... the Forestry Commission in looking at our budget for the coming year, we would like more income than what our forecast is, so that is one particular immediate problem."*¹

*"... we faced it this time with a downturn in the building industry, through the high interest rates, so our receipts - our sales of timber are likely to be, if anything, down on our forecast rather than up so that is an immediate problem we've got."*²

- 8.3 In response to this marketing problem, Mr. Wilson's approach was to prepare advertisements for "quite a range of timber" which is uncommitted³ When questioned about the possibility of seeking overseas markets for Forestry Commission timber, Mr. Wilson stated that he did not intend to send salesmen overseas. Furthermore, he stated that "there is no need to [sell timber overseas]", and that "We see that as a private sector job to sell their product overseas."⁴

1 Minutes of Evidence 19 June, 1990, p. 133.

2 Ibid.

3 Ibid.

4 Ibid., p. 150.

- 8.4 A more constructive approach to overseas markets, in the Committee's view, was recounted in testimony from Mr. William McPhee, the Chief Executive Officer of Australian Heavy Hardwoods Pty. Ltd. Mr. McPhee told of the American Hardwoods Association's enormous success in developing European markets following their attendance at a trade fair for furniture manufacturers in Cologne⁵
- 8.5 Facing a softening of domestic demand for its products, Mr. Andy Kirkland, Managing Director of the New Zealand Forestry Corporation, sent teams of salesmen to Southeast Asia with the objective of establishing overseas export markets between 1987 and 1989. As a result of this initiative, the NZFC was able to double its export receipts from \$53.3 M in 1989 to \$105.1 M in 1990, consisting of log sales as well as trade in manufactured timber products.⁶
- 8.6 This comparison to the New Zealand Forestry Corporation illuminates many of the current problems with the Forestry Commission's marketing efforts. Marketing in the Commission appears to be a passive, reactionary activity, predicated on existing comfortably with present customers in pre-defined markets. In the Committee's view, it is precisely this attitude which has prevented the Commission from taking pro-active market-oriented steps to pull itself out of its subsidised operating mode. This passive attitude has a lot to do with the Commission's corporate culture, built around a timber production ethic and perpetuated by the practice of promoting, for the most part, forestry graduates from ANU for the key Commission posts.

⁵ Minutes of Evidence, 29 November, 1990, pp. 13, 14.

⁶ Annual Report of the New Zealand Forestry Corporation, 1990, p. 5.

Recommendation 36

It is recommended that the Forestry Commission review its market direction and devote significant resources to the development of new markets, for example:

- **assisting customers to penetrate export markets,**
- **providing price and volume incentives to value-adding customers,**
- **re-orienting wood-technology research toward assisting industry to develop new value-added timber products.**

The Committee to review progress in one year.

8.7 Responding to a request to define marketing, Mr. Wilson stated,

*"In the Forestry Commission it is a customer liaison role. The marketing people have to deal with all the customers. We have to do price setting or recommend price setting. We have to make decisions on whether - which companies get timber, we have to make decisions about which timber to put up for tender, we have to evaluate tenders, we have to develop procedures for the sale, you know, like the accounting side of it, make decisions on how that is all done, any changes, any improvements to how it is done and to manage the licensing part of the timber industry side."*⁷

8.8 Mr. Wilson made no mention of developing new markets, conducting market research (an activity which is left largely to bodies such as FAFPIC⁸), econometric modelling, or even looking for new customers. From Mr. Wilson's testimony and discussions with interstate colleagues, the Committee

⁷ Minutes of Evidence, 19 June, 1990, p. 131.

⁸ According to the Commissioner of Forests, Minutes of Evidence, 18 June, 1990, p. 32.

has formed the view that marketing in the Commission amounts to little more than order-taking and administering the quota system.

Recommendation 37

It is recommended that the Forestry Commission conduct its own market research, and not rely so heavily on market projections done by organizations such as FAFPIC and ABARE whose objectives differ from the Forestry Commission's. The Committee to review progress in one year.

8.9 By Mr. Wilson's own admission, pricing decisions are made largely on the basis of cost recovery tempered with some regard to the history of pricing⁹. In other words, the Marketing Division has little idea of what price the market will bear except in markets (such as poles and softwood pulp) where a clear oversupply situation prevails. Furthermore, the Marketing Division has no procedure for determining what price the market will bear. Summing up what techniques were employed to determine market-level pricing, Mr. Wilson used such phrases as *"You push and pull and find out a lot of things."*¹⁰ *"you've got to look behind the data."*¹¹ However, nothing by way of a formal procedure was conveyed to the Committee by Mr. Wilson's testimony.

8.10 Part of the problem may be a lack of staff with economics or marketing training. The present Chief of Marketing was originally trained as a forester and obtained a Master's Degree from Yale University, which included courses in economics, business principles, and operations research. Of the four principal officers in the Marketing Division, all are graduates, and one holds a Ph.D. in economics. Two hold Bachelor of Science degrees in forestry. A project officer happens to be a forester, although when the position was advertised that qualification was not essential. Apart from these officers, the Marketing Division has support staff, 11 timber inspectors, and field staff such as the *"marketing foremen"*. Marketing foremen are present at felling operations. The use of the term *"marketing"* for these employees is confusing,

9 Minutes of Evidence, 19 June, 1990, pp. 135-137.

10 Minutes of Evidence, 19 June, 1990, p. 135.

11 Ibid., p. 136.

and to the Committee's view indicates a lack of perception of the dynamics of marketing.

- 8.11 Dr. W.J. Hurditch, Executive Director of the New South Wales Forest Product Association made the following observations regarding the marketing skills of the Commission:

*"I have personal confidence in the particular qualities of the current marketing staff of the Commission but as a general principle I don't believe that someone with professional forestry training necessarily has the right skills to conduct a marketing operation for an enterprise with a turnover of some \$70 million a year. Surely it needs some input from professional marketers and I personally see that as a need."*¹²

*"I prefaced my comments by saying the current incumbents, the current chief of marketing does have I wouldn't call it marketing but at least some accounting and economic background but looking back through the history of the marketing division it's really been a position that's been filled by field foresters who have been out in the field and have come into Sydney and taken up that position by applying for it."*¹³

Recommendation 38

It is recommended that the Forestry Commission hire marketing professionals and economics professionals with specific marketing orientation in preference to foresters for marketing positions. The Committee to review progress in one year.

- 8.12 Integrally related to the question of marketing is the question of planning, especially the planning of markets. Everyone connected with forestry informed the Committee that the long-term nature of forest harvesting cycles

¹² Minutes of Evidence, 18 June, 1990, pp. 117, 118.

¹³ Ibid, p. 118.

pays lip service to the necessity of long-term planning. It therefore came as a great surprise to the Committee to hear the Chief of Management Planning Division, Mr. Geoff Pople, admit in his testimony that the Commission does not actually have 40 year plans or plans encompassing longer spans of time¹⁴. In fact, the Committee got the distinct impression that the Commission has little or no long-range planning and few resources set aside for this purpose.

- 8.13 Such plans as there are include the Indigenous Forest Policy, published in 1976 (prior to which there was no such policy document) and not amended since, the Preferred Management Priority documents, the Management Plans, and tactical plans such as harvesting plans. All of these documents are primarily oriented toward timber production, and very little consideration is given in these to market projections and future sales prospects.

Recommendation 39

It is recommended that the Forestry Commission put significant resources into strategic planning for timber sources and markets over a range of time horizons. The Committee to review progress in one year.

- 8.14 In the absence of conventional marketing plans, the Commission has tended to rely on ad hoc theories and "hunches" about what sorts of timber would be saleable in the future. Lacking the proper professional backing, these hunches have often fallen flat - to the great distress of the Commission and, indirectly, the State. One example is the supposed burgeoning market for mining timbers - the basis in the early 1980's of a substantial commitment to producing suitable trees. The late Commissioner, Dr. Gentle, informed his senior officers in 1981 of this impending market opportunity.

"... project yourself forward, perhaps 20 years - you are looking, no matter what happens, at a huge expansion of industries like coal mining, which are going to consume a lot of wood. There is a popular feeling of course that those mines are open cuts but in fact that is Stage (1) in a lot of cases and if you actually look

14 Minutes of Evidence, 19 June, 1990, p. 198.

*at the amount of coal that is being won underground versus what is being won on the surface, I think the ratio at the moment is something like 40 million tonnes underground to about 13 million tonnes above ground, underground mining is very much the heavyweight in the coal industry. The new fields opening up, particularly in north-western N.S.W., are going to consume wood and they are going to consume it in underground mining inside that period. So sorts of land that we haven't looked at too closely in the past - we haven't thought in the nature of things that that sort of wood would be needed - we should now be reassessing along the lines of looking at what the State's industrialisation programme is calling for. If you are not familiar with the industrialisation programme in this State I suggest that you get familiar quickly because it's the tail that wags the dog. It's the real reason why employment is a bigger issue than environment."*¹⁵

- 8.15 Unfortunately, this plausible but casual assessment of the mining timber market failed to account for the emerging trend toward longwall mining equipment which makes mining timbers virtually unnecessary underground. As a result of this mistake, the boom in mining timbers never eventuated. On its visit to the woodchipping facility at Teagardens, the Committee saw some of this unsaleable, yet high quality mining timber on its way to be chipped.
- 8.16 A similar type of mistake with possibly farther-reaching consequences was the ambitious pine planting program at Oberon. Anticipating an annual demand of 380,000 cubic metres of pulpwood for the CSR Medium Density Fibreboard plant, the Commission embarked on large-scale plantings of radiata pine in the district¹⁶. Statements by Mr. R. Nimmo, forest inspector, admit to the planning error :

"Excess pulpwood exists through late commissioning of CSR's MDF plant (as Fibron) in particular and through non-performance to allocation levels in the past."

15 Dr. S.W. Gentle, Opening Address to the NSW Forestry Commission Senior Officer's Conference, June 1981, p. 11.

16 Figure provided by Mr. Colin Roberts, district forester, Oberon, in reply to the Committee's question during site inspection, September 21, 1990.

*"Existing domestic markets for softwood pulpwood material are saturated. Because of a downturn in the finished product market, some licensees are struggling to take their compulsory minimum levels of pulpwood quota."*¹⁷

- 8.17 This mild language is explaining the fact that, due to a market downturn for MDF, 14,586 hectares of pine plantation are being passed over for first thinning, which is likely to result in a distinct decrease in the long-term commercial value of that pine plantation area.¹⁸
- 8.18 As these two examples illustrate, failures of the Commission's market vision have proven costly. The Committee recognizes that such problems can be perceived more readily in hindsight, however the lack of professionally qualified marketers in the Commission, the lack of outside directors with commercial experience (a problem which will be discussed in the chapter on Corporate Structure), and a general misunderstanding of the strategic importance of marketing for such an organization must surely have played a role in these costly decisions. This misunderstanding must now be continuing to misdirect the Commission and limit its potential.

Recommendation 40

It is recommended that the Forestry Commission back up any new production initiative with a professional marketing plan which is subjected to scrutiny by outside directors, before resources are committed to production.

¹⁷ Reply to the Committee's question, submitted 12 October, 1990

¹⁸ Minutes of Evidence, August 14, 1990, p. 9.

9. Pine Plantations

- 9.1 In view of its contribution to the State's industrial development, the Committee believes that the Commission's development of pine plantations has been a beneficial strategic direction for the State. While it has some concerns regarding the Commission's management of the pine plantation estate, especially with regard to behind-schedule thinnings, overall the Committee finds much to commend in this program. Some important improvements in economy and effectiveness could be achieved by corporatising the Commission's pine plantation program. However, the Committee feels it would definitely not be in the State's best interests to take the further step of privatisation.
- 9.2 Presently, the Commission holds 185,000 hectares of softwood plantation, comprised mainly of radiata pine. The largest concentrations of pine plantations are in the Tumut and Bathurst areas. Although these plantations represent only 5% of the total state forest area, they generated 42% of the Commission's pulpwood and 32% of the Commission's sawlog volume in 1988-89. Altogether, the pine plantation program contributed 43.4% of the Commission's 1988-89 timber sales revenue.¹
- 9.3 Having discussed with various interested parties the New Zealand government's rationale for privatising their pine plantations, the Committee wished to investigate the pro's and con's of privatising the pine plantations of New South Wales. Clearly, its pine plantation program is one of the Commission's success stories. It is the culmination of many decades of work, and it provides one of the few examples of farsighted strategic planning. The process of corporatisation is likely to generate over time significant performance improvements. The question remains as to whether the ultimate step of privatisation would be in the best interests of the State.
- 9.4 The Committee has come to the inescapable conclusion that such a privatisation step would not benefit the State. A number of valuable lessons can be gained from the New Zealand experience. The motivation for

¹ 1988-89 Annual Report of the Forestry Commission of NSW.

privatisation in New Zealand seems to have arisen from considerations of short-term economic expediency. It is apparent to the Committee that the longer-term consequences of privatisation include a significant diminution of New Zealand's capacity for value-added production. New Zealand's decision to privatise generated a furious backlash from the public at large. Additionally, the decision to privatise led to a great deal of bitterness and disillusionment among the very competent and motivated staff of the Forestry Corporation who had already achieved enormous steps in efficiency and effectiveness. Lastly, it is unclear how privatisation can offer any hope of better performance than would be achieved under corporatisation alone.

- 9.5 It was made clear to the Committee by New Zealand forestry professionals that New Zealand's extreme balance of payments problem made it imperative that the government generate massive injections of foreign capital quickly. It would not be an exaggeration to say that the government's position was perceived as desperate. Asset sales to foreign purchasers provided a short-term solution to the immediate problem. Another short-term consideration was the total inability of the New Zealand Forestry Corporation and the Treasury to agree on a valuation for the nation's pine plantation resource. The Committee sensed a feeling of frustration behind the government's decision to auction off the pine plantations in order to settle the valuation question once and for all.
- 9.6 Members of the New Zealand government explained to the Committee that in the asset auction, foreign investors were preferred to domestic purchasers. It was felt that by borrowing funds to purchase plantations, New Zealand firms would only succeed in transferring the government's external debt to the private sector. New Zealand's external debt would not be reduced. Conversely, the problem with foreign investors, under no obligation to establish industrial infrastructure in New Zealand (or even to replant pine trees after harvesting), is their preference for doing value-added processing outside New Zealand. A likely long-term outcome (which none of the conditions of sale would prevent) is that New Zealand's vigorous timber processing industry would gradually dwindle as the raw materials are increasingly processed overseas by the new resource owners.
- 9.7 Opinion surveys indicated clearly that the majority of New Zealanders were opposed to the asset sales, some under the mistaken impression that both land and trees were for sale. While the land itself was not for sale, the government

was unsuccessful in promoting the privatisation concept in the electorate. Privatisation proved to be a difficult political issue for the then New Zealand government.

- 9.8 Privatisation involving asset sales to foreign buyers is problematic in that the buyers are likely to be industrial organizations with established value-adding facilities overseas. The Committee is strongly of the opinion that New South Wales will benefit most from moving in the direction of greater value-added processing: a direction which is inconsistent with the notion of selling the Commission's pine plantations to overseas interests.
- 9.9 The Commission's pine plantations in the Albury region appear to the Committee to be well run, providing the raw material base for a world-scale newsprint mill and other significant industry. The Albury region itself, on the strength of its pine plantation program, produces the greatest revenue of any of the Commission's nine regions. Developments in this region are a credit to the Commission. Harking back to the disillusionment among the New Zealand Forestry Corporation's employees during privatisation, the Committee perceives that it would be destructive and mischievous to subject the Commission's Albury organization to privatisation in the name of greater efficiency.
- 9.10 Advocates of privatisation may well point to the fact that the Commission's radiata is struggling to compete on price with New Zealand radiata landed in Sydney as evidence that the Commission's plantations are badly run. To be fair to the Commission, it is necessary to acknowledge that New Zealand enjoys some substantial intrinsic cost-of-production advantages related to factors outside the Commission's control. Growth rates are substantially higher for radiata in the North Island of New Zealand than in Albury or Bathurst regions. Bushfire risk is very much lower in New Zealand. Pine plantations are much more concentrated geographically in New Zealand. Labour costs are lower in New Zealand, especially in relation to worker's compensation insurance for contractors.
- 9.11 Finally, the Committee understands that environmental constraints on logging operations with regard to erosion and siltation are comparatively less stringent in New Zealand. For example, snigging logs (dragging them along the ground behind a tractor) from the stump to the log dump is standard practice in New Zealand, whereas in the Albury region, the Commission carries logs from the

stump to the logging truck with a forwarder, causing substantially less ground disturbance.

- 9.12 The Committee believes that the Commission's pine plantation program certainly has room for improvement, particularly along lines noted in the chapter on Pricing. Corporatisation holds the promise of delivering these improvements. Creating a separation between the pine plantation program and the other functions of the Commission will allow the radiata specialists to concentrate on the clear objective of maximising long-term return on the pine plantation assets. An awareness of financial performance and incentives for managers to achieve results will give the program the keenness it needs to compete against organizations which, like those in New Zealand, often enjoy intrinsic advantages. Eliminating subsidies to the Commission overall will establish the competitive neutrality which is so important to sound business decisions.

10. Eucalypt Plantations

- 10.1 The Committee perceives that a plantation program for eucalypt timber would be highly desirable if it could deliver benefits similar to those offered by plantation grown pine. These potential benefits include high yield and uniform quality, and the ability to sidestep the controversy which accompanies harvesting native forests. Such a program could provide a supplementary source of hardwood which would reduce the need to harvest native timber.
- 10.2 Eucalypts are widely used as plantation species in many countries, including Brazil, Portugal, and South Africa. Although eucalypt plantations do exist in several Australian states, nowhere except Tasmania do they constitute a very significant source of timber at present. The reliance on eucalypt plantations is increasing in Australia generally, but not in New South Wales.
- 10.3 Upon enquiring why New South Wales has not proceeded with this promising plantation initiative, the Committee became aware that controversy surrounds various economic and technical determinants of the success of a eucalypt plantation program. The key issues in the debate are:
- Can eucalypt plantations produce enough wood, fast enough, to be economical?
 - Are there large enough areas in which eucalypt plantations can be grown to provide adequate wood supplies?
 - Can plantation-grown eucalypts, grown as fast as possible, produce wood that can be used as sawn timber?
- 10.4 Elements of the controversy are recorded in a small number of landmark documents. The Australian Conservation Foundation (ACF) took the lead in proposing a favourable economic analysis of a eucalypt plantation strategy for Australia with its publication in May 1988 of The Wood And The Trees. The main findings of this study have been contested by the Forestry and Forest Products Industry Council (FAFPIC) in its April 1989 statement entitled,

"Potential role of hardwood plantations in supplementing Australia's forest resources", and by the Forestry Commission in its appendix to the FAFPIC statement entitled, "Eucalypt plantations; NSW". A further unfavourable analysis entitled, "Economics of growing eucalypt sawlogs in plantations" has been submitted to the Committee by the Forestry Commission.

- 10.5 A February 1990 report to the Commonwealth Minister for Resources entitled, "The development of a plantation strategy for the South-East forests of New South Wales" concludes that hardwood plantations offer little scope for replacing native timber within a 20 year time frame, however they could supply a significant proportion of raw resource in the longer term. The ACF prepared a discussion paper entitled, "The Future of hardwood plantations in NSW" addressing criticisms levelled by the Forestry Commission. In May 1990, the Working Party on Eucalypt Plantations presented a report to the Premier's Roundtable on the Environment, which optimistically considered the prospects for using sharefarming to improve the economics of plantations.
- 10.6 Lacking the technical and economic expertise to evaluate the merits of the arguments presented in evidence by a number of witnesses for and against a eucalypt plantation strategy for New South Wales, the Committee sought advice from two independent experts in the field: Mr. Paul Jones of the Forestry Branch, Department of Primary Industry and Energy, and Dr. J.J. Landsberg of the CSIRO Division of Wildlife and Ecology. Each provided written synopses and evaluations of the arguments presented in the seven documents mentioned above. Additionally, Dr. Landsberg testified at the Committee's public hearings on August 14th.
- 10.7 These experts acknowledge that both the ACF and the Forestry Commission approach the question of eucalypt plantations with a policy-induced bias.

*"The ACF in their paper 'The Wood and the Trees' come at the question on the basis that plantations can achieve a policy objective of theirs, to eliminate wood production from native forests. Their analysis therefore, in my view, takes an optimistic view of the parameters to be considered to come to the conclusion that it is viable."*¹

¹ Comments by Mr. P. Jones on eucalypt plantation literature requested by the Committee, p. 1.

*"I was disappointed that apparently in the documents from the forestry industry, let's say, in the general sense which may include both FAFPIC and the Forestry Commission, they tended to be rather negative in the sense that one had the impression that they were fighting a case rather than looking objectively at a situation, and I guess this is probably understandable. They would get a lot of flack and they get a bit defensive, and also there has not been much development of plantations in New South Wales."*²

- 10.8 As the Committee understands it, the basic approach for estimating economic viability is not in dispute. An estimate of the plantation growth rate, which is usually expressed as the Mean Annual Increment (or MAI in cubic metres of growth per hectare per year), is multiplied by the number of hectares under plantation to obtain an approximation of the sustainable annual timber yield. The proportion suitable for sawlog is multiplied by the average sawlog royalty, and the proportion suitable for pulplog is multiplied by the average pulplog royalty to obtain future revenue estimates. These revenue estimates are discounted over time using a nominated discount rate and offset against establishment and maintenance costs, which are also discounted over time. The end result of this analysis is to obtain a net present value of the future net income stream which can be compared to the net present value of investments in the project to determine whether the project will yield a sufficiently high rate of return.
- 10.9 The controversy centres on the ranges of values which are used in this financial model. In particular, the achievable MAI, the potential area under plantation, future royalties, applicable discount rates, and the length of time between harvests are all disputed. Additionally, the assumed establishment and maintenance costs vary between participants in the debate. If one assumes that the plantation land must be purchased, then the establishment cost component is very significant. Generally speaking, the higher the MAI and future royalties, and the lower the discount rate and the length of time between harvests (the rotation), the more attractive the plantation becomes economically.
- 10.10 Growth rates play a pivotal role in the feasibility estimates, and differences of

² Minutes of Evidence, 14 August, 1990, pp. 6, 27.

- 10.10 Growth rates play a pivotal role in the feasibility estimates, and differences of opinion on realistic values are great. Speaking of the growth rate estimates used by the ACF in "The Wood And the Trees", Mr. Jones said,

*"I believe their yield figures of 22 and 25m³/ha/yr for both sawlog and pulpwood regimes are too high for a general average, particularly when the land cost is averaged at a low \$1200/ha indicating a lower productivity zone. Such yields, and much higher ones, are feasible in certain areas, however to base a Australia wide strategy on such a figure is at this stage optimistic."*³

*"Yields quoted in the FAFPIC document range from 6 to 12 m³/ha/yr for sawlog regimes, the lower end of which is in keeping with productive native forest and below I believe what is feasible in plantations. This position is none the less based on actual data, recorded for past plantation performance, hence is realistic. It is pessimistic in that it makes no allowance for advances in site preparation and cultural treatment which have significantly lifted yields in other areas."*⁴

- 10.11 Mr. Jones went on to say that there is evidence to support both positions. FAFPIC and the ACF have taken as representative different ends of a range of a very limited data set to make general conclusions. Dr. Landsberg took a similar view:

"A wide range of estimates of plantation growth rates (and hence of the yields that can be expected per unit area in a given time) was given. The growth rates used by the forest industries (Forest and Forest Product Industries Council (FAFPIC) and the Forestry Commission of New South Wales (FCNSW)) in their submissions are almost certainly too low; growth rates of about 20m³/ha/yr appear to be realistic. As a consequence of the assumptions about growth rates, and hence rotation lengths, the estimates reached by the forestry industry of land needed for

3 Op. Cit., Mr. P. Jones, p. 1.

4 Op. Cit., Mr. P. Jones, p. 2.

- 10.12 Prices obtained for plantation timber are no less important than growth rates. Assistant Commissioner Fisher referred to the relationship between royalty level and economic feasibility in a letter dated August 29, 1990 to the Committee. In that letter, Mr. Fisher presented royalties required to earn a 5% real rate of return for plantation pulpwood under various assumptions about growth rate and establishment costs with the basic assumption of a 20 year rotation. The royalties varied between \$32.90/m³ and \$15.80/m³. Mr. Fisher made the point that current maximum royalty for eucalypt pulpwood in NSW is \$21/m³.
- 10.13 It is important to remember that the Forestry Commission sets these prices. With an 80% market share and a customer base composed of numerous small-to-medium firms, the Commission is clearly a price leader. Mr. Fisher indicated this price-setting capability in his testimony, "... *the Commission decides what its approach will be based on the information given to it by the marketing division. It then approaches the Minister and says, 'Minister, this is what the Commission has decided in relation to royalties. Do you have any comment?'*"⁶ The Committee was concerned at the Commission's apparent presumption that Ministerial approval is just a rubber stamp. Nevertheless, it is apparent to the Committee that it is within the Commission's power to improve the economics of plantations immediately simply by raising prices.
- 10.14 Location and quality of sites play a significant role in a plantation's success. There is a widely acknowledged relationship between rainfall, growth rates, and the cost of land. As one might expect, the most productive country is the most expensive because many uses compete for it. It is tempting to employ low-value, low-productivity land for eucalypt plantations for cost-saving reasons. However, the commercial benefits of plantation forestry are achieved by concentrating investment and effort to achieve maximum crop growth per unit area. The Commission's early experience with pine plantations inclined them to this approach.

"A review of existing plantations in 1935 found that virtually all plantings outside the highland areas had failed. Objectives in plantation establishment were revised to exclude 'high-minded' aspirations of developing unproductive areas and to focus on

p. 1.

⁶ Minutes of Evidence, June 19, 1990, p. 178.

*"A review of existing plantations in 1935 found that virtually all plantings outside the highland areas had failed. Objectives in plantation establishment were revised to exclude 'high-minded' aspirations of developing unproductive areas and to focus on establishment in concentrated units and in areas of optimal growth, with the large term objective of developing a commercially sustainable project."*⁷

- 10.15 One solution to the land purchase cost problem is to employ sharefarming. This practice involves planting timber trees on farmland with the cooperation of the farmers. The farmer retains ownership of the land, and receives an annuity or a dividend once the crop is harvested. Benefits to the farmer include improvement of salinity and high water table problems, shade for livestock, wind, erosion, and catchment protection. A trial program in Western Australia looks promising in its initial stages. A similar program in Victoria appears to have floundered because farmers have reacted suspiciously to the proposals. The Committee is convinced that, for such a program to succeed, it is important to "sell" it to the farmers, and overcome their fears that their land will be resumed.
-

Recommendation 41

It is recommended that to the greatest extent possible, the Forestry Commission employ alternatives to land purchase in initiating eucalypt plantation schemes, drawing upon interstate expertise and experience wherever possible.

- 10.16 A further constraint on land availability is the proximity to processing industry. With economic trucking distances for sawlogs and pulplogs of approximately 100 km, the land used for plantations must either be close to a mill, or new industrial infrastructure must be installed near the plantations. Woodchips are more valuable per cubic metre than pulp logs. Hence it is economical to transport woodchips over much larger distances.

⁷ "Plantations: Lessons from NSW Experience", Drielsma, O'Hara, and Wilson, NSW Forestry Commission, Appendix No. 22, submission to Resource Assessment Commission, p. 2.

- 10.17 The Committee was impressed with the Western Australian authorities who have attempted to integrate the establishment of hardwood plantations in a long-term economic development strategy for the Albany region. The overall strategy clearly indicates a sensitivity to the economic, social, and ecological environment, and provides a useful model for consideration in New South Wales given that the Committee found no evidence of such planning for any region in this State.
-

Recommendation 42

It is recommended that the Forestry Commission plan to situate most plantations within practical distances from existing woodchipping facilities, while leaving scope for the establishment of plantations in locations which will serve future strategic mills.

- 10.18 Apart from quantitative aspects of the economic models, the plantation debate has raised some qualitative issues. Often these issues have highlighted the importance of research and technological adaptation in overcoming obstacles. The eucalypt plantation concept for sawlogs has been criticised on the grounds that rapidly grown eucalypt timber is subject to "*growth stresses*", which make it difficult to saw using traditional sawing technology. Of course technology is not static. Tandem saws, in use in some mills, can overcome this problem. Historically, when plantation pine was first put through sawmills in South Australia (large scale operations began in 1931), considerable problems were experienced applying the Old World sawing technology (developed for slow-growing European timber) to the fast-growing Radiata Pine. Needless to say, advancing technology has turned this situation around, and sawn Radiata is now a major commercial product in the Pacific Rim.
- 10.19 Plantations differ from native forest in that they are monocultures. In New Zealand, the use of tissue culture and "*cloning*" technology has produced extraordinary increases in radiata yields by focusing on genetic traits which produce the best characteristics. The lack of genetic diversity in plantations carries with it some risks, which are generally accepted because of the superior growth performance. One of the risks is the vulnerability to native pests and

diseases. Radiata pine has been a successful plantation species partly because it is an exotic species without any native parasites. For similar reasons, the Tasmanian Bluegum is proving a successful plantation species in Western Australia. The Forestry Commission has taken a rather pessimistic view of this threat, claiming in an undated fact sheet submitted by the Commissioner to this inquiry on 26 September, that *"A good scientific estimate of the 'contribution' by eucalypts to native pests and fauna is 30% of their biomass."*

- 10.20 Paradoxically, despite the vital role of technology, the Committee understands that relevant research is not being done. In examining the divergent opinions between the Forestry Commission and the ACF, Mr. Jones and Dr. Landsberg each made reference to the paucity of key information regarding the crucial determinants of success.

*"The availability of uniform sites and the growth knowledge of a species or limited number of species across those sites clearly does not apply in NSW. The South East coast of NSW has large variations in topography, rainfall and soils with very little past plantings to serve as a guide. As such, although it is possible to give a reasonable approximation to the best species and their likely growth rates, as has been done in the report 'Development of a Plantation Strategy for the South East Forests of NSW' to the Minister for Resources, there needs to be considerable trial work carried out before this region would be on a par with the knowledge base on which programs are being promoted in Tasmania and WA."*⁸

*"It was notable that most of the papers made virtually no mention of research. Most arguments were based on assertion and poor, or very general, data. There is clearly an urgent need for the Forestry Commission to initiate high quality, rigorous research programs aimed at improving the information available, and knowledge about, both plantations and the native forests."*⁹

⁸ Op. Cit., Mr. P. Jones, p. 3.

⁹ Op. Cit., Dr. J.J. Landsberg, p. 1.

Recommendation 43

It is recommended that the Forestry Commission make a decisive commitment to a research program aimed at boosting yields and preventing losses from hardwood plantations.

10.21 Considering all of the factors outlined above, Mr. Jones concluded that,

"It is very important therefore in assessing the viability of a plantation proposal to be very clear as to:

- *what the objectives of development are;*
- *who is accepting the risks; and*
- *who is to receive the internal and external benefits.*

*For plantation development already undertaken by companies these questions are relatively straight forward and have been obviously satisfactorily answered. For the plantation proposals put forward by third parties, such as the ACF and the Western Australian 'Tree Trust', the answers are I believe a lot more complex and involve a mix of public and private benefits and risks all of which are not easy to quantify hence make an overall assessment of viability a complex task."*¹⁰

10.22 In summary, Dr. Landsberg stated that

"The major points that have emerged are:

- *There is a strong case for developing eucalypt plantations for pulpwood in NSW;*
- *The case for eucalypts as a source of sawn timber is not strong, but there should be a commitment to experimentation and technology development toward*

¹⁰ Op. Cit., Mr. P. Jones, pp. 6, 7.

this aim - the forest industry has a negative attitude to such development;

- *The case for moving towards stopping all logging in native forests is not strong; there is a good case for an integrated industry which utilizes native forests - including intensive management of regrowth - as well as obtaining a large proportion of its resources from plantations."*¹¹

10.23 The Forestry Commission appears to have reluctantly reached a similar point of view in some of their public statements. An unnumbered, undated fact sheet submitted by the Commissioner to this inquiry on 26 September states the Commission's traditional viewpoint on hardwood plantations: *"... they are not often economical, even for dedicated (integrated) pulp production to special purpose mills set up solely to use their products."*¹² However, in the Forestry Commission's submission to the Resource Assessment Commission based presumably on more up-to-date information, it is stated that,

*"Current economic analyses demonstrate that plantations of fast growing eucalypts can be profitable in the production of pulpwood (depending on growth rate, rotation length and price)."*¹³

*"However the much longer rotations needed for the production of sawlogs indicate that these strategies are not currently economic."*¹⁴

10.24 Considering the support in the literature for a eucalypt plantation program for pulpwood, and the Commission's acquiescence in principle, it appears prudent to begin laying plans to establish plantation eucalypts as a major alternative pulpwood source. Additionally, recognizing the Commission's preeminence in so many aspects of Australian forestry, it appears prudent for the Commission to play a vital role in the development of eucalypt plantation strategies Australia-wide.

11 Op. Cit., Dr. J.J. Landsberg, p. 1.

12 Unnumbered, undated fact sheet submitted by the Commissioner for Forests on 26 September, 1990.

13 Submission to the Resources Assessment Commission by the Forestry Commission of NSW, p. 87.

14 Ibid.

Recommendation 44

It is recommended that the Forestry Commission formulate and circulate for public comment a 30-year plan for the introduction of plantation eucalypt timber as a major alternative supply of pulpwood.

Recommendation 45

It is recommended that the Forestry Commission give a strong commitment to the creation of and participation in an Australia-wide eucalypt plantation program.

10.25 Given the Commission's qualified support for the use of eucalypt plantations to supplement the native forest resource, the Committee was disappointed to learn that this verbal support is not backed by any tangible activity in the hardwood plantation area. *"Our policy at the moment is one of basically not - we are not in any operational sense carrying out those plantations."*¹⁵ The stated reasons for the Commission's lack of interest in Eucalypt plantations are chiefly poor economics - the bitter lesson of the Commission's own experience.

¹⁵ Minutes of Evidence, Commissioner Drielsma, 18 June, 1990, p. 34.

Recommendation 46

It is recommended that the Forestry Commission make a decisive commitment to an ongoing program of annual eucalypt plantings without clearing forests, with the short to medium-term intention of providing a supplementary supply of hardwood pulp logs.

10.26 New South Wales has the largest area of eucalypt plantation of any state, due principally to the Commission's purchase of APM's plantations in the Coff's Harbour region. The NSW total hardwood plantation area is approximately 24,000 ha. Discussing the Commission's pessimistic view of achievable growth rates, Dr. Landsberg said,

*"I think that figure [of 9 m³/ha/yr used by Dr. O'Hara in his unfavourable analysis] is strongly biased by the fact that New South Wales has eucalypt plantations up in the Coff's Harbour area which were planted back in the 60's I think and they were not planted with what we would call modern technology. They were planted and they were left to survive and they have not done terrifically well and they tend to use figures from those and the growth rates go quite far down."*¹⁶

10.27 Dr. John Turner, Chief of the Research Division, admitted that the Commission had failed to manage its eucalypt plantations for maximum performance.

*"Yes, we have 24,000 odd hectares in New South Wales at present, we have had for quite a number of years. Our big mistake in New South Wales is that we said, 'We will manage them as part of the regular forest estate' and we have tried to do that."*¹⁷

¹⁶ Minutes of Evidence, 14 August, 1990, p. 32.

¹⁷ Minutes of Evidence, 18 June, 1990, p. 62.

- 10.28 It is unfortunate that detailed information regarding growth rates, silvicultural regimes, and economic performance of the Coff's Harbour plantations is not available due to the Commission's decision to aggregate it with statistics for the native forest nearby. While the Commission has claimed that results have been unimpressive, the unavailability of such information has made these claims unverifiable. The testimony from Dr. Landsberg and Dr. Turner suggest that had this information been made public, it would have portrayed the Commission's management efforts in a deservedly unfavourable light.
-

Recommendation 47

It is recommended that the Forestry Commission make information on growth and financial performance for new and existing plantations freely available for scrutiny by the scientific community and the public.

- 10.29 The Commission alluded to the manner in which they have tended to let their plantations "go bush" in their submission to the RAC. Speaking of the loss of enthusiasm for eucalypt plantations in the mid 1970's, it was stated that,

*"... the resulting so-called eucalypt plantations were very similar to naturally regenerated forests. Natural regeneration following logging is usually abundant and occurs with negligible cost. Reliance on natural regeneration has proven to be the most cost-effective and reliable method of regeneration on most forest sites."*¹⁸

- 10.30 If eucalypt plantations are so similar to regenerated natural forest, the Committee wondered why it is economical to derive timber from regeneration, but not from plantations. In considering this question, two points emerged. Firstly, it is clear that the Commission's management of plantations has not been successful in deriving the superior growth performance which distinguishes plantations from natural forest. Secondly, it is obvious that the principal economic advantage of old-growth and

¹⁸ Appendix 22 of submission by Forestry Commission of NSW to the Resources Assessment Commission, p. 3.

regenerated natural forest over plantations is that the Commission does not have to pay land purchase costs, establishment costs, or resource rental tax on the native forest area.

- 10.31 If the Commission were obliged to pay resource rental tax on the native forest areas which they commercially exploit, then the hardwood plantation enterprise would be on a more equal footing with the native forest harvesting enterprise, and the economic evaluations would not be distorted by this government subsidy to the Commission (e.g. nonpayment of rental).

11. Valuation and Rate of Return

11.1 In its interstate inspections, the Committee inquired into the rates of return on assets received by the various forestry institutions. Senior management in South Australia's Woods and Forests Department was able to instantly quote their organization's rate of return. The Chief Executive went on to state that the criterion on which proposed projects were judged was whether they would yield an adequate return.¹ Similar conversations with executives of the New Zealand forestry firms Carter Holt Harvey and Elders Resources New Zealand Forest Products revealed to the Committee that the executives of these organizations were keenly aware of their rates of return on assets. Such a keen awareness seems to the Committee to be prudent when assets are substantial, whether the organization is a public or private concern.

11.2 Approaching the Forestry Commission of New South Wales with a similar range of questions, the Committee derived a markedly different result. The Commissioner stated in his testimony that

*"In our analysis of investments we would normally be looking at a five percent real rate of return net of inflation as being an adequate target to aim for. I might add that currently we are achieving something in the order of about 4.3 percent return on net assets."*²

11.3 The Commissioner went on to state that

*"... we would expect certainly a higher return from our pine plantations than we would from our hardwood..."*³.

11.4 At the conclusion of the Commissioner's testimony, the Committee requested rate of return calculations for each of the forest programs, softwood

1 Chief Executive, Mr. D.R. Mutton, in discussions with the Committee.

2 Minutes of Evidence, 18 June, 1990, p. 16.

3 Minutes of Evidence, 18 June, 1990, p. 17.

plantation, broadleaf (native eucalypt) forest, and cypress pine forest. When these calculations were submitted, more than three months later, they revealed that the pine plantation program generated in 1988-89 a return on net assets of 4.9%, whereas the hardwood forest program generated a return of 8.3%.⁴ Overall, the figures presented in the 1988-89 financial statements were consistent with the stated 4.3% figure for the entire commercial enterprise. The Committee's concern is that the Commission does not appear to possess fingertip knowledge of its own rates of return.

- 11.5 The Committee was interested to read an article in the National Parks Journal entitled "*Forestry Finances*" which employed figures available from the Commission's 1988-89 Annual Report to demonstrate that the Commission was earning 5.6% profit on investment.⁵ Cognizant of the fact that the commercial surplus figure employed in this analysis contained subsidies, the Committee felt that this approach had missed the boat.
- 11.6 The Committee was surprised to find that the Commission's own analysis of return on net assets⁶ had employed the same approach and derived results which differed only very slightly from those in the article.
- 11.7 As the Committee sees it, both the method of determining net revenue and the method of determining net asset value in these analyses are flawed. In the case of net revenue estimates, the problem is clearly one of failing to bring subsidies to account. This question is dealt with in detail in the chapters on Finance, and Accounting. In the case of estimating asset values, the problem is more complicated.
- 11.8 In very general terms, the accounting profession recognizes at least two approaches to asset valuation: depreciated historical cost, and realizable market value. Traditionally, the lower of the two values is used for accounting purposes. When the asset is a forest, which is growing at some points in time and remaining fairly static in others, a useful method of depreciating costs is not easily obtained. Furthermore, when the market value must be realized at some future time, as it often must in a forest grown for sawlog production, assumptions must be made about future prices, growth rates, and discount rates.

4 Reply to the Committee's question from the Commissioner for Forests, received 26 September, 1990.

5 National Parks Journal, July 1990, p. 19.

6 Reply to the Committee's question from the Commissioner for Forests, received 26 September, 1990.

- 11.9 Problems noted thus far with the valuation process relate equally to plantations and native forests. Additional problems arise with native forests. For plantations, the number, variety, and size distribution of trees (what could be called the inventory) is fairly easily obtained since the plantation consists of even-aged stands of single species planted on a grid pattern. Inventory-taking for a natural forest is very much more difficult because of the diversity of ages, species, and physical shapes (among the very things which make natural forests so valuable aesthetically). For this reason, predicting growth in plantations is much more straightforward than predicting it in native forests.
- 11.10 Perhaps the most difficult problem in valuing natural forests is the need to account for non-timber values. These include, among other things, wildlife habitat, recreational use, diverse pool of genetic material, erosion prevention, water catchment, and climate moderation. The existence of alternate uses for an asset gives rise to another possible valuation method - determining what someone would be willing to pay to put the asset to an alternate use. Implicitly, this is the valuation method which is used to justify placing forests which would be capable of timber production into the national parks system: the public is willing to forego the timber production in return for enjoyment of the non-timber values which are maintained by reserving it from logging.
- 11.11 In their valuation of forest assets, the Commission has sidestepped all of these difficulties. To some extent, the Committee finds it puzzling because the Commission pays lip service to the many virtues of natural forests in its 1988-89 Annual Report, giving one the impression that these many virtues are taken into account. Some excerpts from that report illustrate the point:

"The State Forests of New South Wales are managed as a valuable public asset. Forestry is a viable and worthwhile land use. Like agriculture it is important to the economy of rural centres, but unlike agriculture, it contributes positively to conservation of the natural environment."

"Catchments are protected and water quality of streams and rivers is enhanced. The forests form a major feature of the landscape, providing splendid scenery throughout N.S.W. They provide beauty and a diverse range of habitats, deliberately maintained, ensures the protection and survival of all plant and animal species."

*"The State Forests contribute to our cultural and historical heritage, and protect aboriginal places and archeological sites. They are particularly valuable for ecological and biological research because it is possible to examine the impacts on the forest ecosystem of manipulating the vegetation."*⁷

- 11.12 The Commission's method of valuing forest assets is laid out in Note 1. (II) to the annual accounts for 1988-89.⁸ It differs for growing stock in plantation forests and growing stock in broadleaf forests. For plantation forests, all expenditure on growing stock in plantations, except costs associated with marketing and maintenance associated with logging, and amortization of the growing stock, was capitalized until 30 June, 1984. After that date, the historical cost of the growing stock has been revalued by the CPI inflation index.
- 11.13 For broadleaf (native) forests, expenditure on growing stock was capitalised until 30 June, 1984 on the basis that production and capital invested were assumed stable. The note to the accounts admits that this pre-1984 assumption was incorrect, leading at that time to overly favourable statements of the year-end results. The Commission felt that a more appropriate value was obtained by revaluing growing stock at the CPI, a practice which has been employed since 30 June, 1984.
- 11.14 The Committee, unimpressed with the obfuscatory language describing the procedure for valuing native forests, understands that this procedure fails to account for the actual value of the trees in native forests. If it did, the growing stock valuation of \$59.8 M for 2.7 M hectares of eucalypt forest would be ludicrously low, at approximately \$22 per hectare.⁹ For reasons which will be discussed below, the Commission may have a motivational bias towards understating their asset valuations.
- 11.15 South Australia employs a contrasting approach to the valuation problem which could be applicable to the Commission's plantations. The Department of Woods and Forests describes its procedure in the notes to the 1989 annual accounts:

7 1988-89 Annual Report of the Forestry Commission of NSW, pp. 4, 5.

8 1988-89 Annual Report of the Forestry Commission of NSW, p. 95.

9 1988-89 Annual Report of the Forestry Commission of NSW, p. 91, and p. 8.

"Due to the special nature of forestry assets, which includes a long production cycle combined with physical change, historical cost accounting does not provide a meaningful measure of the economic performance or asset value of forestry activities. In order to provide more relevant, reliable and understandable information, a current value based method of forestry accounting was adopted from July 1986. The main features of this method are:

- *the forest is revalued annually at its estimated market value;*
- *the net change in forest value in the year (after depletion from harvesting) is taken into account as revenue in that year;*
- *all revenues related to forest harvesting are taken to earnings at time of sale;*
- *all forest expenditure is treated as a cost in obtaining the incremental growth in the year the spending takes place.*

*"As a result of adopting this method, earnings include all increases and decreases in economic value resulting from the period of investment."*¹⁰

11.16 The Committee notes that the South Australian Auditor General accepted the 1989 financial statements with the qualification that the practice of treating forest revaluation as revenue is a departure from Australian Accounting Standard 10. However, the South Australian Auditor General stated that

*"The annual revaluation of forests is fully supported as it provides an accurate assessment of the value of growing timber for disclosure in the Balance Sheet."*¹¹

¹⁰ South Australian Woods and Forests Department, 1989 Annual Report, p. 38.

¹¹ Ibid., p. 45.

11.17 Leaving aside the treatment of forest revaluation as revenue, the Committee feels that the Forestry Commission would do well to emulate South Australia's approach in valuing its own plantation forests, and attempting to extend the method to value its native forests. At such time as the Australian Accounting Research Foundation concludes its research project into the valuation of regenerative assets, the Committee would like to see the Commission move to the standard approach which emerges. But under no circumstances should the Commission continue to employ its present misleading and inadequate approach either for plantations or for natural forests. To do so is to send distorted signals to managers with the result that poor commercial decisions are made.

Recommendation 48

It is recommended that those Forestry Commission managers responsible for commercial activities adopt a bottom-line orientation to setting and achieving goals.

Recommendation 49

It is recommended that, in goal-setting, the Forestry Commission use rate of return on assets managed as the performance indicator, calculating return on market-valued assets by bringing subsidies to account.

11.18 In a corporatisation exercise, such as has been initiated in the Commission's case, the question of asset valuation can become a vexing problem. Mr. Percy Allan, Secretary to the N.S.W. Treasury, explained the potential problem in the following terms:

"Another difficulty is that associated with valuing the assets of GTE's and the restructuring of their balance sheets - critical

*steps in being able to set meaningful rate-of-return targets, including a return on equity and on total assets. Very crudely, in the valuation process, the enterprise tends to seek a low valuation of its assets to make any rate-of-return target easier to achieve. Its attitude towards its debt/equity ratio depends on whether it wants to minimise its return to Treasury or impress the credit rating agencies so it can borrow more cheaply."*¹²

- 11.19 During the Committee's inspections in New Zealand, many parliamentarians, executives, and senior public servants suggested that the inability of government and the NZFC to agree on a valuation of the state-owned pine forests was one of the primary motivations for the decision to privatise. In that situation, the government was seeking a high valuation, in order to maximize its dividend stream. The New Zealand Forestry Corporation was seeking a low valuation, in order to minimize the dividend stream. Ultimately, faced with a deadlock, the government decided that market valuations could best be established at an auction.

¹² "Corporatisation: The NSW Experience", an address by Mr. Percy Allan to the National Accountants in Government Convention, 2-4 March 1989, p. 17.

12. Research

- 12.1 Initially, comments from interstate foresters led the Committee to suspect that, with a significantly larger research presence than any of its sister organizations, the Forestry Commission may not be deriving value for money in the research area. 1981 comments by the former Commissioner, Dr. Gentle, led the Committee to wonder whether research effectiveness is presently an issue:

*"Now in the area of Wood Technology and Forest Research. I am quite sure that the biggest problem from our viewpoint with this Division is the fact that it is not very well understood by the Commission as a whole. I know from some 30 years listening to people that it is regarded as a place where money just sinks without trace and of course that isn't true. There are manifold projects which are prosecuted out there which don't have very much to do with the ordinary field running of the Forestry Commission; timber marketing activities pushed towards the better use of wood; preservation; sawmilling; all those areas where foresters normally have only the most casual acquaintance and at very, very limited level, all are very big areas in the Wood Technology programme."*¹

- 12.2 Dr. Gentle went on to explain that reporting from the research offices had not been timely, and that the biennial reports deserved more attention than the senior officers appeared to be giving them.² *"However, they do live in a vacuum, and that I think, has to change."*³
- 12.3 With these statements in mind, the Committee was most interested to examine costs and outcomes for the Wood Technology and Forest Research Division. The Committee's approach was to examine costs of doing research, the

1 Dr. S.W. Gentle, Opening Address to the NSW Forestry Commission Senior Officer's Conference, June, 1981, p. 15.

2 Ibid.

3 Ibid., p. 16.

benefits from various points of view, and how research is directed and controlled.

- 12.4 Examining costs first, the 1988-89 annual financial statements indicate that "Research" represents 4.4% of commercial expenditure or \$2.2 M.⁴ In addition to that amount, "Wood Technology Services" represent 5.3% of non-commercial expenditure or roughly \$700,000. Testimony from Dr. John Turner, Chief of the Division, indicated that true costs were considerably higher than those stated in the Annual Report.

Committee: "What does it cost to run the research division?"

Dr. Turner: "In staffing, and this includes what we could call technical services which includes our commission library and other technical services of a like nature, advisory services, salaries are around about \$5 million. On top of that there is materials, electricity, telephone, so we are looking at probably \$5.5 million, without any capital works."

Committee: "... looking at the annual report, it says research 88/89, \$2.1 million. There must be other factors in there?"

Dr. Turner: "Yes, there are. I just said that includes technical services and whatever else."

Committee: "But excludes salaries obviously?"

Dr. Turner: "No, the figure I gave is an estimate that I made of the total value of the division plus all research in the regions and that often gets put under - that's partly under a regional cost but I know that the value of our research is around about \$5 million with the technical

⁴ 1988-89 Annual Report of the Forestry Commission of NSW, p. 83.

services which don't come out specifically as research."

Committee: "So those five research agency centres are costed to the regions?"

Dr. Turner: "Yes, they are put under administration." ⁵

- 12.5 Obviously, the accounting treatment of research in the Annual Report fails to give a true and fair picture of the relevant costs. The Committee wishes to note its displeasure with this practice, which clearly compromises the research division's accountability.
- 12.6 Having established a figure for recurrent costs associated with research, the Committee proceeded to ascertain the replacement value of assets which are specific to research. The market value of the Cumberland State Forest (land and buildings) valued by the Valuer General at June 1, 1989 was \$8.25 M.⁶ Both Wood Technology buildings, and the Sydney District Office are situated on this land. The value attributed to the Wood Technology buildings by the Commission is \$2.8 M.
- 12.7 The research division employs approximately 120 people, of whom about 100 are based in the Pennant Hills complex.⁷ The actual number of staff appears to be somewhat fluid, as far as the Committee is able to determine. Dr. Turner stated in his testimony that the Pennant Hills complex had approximately 90 staff.⁸ A paper detailing the Commission's Public Service Staff at June 1990 indicated that only 84 public servants were employed in Sydney, and that the total number of research public servants was 107. The Committee was rather surprised at the difficulty in establishing the number of employees in the research division.
- 12.8 This mild confusion regarding staff levels seemed to be symptomatic of a deeper confusion within the division. Attempting to get a proper understanding of research benefits, the Committee began by asking Dr. Turner what the division's objectives were. In reply, Dr. Turner launched into a

5 Minutes of Evidence, 18 June, 1990, pp. 67, 68.

6 Reply to the Committee's question from Acting Secretary King, submitted August 30, 1990.

7 Statements by Dr. Turner and Mrs. Marcia Lambert, Deputy Chief, during the Committee's visit to Pennant Hills on May 28, 1990.

8 Minutes of Evidence, 18 June, 1990, p. 52.

lengthy explanation of the structure of the division without really indicating to the Committee what the objectives are.⁹

- 12.9 Since Dr. Turner had referred to the organization of his division in explaining objectives, the Committee made a point of studying the organization chart. This chart is remarkable if only in the great diversity of topics which are encompassed. Apart from five regional research centres, no less than nine branches report to the Deputy Chief: Entomology and Ecology, Hydrology, Pathology, Plywood and Veneer, Seasoning, Silviculture and Plant Ecology, Soils and Nutrition, Timber Engineering, and Wood Structure and Preservation. Additionally, the Deputy Chief oversees the Library, Data Management, Publications, and Information, and the Deputy Administration Officer oversees Administration Services, Stores and Maintenance, Photography, Workshop, and Canteen.
- 12.10 To assist the Committee in understanding this very complex division, it sought an Annual Report into current research projects. Unfortunately, the Committee has been led to believe there is no such report available. The Commission did provide the Committee with a list of current research topics for 1988-89 and 1989-90 but that had to be specially prepared for the inquiry. The Committee understands that a lack of funding is the main impediment to the routine production of such reports.
- 12.11 Lacking evidence of any clear benefit or objectives statement for the research division, the Committee considered the validity of concerns that research expenditure achieved no tangible benefit. The Committee felt that much of the benefit of forest research would be to the foresters in the field. And yet, the annual review process in which funding is allocated to research topics

*"does not currently allow for direct input by Regions or Divisions into proposed W.T.F.R.D. [Wood Technology and Forest Research Division] research at time of review."*¹⁰

⁹ Minutes of Evidence, 18 June, 1990, p. 53.

¹⁰ "Research Project Areas - 1988", NSW Forestry Commission Division of Wood Technology and Forest Research, p. 2.

Recommendation 50

It is recommended that, for forest research, the Forestry Commission move toward a research funding system in which managers of commercial units within the Commission (and in outside organizations) pay for specific research which they intend to exploit commercially.

- 12.12 Beyond that particular concern, the Committee questions the utility to industry of the Commission's research into wood technology. The Committee learned that members of at least one industry peak body are dissatisfied with that research. Mr. Col Dorber, Manager of the NSW Forest Products Association (FPA), stated in correspondence to the Committee:

*"This Association represents the producers of the Veneer and Ply in NSW. For a number of years now those producers have been unanimous in their view that the Veneer and Ply Division of Woodtech should be closed down. The Association has long been concerned that the unit was established using the \$1 million 'rainforest' grant provided by the Wran Government in 1982. It is the view of the producers in the Veneer and Ply sector that much of the research being carried out in that unit duplicates research carried out by the industry proper. The Association believes that the monies used to operate the Veneer and Ply unit could be better utilised either in other areas of research, in which the industry has had input into the development of, or in bringing about a pro rata reduction in Royalty rates for the Veneer and Ply sector."*¹¹

- 12.13 Part of the FPA's disenchantment with the wood technology research stems from its perception that industry supports this research financially to some extent through the Timber Advisory Council (TAC). According to Mr. Dorber, the TAC is funded from royalties paid by his members, but his association and others are denied significant input into the TAC's decisions on allocation of research funding.

¹¹ Letter from Mr. Col Dorber, submitted 19 October, 1990, p. 2.

- 12.14 Potentially, the Commission could play a vital role in assisting industry to develop value-added timber products through its wood technology research. Regrettably, this assistance appears not to be occurring, apparently because the Commission does not permit sufficient industry input into the design of research projects. The Committee notes that this failure has an impact on the failure of New South Wales timber products to win export markets.
-

Recommendation 51

It is recommended that the Forestry Commission liaise with industry to a much greater extent in framing its wood technology research projects, with the specific intention of assisting industrial customers to develop and market value-added timber products.

- 12.15 Given this lack of user-input into allocation of funds noted both in forest research and wood technology research, the Committee wondered whom, if anyone, the research division serves. The Committee sought to approach this question by asking Dr. Turner how these fund allocation decisions are actually made.

Committee: "How are your research topics selected?"

Dr. Turner: "Every year we have a fairly critical review of - and each member of staff is on a performance basis, we set goals and guidelines fairly closely and come up with areas that after discussion with the Commission and the regional areas, we found general areas that need to be worked on and problems that are arising. Some things are ongoing, a short term project is something less than five years in forestry and some of them are, for example, our hydrology projects, many of those are in excess of 15, 20 years. To get a major change of direction

*when we are working with forestry, it is very difficult. It is by a process of negotiation with the researchers and primarily with the Commission as to what they say is the objective in the future."*¹²

- 12.16 This testimony appears to confirm the Committee's concerns that potential users of the research have very little say in what gets investigated or how. In fact, it appears that researchers themselves play a large role in directing the research. Discussing the attitudes of researchers, Dr. Turner drew an important distinction between them and other types of commercial employees.

*"When we are dealing with a research organization, you are dealing with a different group of people and I don't mean that in a derogatory sense but their motivation is completely different to say sales organization or something else. To stay in research egotism plays a high degree so if you ask a specific person they would tell you that they are the Australian expert, and in many cases they are."*¹³

- 12.17 The Committee concluded, after an examination of the research division, that it is a significant drain on commercial income which is yielding very little commercially applicable result. A certain degree of confusion appears to surround the division's purpose, and little monitoring or feedback of performance was evident to the Committee. In the Committee's view, the division is not serving its ostensible clients well, taking direction instead from its scientific officers who may be following their own agendas.
- 12.18 The Committee feels that in a corporate environment where benefits must be shown before costs can be incurred, this division could not possibly survive at its present size or in its current form.

12 Minutes of Evidence, 18 June, 1990, p. 59.

13 Minutes of Evidence, 18 June, 1990, p. 58.

Recommendation 52

It is recommended that the Forestry Commission significantly scale down its basic science research activities, relying on the universities and CSIRO to a greater extent.

13. Corporate Structure, Aims, and Incentives

- 13.1 Although the Forestry Commission is moving in the direction of Corporatisation, the process is far from complete. None of the five principles of corporatisation is very much in evidence to the Committee: 1) clarity of objectives, 2) managerial authority, 3) performance evaluation, 4) rewards and sanctions, and 5) competitive neutrality. Seeing great benefits for the State as well as the Commission in corporatisation, the Committee believes that the Commission should begin the transition by recognizing the need to make sweeping changes in these five areas.
- 13.2 Aware that the New Zealand government had corporatised its Forestry Service in 1987, the Committee decided to examine the formation and results of the New Zealand Forestry Corporation. The rationale for this change in structure is explained by Mr. A. Kirkland, Managing Director of the Forestry Corporation.

*"Multiple use forestry in New Zealand satisfied neither the conservation movement nor those intent on restructuring government administration of trading enterprises and the economy at large. Conservationists argued that environmental values inevitably had second class status in State agencies with commercial functions. Financial reformers argued that the lack of transparency and rampant cross subsidisation in agencies with mixed commercial, social and environmental objectives made it impossible to measure the real cost and effectiveness of satisfying any one of those objectives."*¹

- 13.3 The functions previously undertaken by the Forestry Service were allocated to one of three new organizations: the Department of Conservation, the Ministry of Forestry, and the Forestry Corporation. The Department of Conservation assumed the functions of preservation of natural forests,

¹ "Accountability in Multiple-Use Enterprises - Urgent Problem or Dead Horse?", A. Kirkland, September 1989, paper delivered at Thirteenth Commonwealth Forestry Conference, pp. 8, 9.

management of native and free ranging introduced fauna, and public recreation. The Ministry of Forestry is a non land administering department which assumed responsibility for forest and forest products research, advisory services in forestry and wood processing (subject to cost recovery programs), administration of some forestry statutes and controls, policy advice to Government in forestry, and oversight of afforestation leases of Maori lands. The Forestry Corporation is a company under the Companies Act and the State Owned Enterprises Act which was set up to acquire the State's commercial forestry assets and hence assumed responsibility for production forestry and logging, and wood processing.

- 13.4 One of the significant impacts of corporatisation was a sixty-one percent reduction in the total number of employees and contractors. Although contractor numbers increased slightly during the transition, wage workers and salaried staff bore heavy layoffs. Between March and September 1987, the number of wage workers decreased from 3,780 to 689, and the number of salaried staff decreased from 1,990 to 662. From the latter category cuts at the head and regional office level were severe: from 650 to 102.²
- 13.5 In its first year of operation, the Forestry Corporation recorded a cash surplus of \$54 M on revenues of \$233 M with expenditures of \$179 M. This result is compared, in the Corporation's Annual Report 1988, with the Forestry Service's last year of operation in which it recorded a deficit of \$71 M on revenues of \$178 M and expenditures of \$249 M.³ In 1989 and 1990, the financial performance was increasingly favourable. The 1989 result was a surplus of \$95 M on revenues of \$293 M and expenditures of \$198 M. In 1990, the surplus was \$148 M on revenues of \$386 M and expenditures of \$238 M.⁴
- 13.6 This dramatic financial turnaround is attributed to reduced overheads (arising from the two-thirds reduction in salaried staff members), improved labour efficiency, and to increased sales to export markets. The figures are all the more impressive when one considers that the value accruing from the annual forest growth increment is not included in the accounts either as revenue (as it is brought to account in South Australia) or as capital growth (since technically, the Forestry Corporation does not own the forest resource).

2 New Zealand Forestry Corporation report for first 6 months; New Zealand Forestry Corporation, Annual Report 1990.

3 New Zealand Forestry Corporation Annual Report 1988, p. 5.

4 New Zealand Forestry Corporation Annual Report 1990, p. 19.

- 13.7 The corporatisation experience in New Zealand was not entirely positive. The dramatic reduction in staff numbers led to a great deal of bitterness, disruption at both personal and organizational levels, and even to acts of sabotage. The transfer of ownership of forest assets from the government to the Corporation stalled over the vexed issue of valuation of the forests, leading the government to take the highly controversial step of privatising the forests. The entire public timber resource was put up for auction earlier this year. This privatisation step is essentially the death-knell for the Forestry Corporation since the purchasers of the forests are likely to have their own forestry organizations. The Corporation is reduced to a caretaker role pending the resolution of the asset sale question.
- 13.8 In the light of the New Zealand example, the Committee sought to determine how "*corporatised*" the Forestry Commission of N.S.W. is at present. In making this determination, the Committee considered each of the five principles of corporatisation in turn.

Clarity of objectives

- 13.9 From a management point of view, the Committee believes that the Forestry Commission's principal problem is a lack of focus. This lack of focus is ingrained in the corporate culture and justified under the title "*multiple-use forest management*". It is built into the Commission's organizational structure which combines commercial and non-commercial work in every division. Plantation and native forestry occur simultaneously within most operating units. Nearly every Commission employee must share his time between tasks which contribute to very different, and sometimes conflicting objectives. Under these circumstances, the Committee wonders how the Forestry Commission can possibly achieve the level of excellence which will be necessary to compete for international markets in the 1990's.
- 13.10 The phrase "*multiple-purpose forest management*" is used in the mission statement appearing in the Commission's Corporate Plan 1990-1993. Multiple-purpose management is less a statement of objectives than it is an acknowledgement that severe conflicts of interest impinge on the major activities of the Commission. Principally, these conflicts lie between timber production and conservation of the native forest estate.

- 13.11 However, conflicts also exist between plantation pine and native hardwood, which compete head-to-head in the consumer marketplace. It can be argued that the Commission supplies hardwood to hardwood mills and softwood to softwood mills and that therefore there is no conflict. However, the Committee considers it is most short-sighted of the Commission not to recognize that the competition between its hardwood customers and its softwood customers has an adverse effect on its own pricing, production, and revenue.
- 13.12 The existence of these conflicts of interest within the Commission is highly problematic. Many important value judgements, such as whether to harvest or preserve certain wilderness areas are made within the Forestry Commission with very little outside participation. The Committee believes that these judgements on social values should be made in an open and democratic manner. Having these judgements made by a government agency - one closely allied with the interests of the timber industry - is inimical to social equity and public accountability.
- 13.13 In explaining the principle of clarity of objectives, Mr. Percy Allan, Secretary to the New South Wales Treasury, noted,

*"No organisation can be expected to operate efficiently if it has poorly specified or contradictory objectives. Clear objectives provide a direct focus for management. They prevent management from using multiple objectives to excuse unsatisfactory performance."*⁵

- 13.14 Parenthetically, the Committee notes that in his evidence, Assistant Commissioner Fisher did refer to the Commission's multiple objectives in accounting for its poor returns to its 'shareholder'.⁶

- 13.15 Mr. Allan also noted that,

"it is important to separate regulatory objectives from operational ones. GTEs performing commercial and social objectives should not engage in regulatory objectives. For

5 "Privatisation & Corporatisation", paper delivered at the National Accountants in Government Convention 1989, Mr. Percy Allan, p. 7.

6 Minutes of Evidence, 19 June, 1990, p. 181.

example, the Water Board, as producer, should not set standards of purity for drinking water or effluent discharge. Rather, this should be determined by an independent authority.”⁷

- 13.16 On this point, the Committee observes that the Forestry Commission finds itself in the awkward position of regulating the supply of timber from native forests and deriving commercial benefit from that supply. This conflict of interest has been brought into embarrassingly sharp focus by the recent Land and Environment Court judgment against the Commission in the case of *Corkill v. Forestry Commission*, 29 October, 1990. It would be more satisfactory if the quota-setting and enforcing authority were independent from the body deriving commercial benefit from the sale of quota timber.
- 13.17 There is a clear need, in the Committee’s view, to modify the Commission’s structure to ensure that production and regulatory functions are separated. The Commission’s structure has not changed between 1987 (prior to the move to the outer budget sector) and the Corporate Plan for 1990-1993 (which foreshadows increasing moves toward fully commercial operation). The Commission’s staffing levels have not changed significantly either.
- 13.18 Mindful of the problems noted above with the NSW Forestry Commission’s often conflicting objectives and considering the rationale for splitting New Zealand’s old Forestry Service into separate organizations, the Committee believes that each of the Forestry Commission’s individual objectives would be better served if the single multiple-purpose Commission were split into a number of single-purpose divisions.
- 13.19 The Committee is keenly aware of the need to achieve any transition in the Forestry Commission without disruption to its normal operations. For that reason, in the short term at least, it is necessary to keep the regional and district structure of the Commission intact, concentrating changes on the head office. In the longer term it may well be possible to achieve savings by rationalizing the field operations, but the Committee feels that such a rationalization would come about naturally once commercial objectives, structure, and incentives are in place at the head office level.
- 13.20 At head office, the division between commercial and non-commercial

⁷ Op. Cit., Mr. P. Allan, p. 8.

- 13.20 At head office, the division between commercial and non-commercial functions should be achieved by having separate commercial and non-commercial divisions, with distinct staff, facilities, and objectives. Within the non-commercial side, a distinction should be made between regulatory objectives and the provision of "*public-goods*" from the native forests.
- 13.21 Furthermore, within the commercial side of the new structure proposed for the Commission, separate divisions should be set up for the distinct product lines. A logical approach to this divisional structure might be to establish a plantation pine division, a native hardwood division, and a cypress pine division, each with distinct head office staff and objectives.
- 13.22 Thus the proposed commercial forestry divisions would be responsible for profitably growing and selling timber with the aim of generating a commercial rate of return on assets managed. The management of the commercial plantation pine division would aim to generate the best possible long-term rate of return on plantation pine assets. The management of the commercial indigenous forest division would aim to generate the best possible long-term rate of return on native forestry assets subject to environmental and social constraints on the resource base.
- 13.23 Native forestry presents some potential pitfalls where commercial objectives are applied. Short-term commercial thinking favours unsustainable harvesting levels in aid of profit maximisation. However, long-term commercial thinking places great weight on conservation of native forest values. To some extent the presence of a separate indigenous forest regulatory division would ensure that short-term thinking does not compromise the enforcement of harvesting controls.
- 13.24 The proposed indigenous forest regulatory division would take responsibility for administering forestry statutes and controls, and for preparing environmental impact assessments for any proposed forest operations likely to have significant impacts on the environment. In this connection, the Committee notes with approval that the Minister for Forests has announced that the Commission will set up an environmental assessment unit responsible for managing the environmental assessment process required by law.⁸ For such an environmental assessment unit to be credible, the Committee believes

⁸ The Minister's announcement reported in "Loggers guaranteed access to State's trees", Paul Bailey, The Sydney Morning Herald, 1 December, 1990.

it is essential that the unit come under the control of the regulatory division, rather than one of the commercial divisions, or even the indigenous forest public-good division.

Recommendation 53

It is recommended that the Forestry Commission be restructured into at least four principal divisions which have different objectives:

- regulation of the native forest resource,
- provision of "public good" services,
- long-term profitable running of the pine plantations,
- long-term profitable production of timber from native forests.

The Committee to review progress in one year.

Recommendation 54

It is recommended that the Forestry Commission's new proposed divisions have no common head-office staff or facilities.

Recommendation 55

It is recommended that one set of Forestry Commission field officers be given responsibility for executing forest management in an integrated manner which produces both private and public goods in each area.

Recommendation 56

It is recommended that a distinct set of Forestry Commission field officers be given responsibility for regulating uses of the native forest resources.

Recommendation 57

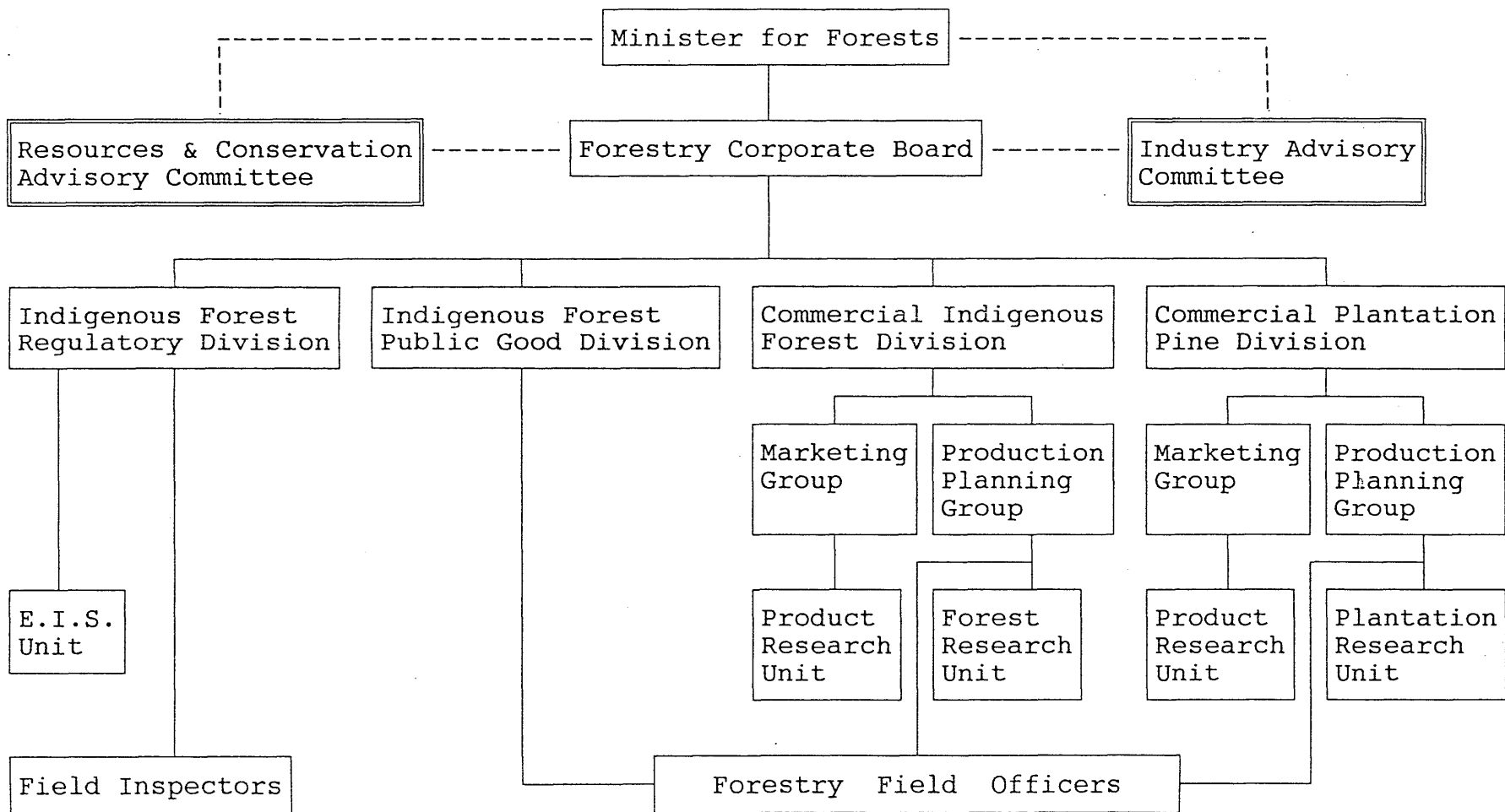
It is recommended that the proposed indigenous forest regulatory division be given control over the soon to be established environmental assessment unit, which will take responsibility for environmental impact assessments for both the proposed commercial indigenous forest division and the proposed indigenous forest public-good division.

(see diagram for suggested structure)

Managerial authority

13.25 The lack of focus discussed above is further exacerbated by the fact that foresters are engaged in a diverse set of specialized tasks for which their training and experience do not always adequately prepare them. As one regional forester put it, *"foresters are jacks of all trades"*. The clear implication is that they are masters of none except forestry. Managerial authority can only

Suggested Model



be held effectively by individuals whose background is relevant to the types of managerial challenges they face.

- 13.26 It is pointless giving managers authority to take chances and succeed or fail unless their experience prepares them for the job. To the Committee it is a telling fact that all of the senior positions at the Commission except the Chief of Corporate Services Division are held by foresters. These positions include Commissioner, Assistant Commissioner, (Acting) Secretary, Chiefs of all Divisions (except as noted above), and all Inspectors. The Committee fails to see why such positions as Chief of Marketing, Chief of Management Planning, Chief of Lands Administration, Chief of Research, and Secretary are necessarily discharged most effectively by foresters. Indeed, there are strong reasons why outside professionals are likely to be more effective in these and other senior roles. The senior positions created by the restructuring (proposed above in the section on clarity of objectives) will demand a mix of skills which can only be found outside the Commission.
-

Recommendation 58

It is recommended that the Forestry Commission immediately implement a policy of facilitating the lateral entry of non-foresters into senior management roles.

- 13.27 At the field level, the Committee believes it is entirely in keeping with the principles of corporatisation to devolve much greater responsibility to regional and district foresters. At present, regional foresters are given very little scope to act upon their own initiative. Spending decisions involving more than a very small proportion of the region's annual income must be referred to head office at present. Staffing decisions (hiring public servants, and firing any staff) must also be referred to head office. Upon reflection, the Committee wonders if it is essential that the highest ranking regional officer be a forester at all. It may be appropriate to have instead a "*regional manager*" with qualifications in business management.

Recommendation 59

It is recommended that the Forestry Commission devolve greater managerial authority to regional and district foresters, for example the ability to hire and fire staff and increased budgetary authorization limits. The Committee to review progress in one year.

Performance evaluation

13.28 The inadequacy of the Commission's present methods of performance evaluation is one of the principal themes of the chapter on Accounting Processes. To avoid repeating that material here, the Committee simply notes that insufficient resources are said to be the reason for an inadequate internal audit function. Additionally, the Committee notes that most performance data which are presented in the annual accounts are distorted by subsidies and failures of the accounting systems.

Recommendation 60

It is recommended that the Forestry Commission redirect sufficient resources to the internal audit function along with a specific mandate to conduct performance monitoring to an acceptable corporate standard. The Committee to review progress in one year.

Rewards and sanctions

13.29 At the top management level, the Commission has moved to S.E.S. contracts which implement rewards and sanctions for those executives. The Committee approves of this approach for the top of the corporate pyramid, but wonders

how effectively rewards and sanctions can be applied for the organization as a whole when so much of the Commission's work is done by permanent staff. At the lower levels of the bureaucracy it is very difficult to implement rewards and sanctions.

- 13.30 The approach employed by the New Zealand Forestry Corporation and private firms, such as Elders Resources NZFP, was to move toward contract labour in preference to permanent staff for the bulk of their field operations. This move was very successful for these organizations. Labour productivity and morale increased dramatically. In many cases, former permanent employees of these organizations became the contractors.
- 13.31 The reasons for such a productive outcome are not difficult to see, in the Committee's opinion. With permanent staff, the tendency is to create activity without critically examining the value of outputs, leading eventually to a perceived need to increase staff and assets to cope with the workload. In contrast, contract labour, contract plant and equipment, and rental office Accommodation, by creating visible variable costs lead the financial control officers to continually question whether these services are providing value for money - an incentive pattern which tends to ensure efficient utilization.
-

Recommendation 61

It is recommended that the Forestry Commission implement rewards and sanctions at the operational level by replacing permanent staff wherever possible with outside contractors who are on reward-for-performance contracts. The Committee to review progress in one year.

Competitive neutrality

- 13.32 In preceding chapters, a great deal has been said about the many subsidies which the Commission enjoys. Perhaps the most significant of these are the payment of a sub-market dividend to Treasury on its equity stake, which includes more than \$100 M worth of loans incurred prior to June 1988, the

nonpayment of any type of rental on Crown Lands which are commercially exploited by the Commission, the nonpayment of notional income tax, and the nonpayment of local government rates and charges. A private firm engaged in the business of growing and selling trees would face enormous costs in respect of market dividends on \$460 M equity investment, resource rental on exploited Crown Lands, income tax, and local government charges. As Mr. R. Pritchard and Dr. M. Thorpe have testified, private plantation pine growers are placed at a competitive disadvantage to the Commission by some of these subsidies.

Recommendation 62

It is recommended that the Treasury assist the Forestry Commission in achieving competitive neutrality, particularly including the phasing out of all subsidies. The Committee to review progress in one year.

- 13.33 Apart from the competitive neutrality issue, it is necessary to subject the Commission to ever increasing fiscal rigour by the phased removal of all subsidies in order to increase internal efficiency and to provide a more adequate return to the State on its forest estate and the funds invested in the Commission.
- 13.34 Finally, the Committee considered the extent of political control which it felt to be prudent to maintain during the corporatisation process.

Political control

- 13.35 Foresters in the field are necessarily very self-reliant. To be effective there, the forester must learn to trust his or her own judgement. When these foresters are promoted to head office, they retain that strength of will. The Committee has seen ample evidence that head office foresters do not welcome outside interference in their decisions. Undoubtedly, one of the perceived benefits for the Commission in corporatisation is the potential freedom from political control.

13.36 Looking to the future, when forestry is on its feet as a State-Owned Corporation, performing well commercially and working harmoniously with the public-good requirements, the Committee can see no necessity for active political control. However, it is clear to the Committee that the Forestry Commission is far from performing well commercially. During the transition to a corporatised entity, the Committee feels that political control is essential to ensure that the first positive steps are followed up with more positive action. The Commission, and the State, cannot afford to have forestry continue to languish in its present inefficient isolationist condition.

Recommendation 63

It is recommended that during a transition period of approximately five years the Forestry Commission be readied for the step to corporatisation, in which period the five principles of corporatisation:

- **clarity of objectives,**
- **managerial authority,**
- **performance monitoring,**
- **rewards and sanctions,**
- **competitive neutrality,**

should be put into place. The Committee to review progress in one year.

Recommendation 64

It is recommended that the State Government retain ministerial control over the Forestry Commission until such time as its performance merits State-Owned Corporation status.

14. Amenity Nurseries

- 14.1 The Commission operates two types of nurseries: production nurseries, and amenity (or retail) nurseries. The Committee's interest in amenity nurseries was attracted when some private nurseries claimed that the Forestry Commission sells competing products at prices set below cost, undercutting the competition and gaining market share by drawing on the deep pockets of the State Government. Specific complaints about the Commission's activities in the retail nursery arena were brought to the Committee's attention in a submission by Mr. Bryan Spencer, Principal Executive Officer of the Nursery Industry Association of N.S.W. Limited. Mr. Spencer's association

*"... believes the Forestry Commission is working outside its charter by operating retail nurseries and as a consequence is harming small business people who own retail garden centres in country areas."*¹

*"Unfortunately, the Forestry Commission has expanded the operation of its retail nurseries to compete with retail garden centres. The Forestry Commission now sells native and ornamental plants, bark and woodchip and in some cases fertilizers to the general public. These activities are considered to be outside the charter of the Forestry Commission."*²

- 14.2 Mr. Spencer went on to state that the Commission can afford to undercut retail prices because their production and selling costs are substantially reduced. In particular, Mr. Spencer claims that the Commission is able to reduce operating costs in the following manner:

- It does not pay rent or mortgage repayments for its land holdings,
- It does not pay land tax or local council rates,

1 Submission from Mr. B. Spencer, 30 May, 1990, p. 1.

2 Ibid.

- No sales tax is paid on capital equipment, yet the Commission is able to dispose of its assets at full market value,
- Through scale of operations the Commission is able to negotiate fuel prices well below that of small businessmen, and
- The Commission does not pay taxation.

14.3 Mr. Spencer concluded that

*"If the commercialisation of the Forestry Commission continues it will place many country nursery persons in financial hardship, with many being forced to close their businesses."*³

14.4 Keen to assess the validity of these claims, the Committee sought comment from the Commission. The Commission addressed many of these points in a submission dated 31 May, 1990. In that submission, the Commission points out that section 11 of the Forestry Act, 1916, Parts I (c), (g), (h), and (n), specifically permit the sale of seeds, trees and shrubs from seed orchards and nurseries. The Act does not make the distinction between production nurseries and amenity nurseries, however this part of the legislation appears, in the Committee's view, to support the Commission's use of amenity nurseries. In this sense, the Commission appears to be operating within its charter.

14.5 The submission goes on to state that,

*"From time to time accusations are made that Forestry Commission nurseries provide unfair competition, as it does not pay tax, indirect tax and enjoys other advantages. Historically, criticism directed at the Commission was based on subsidised pricing. Prior to and during the 1970's this criticism would have been valid. From about 1980 the Commission first attempted to achieve profitability on a cash management basis. This was fairly quickly and successfully achieved and the aim has now been to achieve full commercial profitability. Headway is being made."*⁴

³ Ibid., p. 2.

⁴ Submission from the NSW Forestry Commission on amenity nurseries, 31 May, 1990, p. 13.

14.6 This headway towards profitability is refuted by accounts provided by the Forestry Commission for the retail nursery operations, which indicate that these business units generally do operate at a deficit. The combined nursery operations have been in deficit for each of the past five years with the exception of 1987. The five-year total deficit (\$901,000) is 12.5% of the total turnover for that period.⁵ Although the total turnover figure is steadily increasing each year, there is no evident improvement in the deficit/turnover ratio--in fact it may be worsening. These data lend credence to the argument that the Forestry Commission nurseries are increasing State borrowing to finance their market penetration.

14.7 Responding to the charge of receiving unfair advantages by virtue of its being a government instrumentality, the Commission points out that it:

- does not receive subsidised water from local councils,
- accounts for costs of telephone calls,
- does not enjoy subsidised petrol,
- does not pay sales tax on supplies purchased to cultivate seedlings, but that similar concessions are available to private nurseries,
- does pay sales tax on any items purchased for resale
- takes full account of superannuation, annual leave, sick leave, worker's compensation and pay-roll tax,
- does not presently use employment schemes,
- courses attended by nursery employees are costed to the nursery account,
- the exemption from government charges amounts to only \$32 per nursery site per annum,

⁵ Report to the Minister for Natural Resources on the NSW Forestry Commission Amenity Nurseries by Mr. George Souris, M.P., August, 1989. Information contained in this report led the Minister to request the present inquiry.

- purchases of seedlings comprise a small percentage of sales,
- most private nurseries do not pay pay-roll tax.

The Commission concedes that it does not pay local government rates.

- 14.8 The comparison of cost structures between private nurseries and the Commission is difficult. It is certainly true that the Commission does not pay rent or mortgage on all its land holdings, local government rates, or notional income tax. However, the Commission does correctly allocate all costs of the nurseries including several overheads such as pay-roll tax and Head Office administration that are not borne by small private nurseries. It is not clear that the costs avoided by the Commission nurseries would very significantly impact their commercial results. In his testimony before the Committee, Mr. Wayne Tapping, of the Nursery Industry Association, repeated the earlier claims that the Commission enjoyed many subsidies, but when asked to indicate how significant these costs were for his own operation, he was unable to provide any quantitative data, leading the Committee to wonder if these costs were indeed significant.
- 14.9 At the conclusion of his 1989 report into the operations of the Commission's amenity nurseries, Mr. Souris, commenting on conflict with private nurseries, said,

"There was a boom in retail nursery sales in the early 1980's. This collapsed during the second half of the 80's. Many private retail nurseries are encountering severe reductions in turnover and profitability and some are looking for the excuse to blame nearby and 'flourishing' Commission nurseries. There were many entrants during those boom years. The decline in retail nursery turnover was confirmed by the Nursery Industry Association of New South Wales. If the Commission's nurseries continue to serve the farming, mining and government sector and continue to provide specialist advice, education and back-up advice and do not stock such items as fruit trees, indoor plants, accessories and supermarket lines, and the proportion of turnover from town gardeners remains around 5% of total turnover (max. \$25,000), then I believe the raison d'etre of

amenity nurseries and their actual performance in the market place to be the same.”⁶

- 14.10 Although it is difficult to arrive at precise quantitative estimates, the Committee has come to the view that broadly the Commission operates at a cost disadvantage compared with small private nurseries in that allocation of head office administration expenses, pay-roll tax, and other related expenses probably exceeds the cost advantages accruing to the Commission by virtue of its governmental status. The fact that private nurseries are struggling for survival appears to be less a reflection on the Commission’s activities than it is a reflection of the softness of the market.
- 14.11 Nevertheless, the poor financial performance of the Commission’s nurseries is cause for concern. To some extent, the Committee feels that this performance problem is related to the fact that the Commission persists in making retail sales of small quantities of plants, tying up staff for an inordinate amount of time with very little income to recover the costs. Instead, the Committee believes that a more advantageous approach for the industry and the rural population at large would be for the Commission to reposition its amenity nurseries in the market, restricting casual retail sales to core-business products.
- 14.12 An additional constructive approach⁷, concerns the adoption of a different pricing and cost control philosophy. Prices must obviously be set at a level which the market will bear. The price must contain a commercial markup of at least 33 1/3%. Having established a market price and a commercial margin, the Commission’s nursery management would have an implicit cost-of-production target. Management decisions should then focus on bringing production costs down to (or below) the target, and critically examining the commercial viability of products which cannot be produced at target cost.

⁶ Ibid., p. 9.

⁷ This approach was suggested in the August, 1989 report by Mr. G. Souris, cited previously.

Recommendation 65

It is recommended that the Forestry Commission adopt a pricing policy/management approach for the amenity nurseries which establishes cost targets by deducting an appropriate profit margin from market prices.

14.13 Although the Commission states in its submission, that it *"occupies a different market niche, particularly concentrating on farm trees, for beautification, rehabilitation and soil conservation activities..."*, in fact it does also occupy the retail garden centre market by virtue of its casual retail sales. The Committee believes that the Commission would be acting in the best interests of the State if it focused instead on the rural reforestation, mining rehabilitation, public native tree planting programs, and public utility works for which it is so well regarded in the rural community.

Recommendation 66

It is recommended that the Commission's amenity nurseries continue the important work of rural reforestation, mining rehabilitation, public native tree planting, and public utility works.

14.14 The Committee can see no reason for the Commission's amenity nurseries to sell non-core products such as pot plants and hose-fittings which can be supplied by the private sector. The amenity nurseries should disinvest in stock on hand in these commercial product lines. There is a case for the Commission continuing to provide a retail outlet for rare native varieties which would otherwise be unavailable, insofar as that activity is consistent with the amenity nursery core business of public planting programs. However, the Committee recognizes how labour-intensive such retail sales are, and for that reason recommends against promoting retail sales.

Recommendation 67

It is recommended that the Forestry Commission reconsider its domestic retail sales policy for amenity nurseries, with a view to selling only products which are consistent with the core business of large-scale revegetation programs.

14.15 Touching briefly on production nurseries, the Committee has observed on inspections in Western Australia and New Zealand that large-scale operations offer enormous economies of scale and improvements in quality control. For many tree varieties, the Committee appreciates that these advantages of large-scale production outweigh the disadvantages of transplanting seedlings to different climatic regimes, although survival rates depend critically on timely and sensitive transportation. To attract the advantages of large-scale production of seedlings, the Committee believes it is necessary to centralize its production nursery facilities to a greater degree. That is not to say that local production should cease. Rather it should concentrate on smaller production runs of local indigenous species.

Recommendation 68

It is recommended that the Forestry Commission place greater emphasis on larger, centralized production nurseries, which are necessary to improve output and quality, and to reduce unit costs.

15. Consistency of Activities with Charter

15.1 The Committee notes first of all that the officers of the Commission are uniformly aware of their roles and responsibilities under the Forestry Act. The Act is frequently referred to as the legitimate basis of many of their actions. For instance, the Commissioner read from the Forestry Act in response to the Committee's questions about his objectives.¹ On page 18 of the 1988-89 Annual Report, the Commission relies on quotations from the Act to explain its constitution and objectives. Even officers in the field appear to possess a thorough and detailed knowledge of the Forestry Act's provisions, stemming apparently from their frequent references to it in justifying their actions.

15.2 Organizational structure is determined to a striking extent by the Forestry Act. The Act prescribes that the Commissioner shall be the head of the corporate body, supported by two Assistant Commissioners, that there shall be a Secretary to the Commission, and that the Inspectorate shall consist of not less than three forest inspectors, one of whom is to be the chief forest inspector. Furthermore, the Act specifically countenances the Commission's preference for appointing forestry graduates,

"Provided that in making appointments to the positions of secretary and chief forest inspector preference shall be given, other things being equal, to persons holding a degree or diploma of a recognised school of forestry".²

15.3 Bearing in mind that the Forestry Act was originally drafted in 1916, and that great advances in the science of organizational behaviour have been made in the interim, the Committee believes that the Act is overly prescriptive in its definition of structure. Significant improvements to the Commission which might be achieved by corporatisation would be thwarted or hindered by the requirement to adhere to legislative constraints on structure. The Committee

1 Minutes of Evidence, June 18, 1990, p. 6.

2 The Forestry Act, 1916, Part 1, section 9B, subsection (2).

believes it would be more appropriate for the Act to provide some discretion for the organization to determine its own structure and in the future modify it as necessary on the basis of current principles of organizational behaviour.

Recommendation 69

It is recommended that the Forestry Act be amended to remove clauses which might unduly prevent the Forestry Commission from adopting a fully corporate organizational structure.

15.4 Although the Commission generally follows the Act closely, one striking exception is provided by the Inspectorate. The present range of activities undertaken by the Inspectorate is a clear indication that the Act's provisions are out of step with current practice. The Inspectorate is responsible for recruitment, training and staff development of professional, technical, and field staff, in addition to any duties which could conceivably have been considered "*inspection*" within the meaning of the Act.

15.5 The Committee perceives a stark contrast between the current activities of the forest inspectors and those recommended by the 1907 Royal Commission of Inquiry on Forestry:

"These officers should be continuously employed in travelling over the State and in enquiring into the systems and conditions of working within each district. They should also be required to see that uniformity in forest management, in methods of collection of royalty, and in forest book-keeping, is maintained.

"We consider that the absence of such inspecting officers has been a very weak point in the past system of administration, and that it is a matter of very great importance that these officers should be appointed as early as possible."³

³ Quoted in "The NSW Forestry Act, A Review with Suggestions for Reform", July, 1985, Peter Prineas, Solicitor, p. 5.

- 15.6 Mr. Graeme King, Chief Forest Inspector, testified that on average each inspector only spends three to four days per fortnight in the field.⁴ The current target level of inspection is one inspectorial visit to each administrative unit every 12 months. The Committee has serious reservations as to whether such a system can possibly yield a satisfactory independent management audit, as it is intended to do.
-

Recommendation 70

It is recommended that section 9B of the Forestry Act be repealed and in its place provisions inserted which aim to achieve:

- a clear statement of the powers, functions, and duties of the Inspectorate,
 - inclusion of field inspections and enforcement of forest management regulations in those duties,
 - creation of genuine independence of the Inspectorate from the commercial operations of the Commission.
-

15.7 The above recommendation would establish a prescriptive statutory basis for the Inspectorate's regulatory functions. In the Committee's view, the current lack of such a prescription in the Act has contributed to the unacceptable situation where the inspectors appear to spend more of their time acting as personnel officers than they do inspecting.

15.8 The separation of regulatory functions from commercial and public-good functions is discussed further in the chapter on Corporate structure. Such a distinction is obviously necessary to avoid conflicts of interest.

15.9 The Commission does not take advantage of every opportunity provided it by the Act. Powers and duties of the Commission are set out in section 11, Part 1 of the Act. This section empowers the Commission to undertake its full range

⁴ Minutes of Evidence, 19 June, 1990, p. 162.

of current activities. Under this section the Commission is also empowered to own and operate sawmills, factories, and other premises for converting timber into logs, woodchips, pulp, sawn timber, and other timber products. Thus far, and in the immediate future, it appears that the Commission has no intention of utilizing those subsections of the Act.

- 15.10 The use of management plans, which are the Commission's chief planning and management instrument, does not derive from the Forestry Act, but rather from the Forestry Regulation, 1983. Mr. P. Prineas comments in his review of the Act,

*"As has been noted, the Forestry Act, 1916 makes no mention of 'management plans' for State forests and yet the Forestry Regulation, 1983 does refer to such plans. This departure by the Regulation from the terms of the Act may be proper as sufficient power would appear to exist under Subsection 41 (1) of the Act which provides power to make regulations. It does however, raise many questions as to the adequacy of legislation which makes no provision for such plans and provides no guidance as to drafting procedure, criteria, adoption, implementation and security; this situation is to be contrasted with that obtaining under the provisions of the National Parks and Wildlife Act, 1974, which contains detailed provisions in respect of the drafting, adoption and implementation of management plans for national parks and nature reserves dedicated under that Act."*⁵

- 15.11 The absence of a clear mandate for public consultation within the forestry legislation, combined with the Commission's reluctance to consult brings about some serious problems with planning and implementation of plans. This topic is considered in greater detail in the chapter entitled Policy Impact on the Community. The Committee notes that many of the necessary consultative mechanisms are already enshrined in the EPA Act, and that if the Commission adhered to its obligations under that legislation, public consultation would not be such a contentious issue.

- 15.12 In considering the Commission's adherence to its charter, the Committee took

⁵ Op. Cit., P. Prineas, p. 50.

the view that the Commission's charter consists not only of the Forestry Act, but also overarching legislation to which it is subject, such as the Environmental Planning and Assessment Act of 1979, and the Freedom of Information Act of 1989. A great deal of controversy has surrounded the Forestry Commission's reluctance to undertake Environmental Impact Statements prior to commencement of roading or logging operations. The provisions of part V of the EPA Act with regard to environmental impact assessment would seem to supplement the requirements of the Forestry Act, Part 1, subsection 8A(2), under which the Commission is obliged to take "*all practicable steps that it considers necessary or desirable to ensure the preservation and enhancement of the quality of the environment*".

15.13 However, Mr. P. Prineas comments that,

*"there is evidence of an attitude in the Forestry Commission that it does not accept the appropriateness of applying the [EPA] Act's environmental impact assessment procedures to specific forest developments; recent calls for the production of environmental impact statements (apart from those the Commission earlier agreed to do on a 'representative' basis) have not been heeded..."*⁶

15.14 In a further concrete indication that the Commission does not accept the applicability of the EPA Act to its situation, the Committee notes that the "*Indigenous Forest Policy*" (October 1976) has not been revised to acknowledge the passage of the EPA Act in 1979.

15.15 Section 111 of the EPA Act states:

"For the purposes of attaining the objects of this Act relating to the protection and enhancement of the environment, a determining authority in its consideration of an activity shall, notwithstanding any other provision of this Act or the provisions of any other Act, examine and take into account to the fullest extent possible all matters affecting or likely to affect the environment by reason of that activity."

⁶ Op. Cit., P. Prineas, p. 1.

- 15.16 There is a subtle distinction between the Commission's environmental obligations under the Forestry Act *to take steps it considers necessary and desirable to ensure preservation of the environment*, and those under the EPA Act *to take into account to the fullest extent possible all matters affecting the environment*. Under the Forestry Act, the Commission is only obliged to take steps which it considers necessary.
-

Recommendation 71

It is recommended that section 8A(2) of the Forestry Act, 1916, be amended to be consistent with the Environmental Planning and Assessment Act, 1979.

- 15.17 In the March 1988 Judgement in the case of *Jarasius v. the Forestry Commission and others*, Justice Hemmings said,

*"This hearing has arisen out of a serious dispute between public authorities as to the nature and extent of obligations of the first respondent [Forestry Commission of NSW] pursuant to the E.P.&A. Act, which the Court was compelled to resolve. The first respondent also clearly demonstrated a resentment to the participation of the Department of Environment and Planning or other public authorities in any decision making process in relation to activities in Crown timber lands. It contends, and undoubtedly believes, that in the performance of its functions under the Forestry Act and the attainment of its objects all relevant matters relating to the environment are taken into account by it."*⁷

"However, in the attainment of such objects it is obvious that the prime consideration of the first respondent is its responsibility to meet its 'quota' under the said Agreement. Consideration of the steps to be taken to conserve fauna and flora, or to ensure the preservation and enhancement of the quality of the

⁷ Judgement, *Jarasius v. the NSW Forestry Commission and others*, Justice Hemmings, 4 March, 1988, pp. 49, 50.

*environment, appear to be secondary and limited to that compelled by ss. (2) of s.8A; i.e. to that which the first respondent 'considers necessary or desirable'. What is considered by it to be necessary or desirable appears to be markedly different from that of the National Parks and Wildlife Service, the Department of Environment and Planning and sections of the public."*⁸

Recommendation 72

It is recommended that the Forestry Act be amended to include provisions for formal public participation in the management planning process.

15.18 More recently, the Commission's actions which gave rise to injunctions pursued by Mr. J. Corkill (Mt. Royal SF and Chaelundi SF, 1990) seem to indicate that the Commission continues to rely on the discretion afforded it by the Forestry Act in deciding whether to complete an EIS prior to commencement of forest operations, rather than facing up to its responsibilities under section 112 of the EPA Act.

Recommendation 73

It is recommended that the Forestry Commission accept that logging and roading are significant effects under the Environmental Planning and Assessment Act, 1979, and take immediate steps to gear up for efficient, professional, routine production of environmental impact statements.

⁸ Ibid., pp. 50, 51.

Recommendation 74

It is recommended that the Forestry Commission ensure that all its staff are thoroughly briefed on their obligations under the Environmental Planning and Assessment Act, with particular care to explain what course of action is dictated by law when an apparent conflict arises between the Forestry and Environmental Planning and Assessment Acts.

Recommendation 75

It is recommended that the Forestry Commission update its Indigenous Forest Policy document to reflect the Environmental Planning and Assessment Act requirements, research results, and industrial realities which have emerged since 1976.

- 15.19 This preference for the Forestry Act over the EPA Act despite the clear statement in section 111 that the EPA Act has precedence, has taken the Commission to the Land and Environment Court many times in the past decade. In his evidence before the Committee, the Commissioner of Forests discussed this topic.

"The whole issue of environmental impact assessment is a crucial one for the Commission at the current time. Recent legislation or judicial interpretation of the EPA Act have put the commission in a difficult position in regard to the extent to which we need to do EISs and obviously the financial implications of that sort of activity, so in trying to come to grips with that and weave our way through the judicial processes and getting our capacity to undertake these sorts of analyses up to a level that is required, and at the same time keeping the flow of timber going in an orderly manner is probably one of the major

issues at the moment up and down the coast.”⁹

- 15.20 Although the Commission complains frequently about the high cost of doing environmental impact studies, often resorting to that cost as a reason for not doing them, it is certainly true that defending actions in the Land and Environment Court is expensive, not only for the Commission, but also for the State. Given the fact that the Commission has a relatively large legal branch, experienced by now in Land and Environment Court actions, and that the Commission is only now gearing up for frequent preparation of EIS's, the Committee wonders whether the Commission's strategy has been to avoid the up-front cost and inconvenience of doing an EIS, preferring to fight it out in court in those instances where litigation is initiated.
-

Recommendation 76

It is recommended that the Forestry Commission separately monitor its expenses in preparing environmental impact statements and its expenses in fighting environmental actions in court, including these figures in its Annual Reports.

- 15.21 Responding to the question of whether litigation is a burgeoning field as far as the Commission was concerned, the Commissioner said,

“We hope not, we have been involved in a few cases in recent years that have taken up more time than we would have liked, but we are certainly attempting to minimise that and I think probably will be able to do that, so I don't see that as an area that is going to take up more time because we are certainly not looking to fight all these battles in court. It is a matter of our responding to the law as we see it at the time, so I would see us spending more time preventing us getting into court rather than fighting court cases.”¹⁰

⁹ Minutes of Evidence 18 June, 1990, pp. 6, 7.

¹⁰ Minutes of Evidence, 18 June, 1990, p. 7.

15.22 It is the Committee's hope that under the direction of the new Commissioner, the Forestry Commission does indeed seek earnestly to meet its obligations under the EPA Act, thus avoiding the extremely costly and socially divisive confrontations and court cases which have blotted the Commission's record in the past on environmental matters.

15.23 Recent events have made the Committee aware that the Commission's breaches of the EPA Act are not "*ancient history*". The Interlocutory Judgment of the Land and Environment Court of New South Wales in the case of *Corkill v. Forestry Commission*, 29 October, 1990 makes it quite clear that breaches continue to the present instant. In that judgment, Justice Hemmings states:

*"However, it is obvious that since 1982 the Commission has approved logging of rainforest areas in North Washpool in breach of the provisions of the E.P.&A. Act. It was ultimately conceded by Counsel for the Commission that all rainforest areas of North Washpool were expressly excluded from areas to be logged in the 1980 environmental impact statement. When logging was approved in December 1982, it was limited to the strategies and prescriptions in the said environmental impact statement. Notwithstanding such express exclusion, the Commission authorized rainforest logging within North Washpool. I am satisfied that, until the institution of these proceedings, it was the intention of the Commission to authorise such logging in rainforest areas to resume."*¹¹

*"Regrettably, there is conceded to be a history of departure by the Commission from not only its own approvals in the logging of this area, but apparently a continuous avoidance of the obligations imposed by the E.P.&A. Act. In such circumstances, it is difficult to have confidence that, unless restrained, the Commission will observe its statutory duties."*¹²

11 Interlocutory Judgment, *Corkill v. Forestry Commission of N.S.W.*, Land and Environment Court of N.S.W., Justice Hemmings, 29 October, 1990, pp. 7, 8.

12 *Ibid.*, p. 9.

16. Policy Impact on the Community

- 16.1 Policies of the Forestry Commission have a broad ranging impact on the community, both within the State and outside it. This fact is understandable when one recognizes that the Commission is charged with the management of a cherished public resource the exploitation of which is vital to continued economic survival of much of rural New South Wales. Timber and timber products are increasingly traded on international markets, providing some opportunity (mainly theoretical at the moment) for the development of an export trade in value-added forest products.
- 16.2 Given this broad policy impact, the Committee decided to examine the extent of community involvement in the Commission's policy formulation. This examination was motivated by point 5) of the terms of reference, in which the Committee was requested to examine matters relating to the accountability of the Commission. The starting point was to canvass the groups and organizations which are principally impacted by the Commission's policies. Limiting itself to bodies within the State, the Committee felt that a list would have to include: the Commission's customers, its competitors, the rural public, the urban public, and other government agencies.
- 16.3 Policy impacts are inextricably linked with planning issues because policy is a guide for future decisions. A booklet published by the Forestry Commission entitled "Planning for the Future" provides some insight into the Commission's planning methodology and the extent of consultation in the policy-setting process. The setting of objectives is the starting point for the planning process. Information used in the Commission's planning judgements is derived from a range of sources, including:
- The Commission itself;
 - other government and semi-government bodies;
 - resource user groups; and
 - previous plans.

- 16.4 Significantly, this list does not include community interest groups or conservation groups. This fact is a serious bone of contention with the conservation movement. Mr. Jeff Angel, Assistant Director of the Total Environment Centre, explained in response to the question, "What sorts of problems do members of your organization and people connected with your movement experience with the Forestry Commission?":

*"The basic problem they have is a sense of powerlessness in that they are never given a genuine chance to influence the future of native forests. We would normally become aware of a forestry dispute because a local community has contacted us and much to their surprise, the bulldozers have moved into some favourite or valued piece of bush. There was no public announcement there was no public environmental impact statement, there was no extensive and meaningful public participation program in the management plan, those sorts of things are things that would have alerted - at least those procedures would have alerted people to what was going on ..."*¹

- 16.5 The Committee questioned Mr. Geoff Pople, Chief of the Management Planning Division about the actual extent of public involvement in decision-making.

Mr. Pople: "Yes, to get public involvement in policy or in decision making you have to put a lot of effort in getting all the issues understood, and we are still working very hard to achieve that.

"The people who want to participate publicly are those people that don't really want to participate in decisions within existing forest management plans and existing policy level, or even within the existing Forestry Act."

Committee: "Not always, because we have had evidence where people who have been ostensibly

¹ Minutes of Evidence, 18 June, 1990, p. 78.

disadvantaged by the Forestry Commission coming into an area have only found out that the Forestry Commission will be logging an area the day the bulldozers came in. They would have rightfully wanted to have some input into that, but there is obviously no mechanism which allows those people who are interested enough to create a local group, I mean, you have to have some interest to spend that time and effort, they would have been if they were given the opportunity to have some dialogue and discussion prior to the commission's presence in an area. That is why I wanted to pick you up on that. What I am saying is true, isn't it?"

Mr. Pople: "Partly true, and what I said is partly true. I believe as a generalization what I said is true, but obviously like all generalizations it can't be wholly true, you are dead right, but certainly - -"

Committee: "So you have no formal mechanism which is set in place to allow people to have an input into future logging programs?"

Mr. Pople: "No formal mechanism."

Committee: "You have to have a formal mechanism if it is going to work properly?"

Mr. Pople: "What I have tried - -"

Committee: "Is that an answer yes or no, there is no formal mechanism - you would know because you are at the forefront of planning those areas, you have no mechanism where you will dialogue with groups or individuals?"

Mr. Pople: "I see it this way - -"

Committee: "Just give me an answer, yes or no?"

Mr. Pople: "I am sorry, but in the terms that you have put my answer would have to be no."²

16.6 When the Committee inquired of Assistant Commissioner Fisher why the Commission did not appear to act constructively on criticism from the environmental movement, Mr. Fisher shed some light on a typical Commission attitude to environmentalists.

Committee: "What is wrong with the Commission when everybody who comes before us - not everybody, but a vast number of rather intelligent people come before the committee and say, 'There are problems down there', what is wrong with it?"

Mr. Fisher: "I believe quite sincerely that they are coming at it from the point of view that the Forestry Commission is operating in indigenous forests and they resent that, they want to stop all commercial operations in indigenous forests. I think even if you asked an honest question of Peter Garrett, or whoever, Australian Conservation Foundation, they would say, 'Yes, our ultimate aim is to have no commercial activity in indigenous forests.'"³

16.7 Mr. Fisher enlarged upon this point of view later in his testimony:

Committee: "Let's take the conservationists. I am not so certain that they presented a point of view that they were interested in prevention of saw milling in all native forests, it was only the

² Minutes of Evidence, 19 June, 1990, p. 202.

³ Minutes of Evidence, 19 June, 1990, p. 182.

old growth that they came to us on. We talked about plantation and other areas and they seemed quite happy with the Forestry Commission's activities in those areas."

Mr. Fisher: "Perhaps I am putting myself on the line here, but I will put it to you and I honestly believe this, and I think if you really scratch the surface a lot of these people, as I said, the ultimate aim is to stop all native forest operations.

They realise the way to achieve that is by an incremental approach, if they came straight out and said, 'We want to stop all operations', quite rightly there would be an outcry because a whole lot of industry, particularly based in the rural areas, would have to close up. There would be people thrown out of employment and so on.

*For tactical reasons they have adopted the incremental approach, we will achieve old growth today, we will make another move tomorrow and eventually we will achieve our aim and so far they have been supremely successful."*⁴

- 16.8 According to the conservation movement, it is possible to predict long in advance which forest areas are likely to give rise to conservation-logging disputes. In most cases, these areas are old-growth stands previously identified as sensitive areas, and have actual or provisional heritage listing. This forward visibility to conflict makes it possible to conduct a sound public consultation before any action needs to be taken in specific cases. However, the Commission does not find it within its institutional character to take a consultative approach due, in large part, to attitudes like those expressed by

⁴ Minutes of Evidence, 19 June, 1990, p. 182A.

Mr. Fisher. In the end, many of these debates are waged in court at great public expense.

16.9 The Committee's enquiries revealed that the conservation movement is not the only interest group denied participation in the Commission's decision-making processes. Competitors to the Commission in the growing and selling of timber and other forest products have made numerous submissions to the Committee complaining about the way in which they feel commercially disadvantaged by the Commission. These competitors are mainly either private investors in pine plantation projects or proprietors of amenity nurseries. The Committee has investigated in detail these complaints, presenting its findings in the chapter on Pricing (of pine logs) and the chapter on Amenity Nurseries.

16.10 While the Committee is generally of the view that the Commission has not improperly used its government status to commercially damage either investors in private pine plantations or private nursery proprietors, the Committee found the Commission's attitude toward competitors to be rather counter productive and short-sighted.

16.11 The Committee asked Assistant Commissioner Fisher what was the substance of complaints from competitors. Mr. Fisher replied:

*"I will tell you what their attitude is, they represent private growers, those people, they are having great difficulty in marketing their products and they are blaming us. I don't see how they can blame us, all we are doing is trying to go out and market our products, and a lot of people are saying, 'You are not doing it well enough'. They are saying, 'You are doing it too well because you won't let us in on the act', that is where they are coming from."*⁵

16.12 When the Committee pursued the same line of questioning with the Chief of Marketing, Mr. Ron Wilson, he appeared not even to acknowledge that the Commission's policies had any impact on private growers of plantation pine:

⁵ Minutes of Evidence, 19 June, 1990, p. 182.

*"The private sector has had some difficulties up in the Oberon area in getting a market for pulpwood. Originally they criticised the Forestry Commission, but really it is nothing to do with us, the fact that they don't have a market for their timber."*⁶

"I guess the bottom line is that I don't believe that anything we do really impacts adversely on that private sector growers, but I do know that they have had complaints about various things. They say that our pricing is too low or something, they have made complaints about various things, but I have had difficulty understanding whether there is anything real in it or not.

*"I am not saying if you went and looked at every case there might be something in it, but as a general statement I don't feel that our actions are particularly damaging to that industry."*⁷

- 16.13 While the Committee was in general agreement with Mr. Fisher's statement, it felt it was unrealistic to contend, as Mr. Wilson appeared to do, that the Commission's near monopoly market position had no impact on private growers. However, what seemed to be lacking in both Mr. Fisher's and Mr. Wilson's perspective was any recognition that the private growers could contribute towards meeting the Commission's objectives of strengthening the State's forest resource base. The Commission appeared bent on viewing the important task of providing timber resources as a purely competitive venture, where the dominant supplier is the winner and lesser suppliers the losers. The Committee felt that a more constructive approach might have been to try to find workable mixes of public and private supply to meet the State's timber production needs. As long as the timber is supplied, why does it matter who supplies it?
- 16.14 Coming next to the degree of consultation and cooperation between the Commission and other government bodies, the Committee noted that the Commission's historical relationship with National Parks and Wildlife has been less than cooperative. The Committee surmises that, in part, this poor relationship stems from competition between the two services for control over parcels of Crown land. Justice Hemmings made particular note of the

⁶ Minutes of Evidence, 19 June, 1990, p. 152.

⁷ Ibid.

Commission's attitude toward the involvement of other public authorities in his judgement on the first Jarasius case:

*"The first respondent [the Forestry Commission] also clearly demonstrated a resentment to the participation of the Department of Environment and Planning or other public authorities in any decision making process in relation to activities in Crown timber lands. It contends, and undoubtedly believes, that in the performance of its functions under the Forestry Act and the attainments of its objects all relevant matters relating to the environment are taken into account by it."*⁸

- 16.15 Following this process of deduction, the Committee came next to consider the extent to which industry is consulted in the Commission's decision-making process. Mr. Col Dorber, Manager of the NSW Forest Products Association Ltd., stated in a letter to the Committee that:

*"One useful observation that we believe should be made strongly to your Committee is that we do not believe that there is any evidence to support the claim that the Commission is a 'tool of the industry'. Indeed, the frequency with which the Commission takes a course of action either without industry consultation or contrary to the views that may have been expressed by the industry is a clear reflection that it entertains little doubt about its own independence."*⁹

- 16.16 Certainly this point of view regarding the independence of the Commission has been put numerous times to the Committee by foresters in the field and head office. Based on industry submissions, the Committee believes that there are numerous instances in which the Commission has acted without consulting industry, to the chagrin and bemusement of industrial firms. Quota allocation, and road maintenance spending are two types of decision which often give rise to such complaints.

⁸ Judgement, Jarasius v. Forestry Commission and others, Justice Hemmings, 4 March, 1988, pp. 49, 50.

⁹ Letter submitted by Mr. Col Dorber, 19 October, 1990, p. 3.

- 16.17 However, on the vital question of pricing, the Committee believes that there is very strong evidence (presented in detail in the chapter on Pricing) that the Commission pays great attention to the requirements of industry, and that industry's input into the decision-making process is very significant. Additionally, whenever the issue arises of making more forest available for logging, the Commission appears to come down strongly on the side of industry in seeking to expand the harvestable forest area.
- 16.18 Thus having considered the various means by which parties affected by Commission policy can influence that policy, the Committee has come to the conclusion that decision-making is very much a closed process. Input is sought primarily from the Commission itself, and to some extent from the Commission's paying customers. However, the evidence strongly suggests that the general public, competing firms, and other government organizations have no opportunity to participate meaningfully in planning, policy, or lower-level decisions which affect them unless they resort to extreme measures such as litigation.
- 16.19 The Committee has heard from the Commission that it suffers from a poor public image. This image problem is attributed to a lack of public relations effort. The problem is thought to be simply one of presentation. After examining this question, the Committee believes that good public relations is a two-way street. It is not simply a matter of telling the public everything is fine; the forests are well managed. It is also a matter of listening to the public, asking them how they would like to see the forests managed and encouraging them to express any dissatisfactions which they may have. Until the Commission tackles that problem seriously, its public relations exercise will be superficial, and its activities will fail to serve the principles of democratic government.
- 16.20 In the chapter on accordance with the charter, the Committee recommends that the Forestry Act be amended to include specific provisions for public consultation. Aspects of public participation which are especially important include providing advance information about logging, roading, and other significant activities, presenting draft proposals, allowing for public review before proposals become final, and providing some means of appeal. The recommendation below amplifies earlier recommendations for public participation, specifying that it should embrace the preparation of particular Commission documents as well as the planning process overall.

Recommendation 77

It is recommended that the Forestry Commission urgently address the need for public participation in its planning processes generally, and in its preparation of Indigenous Forest Policy Documents, Management Plans, and Preferred Management Priority Classification documents specifically.

- 16.21 Having considered some of the problems with the Commission's present methods of dealing with community impacts, the Committee felt it would be remiss not to suggest some positive directions. Here, the Committee is examining the question of how to resolve some of the bitter controversy which has afflicted forestry over the last ten to fifteen years. Is it possible to give all the parties in the debate what they want, or is State forestry a zero sum game, allowing some to win only if others lose? Whatever the answer to that question, what role should the Commission be playing to attempt to resolve the disputes in the best interests of the State?
- 16.22 It is possible to sketch the problem in terms of the needs of the three main players. Industry desires secure sources of supply for its raw materials, but whether that desire can be completely fulfilled or not, industry requires a much greater ability to predict what its future sources of supply are likely to be. The conservation movement desires the conservation of non-timber values in the native forest estate, particularly an end to logging of old-growth, but whether that desire can be completely fulfilled or not, the movement requires that forest operations utilize forest resources in a sensitive and appropriate manner. The government desires an equitable, lasting solution to the debate over forestry, but even if such a solution does not appear in the short term, government requires a stable consultative mechanism which is likely to yield a solution eventually.
- 16.23 The Forestry Commission is uniquely placed to play a constructive, healing role in this public debate. Unfortunately, for reasons which seem to derive from its corporate culture, history, and attitudes, the Commission has not so far seen fit to pursue this type of role. Instead of encouraging constructive criticism, it has chosen to batten down its hatches and weather the storm

which often follows its unilateral decisions. Instead of providing a forum for debate, it has tended to make decisions affecting the public interest in its "cocoon of isolation" and follow them up with a grim determination not to be influenced by public pressure.

- 16.24 Based upon some constructive approaches tried recently in Tasmania and in Oregon¹⁰ in the U.S.A., there may be greater scope than was previously thought to satisfy the needs of all three interests. "Tripartite agreements", as they have been called, involve tradeoffs offered to the various interest groups by the forestry authority. Typically, industry is offered security of supply in return for a commitment to more efficient utilization of timber with greater emphasis on value-added processing. Conservation groups are offered the opportunity to play a meaningful role in the planning process and the commitment that pricing and regulatory tools will be used to reduce and control the annual harvest in return for their acquiescence to long-term wood supply agreements with industry. With broad community participation in forest-use decisions, and general acceptance of long-term wood supply agreements, government's desire to create peace and equity is largely satisfied.
- 16.25 The Committee recognizes that it has a limited role in suggesting what directions the Commission should take in this context. Recognizing the Commission's reputation for inertia, the Committee feels that, at least in the early stages, the strong hand of ministerial intervention will be required to guide the Commission toward the constructive role which it is positioned to play. In the course of this inquiry the Committee was convinced that a State forestry authority could play such a positive, pro-active role given the imagination and the will, and that a more satisfactory solution for all interest groups is achievable.


10 House Bill 3396 of the State of Oregon, U.S.A., passed in 1987, enshrines the notion of consensus-building in forestry legislation. This bill replaced the former 12-member Board of Forestry with a seven-member board, of which no more than three members may hold financial interests in forestry. Sole authority for regulating commercial forestry activities resides in the Board of Forestry. The process of implementing House Bill 3396 has involved hundreds of interested Oregonians. This legislation and the process which gave rise to it have drawn warm praise from the Portland Audubon Society, the Oregon Forest Industries Council, the Governor's Office for Natural Resources, and the Oregon State Forester.

Recommendation 78

It is recommended that the Forestry Commission initiate a working party composed of Commission, industry, conservation, and government representatives to consider how tripartite agreements could feasibly be implemented in the New South Wales context.

APPENDIX 1

Call for Submissions



**LEGISLATIVE ASSEMBLY OF
NEW SOUTH WALES**

Inquiry into Forestry Commission Retail Nurseries

The Public Accounts Committee has received a reference from the Minister for Natural Resources, The Hon. I. R. Causley, M.P., under Section 57(1) of the Public Finance and Audit Act 1983, to inquire into the Forestry Commission of New South Wales.

The Terms of Reference of the inquiry are "To inquire and report upon the Forestry Commission of NSW, with particular reference to the following matters:

- (1) The accounting processes of the Forestry Commission.
- (2) The performance of the Commission with respect to—
 - (a) efficiency
 - (b) economy
 - (c) effectiveness
 - (d) marketing and pricing policies.
 - (e) production controls
 - (f) finance and administration
 - (g) procedures and controls
- (3) The extent to which the functions and activities are in accordance with the charter of the Commission.
- (4) The functions and activities of the amenity nurseries.
- (5) Any other matter which impacts on the accountability, efficiency and effectiveness of the Forestry Commission.

Submissions relevant to this inquiry from interested parties and members of the public are invited. Submissions will be treated as public documents unless otherwise requested and should be sent to:

The Director, Public Accounts Committee, Parliament House,
Macquarie Street Sydney, NSW 2000

Closing date for submissions: 31 May, 1990.


Inquiries should be directed to Ms. V. Walker on (02) 230 2629.

Phillip Smiles, LL.B., B.Ec., M.B.A., Dip.Ed., M.P.,
CHAIRMAN

1
7
9
5
0
6
A

APPENDIX 2

Call for Submissions



**LEGISLATIVE ASSEMBLY OF
NEW SOUTH WALES**

Inquiry into the Forestry Commission

The Public Accounts Committee has received a reference from the Minister for Natural Resources, The Hon. I. R. Causley, M.P., under section 57(1) of the Public Finance and Audit Act 1983, to inquire into the Forestry Commission of New South Wales.

The Terms of Reference of the inquiry are "To enquire and report upon the Forestry Commission of NSW, with particular reference to the following matters:

- (1) The accounting processes of the Forestry Commission.
- (2) The performance of the Commission with respect to:-
 - (a) efficiency
 - (b) economy
 - (c) effectiveness
 - (d) marketing and pricing policies
 - (e) production controls
 - (f) finance and administration
 - (g) procedures and controls
- (3) The extent to which the functions and activities are in accordance with the charter of the Commission.
- (4) The functions and activities of the amenity nurseries.
- (5) Any other matter which impacts on the accountability, efficiency and effectiveness of the Forestry Commission.

This notice is readvertised to extend the submission period.

Submissions relevant to this inquiry from interested parties and members of the public are invited. Submissions will be treated as public documents unless otherwise requested and should be sent to:

The Director, Public Accounts Committee, Parliament House, Macquarie Street, Sydney, NSW 2000

Closing date for submissions: 31 August, 1990

Inquiries should be directed to Ms. V. Walker on (02) 230 2629.

Phillip Smiles, LL.B., B.Ec., M.B.A., Dip.Ed., M.P.
CHAIRMAN

1
7
8
6
0

APPENDIX 3

Submissions and Correspondence Received

Date Received	Name (as on letterhead or below signature)
12/04/90	Martin Hogan, Member Bellinger & Plateau Conservation Society
17/04/90	Bill Hurditch, Executive Director New South Wales Forest Products Association Ltd.
17/04/90	Jeff Angel, Assistant Director Total Environment Centre
19/04/90	Robert L. Pritchard, Managing Director Pritchard Associates
26/04/90	John R. Horne
01/05/90	Colong Foundation for Wilderness Ltd.
02/05/90	N. Armstrong, Shire Clerk, Cowra Shire Council
14/05/90	C.O. Wilkinson
23/05/90	G. Ballard, Thora Sawmilling Pty. Ltd.
23/05/90	Michael J. Morton
30/05/90	Bryan Spencer, Principal Executive Officer Nursery Industry Association of NSW Ltd.
31/05/90	M.E.C. Thorpe, President New South Wales Chapter, A.F.D.I.
01/06/90	Mr. G. Gibson, Miss K. Batchelor Upper Clarence Action for the Repair of the Environment
01/06/90	Marg McLean Australian Association for Sustainable Communities
01/06/90	Dr. John I. Cameron, Consulting Resource Economist, Australian Conservation Foundation
06/06/90	Megan Edwards, Secretary Coff's Harbour Environment Centre

Report on the Forestry Commission

Date Received	Name (as on letterhead or below signature)
21/06/90	P.G. Laird, Department of Mathematics The University of Wollongong
26/06/90	W.J. Gillooly, Director National Parks and Wildlife Service
14/08/90	Helmut Aimann, Wingham Forest Action
14/08/90	Chris Sheed, Oxygen Farm Inc.
24/08/90	N. Humphreys, Wood Production Manager Australian Newsprint Mills Ltd.
28/08/90	John Kelemec, Secretary Clarence Valley Conservation Coalition Inc.
29/08/90	Milo Townend, International Reform Alliance
29/08/90	G.C. Laws, Secretary Rotary Club of Parramatta North
30/08/90	John Corkill, North-East Forest Alliance
31/08/90	Anne Reeves, Consultant, South-East Forest Alliance
31/08/90	R.B. Smyth, Richard Smyth Planning Consultants Pty. Ltd.
07/09/90	George Day, Operations Manager Boral Timber Division
10/10/90	Steve Vine, Production Manager - Wood Supply CSR Wood Panels
19/10/90	Col Dorber, Manager New South Wales Forest Products Association Ltd.
19/10/90	P.G. Laird, Department of Mathematics The University of Wollongong
31/10/90	Jim Somerville
06/11/90	Greg Clancy, President Clarence Valley Conservation Coalition Inc.

APPENDIX 4

WITNESSES AT PUBLIC HEARINGS

Date of Hearing Name of Witness

18 June 1990

**Dr. J H Drielsma
Commissioner for Forests
Forestry Commission of New South Wales**

**Mr P A Fisher
Assistant Commissioner for Forests
Forestry Commission of New South Wales**

**Dr J Turner
Chief of Division, Wood Technology and Forest Research
Division
Forestry Commission of New South Wales**

**Mr J S Angel
Assistant Director
Total Environment Centre**

**Dr J I Cameron
Consulting Resource Economist
Australian Conservation Foundation**

**Dr W J Hurditch
Executive Director and Company Secretary
New South Wales Forest Products Association Ltd**

**Dr M E Thorpe
President, New South Wales Chapter of Australian Forestry
Development Institute**

19 June 1990

**Mr R V Wilson
Chief of Marketing Division
Forestry Commission of New South Wales**

**Mr G A King
Chief Forest Inspector
Forestry Commission of New South Wales**

**Mr F G Hoschke
Fire Management Officer
Forestry Commission of New South Wales**

Date of Hearing Name of Witness

19 June 1990 Mr P A Fisher
Assistant Commissioner for Forests
Forestry Commission of New South Wales

 Mr G D Pople
Chief of Forest Management Planning Division
Forestry Commission of New South Wales

 Mr J M Lowery
Chief of Lands Administration Division
Forestry Commission of New South Wales

 Mr D J Pettigrew
Chief of Administration Division
Forestry Commission of New South Wales

14 August 1990 Mr R L Pritchard
Solicitor/Managing Director
Pritchard Associates Pty Ltd

 Dr J J Landsberg
Deputy Chief, CSIRO Division of Wildlife and Ecology

 Mr L G Braithwaite
Shire President, Bellingen Shire Council
Logging Contractor

 Mr W W Tapping
Nursery Retailer

29 November 1990 Mr W D McPhee
Managing Director, Australian Heavy Hardwoods Pty Ltd