"transparent" than it first appeared. It was only because of a court case involving Carter Holt Harvey that it was revealed that Mr Prebble approached Carter Holt Harvey and invited them to make a secret pre-emptive bid to buy the Hawke's Bay and Canterbury forests.[5] How much other information involving other sales isn't public and won't be revealed because there is no court case?

At the moment the sales mechanism is a perverse sort of Dutch auction whereby the negotiators have established a forest value and are approaching the losing bidders individually. If a bidder does not come up with an acceptable bid in negotiations, the next bidder is approached. This system is not open. It is not fair. And it is not transparent.[6]

In announcing the withdrawal of the Bay of Plenty forests and the creation of Timberlands (BOP) Ltd., Andy Kirkland, General Manager for the Forestry Corporation, noted: "It may sound a little vague, but it is better to enter into (the sale) in a flexible way".[7] One is left to wonder that if it is a better way now, why wasn't it the way recommended by the Forestry Working Group to Government and why wasn't it the method which was adopted in the first place?

Repeated assurances were given all during the sales process by the Prime Minister and others that the sales were necessary and essential to repay debt. Yet a large portion of the sales are now to be included in current income and used to pay current operating expenses.

It is clear why Government is selling the assets. Mr Caygill noted in his budget address that Government no longer needed to reduce the country's debt. That is gratifying since Treasury predicts that next year's deficit will be $2.2 billion. However, if all goes as Mr Caygill hopes, there will be no further opportunities for cash flow from State forest assets other than tax recovery and minimal land rentals. Given these scenarios, Government will have to either increase the country's debt, increase taxes, or expand the money supply.[8] They will have little choice. They will not be able to depend on rapidly increasing cash flows from the forests. The forests will all have been sold. Why is it imperative that the forests be sold if the proceeds don't have to be used to retire debt?

Everyone seems to agree that an enormous amount of capital will be required if the forest assets are going to be processed onshore. And Government cannot and should not provide that capital. Overseas capital will be needed to build up the processing sector in the forest industry. But with the creation of the Forestry Corporation, there were opportunities to develop this processing in a commercial manner without Government funding. The Corporation could have entered into joint ventures and partnerships to develop the processing sector in New Zealand. Now it appears highly unlikely that they will have that opportunity. They are scheduled to go out of business on March 31, 1991.

A final irony is that the Forestry Corporation has a new advertising campaign. One television ad shows a mature radiata being felled. The message is that it was the plan all along to sell trees and now is the time to do it. The television commercial is nicely done, but it is misleading. The implication is that mature timber is being sold. A more appropriate picture would have been of a stand of young pines, roughly halfway through their expected rotation. For the most part, it is these trees and at least one additional rotation which are being sold.

Government is conducting a forestry sellout. The country's State forest assets which have been built and developed for at least 70 years are being sold. A large part of the revenue will go to fund Government programmes in one year, and an election year at that. Looking at the expected development beyond 1990, nothing, including this Budget, has convinced me that it is either the right time or the right way for Government to sell out forestry.

[5] MacLennan, Catriona. 1990. "Carter Tells Court About Secret Offer". National Business Review. June 29, p.3.

[6] For a discussion of auctions and administrative issues regarding the sale, see: Bilek, E.M. and G.P. Horan. 1990. "Organisational and Administrative Challenges Involving Large-scale Transfer of Public Assets to the Private Sector. New Zealand's Experience." Paper presented at the International Union of Forestry Research Organisations. XIXth World Congress, Montreal, August.

[7] Anonymous 1990 "Tasman not Ready to Withdraw Injunctions." Rotorua Post, April 18.

[8] The latter choice is objectional since without an increased output in goods and services, this will lead to inflation.

State Forest Assets Sale: Myths and Realities

Jim Sutton, Minister of Forestry

In the May/1990 issue of New Zealand Forestry E.M. Bilek identified "myths from realities" in the reasoning behind the long-term sale of cutting rights to the Crown's plantation forests. The "realities" he identified show more "myths and red herrings" than helping to identify the issues involved. Where necessary I shall deal with individual questions. But in the first place let me answer the initial question he raised: why is the Government selling cutting rights? That will clarify the position on most of the other questions.

Since the 1920s hundreds of millions of dollars in taxpayer money has been spent in establishing our State plantation forest resource which now stands at 550,000 hectares. At the same time through generous incentives (again using taxpayer funds) the private sector too has planted a similar area. This expansion was the result of a conscious decision to establish an export-based forestry industry. The Government's role then was to support and nurture an immature industry. As a part of that strategy long-term contracts were entered into to supply wood at subsidised prices and the Government itself was involved as a shareholder in some operations.

Those mechanisms served their purpose: we now have a largely efficient forest industry which annually contributes over a billion dollars in export income. But in reaching that stage the taxpayer had to bear a large cost; until the Forestry Corporation was established in 1987 the taxpayer continued to directly pay for the Government's plantation forestry operations. Furthermore, the taxpayer as a consumer had to pay higher prices for forest products because of various government restrictions such as import controls.

Let me turn the initial question around: why should the Government continue to manage a commercial forest estate?

Forestry is no longer an infant industry; thanks to the taxpayers and the entrepreneurs we now have mature plantation and processing industries in New Zealand. Over the next ten years wood supply will double; if the country is to derive maximum benefit from this increase critical decisions on its use have to be made now to give sufficient lead time to establish the necessary processing plants.

Wood processing plants are generally highly capital intensive; one consultancy study estimated the need to incur capital costs of $10-11 billion over the next 20 years to process that wood. I maintain that there is no need to use taxpayers' money in such ventures. Plantation forests were established for commercial wood production: there are other values derived from the forest but they are secondary. So why should the Government have a role in managing them? Isn't it more appropriate for the private sector to make business decisions?

Bilek argues that all that is required to get private investment into domestic processing is a stable economic environment and a guaranteed wood supply. I couldn't agree more; and that is exactly what we are doing. What more guaranteed supply than owning the cutting rights!

Ministers are not competent to make sound business decisions. Readers need not go beyond a few years to recall the several billion dollars the taxpayer lost because of Government involvement in the "think big" projects.

It was argued that a government corporation can do as well as the private companies. Corporatisation has definitely changed things around but it is too simplistic to assume that is the end to the matter. The fact is the chance of underperformance is higher in a public than a private organisation. The simple reason is that in the end public corporations are not subject to market discipline. This is not to say the capital market is perfect but it is clearly superior to Ministerial control. Ministerial involvement always carries with it the potential for political interference: Ministers appoint the Boards and they are the shareholders; they would not allow the enterprise to be taken over or go bankrupt. The halfway house approach is undesirable for a business operation which has to operate on a commercial base.

It can be argued that in industries where there are large social issues involved there could be a reason for direct or indirect State ownership; I do not see plantation forestry as one. It is a resource grown for production of wood commercially.

There are a few of Bilek's "myths" I would like to discuss further.

Necessary in order for the Government to pay off debt?

Bilek argues "the sale will result in a large reduction in future income which could be used to pay off that debt". The more likely scenario is the complete opposite. The sale is timed to take advantage of opportunities in the market; the shrinking wood supplies from tropical forests and major forestry companies are cashed up. The earning capacity of over 10%, currently enjoyed by the Forestry Corporation, implies good prices will be paid for the cutting rights to the Crown's plantation forests. To sell these rights in any other situation than when "it is both earning more than it is costing and earning more than the hurdle rate" will surely reduce the price. I hope the writer was not suggesting that the Government should wait until costs are greater than earnings, to sell the forests. Very few people want to buy into a business which is incurring a loss, and if they do it is only at a substantially discounted price.

To avoid future calls on Government for cash?

Bilek calls this another red herring. "All along, Government has insisted that the SOEs are independent limited liability companies." His isolated example of Government's failure to come to the aid of DFC, is a "red herring". Government certainly heeded the call for cash from the BNZ. The past practice of guaranteeing cheap, long-term supplies of wood to forestry companies, was a disguised means of heeding the cash-call. The point to note is even if the Government does not heed a call for cash the fact that it is seen as a Government responsibility could have other implications for investment and capital markets.

Buyers will replant trees they cut?

Bilek in his paper was suggesting that replanting should be compulsory. I do not believe it should be. For one thing there are forests in places where it will be uneconomic to replant. I agree that "if it is in its best interests to replant trees, they will". A large number of factors exist to suggest that it is indeed in the owner's "best interests".

Cutting the existing tree crop, with no effort made to invest in its continued profitability, is inconsistent with the young age of the forests, with New Zealand's medium and long-term prospects as a competitive supplier of forest products, and with international market expectations. Replanting is the best means of maximising the return on the investment. It "makes no economic or business sense" to pay a rental of 7% and keep land unused. Even if a buyer has no interest in using a replanted crop he or she can profit when on-selling the cutting rights to the forest if it has been replanted.

It may be worthwhile noting that half of New Zealand's production forests are currently privately owned, and these are being replanted without any compulsion.

There is no need to require replanting, except in cases where "wise land use", from a conservation, research or cultural perspective, deems this prudent. This is indeed what has been done. Prohibitive covenants on replanting, in any other situation, are neither necessary nor wise. Of course the buyer of the cutting rights should have the option to put land to its most productive use. Constraining buyers' land-use options will "diminish the forests' current market value", in terms of what the buyer is willing to bid, and will lessen the return on taxpayers' investment into this most important sector.

To minimise the Government's risk exposure in the business sector of the economy?

I am surprised that an economist is arguing on such simplistic grounds that by selling forestry assets the government risk-exposure increases. All good business people will tell you that to be successful in business you "stick to your knitting". This is the best way of managing risks and the Government is doing exactly that. Sources of government income are diverse, including direct and indirect taxes and there is no risk exposure from selling a commercial asset.

The role of Government is not in commercial business: its role is to create the right environment for businesses to operate efficiently. Government or government-owned corporations are more prone to inefficient management than private companies in business ventures. There is no need to expose the taxpayer to the risks of commercial investments when there are others who are more capable of making such decisions. In areas where the Government considers that the market will not operate efficiently, such as replanting in areas prone to soil erosion, measures have been taken to meet the requirements.

I am aware of the concerns of many foresters relating to the sale of cutting rights; the sale was necessary in the long-term interest of the taxpayer. We have taken necessary steps to ensure that essential non-commercial values of the forests are protected. I believe the sale of cutting rights is a logical step at this stage in the development of New Zealand's forest industry: an industry which has a bright future and which will assume a key place in the New Zealand economy.

Jim Sutton
Minister of Forestry