each time the fellow overseas has to go further into his forest and incur higher cutting costs.

What's more, if anything, you should be increasing your productivity and reducing your production costs while the real price overseas is rising.

Flexibility

But to make the most of this, you must keep flexibility in the way you use your material. If your use is locked in – specially to a low-value-added item like plywood – then your, and the national, economy doesn't get the optimum economic rent.

Or to put it another way, as with the old meat industry, we are not adding as much value as we can, although to some extent this can be blurred by figures showing – for example – an 18 per cent increase in sawn timber exports in the past year. When you compare the volumes involved with log volumes, it becomes clear the economics encourage our flogging logs as commodity exports rather than turning them into products with value added in this country.

Kel Sanderson, at BERL, has taken the best stab he can at analysing what's happened in recent years.

His methodology – limited availability of statistics, he concedes, means it's not perfect – measures products for which data are published.

Sawn timber export volumes doubled between 1988 and 1992, while log volumes increased almost four-fold.

But the Sanderson model goes further, adding up a sample of logs, sawn timber, particle board, medium density fibre board, pulps, kraft paper and coated paper, and so on, and treating each as if it were measured the same way. The data from this show exports of 1.8 million metres or tonnes in 1988 became 5.5 million tonnes in 1992. But the average price per tonne was $402 in 1988 and just $246 in 1992 – a whopping decline.

Only Difference

Figures like these tell us we aren't processing the same percentage of forest product as we were four years ago. The only difference between now and the old days of the meat industry is that today's butchers cut loose in forests with chainsaws and the commodity doesn't need chilling during its journey to the workforce where value will be added.

Bob Edlin

Rising log prices – an industry living in interesting times

In February and March of this year increasing log prices produced a rash of stories in the New Zealand media. Many of these concerned tensions between local processors and log exporters over the availability and price of logs for domestic processing. Some, particularly representatives of smaller independent sawmillers, expressed concern that despite being prepared to pay fair prices, employment-creating, value-adding processors were unable to get reasonable supplies of logs. This was blamed on large forest owning companies being interested only in exporting unprocessed logs to Asian markets. (With the national unemployment rate in excess of 10 per cent and log exports up yet again to some 4,117,000 m^3 for the December 1992 year the predicament of these processors quite naturally attracted interest.) As might be expected in these days of a market-driven world not all of the comment was completely sympathetic to plight of the small processor.

The argument that export logs are themselves a value added product was once again dusted off. Exponents of the free market were also quick to point out that if log exports provided the best return on the investment in forest growing, taking steps that would inhibit the trade would be detrimental to forestry's long-term interests. In his weekly National Business Review column Gareth Morgan even suggested that instead of complaining about log availability and other countries' barriers against imports of processed forest product local sawmillers could benefit both themselves and New Zealand by considering shutting up shop here and investing in processing in Japan or Korea.

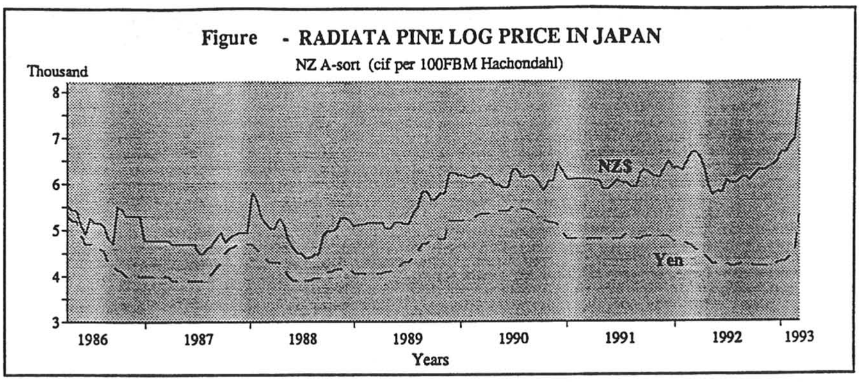
There's no denying that log prices have risen in the last few months. The NZ Forest Owners are on record as saying that in the six months since September 1992 the price of 'C' grade logs went up 77%, 'K' grade 30% and 'A' 39%. As well the Ministry of Forestry's Market Report for February 1993 states that at-wharf prices for pruned log have reportedly increased by 80%. These days (March 1993) one can, without too much difficulty, find reports of FOB prices of the order of $290/m^3$ for (some) pruned logs. This price is well up on the $130/m^3$ used in a number of recent forestry investment proposals, or for that matter on the $150/m^3$ that one would get from taking the 1988 BERL report forecasts and simply adjusting them into 1992 dollar terms. But so what?

What's behind the log price rise?

For some the current rise in log prices is nothing more than the growing pains of an industry in the process of reaching its rightful place on the world stage – a painful but necessary adjustment to the real world where New Zealand radiata pine will be green gold. Moreover, as claims about the log supply problems diminish as the result of what Wayne Coffey describes as "a lot of positive discussion" between processors and growers, it is very easy to dismiss a lot of hoo-ha of the last couple of months as simple posturing by two sides about to enter into new supply contract negotiations. Is that all there is to this story?

Like most stories with an economic twist, the answer to that question really depends on the future and people's expectations as to whether or not the current log price level will prove to be sustainable. However, before tackling that question it might not be a bad idea just to look at what has happened to export log prices, but rather than the last six months it is perhaps wiser to take a slightly broader perspective and look at say the last six or seven years.

The MOF graph (Page 8) shows that over the seven years from 1986 the delivered cost of 'A' grade logs has been steadily rising in NZ dollar terms by about 5 per cent per annum. But the graph also gives the log price in Japanese yen and this reveals that much of the increase has been due to depreciation of the New Zealand currency rather than an improvement in the Japanese price for radiata pine logs. It is only in the last couple of months that prices have really taken off in both yen and NZ dollar terms. Another point that is perhaps a little worrying, from the point of view of the longer-term stability of the current price levels, is that as one looks at the graph one can see other examples, e.g. in 1986, 1987/88, 1988, where prices started to take off as they have at present only to rapidly collapse back. Could history repeat itself yet again?



One other point perhaps worth making is that today's high prices are not that very different from what was being forecast back in 1985/86. Then FRI's Conversion Planning was forecasting the current export log prices would be of the order of \$NZ200-\$230/m³ for pruned logs, \$140-\$150/m³ for A grade and \$105-\$115/m³ for B. The weighted average of these prices would be around \$130/m³. Perhaps the current prices only seem so high because the actual prices over the last six years were so poor that they caused people to ignore or discount those predictions!

Future speculations

Let's now turn to the question of the longer-term sustainability of the current prices. If the current "high" price levels prove to be nothing more than a flash in the pan then their longer-term impact should be rather limited. Existing owners of mature forest blocks will make a few quick bucks by felling trees and exporting the logs – although given the age structure of the existing estate and the harvest history of the last three or four years this option has to be a rather limited one. While the higher prices may prove to be the death knell for a few processing companies, a more significant longer-term impact is likely to be that the lure of high prices will have attracted a few more investors into forest growing than would otherwise have been the case. Some of these investors are likely to become disgruntled critics of the industry when price levels drop. It is also likely that some sales of interests in immature forest blocks will be delayed while the parties involved argue over whether or not the increase in price is a temporary or a permanent phenomenon.

But what if the current price increase is only just a foretaste of things to come? After all *Investment Opportunities in the New Zealand Forest Industry,* which was released by the Ministry of Forestry just a few weeks ago, projects a fall in Pacific Rim industrial roundwood supplies by some 36 million m³ over the period 1990 to 2005. If this projection is correct, and should substitutes for wood prove to be as difficult to find and as environmentally unfriendly as some would have us believe, then it has to be highly likely that the current price increases are just the start of something really big.

Taxpayer the loser

In this case I suppose the first point to make is that anyone owning plantation forests is likely to do rather well. Following on from this comes the inescapable conclusion that one of the biggest losers is likely to be the poor old taxpayer. Why? Well up until 1990 the taxpayers of New Zealand owned some 47% of the resource. Today after a couple of asset sales rounds taxpayers can claim ownership to no more than 20% of the resource. Those forests that were sold went for an average price of a little over \$4000 per hectare; with the current export log prices those selfsame blocks should be worth one and a half to two times this amount plus in some cases a bit more for the fact that they're now a couple of years older.

Now it's very easy to say with 20:20 hindsight that perhaps July 4, 1990 was not the best time for the "sale of the century" but criticism based solely on hindsight is hardly fair. Could potential problems with forest worth have been foreseen before the sale? The answer is yes. Writing in 1990 before the sale Bilek and Mead raised the question as to why one particular date was the optimum day for Government to try to quit at least 70 years' involvement with plantation forestry. Bilek and I, also writing before the sale and addressing the topic of when to sell, concluded that "a prudent financial adviser would recommend that an orderly divestiture should occur over time – if it must occur at all." In our conclusions to that paper we stated that deficiencies in the sale process guaranteed some losses for New Zealand and we warned that there could well be further losses to taxpayers if the forestry sales did not return at least the long-term value of holding on to the assets.

Waitangi Tribunal Claims

There is also potential for taxpayers to lose yet again by the sale and this arises from a contingent liability that the corporatisation/sales process produced. In most cases questions about rightful ownership of forest land have yet to be resolved. In the event that decisions about this go in favour of Maori, taxpayers will, quite rightly, have to pay compensation. Under the Crown Forest Assets Act the minimum compensation will be an inflation adjusted 105 per cent of what the Government received for Crown Forest Licence when it sold it. Alternatively, compensation can be based on the market value of the tree crop – the rightful owners having the right to choose the compensation option to be used. If log prices and hence forest values increase substantially in the next few years, picking the option that successful claimants will choose will not be a hard exercise!

Maori Lease Forests

Rising prices and the Government's desire to quit forestry also has the potential to create problems with crown leases. Many of these are in reality joint ventures with Maori groups. Should Government in its haste to quit these use valuations that don't fairly reflect current perceptions of the worth of these blocks some taxpayers will no doubt feel aggrieved. On the other hand using the latest prices, or perhaps prices that are even higher than these to reflect the longer-term potential, exposes the new purchaser of the Crown's share of these JVs to the commercial risks of any downward change in prices. As the Crown's stated preference is sell to its lease partners – who in many cases entered into a lease simply because they didn't have sufficient money to carry out the investment on their own – a hard-nosed attitude on the part of the Crown, particularly if coupled with a later downward revision in the assessment of forestry's longer-term potential, is almost certain to leave these people feeling highly aggrieved.

Decision making in a rapidly changing market

And assessments of potential can change and change quite rapidly. It is, after all, just three years since Alan Gibbs, then Chairman of the NZ Forestry Corporation, stated that "in forestry, for example, contrary to popular opinion New Zealand does not have a lot of natural advantages. We cannot grow trees much better than many other countries do and the world is not desperate for our supplies." That perception was not universally agreed when it was first made and based on the optimism about forestry as revealed by the levels of new plantings it has even less acceptance today. With current export prices making returns of $60,000 to $70,000 per hectare possible it would appear that returns of 10% to 15% per annum or better could be available from forest growing. Perhaps one of the biggest impacts of rising real log prices is how quickly they can apparently render redundant any analysis of New Zealand forestry investment. A classic example of this would have to be the example of typical costs and returns given in the MOF Investment Opportunities booklet – already the returns given in this are about half those one would calculate using the current export prices.

A Challenge for Processors

If we truly are at the start of a period of sustained real price increases then it is the processors that will face the greatest challenge. They are going to have to find the investment money that will allow them to do more with the same amount of wood, to become more efficient. At the same time they're going to have to face up to an increasing reluctance on the part of wood growers to commit themselves to long-term supply contracts. If one is dealing with a highly concentrated industry, and forest growing in New Zealand is at present quite concentrated with four groups accounting for some 60 per cent of the resource, the lack of long-term commitments can be a problem. Bankers can be a bit chary about lending large amounts of money on processing projects that are dependent upon one or two suppliers for their raw material; projects that can be wiped out at any stage by a failure to secure sufficient raw material. If processing is not to become the sole preserve of large vertically integrated groups then the independent processors are almost certainly going to have to become more entrepreneurial, adaptive and innovative.

In the longer term high log prices should solve any problem of concentration in forest growing. Already over 20% of the estate is owned by a large number of smaller investors. Most of the current growth in the size of the plantation estate is due to this group. With growing forests yielding far better returns than virtually any other form of investment eventually most individuals with money to invest are going to be persuaded to put at least a little of it into growing a forest. Once most of the wood harvest is produced by a large number of smaller suppliers the problems of concentration should disappear. There remains only the problem of having to survive until this utopia arrives. Regardless of one's views on this, or for that matter on the long-term sustainability of higher log prices, now is certainly an interesting time to be involved in New Zealand forestry.

G.P. Horgan

East Coast woes

In the 1992 Budget Finance Minister Ruth Richardson launched the Government's only major development and environmental initiative since taking office: the East Coast Forestry Project. The goal was to plant 7000 hectares of forest a year for the next 28 years, creating a huge 200,000 hectare plantation.

Yet, less than a year later the project is in disarray following the withdrawal of Tasman Forestry from a proposed joint venture with the major landowner in the region, the Ngati Porou. Tasman was the only major forestry company enthusiastic about participating in the East Coast project. Enticed by the generous subsidies (or grants as they are described in the post-Rogernomics era). Tasman planned to develop a 50,000 hectare plantation centred around Ruatoria in the remote northern quarter of the East Coast. However, up to half the proposed planting area is covered in closed canopy kanuka, much of it over 4 metres tall, that the forestry industry agreed to exclude from clearance when they signed the New Zealand Forest Accord in 1990.

Lengthy negotiations between Tasman, Ngati Porou and conservation signatories to the Forest Accord failed to reach any agreement on the proposed clearance of the kanuka. The Forest and Bird Protection Society publicly withdrew from negotiations and precipitated Tasman's eventual withdrawal from the project in March this year. This led to recriminations all round with officials, politicians, foresters, and the Ngati Porou all criticising the inflexible stance of environmental groups. Lending weight to their criticisms was the Maruia Society's Guy Salmon who blamed "extremist elements" in the conservation movement for the collapse of the project.

Much of the criticism has been directed at Forest and Bird as we campaigned hard to have the native forest shrublands excluded from the scheme as required by the New Zealand Forest Accord. However, sheeting home blame to environmental extremists for the "reckless handling of their new power" is a superficial conclusion to draw from the conflict. Three key factors led to the downfall of the East Coast project.

Firstly, there was the failure of the Ministry of Forestry and, ultimately of the Government, to recognise and uphold the New Zealand Forest Accord, a pre-existing agreement. Ministers celebrated the Accord at its signing and promoted it internationally at the Rio Earth Summit as a model for others to follow. Everyone involved in the Accord recognised the potential commercial advantages for the forest industry and the country from a voluntary agreement that ensured the nation's forest exports had an environmental seal of approval. But this unique marketing advantage was obtained at a price – the agreement under the Accord that native forest communities, including kanuka forest and shrublands, would be excluded from clearance. Forest and Bird has simply asked that this Accord be upheld and that it be recognised by the Government. Instead, the Government has offered generous financial rewards through the grant scheme to companies prepared to ignore the Accord's requirements. To their credit, Tasman Forestry, an environmentally progressive company, chose to honour the Accord and withdrew from the venture.

The second factor leading to the project's troubles has been the insistence of officials and Ministers that the clearance of potentially up to 78,000 hectares of kanuka was a legitimate component of a soil conservation project. Complicated technical analyses of the relative erosion-proofing capabilities of tall kanuka versus radiata plantations miss the point. If it ain't broke don't fix it! There can be no dispute that the kanuka/manuka forest shrublands of the East Coast provide effective erosion control irrespective of whether it is marginally better or worse in this role than radiata plantations. Taxpayer money spent on clearing the kanuka is money diverted away from planting actively eroding cleared land. Clearance of the kanuka is also contrary to the nature conservation objective belatedly added to the project's objectives.

The final factor contributing to the project's woes is its mixed, and at times conflicting, objectives. These mixed objectives raised alarm bells in Treasury during the development of the project but their concerns were not shared by other officials. The project was sold to the country as a long-overdue erosion control initiative. More than 90% of the publicity, including Ministerial statements and supporting documentation on the project, focuses on the East Coast's horrendous soil erosion.