New Zealand wood products industry in the 1980s and beyond

D. Evison

ABSTRACT

This paper examines production, employment, investment, profitability and competitiveness in the New Zealand wood products industry over the 1980s. The measures taken to restructure the New Zealand economy, and their effects, are described. While there is evidence of increased efficiency (particularly in the use of labour) and profitability, there has been no sustained increase in total output, or total exports over the last 10 years. The recent recession in the New Zealand economy, and the lack of additional mature timber from the New Zealand forest resource may have prevented the industry increasing output. Major issues facing the industry in the future are the need to increase competitiveness in export markets, increased competition for sawlogs from log exports, the outcome of privatisation of the Crown forest resource and the changing nature of this resource.

INTRODUCTION

This paper describes the performance of the New Zealand wood products industry over the 1980s, and evaluates the effects of recent economic restructuring of the New Zealand economy on the wood products industry.

For the year ended March 1989, sawlogs and peeler logs used by the domestic wood products industry comprised 45% of total roundwood volume harvested. Pruned logs and unpruned sawlogs are priced well above pulp logs and therefore constitute a major source of revenue to the forest grower. Sawmill residue has been used increasingly as a fibre source, so that now about one-third of sawlog input (about 1.4 million cubic metres roundwood equivalent) is sold to the fibre products sector.

The analysis was carried out by developing measures of economic activity for the wood products industry, largely following suggestions made in a report entitled 'The Economy in Transition: Restructuring to 1989' (New Zealand Planning Council, 1989). Data from the Department of Statistics Quarterly Manufacturing Survey and other sources were used. It is not possible in an analysis of this type to determine a causal relationship between government economic policies and the performance of the wood products industry. Industry performance is a response to new and existing policies, changes in processing technology, and domestic and international markets. This paper documents the changes in policy and the economic environment directly relevant to the wood products industry, describes the performance of the industry over the 1980s, and discusses necessary conditions for future industry growth.

THE ECONOMIC AND POLICY ENVIRONMENT

Radical restructuring of the New Zealand economy followed election of the Labour Government in July 1984, and re-election in August 1987. Policies were implemented to improve the adaptability and flexibility of the New Zealand economy, by adopting measures to ensure that market signals reach economic agents with little distortion as possible (Planning Council, 1989). The purpose of deregulation and liberalisation has therefore been to improve firm productivity and product quality (Cambell et al. 1989). Nevertheless implementation has led to industry concern about mill closures, reduced export competitiveness and a lack of investment in new plant and equipment (see, for example, New Zealand Timber Industry Federation 1988).

Microeconomic and macroeconomic policy measures were both employed as instruments of restructuring. The main features of macroeconomic policy have been a firm monetary policy, a floating exchange rate since March 1985, and measures to reduce government fiscal debt. Table 1 shows that growth in the New Zealand economy averaged nearly 2% per year but slowed over the period, with the economy contracting slightly in 1989. However, dwelling construction — a major domestic end-use of wood products — increased after 1983. Changes in output of the wood products industry generally followed construction trends, but there has been little sustained

Table 1: Economic Activity in New Zealand

<table>
<thead>
<tr>
<th>YEAR</th>
<th>NEW DWELLING PERMITS (year ending March)</th>
<th>CHANGE IN REAL GDP (%) (year ending March)</th>
<th>CHANGE IN REAL OUTPUT (%) WOOD PRODUCTS (year ending March)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>15,197</td>
<td>2.6</td>
<td>7.8</td>
</tr>
<tr>
<td>1981</td>
<td>14,442</td>
<td>1.1</td>
<td>1.7</td>
</tr>
<tr>
<td>1982</td>
<td>19,006</td>
<td>4.9</td>
<td>11.3</td>
</tr>
<tr>
<td>1983</td>
<td>15,999</td>
<td>0.5</td>
<td>-12.3</td>
</tr>
<tr>
<td>1984</td>
<td>20,226</td>
<td>2.7</td>
<td>2.7</td>
</tr>
<tr>
<td>1985</td>
<td>21,782</td>
<td>5.6</td>
<td>10.2</td>
</tr>
<tr>
<td>1986</td>
<td>23,035</td>
<td>1.6</td>
<td>0.1</td>
</tr>
<tr>
<td>1987</td>
<td>20,128</td>
<td>1.4</td>
<td>-4.0</td>
</tr>
<tr>
<td>1988</td>
<td>19,583</td>
<td>0.1</td>
<td>-4.8</td>
</tr>
<tr>
<td>1989</td>
<td>19,583</td>
<td>-1.2</td>
<td>-3.8</td>
</tr>
</tbody>
</table>

Source: Department of Statistics

1 The author, David Evison, is an economist in the Trade, Marketing and Economics research field of the Forest Research Institute, Rotorua, New Zealand.

2 Unless otherwise stated all nominal monetary values in this paper are converted to real 1989 values using the Producer Price Index for All Market Groups Outputs. Real GDP is calculated by the Department of Statistics.
growth in output over the 1980s. Table 2 shows that tight
monetary policy has maintained high real interest rates since
1987.

Table 2: New Zealand Interest and Inflation Rates

<table>
<thead>
<tr>
<th>YEAR</th>
<th>BANK BASE LENDING RATE (%) at March</th>
<th>PRODUCER PRICE INDEX INFLATION (%) annual at March</th>
<th>REAL INTEREST RATE (%) at March</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>13.2</td>
<td>13.6</td>
<td>-0.3</td>
</tr>
<tr>
<td>1981</td>
<td>14.9</td>
<td>16.8</td>
<td>-1.9</td>
</tr>
<tr>
<td>1982</td>
<td>16.5</td>
<td>22.8</td>
<td>-6.3</td>
</tr>
<tr>
<td>1983</td>
<td>17.3</td>
<td>13.9</td>
<td>3.4</td>
</tr>
<tr>
<td>1984</td>
<td>15.5</td>
<td>5.9</td>
<td>7.6</td>
</tr>
<tr>
<td>1985</td>
<td>14.2</td>
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<td>21.1</td>
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<td>10.2</td>
</tr>
<tr>
<td>1988</td>
<td>18.4</td>
<td>5.8</td>
<td>12.6</td>
</tr>
<tr>
<td>1989</td>
<td>15.8</td>
<td>3.3</td>
<td>12.5</td>
</tr>
</tbody>
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Sources: Department of Statistics, BNZ Economics Department, Reserve Bank of New Zealand.

Microeconomic policies of trade liberalisation, reduction in assistance to industry, regulatory reform, and agency reform were implemented to improve economic efficiency of the wood products industry by increasing competitive pressures. Specific trade and industry assistance policies are dealt with later. Two other major policy changes affected the wood products industry directly. First, price control was finally removed from rough-sawn timber in 1982, although economy-wide price controls were imposed soon after, and not lifted until November 1984 (OECD, 1989). Secondly, the timber production role of the New Zealand Forest Service was taken over by the New Zealand Forestry Corporation, a State-owned enterprise. At the time of its demise (March 1987) the New Zealand Forest Service supplied logs that produced 56% of NZ's output of sawn timber (Ministry of Forestry, 1988), and was required by government policy to favour domestic processing over log exports. The Forestry Corporation has not been constrained in this way, which has raised concerns from the sector of the industry that has historically relied on the Crown timber resource. Government policy is now to withdraw from commercial forest ownership by selling cutting rights to the forests currently managed by the Forestry Corporation. The result of this sale, due to be completed in 1990, is likely to be influential in determining the future structure of the wood products industry.

WOOD PRODUCTS PRODUCTION AND INVESTMENT

Table 3 describes the composition of the wood products industry. The industry primarily services the domestic market.

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<table>
<thead>
<tr>
<th>Primary processing</th>
<th>Secondary processing</th>
<th>Manufacturing Plants</th>
</tr>
</thead>
<tbody>
<tr>
<td>sawmills</td>
<td>planing, preservation and drying</td>
<td></td>
</tr>
<tr>
<td>wood-based panel mills</td>
<td>joinery</td>
<td></td>
</tr>
<tr>
<td>chipmills</td>
<td>wooden containers</td>
<td></td>
</tr>
<tr>
<td></td>
<td>cork products</td>
<td></td>
</tr>
<tr>
<td></td>
<td>wooden furniture</td>
<td></td>
</tr>
<tr>
<td></td>
<td>mattresses</td>
<td></td>
</tr>
</tbody>
</table>

INVESTMENT AND WOOD PRODUCTS PRODUCTION

The base lending rate is derived from the first mortgage lending rate (excluding government) prior to 1985. For 1985 and 1986 the BNZ base lending rate was used, and subsequently data published by the Reserve Bank were used. The producer price index used is Wood and Wood Products output price. Real interest rates are calculated as the nominal interest rate minus inflation.

(1989 less than 17% of total wood products output was exported). The wood products industry contributed 1.4% to GDP in 1987, and 6.3% of the value of manufacturing output in 1989 (Department of Statistics). About 30% of the total value of forest products exported in 1989 was produced by the wood products industry. Figure 1 shows the contribution of various sectors of the wood products industry to the total value of wood products exports.

Investment in capital equipment in the industry has been generally higher in the years since 1984 (Figure 2), in spite of high real interest rates (see Table 2). This investment may be largely due to the changing nature of the timber resource (caused by a shift to harvesting younger and smaller trees) requiring the adoption of new technology (Doyle 1989, Cox 1989). Levels of stocks of materials and finished goods have both declined, suggesting better stock management under high interest rates.

INDUSTRY EMPLOYMENT AND LABOUR PRODUCTIVITY

Total employment in the industry declined 29% recently, from 23,800 in 1986 to 18,500 in 1989 (see Figure 3). Many job losses have been caused by mill closures due to mergers, ratio-

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4 Total employment for 1989 is the author's estimate, based on unofficial information provided by the Department of Statistics. The source of previous years' data is the Department of Labour Quarterly Employment Survey.
nalisation and bankruptcy (Cox, 1989). Increases in labour productivity are lower than would be expected for the estimated level of job losses; nevertheless real output per employee hour has increased by 23% (Figure 4). Figure 4 also shows average labour productivity trends for all manufacturing in New Zealand. Labour productivity gains indicated by this measure should not be interpreted as simply relating to an increase in the quality of the labour input. The introduction of labour-saving technology has also decreased labour requirements.

Figure 3: Total employment in the wood products industry.

Figure 4: Net real hourly output.

INDUSTRY PROFITABILITY AND COMPETITIVENESS

Profitability in the wood products industry is indicated by 'operating margin' in Figure 5. Figure 5 shows that a 7%-8% margin has been normal for this industry, but a generally increasing trend in operating margin over the period can be observed. This trend may be at least partially explained by increasing capital costs, although better inventory management and reductions in the labour force may also have contributed.

Figure 6 shows the value of wood products exports from New Zealand. Comparison of the value of total exports with the operating margin shows a strong positive correlation. Both series peak in 1981, 1985 and 1989 and have troughs in 1983 and 1987. Cyclical trends in Australian import demand for New Zealand wood products are the major influence on the level of total New Zealand exports. Margins were low in 1983 due to a coincidence of low demand in both the New Zealand and Australian markets (housing permits issued in New Zealand were only 16,000 and sawn timber exports to Australia declined by about 25% from the previous year).

Figure 5: Operating margin.

Figure 6: New Zealand wood products trade.

Trade barriers can protect domestic industries from import competition, and export incentives can improve export competitiveness. Before government reforms, the wood products industry received assistance and protection from tariff and quantitative trade barriers, and from export subsidies. Syntec (1984) estimated that 90% of the output of the wood products industry was protected by import licensing, with a further 7% protected only by tariffs. By July 1988 import licensing had ended for most goods (Planning Council, 1989). The wood products industry is now more subject to import competition, and there has been a steady increase in the value of imports over the period, although the value of exports is still far larger. New Zealand's remoteness and the relatively small size of the domestic market may continue to provide natural barriers to widespread competition from imports, although the dominance of North American lumber in the Australian market for imported softwoods offers little reason for complacency.

A major subsidy to wood products exports—the Export Performance Taxation Incentive (EPTI)—was phased out over a three-year period from April 1985 to March 1988 (New Zealand Planning Council, 1989). Makin (1983) estimated that the effective subsidy for private sector sawmilling resulting from the EPTI and cost excesses due to import controls was 24.9%. Zeitsch (1984) estimated that the nominal rate of assistance

5 Operating margin is defined as the value of sales revenue minus labour and other operating costs, expressed as a percentage of total revenue. Because this industry holds stocks of finished goods and raw materials this measure does not strictly indicate the margin from current period production; however this error is likely to be small. This measure also excludes capital costs.
under EPTI for the wood products industry in 1981 was 19.3%. The effective rate of assistance takes account of both protection of an industry's output, and cost incentives that the industry incurs because of protection of upstream industries. The effective rate of assistance to the wood products industry excluding the effects of export subsidies was estimated (Syntec, 1989) to have declined from 51% in 1982, to 28% in 1986 and 21% in 1988.

One measure of export competitiveness is the relative price of an industry's output in domestic and export markets, which can be measured by the real exchange rate. Figure 7 shows a real exchange rate index calculated in such a way that an increase in the index represents an increase in competitiveness. The competitiveness of New Zealand wood products in Australia and Japan has fluctuated widely over the period, but is now virtually the same as it was in 1980. (In 1989 Australia took 60% of New Zealand wood products exports and Japan 20%). Since the New Zealand currency was floated, wood products export competitiveness has decreased by about 25% in the Australian market, and increased by 10% in the Japanese market.

Figure 7: Wood products industry export competitiveness.

Over the entire period, the New Zealand dollar depreciated by 10% with respect to the Australian dollar and 64% with respect to the Japanese yen. New Zealand currency depreciation was counteracted almost fully by increases in the relative price of New Zealand wood products in these markets. Depreciation will itself induce inflation due to increases in costs of imports (Hodgetts and Clements, 1989), but it is unlikely that the total increase in inflation over this period can be explained by exchange rate changes.

Clearly there are important factors affecting competitiveness that are not included in this index. The value of export incentives is not included, since New Zealand producer price indices exclude producer subsidies. Therefore over the period that export incentives were phased out (1985 to 1988) there was a decline in returns to exporting not reflected in the real exchange rate. In addition, the index does not reflect changes in competitiveness due to changes in cost of transporting wood products from mills to export markets, since the New Zealand producer price index is based on mill-door prices. Nor does it reflect changes in non-price competitiveness (or product quality).

The industry is not only subject to competition in export markets for its products. The processing industry also competes with overseas processors for logs from New Zealand forests, and wood-based manufacturers compete for the outputs of the primary and secondary processing industries (primarily sawn timber and wood-based panels). Discriminatory trade barriers in key Asian markets favour the export of logs from New Zealand and reduce the ability to compete. Figure 8 shows that the volume of logs exported increased markedly from 1987. Restrictions on log exports from Crown forests in favour of domestic processing were removed with the formation of the New Zealand Forestry Corporation in 1987. Since the EPTI applied only to goods with a value-added content—not logs or squares (Makin op. cit.)—abolishing incentives may be expected to have reduced the exports of processed products in favour of exports of logs and squares. Short-term cash-flow requirements of major forest owners, strong demand in Asian markets, and a destructive cyclone in March 1988 may have also contributed to the increase in log exports.

Figure 6 shows that wood products exports have also increased markedly since 1987. The analysis above suggests this trend has not been caused by an increase in competitiveness, but by increased demand in the Australian market. Total dwelling commencements in the States of New South Wales, Victoria and Queensland increased by 50%, from 85,000 in 1987 to 128,000 in 1989 (Australian Bureau of Statistics). The recent downturn in the New Zealand economy may also have increased the exportable surplus of the New Zealand industry.

FUTURE TIMBER RESOURCE AVAILABILITY

The supply of logs available for processing by the New Zealand wood products industry depends on availability of mature timber as well as the level of demand for log exports. Figure 9 shows the projected availability of timber over the next 20 years for unpruned sawlogs and pruned logs3 (Burrows, et al. 1986). A significant increase in log availability will not occur until after 1995, with the largest increase occurring around the turn of the century. Comparison of the forecast annual harvests for 1986-90 (10.33 million cubic metres) with the average of the actual annual harvests for 1986-1989 (10.03 million cubic metres), provides some validation for these forecasts. Major challenges for the industry in the future are the profitable utilisation of pruned logs (rising from 400,000 cu.m. in 1986-90 to 2,400,000 cu.m. in 2001-05) and large-branched sawlogs (rising from 1,360,000 cu.m. in 1986-90 to 3,390,000 cu.m. in 2001-05).

The sale of cutting rights to all New Zealand State forests, due to be completed in 1990, will have a major bearing on timber availability to established wood products industries in New Zealand. Unsuccessful bidders for cutting rights will depend on their competitors for logs previously supplied by the State, or on new investors in the industry.
The value of wood products output has remained fairly constant in real terms over the 1980s. This is not a negative result for the industry, considering the decline in employment, plant closures and generally poor performance of the domestic economy. Operating margins have also increased, but so have capital costs. Level of operating margin appears to be closely correlated with the level of Australian imports of New Zealand wood products.

Investment in new plant and equipment was generally higher after 1984 than before, in spite of high real interest rates. Some major investment may be delayed until the sale of cutting rights to State forests is concluded, and the increase in log availability from the mid 1990s. Recent declines in stocks of inputs and finished goods may be a result of improved inventory management. Labour productivity of the industry has increased, largely by reducing employment after permanent closure or modernisation of old and inefficient mills.

Export price competitiveness has fluctuated widely over the 1980s due to rapid changes in the exchange and inflation rates, making the maintenance and development of export markets very difficult. If government policies maintain a lower inflation rate in New Zealand than in the wood products industry export markets, fluctuations in competitiveness will be reduced, and overall competitiveness should increase. A relatively stable exchange rate is clearly also desirable to decrease fluctuations in export returns. Competitiveness in major markets is about the same in 1989 as in 1980 in spite of significant depreciation of the New Zealand currency, because the effects of currency depreciation were negated by increases in the relative price of New Zealand wood products output. Increased industry efficiency leading to lower production costs, and improved product quality are more likely to result in long-term increases in competitiveness than reliance on currency depreciation.

The New Zealand wood products industry is currently highly dependent on the New Zealand and Australian markets. Most exports (84% in 1989) are commodity products - sawn timber and squares, wood chips, medium density fibreboard, particle board and plywood. Protection has declined for the New Zealand wood products industries, and may have resulted in some increase in imports of competing wood products. Phasing out export incentives did not prevent a recent increase in wood products exports.

In the short term, the opportunities for growth in wood products industry output are limited, since resource availability and harvest are fairly close to balance. Expansion in output over the next few years may occur as a result of the wood products industry utilising logs currently exported to overseas markets, increasing the efficiency of converting logs to wood products, or by further and more profitable processing of the products of the primary industry. Lower real interest rates would benefit the wood products industry directly, through increased profitability and incentive to invest in new plant and equipment.

Because of its domestic market orientation, the industry would benefit from any increased growth in the domestic economy (and specifically residential construction) that lower interest rates generated. Lower interest rates may also lead to some exchange rate depreciation, thereby improving export competitiveness. If the cyclical pattern of exports to the Australian market is repeated, exports of wood products will decline over the next two years. Agency reform, through corporatisation and privatisation of the New Zealand Forest Service, has already had major impacts, and will have a strong influence on the future structure of the wood products industry.

In the absence of controls imposed by government or company policy, export of logs suitable for processing by the wood products industry is likely to continue, unless the primary processing industry (predominantly sawmills) is able to meet the stumpages provided to the forest grower by log export markets. The ability of these industries to compete on this basis in the future will affect expansion of the entire industrial forestry sector, since flows of product from the primary processing industry to secondary processing and wood manufacturers, and flows of residue to the pulp and paper industry cannot occur if logs are exported directly. Wood products industry efficiency will have a major bearing on ability to compete with log exports, as will the location of supplying forests with respect to export ports. Moreover, the New Zealand wood products industry cannot compete on an equal basis with log exports unless discriminatory trade barriers in key export markets are also removed. Forest growers should also take account of the historical volatility of log exports when comparing the returns from supplying export log markets and the domestic wood products industry.

Longer term, major challenges for the industry lie in the improvement of export competitiveness, and diversification and expansion of export markets. Technical and marketing challenges caused by the changing nature of the resource must also be met, if the industry is to take advantage of the large increase in the availability of sawlogs and veneer logs from the New Zealand resource, beginning around the turn of the century.

ACKNOWLEDGEMENTS

The author would like to thank Jill Cameron, James Barton (Ministry of Forestry) for their assistance in providing and interpreting data used in this paper. Helpful comments on earlier drafts were provided by John Budde, Owen Cox, John Doyle and Bruce Glass. Any remaining errors are the responsibility of the author.

REFERENCES

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Members were advised that these issues were still under review by Government and that it was not too late for the voice of the profession to be made more plain.

Whilst there were a number of concerns it was agreed that the question of replanting of existing forests was the number one issue. Whilst the record of the major New Zealand-based companies in this matter has been very good to date, there is less confidence that a prospective overseas forestry company, or indeed a New Zealand-based investment company, would take the longer-term commercial forestry management goal.

Members believe that (1) the placing of a special replanting covenant (not included at this time) would remove much uncertainty on the part of all parties to the new leases, (2) sustainability of the productive role of land already committed to forestry is vital to the economic wellbeing of New Zealand, (3) carefully planned replacement of present forests with an absolute minimum of delay following harvesting would provide excellent insurance against weed infestation – a problem more important in the rapid growth environment common to most New Zealand sites, and (4) there should be provision for professional input in the formal planning procedures in the event of any justified subsequent change in land use following the sale with safeguards to protect public accountability.

The meeting also considered various aspects of the current and planned provision for accommodating greatly increased forest product cargoes at the Port of Otago. Members are keen to support moves that will enhance the flow of timber through the port since the huge forthcoming increase in harvest will be ultimately destined for export markets irrespective of the degree of processing that can be economically managed within Otago.

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INSTITUTE NEWS

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Whilst there were a number of concerns it was agreed that the question of replanting of existing forests was the number one issue. Whilst the record of the major New Zealand-based companies in this matter has been very good to date, there is less confidence that a prospective overseas forestry company, or indeed a New Zealand-based investment company, would take the longer-term commercial forestry management goal.

Members believe that (1) the placing of a special replanting covenant (not included at this time) would remove much uncertainty on the part of all parties to the new leases, (2) sustainability of the productive role of land already committed to forestry is vital to the economic wellbeing of New Zealand, (3) carefully planned replacement of present forests with an absolute minimum of delay following harvesting would provide excellent insurance against weed infestation – a problem more important in the rapid growth environment common to most New Zealand sites, and (4) there should be provision for professional input in the formal planning procedures in the event of any justified subsequent change in land use following the sale with safeguards to protect public accountability.

The meeting also considered various aspects of the current and planned provision for accommodating greatly increased forest product cargoes at the Port of Otago. Members are keen to support moves that will enhance the flow of timber through the port since the huge forthcoming increase in harvest will be ultimately destined for export markets irrespective of the degree of processing that can be economically managed within Otago.

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