

FORESTRY AS A BUSINESS

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Forestry, like any other industry, forms part of the general economic structure. It does not, and cannot, stand alone in splendid isolation. The forest industries compete with one another, and with other industries, for the national resources of land, materials, labour and capital, and accordingly must fit into the complex pattern of the economic system.

At this symposium, and later in the broad pattern of the forthcoming National Development Conference, the future of the industry will be discussed. Foresters and their colleagues will be planning for development; if these plans are to be realistic and capable of achievement, it is an essential prerequisite that the planner should be able to make a dispassionate and reasonably accurate assessment of the general economic conditions, both present and future, within which the industry must operate.

In the development of industry in New Zealand, as in any other modern economy, it is dangerous to assume that a *laissez-faire* policy is adequate. The whole of the economic system and each of its components should be flexible and responsive to change. Sound development of the economy requires, and, in fact, is largely dependent upon, an alliance between the State and private enterprise, each filling an appropriate role in the partnership—the separate spheres of activity clearly defined, yet each complementary to the other.

From the Government, industry is entitled to expect a political policy, based on a proper appreciation of economic facts, designed to take some of the steepness out of the hills and hollows of trade—to mitigate and not accentuate economic fluctuations.

That this responsibility is recognized and accepted by the Government is evidenced by the following extract from the Economic Review presented to the House of Representatives in June 1967 by the Minister of Finance:

It is accepted that, in addition to providing a wide range of public services, Government should be concerned with such objectives as the maintenance of full employment, economic growth, welfare standards, reasonable stability in prices, and balance of payments equilibrium. If such objectives are to be achieved, Government economic policy must be aimed at the promotion of economic stability by bringing about a reasonable balance between the level of demand and the resources available.

... and further,

The increasing complexity of modern economies requires a greater degree of sophistication in economic management if a reasonable balance between demand and resources available is to be achieved. Thus, Governments throughout the world have found that it is necessary to use all types of economic measures as a matter of course if economic stability is to be maintained.

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This leads to a consideration of the instruments of management available to Government to attain its economic objectives. The three principal instruments of management are: Monetary policy, fiscal policy, and direct controls.

Monetary policy is concerned with the supply of money, the availability of credit, and variations in interest rates. Fiscal policy involves the making of deliberate adjustments in revenues and expenditures, including full use of the tax system, so as to get more stable growth. Direct controls include controls on imports, exchange transactions, building, and a number of other activities.

Over-reliance on monetary policy and direct controls often has undesirable side-effects. This is particularly true for direct controls, which tend to limit the flexibility of the economy. While monetary techniques must, and direct controls may, continue to be used, the most desirable and effective combination is a finely balanced use of monetary and fiscal policies in conjunction. There is an increasing willingness on the part of Government to employ fiscal measures to a greater extent than in the past, and I, for one, welcome and commend this attitude.

For many years, the dominant economic problem in New Zealand has been the need to restrain a persistent tendency towards inflation caused by rapid growth of both public and private expenditures and the consequent pressure on all resources, in particular, labour and imports. Government is faced with a dual problem—the regulation of its own expenditure, and how to limit private expenditure to the available resources. The monetary and fiscal measures of February and May, 1967, have gone some distance in easing the pressures. I hope that the ground gained will not be lost on purely political considerations.

Industry should not, and in fact cannot, leave planning to the Government alone. National progress will depend also upon the extent to which organizations outside Government are prepared and able to contribute from their own resources to the extension of planning into the sectors with which they are concerned.

In brief, then, the Government can indicate and to some extent control the economic climate, but it is over to industry to plan and develop within that climate. An understanding of the whole complex structure of national economics is necessary as a prerequisite to industry planning. I believe that industry must accept a large measure of responsibility for its own welfare. It can turn to the Government for guidance, and is entitled to expect Government to use all the economic tools at its command to create the most favourable possible circumstances for industrial growth, but there should be a limit to industry's dependence on Government. I have often detected a two-voiced attitude, with some industries asking for greater freedom and more protection in almost the same breath. The world of business is a fairly rugged playground, and to use a phrase popular at present, we should be prepared to "throw the ball around".

In at least one respect, planning in the forestry industry is more difficult than in most other industries, because of the element of time—the growth cycle. This aspect has apparently been recognized in programming the National Development Conference. Almost every committee has as its order of reference "to indicate desirable and practicable economic growth rates and targets for

the development of . . . resources and processing industries during the periods ending 1972/73 and 1978/79". Thus, a two-phase analysis is sought. But it is significant that, in the order of reference for the Forestry Committee, the following additional words are added . . . "and in the longer term to the year 2000 or beyond".

Because of this necessity for longer-term planning, and because forestry is a capital-intensive industry, a greater degree of courage is required in formulating policy. The confidence from which this courage can spring has its roots in knowledge, and this is, of course, where foresters have such an important part to play. I suggest that the forest industries, like so many others, are suffering today as a result of haphazard growth—lack of planning in the past. In the highly competitive world of today and tomorrow, skilled advice and direction are paramount requirements.

That forestry and forest industries have a great future there can be no doubt. Recently, I read with a great deal of interest a special supplement published by the *Australian Financial Review* and titled, "Timber's New Horizons". This was, of course, written in the Australian context, though with some reference to the competitive aspects of forest industries in New Zealand. The various articles left with me the impression that New Zealand is perhaps more advantageously placed than her Australian neighbour. It is, in any case, important that, whereas Australia is a net importer of timber to the tune of about 120 million cubic feet of log equivalent per annum, New Zealand has become a net exporter of about 30 million cubic feet in log equivalent annually. It is also significant that the N.A.F.T.A. agreement appears to have centred largely around the timber and allied trades. It is too early yet to say whether this agreement is going to be of major benefit to New Zealand or the forest industries, but it does at least open an important avenue for exports. And of one thing there can be no doubt. If New Zealand is to maintain her standard of living, there will have to be less reliance on earnings from the traditional exports of meat, wool, and dairy produce, and more on other commodities and other avenues for acquiring foreign exchange. Australia is already a valuable market for New Zealand timber and timber products, and can become even more valuable. However, I believe we must face up to two facts of life. One is that we have to deliver the goods in the form and at the price required by the overseas buyer, and the other is that we will have to look further and be tougher in our international trade arrangements.

One article in this special Australian supplement rather intrigued me. It stated, *inter alia*:

The key questions as far as the forest products trade between Australia and New Zealand is concerned are in essence pretty simple: whether New Zealand is *to be allowed* to earn additional foreign exchange by processing forest products before exporting them or whether it is to be held to supplying raw materials only.

The article goes on to suggest that it is the desire of a diverse array of Australian interests to ensure that as much processing as possible is done in Australia, with tariff, import quota and/or voluntary restraint protection if necessary.

This really crystallizes the problem of trade with Australia. We are not entitled to, nor should we seek, any special treatment

engendered by a feeling of responsibility or sympathy. We certainly do not need the latter. There is a lot of irresponsible nonsense spoken and written about trade between the two countries. I deplore the "Big Brother" attitude adopted by some Australian journalists, and, in any case, there is plenty of indication that the Australian businessman soon forgets the brotherly love aspect when his pocket is affected, and he is not slow to run to his Government for protection.

Also, let us forget about political union with Australia. This is neither practicable nor desirable. We are an independent sovereign nation now, and I hope we will stay that way. Those who advocate political union display scant regard for the practical issues, and almost completely ignore the ideological issues. By all means, let us try to get closer to our Australian neighbours in every possible area — international finance, trade, defence — but political integration — no.

A great deal is written and spoken about our trade deficit of some \$100 million with Australia. If multilateral trade is to develop, then balanced trade with any particular country is not necessary. It is clearly impracticable to achieve a precise balance with every country we trade with — the thing that matters is that our total trade should be in or near balance. However, we appear to be a long way from achieving the goal of multilateral trade on a world basis, and, as far as New Zealand is concerned, it is clear that to some extent at least we must look to bilateral trade in order to secure adequate markets for our exports. In these circumstances and taking the long-term view, it is not unrealistic to state that New Zealand's current trade deficit with Australia is Australia's problem, not New Zealand's. We provide a valuable market for Australian production, and if Australia wishes to preserve that market, then obviously she must be prepared to provide for reciprocal trade. This is why we may have to look further and certainly be tougher in the tough arena of world trade. And this is an area where the closest co-operation and harmony between Government and private enterprise is necessary. Industry must find the markets and Government should do all in its power to facilitate international trade.

Forestry has already established manufacturing in depth and is contributing significantly to export earnings. The title of this symposium might be altered slightly to read "Forestry is a Business"; the development of that business involves the most skilled appreciation of future volume and variety of production in relation to the markets of the world.

As forestry is a business, it must, as pointed out earlier, compete with other businesses for available resources. In competing, it must recognize the pervasive influence of the profit motive in all business enterprise. To evade this issue is to court disaster, for we work and live in a capitalist economy where the profit motive dominates the utilization of resources. Nor is there any need to regard profit as a dirty word. It is, or should be, generally accepted that, under normal competitive conditions, the profitability of any enterprise is a measure of its economic efficiency. Most of us strive for greater efficiency and there can be little doubt that efficiency and profits are very closely linked indeed.

Apart from the technical aspects of forestry, the major issue in the growth of the forest industries is undoubtedly the provision of finance for the acquisition of land and the planting and care of trees until they mature and so provide income and realization of the capital investment. It is in the realm of finance that forestry differs so vitally from other industries.

The private investor normally expects two things from his investment in business. He requires an annual return on his capital, and he looks for an increment in the capital itself, at least sufficient to keep pace with normal inflationary trends. The growth cycle of our exotic forests, though favourable, does pose a problem which is not found in any other industry. The farmer shears his sheep or reaps his crops once in every year: the manufacturer utilizes his buildings and plant for an immediate return: the merchant turns over his investment in goods several times a year: but if money is invested in trees it is locked up for twenty years or more. During this period, the owner of the trees can expect no annual return on his money and he must hopefully wait and see if the ultimate realization of his forest on maturity has in fact accumulated an adequate income on the investment while at the same time the capital sum has been maintained at true values by increasing at a rate at least equal to the annual depreciation of money. In this regard, it should be noted that, during the last two decades in New Zealand, money values, as measured by the Consumers' Price Index, have declined by about 3% per annum. I think that this point is important because I feel that there is little or no attraction to the individual to invest substantial sums in purely forestry companies—that is, companies with no interest other than the planting and growing of trees. The problem, of course, does not stop at the initial outlay—each year of growth demands a further investment for forest care and maintenance.

The position of financial institutions is not very different from that of individuals. While they can afford to take a longer-term view of investment, they normally look for an annual return as well as capital growth.

In these circumstances, it is natural that forestry activity has been largely confined to three groups:

- (1) The State.
- (2) Companies concerned with forest utilization.
- (3) Farm woodlots and shelterbelts.

The role of the State has always been an important one and is likely to continue so. The establishment of State exotic forests dates from 1896 and the State owns over 50% of the total area of exotic production forest. This is an instance of a rather unique association of the State with private enterprise, and while there may be aspects of the State's activities which may not find favour with everyone, there can be no doubt at all about the vital national importance of the State's exotic forests.

Apart from the State, the major forestry activity lies with commercial enterprises associated with various aspects of wood production and utilization. The combination of forest planting and growth with industrial activity provides at least one effective solution to the financing of exotic forests. So long as capital invested can be serviced from the profits of industrial activity,

companies can afford to take the long view about forestry and plough back surplus profits into trees for the future. Doing this does, in fact, have a two-fold attraction. It is both an avenue of investment and a source of raw material at minimal cost for future industrial activity. Here, I can speak with some first-hand knowledge of the value to a timber company of having control of an adequate supply of its essential raw materials. There is also a human problem involved. While the individual is normally reluctant to tie up his resources in a long-term venture from which he personally may never derive a benefit, the same considerations do not apply to a timber company. The company is a continuing entity, and directors are more inclined to plan and invest for posterity.

Even so, the overall financial situation still remains a governing factor. Capital for forests must be found, but that capital must be serviced on an annual basis. There are three principal sources of funds which can be utilized for forestry purposes. Briefly, these are share capital, loan capital and retained profits.

For the reasons already advanced, I am doubtful if any substantial volume of equity share capital is likely to be attracted to a purely afforestation venture. In a recent (1967) survey of 292 public companies by the Reserve Bank, it was established that net profit after tax averaged 9.7% of shareholders' funds. Included in this survey were 17 companies classified as "Forestry and Wood": the combined shareholders' funds were \$99.2 million and profits were 10.1%. This is not too far away from the average for all manufacturing groups (excluding food) which showed a return of 11.1%.

By far the most attractive source of finance for forestry purposes is retained profits. Again using the Reserve Bank statistics, I have extracted some quite interesting comparisons showing the source of funds for capital investment in property and plant. The following percentages indicate the extent to which share capital was raised during the year ended 30 June 1967 to finance acquisition of property and plant:

All groups surveyed (excluding finance companies)	17.1%
All manufacturing	10.6%
Forestry and wood	6.6%

This comparison indicates that the forest industries rely more than other industries on retained profits and borrowing, for expansion and growth. Another interesting comparison available from the same survey is the extent of reliance on bank overdraft to finance current assets. Here the Forestry and Wood group are the lowest of all manufacturing groups with 9.6%, compared with an average for all manufacturing of 16.8%.

Once a company embarks on an afforestation project, it must of necessity simultaneously plan its finances on a long-term basis. On the average, Forest and Wood companies distribute 53% of tax-paid profits as dividends. The remaining 47% plus depreciation constitute the internally generated funds for development. Obviously, all of these funds cannot be earmarked for afforestation, as the other branches of company activity will also require annual capital injection. However, a proportion of these internal funds

can be appropriated for forestry, and once again a long-term policy decision is required.

To the extent that further finance is necessary, borrowing, but definitely long-term borrowing, is the most attractive source. To a minor extent, issues of convertible notes are a satisfactory source of finance but these normally have a five-year term only, in order to secure the tax benefit from the deduction of interest.

Over recent years, there has been an increasing use of tax concessions as incentives to industry. The increasing use of the tax system as a means of encouraging particular industries was criticized in the Report of the Taxation Review Committee and no doubt you will expect me to comment. First, I want to make it clear that the Committee fully accepted that it is the function of Government to influence economic development and guide the allocation of resources into those fields of enterprise which are considered to contribute most to growth and welfare. In general, however, the Committee considered that incentive tax concessions, based on deductions from assessable income, suffer from three main defects:

- (1) In many cases they lead to wasteful expenditure.
- (2) In all cases they are inequitable in their effect on taxpayers.
- (3) There is no way in which the national benefit derived from the concessions can be measured. Neither their total cost nor their effect on economic growth is known.

The Committee preferred a type of concession which would enable the cost to be known with certainty and which would avoid creating inequalities and distorting the taxation system. Acceptable incentives are those based on tax rebates, direct grants or loans.

There are three incentives available to the forest industries, all of which escape the worst defects of other tax concessions, and all three were accepted by the Committee, though in one case with a reservation.

- (1) The provision whereby the initial cost and maintenance of exotic forests can be claimed as a deduction for tax purposes in the year in which the expenditure is incurred is, in effect, tax deferred. The forest cost is written off progressively during the years of growth instead of at the time of extraction of the trees. This can be compared to an interest-free loan from the Government.
- (2) Under the Forestry Encouragement Act 1962, farmers who own or lease land may apply to the Minister of Forests for a loan to establish a commercial woodlot or plantation. Any farmer who is granted such a loan is entitled to deduct from his assessable income:

Loan interest.

The costs of planting and maintaining trees over and above the amount covered by the loan.

Repayments of the loan capital in the year such repayments are made.

When land is sold with standing timber grown or maintained under a forestry encouragement agreement, the amount re-

ceived from the sale of the standing timber is not taxed. Income from the sale of felled timber or from the granting of any right to remove timber is taxed in the year of sale or it may be apportioned over five years. Standing timber grown or maintained under such an agreement does not form part of the farmer's dutiable estate and is, therefore, not subject to estate duty.

The emphasis in the Forestry Encouragement Act is on the establishment of commercial woodlots or plantations. While the provision of direct monetary assistance is the type of incentive which the Committee prefers to tax concessions, in this case the two types are linked in such a way that the loan virtually becomes a subsidy to the farmer. A concession of this type distorts the tax system and destroys equity as between taxpayers.

- (3) The export sales concession escapes the worst defects of many other tax concessions. It is linked to results, namely, increased export sales, and hence waste is avoided.

The question of incentives, whether by way of tax concessions or other means, is important, and is linked with the broad issue of finance for forestry development. When considering the financial aspects of the forest industry, remember that a concession need not be based on deductions from assessable income; tax rebates or direct grants are more valuable incentives and certainly more equitable.

To conclude: I believe that the forest industries have a great potential in New Zealand's economic progress. They certainly offer a challenge to technical skill and management ability. Planning is the keynote and fullest co-operation between Government and private enterprise is an ingredient essential to success.