State Forest Asset Sales: Myths and Realities

Why is Government selling the cutting rights to the Crown plantation forests? Much of the "news" from Government concerning the sale is really a repeat of old information. There is a theory that if something is repeated often enough, people will believe it. What I have attempted to do is isolate the often-repeated statements and critically examine them. References are given for all Government's statements. This does not mean that this is where they first appeared. Nor does it mean that it is the only place they have appeared. Unfortunately, where they have appeared, they have not generally been questioned.

MYTH: "The billions of dollars that will be needed to finance the colossal development of wood processing from State forests is too heavy and too risky a burden to lump onto taxpayers." Mr J. Sutton, Minister of Forestry, in: Choy, Harris. 1990

REALITY: This is not actually a myth, it is a red herring. It is not a valid argument. In using this argument, Mr Sutton is assuming that the alternative to selling the forest cutting rights means that the State will have to invest billions in financing processing developments. There are other alternatives which Mr Sutton ignores. One is log exports. If the State exported the logs it could not sell to the domestic processing industry, no investment would be required. This may not be the most desirable alternative with regard to the wealth of New Zealand. However, investment in domestic processing could occur with no State investment. All that is needed is a stable economic environment (something Government claims they are achieving), and some sort of guarantee to forest processing industry that they will have a guaranteed wood supply, or at least the first opportunity to purchase the wood at a market price.

Due to the fact that they were negotiating with Government over the value of the forest assets, the Forestry Corporation has not been willing or able to guarantee any sort of wood supply during its brief history. As a result, there has been little new investment in the processing sector of New Zealand's forest industry over the past three years, except by companies with a captive wood supply.

An outright sale of the State assets is not needed. Long-term contracts, or joint ventures are other equally suitable possibilities which will encourage processing investment without additional State investment. In a commercial environment, the Forestry Corporation should be able to make such contracts and provide continued market returns. Is that not one of the reasons they were established?

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1 Andy Kirkland, Managing Director of the Forestry Corporation, recently reported: "With good forest management, the value of the present forest area can be doubled by the end of the century and net revenues of $2 billion in real terms earned between now and then." (Anon. Herald, 1 July 1989. "For Sale Signs Out on State Forests.")

While Mr Kirkland did not state what value could be doubled, using some conservative assumptions (beginning asset valuation of $3 billion implying an ending asset valuation of $6 billion, and the entire $2 billion earned at the end of the century), this equates to an expected real rate of return of 10.3 per cent. Reducing the beginning value or assuming the returns were earned before the end of the century would increase this rate of return.

2 Real interest is interest over and above inflation.

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paying roughly 5.4 per cent real interest on its borrowings. Treasury's hurdle rate (the minimum rate acceptable) for Government investments is 10 per cent real interest. Why should an asset be sold if it is both earning more than it is costing and earning more than the hurdle rate?

MYTH: Ministers are not good owners of businesses.
REALITY: Ministers probably are not good business owners. But this is more a failure of the structure established by the State Owned Enterprises Act 1986. Ministers were not supposed to be involved in the day-to-day running of the businesses. That was one of the purposes of the Act. Ministers were supposed to be involved with matters of economic and social policy. If they were not, then it was a failure of Government's structuring of the Act. And a failure of the Ministers.

MYTH: The sale is occurring to avoid future calls on Government for cash.
REALITY: This argument is another red herring. All along, Government has insisted that the SOEs are independent limited liability companies. The failure of the Development Finance Corporation proves that Government would not bail out even a bankrupt company. Even if a future call for cash occurred, there is no evidence that Government would need it.

MYTH: The sale is occurring to minimise the Government's risk exposure in the business sector of the economy.
REALITY: There are two ways to minimise risk. The first is to eliminate it completely. The second is to have a diversified portfolio of holdings so the poor performance of any one asset will not have a catastrophic effect on the performance of the entire portfolio. Government's risk exposure in the business sector of the economy will be minimised only when it is completely eliminated. While this may be Government's ultimate goal, until it is achieved, selling any given asset will actually increase Government's business risk. This is because, when an asset is sold, the Government's portfolio is less diversified. This subjects the remaining assets in the portfolio to greater financial risk than occurred before the sell-off.

MYTH: Buyers will replant trees they cut. "They would be insane not to. It makes no economic or business sense to pay millions of dollars for a forest in a country that can grow trees twice as fast as anywhere else, pay a handsome rental on the land, and not replant for a continuing asset."
Mr J. Sutton, Minister of Forestry, in: Choy, Harris, 1990.
REALITY: This may or may not be a myth. It is certainly wishful thinking. Only time will tell whether or not the trees are replanted. Everyone hopes that they will be, but there is no guarantee. If a company believes that it is in its best interests to replant trees, they will — but not otherwise. While the economics of forestry look very good in New Zealand compared with most other countries, a company's investment decisions will be based on its investment opportunities worldwide.

Will a company perceive that its best interests lie in investing possibly in a foreign country in an asset which will not show a positive cash flow for 25-30 years? If they do not replant, it will mean large economic loss for New Zealand. Government does not have a monopoly on foolish business decisions.

If it "... makes no economic or business sense" not to replant, then placing replanting covenants on the forests would not diminish the forests' current market value. If current market value would not be diminished, why is Government so opposed to some general replanting or "wise land use" covenants?

GENERAL DISCUSSION: Calling these Government statements "myths" is perhaps an exaggeration. More properly, they are fallacies. But a fallacy repeated often enough gains mythical qualities. Before that happens, the statements should be recognised for what they are. None of Government's reasons for selling the forests stands up under close scrutiny.

This brings me back to my original question. Why is Government selling the cutting rights to the Crown plantation forests. It is a question to which the New Zealand public and the forestry profession deserve a full and honest answer.

REFERENCES
E.M. Bilek

A Chilean contribution: Serious threat to the native forests in Chile

It is becoming apparent that clearfelling and woodchipping of the humid zone native forests in Chile is becoming a quite profitable enterprise for some of those involved. However, this process is becoming an ecological threat which may cause irreparable damage if certain legal or technical measures are not soon taken.

The ecological viability of our native forests cannot withstand the commerce and profit yearnings. Whether in league with large foreign corporations or not, some Chilean entrepreneurs are currently prospering at the expense of the future of our native forests.

This goes beyond threatening the Araucaria araucana (araucaria, pinon) or the Chilean Larch (Fitzroya cupresoides), because now other valuable trees are being threatened, namely the Chilean beech (Nothofagus spp: rauli, robuste, coigue, huilo, raul, etc) and many other secondary species. Surveys carried out by CODEFF, the National Committee for the Protection of Flora and Fauna, supported by multinational funds from the World Wildlife Foundation, have recently come to the conclusion that between 1978 and 1987 more than 50,000 hectares of native forests within two regions of Chile have "disappeared". This represents over 11% of the existing forests in those two regions.

As this business is profitable, it has promptly expanded into the southernmost provinces, especially the beautiful lakes region. There, we still preserve more than 3.5 million hectares of temperate humid forests. We wonder how much longer this will last.

Chile urgently needs to re-examine its forestry policy and clearly define the courses of actions through which the native forestry resources would be protected and managed against the voracious chip export enterprises. The simple replacement of the native species by radiata pine or Eucalyptus is not a viable solution in the mid-term. We can already predict that, in this region, serious ecological problems will arise from the transformation of an environment presently being kept in precarious dynamic equilibrium by the climate-water-soil-plant relationship.

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(Edited version)