

## Forests – 13 Oct 2010

**The ACTING CHAIR (Mr Piccolo):** Minister, I understand that we are now moving to the examination of ForestrySA and forestry policy; is that correct?

**The Hon. M.F. O'BRIEN:** That's correct, yes.

**Mr PEDERICK:** No, I am ready to go. I refer to Budget Paper 4, Volume 2, page 6.8, dot point 1, which refers to the finalising of the **forestry industry strategy** and industry and public consultation. My first question is: when will that strategy be finalised?

**The Hon. M.F. O'BRIEN:** The final strategy is expected to be published during 2010-11, following further industry and public consultation. This is more a policy matter, so I will ask Stuart West.

**Mr WEST:** The Industry Development Board is reviewing the final draft at the moment and making amendments. I know they were doing that yesterday, so, hopefully, shortly after Christmas. They will have further discussion between now and then with industry and it should be released shortly after Christmas, they anticipate.

**Mr PEDERICK:** In response to that answer, are you saying a few months after that or in the shorter term, or will it be longer than that and will it be out to six months?

**Mr WEST:** The board only meets three or four times a year, and I think they have one more meeting between now and Christmas at which I expect they will finalise the strategy, and probably quickly after that it will be printing and what have you. I would imagine, hopefully, very close to after Christmas.

**Mr PEDERICK:** Minister, is the proposed forward sale of rotations of pine forests an integral part of the strategy?

**The Hon. M.F. O'BRIEN:** My understanding is that it isn't. I will again ask Stuart. I think the strategy is more one of broad directions in terms of land use, water availability, potential markets, selection of timber or varieties for plantation and the like, rather than issues of ownership, but I will pass it over to Stuart again.

**Mr WEST:** That is correct, as the minister has just said. I do not believe the final version will identify particular initiatives such as that, but I expect it will talk about issues such as value-adding, encouraging development and expansion of industry without specifying individual actions.

**Mr PEDERICK:** Just in line with that answer and in line with the same budget line, what **further consultation** is planned with industry stakeholders and the public?

**The Hon. M.F. O'BRIEN:** Again I will ask Stuart to deal with that matter.

**Mr WEST:** As I understand, the board's final board member comments were due this week, I believe, and then that version will go out to industry. This strategy has been well recognised by industry as having extensive industry consultation, so I believe it has been over consulted on and the intention will be to continue that. So, there certainly will be an opportunity for industry to have access to the next draft.

**Mr PEDERICK:** I refer to Budget Paper 3, page 5.2, paragraph five, which refers to an improvement in net lending, partly as a result of the **proposed sale of**

**ForestrySA assets.** Can the minister absolutely confirm that the government has made the decision to proceed with the forward sale of a number of rotations, as stated by him on ABC radio recently?

**The Hon. M.F. O'BRIEN:** I will answer the question, because obviously it is an area over which I have ministerial responsibility, but this is really a central Treasury budget issue. The Treasurer made a reasonably comprehensive statement to committee A on 7 October in which I think he gave a fairly explicit undertaking that there would be the forward sale of rotations.

**Mr PEDERICK:** Minister, don't you think that conflicts with a comment that the Treasurer made in the media last month that the government is still deliberating the forward sale of future rotations of timber? I guess the nub of my question is: has the government made the decision to sell these rotations or not? The public have a right to know, especially the people of Mount Gambier.

**The Hon. M.F. O'BRIEN:** Again, I would refer you to the Treasurer's statement of 7 October on which he was asked a number of questions by the Hon. Iain Evans. In that, I think the Treasurer was asked a similar question and he indicated that a proposition was being worked up which would go to cabinet and, because it had yet to go to cabinet, he could not really be drawn into further elaborating on both the process and the ultimate conclusion. So, I really have to constantly refer back to the Treasurer's most recent statement of 7 October to Estimates Committee A as being the definitive position of the government.

**Mr PEDERICK:** There is a bit of confusion, because there have certainly been media statements by you saying that the decision has been made and the Treasurer saying that you are still deliberating on the issue. Have you or the Treasurer been misleading the public in these remarks?

**The Hon. M.F. O'BRIEN:** No. This has been in the forward estimates, I think, since December 2008, so the proposition has been well and truly in the public domain for quite some time. It may well be that the Hon. Iain Evans hit the nail on the head when he talked about the outcome for the sale of Queensland government assets, where he said that, in his view, they did not realise market value. Our attitude is that we will do, among other things, a net present value analysis on the dividend stream. That would then put an underpinning benchmark sale figure, and we will go to the market having a fairly clear idea on what the asset is worth. If the bids come in nowhere near that, it may well be that the asset is not sold.

This is not going to be a fire sale, and it may not be a sale that occurs in the immediate future. We have to be cognisant of what is happening out there in the marketplace. As I said, the Queensland government have just put their forestry assets on the market. We have had a collapse in MIS schemes around the nation, or a lot of those are currently in administration and will be offered up to the market. Some of them have already been offered up to the market. So, we have to make a timing decision and then, when the asset is on the market, on the basis of an NPV calculation, determine whether the bids are attractive. That is where we are currently sitting.

**Mr PEDERICK:** So, minister, in relation to this being on the budget books since 2008—and you can correct me if I am wrong—why has there not been a **regional impact statement** completed as to the effect this sale will have on the

communities, especially in the Green Triangle, where timber supports 30 per cent of the local economy?

**The Hon. M.F. O'BRIEN:** I think for the simple reason that we engaged the Royal Bank of Scotland to do an economic analysis which would ultimately be a guide to what path we went down. I think they looked at a whole range of options, including the forward sale of one rotation, two rotations, three rotations. The Treasurer indicated that the Royal Bank of Scotland also looked at total privatisation. We have a no privatisation policy but I think it was considered prudent to at least look at that to assure ourselves that the state was not selling itself short by not going down that particular path.

Against all of those particular options we then looked at continued management by Forestry SA. So, all-up there were at least eight—and it may have been ten—various options. That work has now been done. I am travelling to Mount Gambier later this week or early next week to meet with key stakeholders, so now the process of consultation commences.

**Mr PEDERICK:** Minister, on the same budget line I was a bit confused at some of the answers the Treasurer gave the other night in estimates where he indicated that Forestry SA would be still **processing that timber** but then I believe one of his advisers said, 'Hang on; no, we don't guarantee the customer.' What I am getting at is that if there are two or three rotations, and especially the spectre of selling three rotations forward, can you guarantee that that timber will be processed locally? I do not believe you can because someone will process that timber in the cheapest place they can. If it is cheaper for them to export it to India and then process it, I would say the whole timber industry in the Green Triangle is at risk.

**The Hon. M.F. O'BRIEN:** I may call on the advice of Islay, who is the Acting Chief Executive Officer for Forestry SA, but my understanding is that while the Australian construction industry is robust, we have a ready-made market for our product but there is no financial incentive to send it offshore. It is a reasonably bulky commodity but, in the event of there being a collapse in the construction industry in Australia, then these plantations have to be harvested. On occasions, we have sold timber for processing overseas just because there has not been the domestic market to take up the timber.

One of the challenges we currently have is that the US domestic market has effectively dried up because the US home construction market is in the doldrums. My understanding is that we may have, in the past, on occasions exported to the US market. They no longer need our product—they have surplus product to dispose of and they know that their domestic market cannot consume it so they are looking for opportunities elsewhere in the world. I believe that imported US timber is a bit of a difficulty for us at the moment, combined with a surplus of international shipping capacity as a result of the global financial crisis. There are a lot of ships out there that are in need of cargo to remain economically viable.

I think that probably fleshes out the answer that I gave, that if your domestic market goes into a bit of a slump—whether it is the Australian domestic market, the US or the European market—there is less call on domestic product and, in those instances, like the Americans are currently doing, you look for international markets.

**Mr ROBERTSON:** There are a number of products that come out of the forest: the main products, you would say, are pulp logs and sawlogs. For a long

period of time there has been a surplus of pulp logs, surplus to domestic processing capacity. Over the years, a number of those issues have been dealt with: Kimberly-Clark having its pulp mill, and Carter Holt Harvey has a panels plant that takes that sort of product. Still, at the end of the day, the local softwood market for pulpwood and its product—woodchip—is not sufficient. Softwood woodchips have been exported through Portland for a long time, and that will probably continue.

On the sawlog front, certainly, when the housing market drops, the demand for logs drops. Local customers like a higher quality log, so to try to improve their operating cost structure they select the better log. To keep the harvest and transport contractors operating and to dispose of the less desirable sawlog, we have entered the export market for log, and we export a small amount of that. That waxes and wanes, but fundamentally we supply sawlog into the domestic market.

For a very long time, the domestic demand for sawn timber has been above the domestic capacity to produce it. If anything, there is a gap currently, so their imports must come in for supply and demand, even in a low housing market. As the economy grows, population grows, and the gap will be greater. There will be more imports, but there will also be more demand for local timber. The issue will become about what price people pay because, with the high Australian dollar, people will be able to bring that timber in at a lower price and that currently caps the price on timber, but the domestic market still produces, and in good times it does very well.

**Mr PEDERICK:** In relation to the same budget line, are you saying there is not a risk to investments made by sawmill companies in the South-East? I understand quite a few of them need to spend some money refurbishing and gearing up. Are you saying that they are not under significant risk from this forward sale of timber? I firmly believe they are.

**The Hon. M.F. O'BRIEN:** I think Islay probably answered it. As long as the domestic residential construction industry is robust, we have a robust domestic timber and timber processing industry. Standard & Poor's made the point today that we will probably be one of the last countries in the developed world to lose our AAA rating, because we are dealing with the ageing of our population through natural fertility but also thorough a fairly robust immigration policy. For that very reason, I think the domestic construction industry has got a couple of very solid decades in front of it.

Standard & Poor's took their projections out to 2030 for attention to the AAA rating by the Australian government. We will have peaks and troughs over the next 20 years; we are obviously going to experience one if not two recessions. I hope they are mild, but the long term trend is for fairly solid activity in the residential construction sector, which is then going to underpin the plantation activities in the South-East. I would be fairly confident that it would lead to investment in the processing capacity in the South-East as well, and there are indications that that is currently being looked at.

I am not sure what stage that forward planning is at, but I think it is highly unlikely, given the sheer volume of unprocessed log, that it is going to go to a place like India and then return in finished form. I have been told that the structural integrity—the strength—of our softwood is some of the best in the world as well.

I am reasonably confident, for those reasons, that the industry in the South-East is going to remain quite robust. In relation to the sale of the Victorian

government forestry assets—and there was effective privatisation there—there has been investment by the purchaser, or investment has been made by processors in Victoria and in New South Wales. With the Victorian situation, it has not been a turn-off for investing and processing capacity, and I think that that is going to hold true in the South-East as well.

**Mr PEDERICK:** In regard to the proposed sale, will the government be making sure that it realises a dividend return of at least \$44 million a year to Treasury or will it basically sell a very good asset and not put those funds back into the community? Will it basically be three rotations of forest and we get Adelaide Oval revamped?

**The Hon. M.F. O'BRIEN:** I said in response to two of the questions that we will do what is called a net present value calculation, which calculates the benefit at a future date of the dividend stream leading up to that particular date. You can actually determine a particular interest rate, and that is the science in it, but the calculation is fairly straightforward.

We will do a net present value calculation against all of the bids and, if the bids come in well below the long-term value of the dividend stream, I think there would be an extreme reluctance to forego the dividend stream to sell an asset at well below, not so much market value, but well below what it could attract in a healthy, robust market environment.

**Mr PEDERICK:** Referring to the same budget line, the disappointing thing for me is that the Treasurer basically said that the **sale would go against debt**. That is why I make the comment that I would not be surprised if the numbers actually add up very close to the botch-up at Adelaide Oval, but that is just an observation.

**The ACTING CHAIR (Mr Piccolo):** Member for Hammond, I have been very tolerant with you so far. Can I suggest that if you are going to ask a question, you ask a question. If you are going to provide an answer, then I will not let your question proceed.

**Mr PEDERICK:** Thank you, Mr Chair. You are very strict.

**The ACTING CHAIR (Mr Piccolo):** I am very lenient. Don't push it, though.

**Mr PEDERICK:** I refer to Budget Paper 3, page 5.3, line 4: Forestry SA Dividends. What caused the estimated result of the **dividend** for 2009-10 to be \$11.8 million higher than the \$19.3 million that was budgeted?

**The Hon. M.F. O'BRIEN:** I will give that over to Islay. My understanding is that it was an improvement in domestic market conditions, and also the senior management team has a strategy in place for basically driving the business hard, but Islay can give the specifics.

**Mr ROBERTSON:** There are probably three key reasons why we performed very well last year. The previous year was a tough year as we went into the GFC, and we made some critical decisions probably before the year started. One of those was that we would take surplus small diameter log and put that into the export market, and we exported approximately 100,000 cubic metres over the year.

The two key reasons we did that were, first, to maintain the volume throughput for our harvest and transport contractors because there was a risk that, by not selling that export wood, we would run into minimum obligations in terms of

harvest and transport services. The second reason we put this log into market was that we were able then to improve the quality of the diameter and the overall quality of the log to our domestic customers.

We were fairly selfish in that because when they take a larger log, not only do they get improved capacity and improve recoveries from those logs—which helps then get a better product into market at a lower cost—it also improved our revenue outcome because a larger log gets a better price. The other two aspects were that we ended up achieving a price adjustment mechanism for most of our customers, a price improvement for that year better than we anticipated. That is just the function of how our price adjustment mechanisms work.

Finally, one of our major customers resolved to cut less of their forest and take more of our log and we were able to put some short-term sales into the market. We started out in an environment where it was pretty tough and we thought it was going to be a very difficult year. We put three or four things in place to try and rectify that situation and meet our budget target. They all came to fruition, they all did very well—and we overachieved, based on budget.

**The Hon. M.F. O'BRIEN:** I like to hear that.

**Mr PEDERICK:** Thank you. I refer to Budget Paper 4, Volume 2, page 620, performance commentary, dot point 5, which refers to the development of national, state and regional forests and water policy. With the government proposal to forward sell around 100 years of timber growth and given the government's intention to make forestry accountable for water use, will the government take into account the **value of water** that will sustain that growth over the next 100 years and, if so, how?

**The Hon. M.F. O'BRIEN:** We have had some quite significant science done on the water resource in the South-East with a view to developing a water plan for the South-East. I think several of the members here would be aware that there are conflicting water demands. The Coonawarra had a view which, I think, has been borne out by the science that the hardwood plantation at Coles and Short may have had an impact on their activity and on Bool Lagoon.

The dairyists on the border also have concerns about ongoing surety of water. It is a slightly different issue in that it is governed by an agreement between South Australia and Victoria. Essentially, we have to work out in the South-East what quantum of water forestry activity consumes. I think we have agreed that the science is fairly compelling. The industry at a national level has concurred that plantation forestry activity is a water consuming activity.

We had the science presented to us probably a fortnight ago. We are now in the process of consulting in the South-East to develop a regime that not only gives surety to the viticulturalists and the dairyists but also lays a fairly solid legislative and regulatory regime for expansion by forestry. It could well be that there will be some movement in the parliament on that particular matter in the not-too-distant future.

We are making strides. I know that it has been a fairly frustrating activity for people in the South-East. It seems to have been going on forever and a day but we now have, I think, a bit of an understanding of the science. It is very difficult in a time of drought to determine whether it is a shortage of rain over a pronounced period of time or whether it is the introduction of large-scale hardwood plantations that is making adjustments to the levels in the aquifers, but I think we have a fairly good

understanding now, and the impression that I get is that people are now prepared to accept a regulatory structure to give some surety for longer term investment.

**The CHAIR:** According to the agreed timetable, we are meant to be going on to regional development now.

**Mr PEDERICK:** Can I ask one quick question? In regard to the last answer, is that water use being taken into account when modelling this forward sale process?

**The Hon. M.F. O'BRIEN:** It has been, because, if you are asking someone to make a purchase of three rotations, I think you have to give them surety that the second and third rotations will actually occur on the same scale as what is being removed. One of the reasons we are slowly moving to a decision on a whole range of matters is that we wanted to establish the science and then the regulatory regime before we took this particular asset out into the marketplace. That has been one of the restraints. I am hoping that, sooner rather than later, we will be able to give the legislative/regulatory surety that would be sought by a potential purchaser.