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Forests for sale: The historical perspective

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ABSTRACT: Historical and recent reports show that logging of our forests has resulted in little or no direct financial benefit to its owners. Although small returns were achieved early in the 20th century, these have been whittled away and, based on a holistic view of forestry, West Australian taxpayers now pay to have trees taken from their forests. The large areas of forests that have been protected by the State since 1920 are important assets, but are surrounded by the remaining loggable forests which, under policies mandated by successive governments, are a net liability to the State.

1 INTRODUCTION

Although the so-called "forest debate" is often perceived to be a dispute between conservationists and economic rationalists, the economic rationale for logging our forests seldom forms part of this debate. The forests are owned by the people and have been logged and sold on their behalf. I ask the question: historically, what profits have been made from logging our forests and how do historical returns compare to those of today?

This talk is about the financial aspects of forest management and I have compared the approach and results of the past with those of today. This has been far from easy. Firstly there is the anticipated problem of comparing apples with oranges, and secondly the financial accounts of the forest managers, both past and present, are not easy to interpret. Nevertheless, the differences are sufficient to enable meaningful comparisons to be made. The figures and statements included in the paper delivered by C.E. Lane-Poole to the British Empire Forestry Conference held in London in 1920 permit quite a good understanding of what financial benefits the State then received from the logging of native forests. The Forest Products Commission (FPC) has been the main source for modern data.

I have looked at this comparison from three aspects: the perceived value of the forest estate, profits earned from forestry; and cash returns to the State from forestry. I have also considered capital gain and loss as a measure of good financial management. I have taken a holistic approach. By this I mean that I have taken the view that West Australians are the owners - the shareholders - of the forests and I have considered what the financial impact of logging has been on these shareholders.

In referring to the forest managers and to management of the forests I consider the government of the day to be the primarily responsible body. While successive governments must be commended in some areas of forest management, specifically in the creation and management of national parks, at the outset I would emphasise out that the lack of good financial management (as I

perceive it) has often been against the recommendations of government-appointed and statutory bodies.

2 HOW MUCH ARE OUR FORESTS WORTH?

As would be expected, in 1920 there was no attempt to place an absolute value of the (loggable) forest estate. Nevertheless, we can get a pretty good idea of what the State perceived its worth to have been.

Prior to the introduction of the *Land Act* in 1898 the forests were considered as "waste lands" and timber concessions were granted, it would appear, at no cost. In the late 19th and early 20th centuries, 'The sawmiller was regarded as the forerunner of settlement and, when he had removed as what he was pleased to regard as marketable timber, the country was thrown open to selection' (Lane-Poole 1920). With these prevailing attitudes one would expect that the government of the day would have considered the timber to be of little value; indeed that its very existence was viewed as a hindrance to progress. Under the 1898 *Land Act* timber leases were granted for a term of 25 years at an annual rental of £20 pounds per square mile. Allowing for inflation of 5% per annum (calculated mid-term through the lease) this would place a value on the cash received during the term of lease at a bit over $500 per hectare. Not a madly accurate calculation, but good enough for an order of magnitude.

Since 2001 the FPC has reported the value of the forests in its annual accounts. This value is determined by estimating future costs and revenues and discounting the projected annual cash flows to today's dollar. In 2001 the FPC calculated the value of our loggable native forests to be $0 (2002 p. 43, note 22). In 2002 they were considered to be worth $66.5 million, and in 2003 the FPC revalued them to $65.5 million (p. 64, note 21). The increase in value from zero to over $60 million came about through the FPC debiting some costs away from forestry to its other activities.

With 850,000 hectares of loggable forests, the valuation of $65.5 million amounts to a value of $80 per hectare. It compares poorly to the implied historic value and some other comparisons are also interesting: it is equivalent to less than 3% of the FPC cost per hectare of establishing plantations ($2758/ha, p.46, note 3), it is equal to one quarter of the annual FPC cost per hectare of managing plantations ($302/ha p.46, note 2), and based on information contained in public prospectuses it is less than 2% of the cost of establishing commercial plantations.

The valuation of $65.5 million does not include a range of costs and liabilities not met or taken into account by the FPC. First, there are the one-off quantifiable costs. Under the Government's "Protecting our old growth forests" policy, the State agreed to certain payments for industry restructuring. The total package provided to facilitate this is worth over $165 million ($25 million of this is to establish and manage national parks*)* (Forest Policy Implementation Office advice) of which $65 million has already been paid. There remains a further $75 million to be paid by the State. As well the Commonwealth has paid or is about to pay an amount of about $15 million in industry assistance. These payments and liabilities exceed the value of the asset by about $90 million.

There are other costs and subsidies related to logging our forests which also fall outside the FPC's operations and naturally do not appear in its accounts. These include both the preparation of the 1999 Regional Forest Agreement and the Forest Management Plan 2004-2013. These were not insubstantial exercises, and although both were required almost solely because we log native forests, the costs were charged not to the FPC or to the industry, but to the shareholders of the forests: the WA taxpayers.

Then there is a host of often less definable costs not met by the FPC and therefore not allowed for in the cash flow valuations. These include rental of public land, local government rates (the *Forest Products Bill, 1999*, Section 43, recognises this as a cost, and these now may be met by the FPC), tax on vehicles, plant and equipment, stamp duty on contracts, diesel fuel tax, ministerial administration and policing. To these must be added environmental and other costs: the loss of soil through erosion; the loss of soil fertility by salination; the loss of water catchment quality; the loss

of wild life, biodiversity and species; the loss of opportunity for other forest uses, and the loss of place, recreation and beauty.

I have no doubt that in the early part of the last century there were also costs of forestry not shown in the 1920 paper, and that allowing for these would reduce the value of the forests. Nevertheless, it is difficult not to conclude that 100 years ago our loggable forests were a financial asset whereas today they are a liability.

3 PROFIT FROM LOGGING NATIVE FORESTS

Lane-Poole's paper tables revenues ('all royalties and proceeds from the sale of forest produce, license fees, rents and damages awarded for offences') and expenditures from 1895 to 1919. Over that period, revenue amounted to £679,565 0s 4d and expenditure to £165,275 6s 8d to give a cash surplus of £514,289 13s 8d. Thank goodness for decimal currency. In today's dollars (5% inflation) this equates to an average cash surplus or profit of $2.7 million per year.

Today there is no clear separation of the native forestry accounts in the FPC's annual reports and it is not possible to determine exactly what profit or loss was incurred in native forestry (excluding sandalwood). But we can get close enough to draw a fairly accurate picture. Last financial year (2003) the FPC reported a profit after income tax equivalent for all its activities of $14.5 million (p.33). The plantation division recorded a loss of $0.7 million (p.77, note 42), so, allowing for rounding-off, the profit from native forestry including that from sandalwood can be taken as $15.2 million. Included in this profit was a revaluation of standing sandalwood of $19.6 million (p.64, note 21), a revaluation of forest infrastructure of $6.9 million (p. 58, note 3) and receipt of a Government grant of $1.6 million (p.77, note 42). When these non-native forestry items are taken into account, the loss from native forestry was approximately $13 million.

In the previous year (2002) FPC's reported profit (before extraordinary items) was $13 million (2002 p. 17). Excluding corrections to fundamental errors relating to the 2001 accounts of $10 million (2002 p.17) which were brought into the 2002 profit statement, the profit would have amounted to only $3 million. Allowing for the loss from plantations of $16 million (p.77, note 42) we can take the "reported" profit from native forestry for that year as $19 million. However this profit included a revaluation of the native forest asset by $66 million (2002 p.29, note 8). Without this revaluation the result in that year for native forestry would have been a loss of $47 million. Again, there are additional costs not met by the FPC. Amortising the industry restructuring payments over 10 years would have increased losses by about $15 million. Other ongoing costs, referred to above, are paid by the shareholders and exacerbate losses already incurred.

Even though it is not possible to find out what additional costs may have been attributable to forestry some 100 years ago, it would seem that while forestry may have been run at a small profit then, it is now run at a loss.

From a forest management point of view, one cannot help but think what profits we have forgone and what we should be receiving from logging our native forests. Suppose the loggable forests were considered to be worth $1000 per hectare, that is, one fifth of the cost of establishing a commercial plantation. Plantations certainly provide more timber, but it is of lower quality and certainly not unique. Lane-Poole's stated:

> This tree [jarrah] is the principal timber of the State. In the early days it was called mahogany, owing to the semblance it has to the Honduras timber. About 1860 the name was altered to jarrah, as it was generally recognised that this was a better timber than mahogany, and that it had so many fine qualities that it deserved a name of its own.

At $1000 per hectare the total value of our native forests would be over $850 million. Even if we achieved a return of only 5% annually, the profit would be over $40 million - still small beer compared to corporate profits.

4 CASH RETURNS TO THE SHAREHOLDERS

Another test of the financial viability of an enterprise is to consider the return to shareholders by way of dividend

The 1920 paper makes some interesting statements. It quotes the 1918 *Forests Act* which in summary states that 60% of net revenue from logging native forests is to be used for re-forestation, development and research into forestry and the remaining 40% is to go to consolidated revenue. In 1920 revenue amounted to £47,000 and expenditure to £12,000 to give a net revenue of £35,000. At 5% inflation this is equivalent to $4.4 million today. The 40% retained by the State would have amounted to $1.8 million and can be considered as equivalent to a dividend.

4.1 *How does this compare with today's performance?*

The FPC now does more than attend to the logging of native forests, and although this is its principle activity, dividends declared or paid are in respect of the corporation's entire performance. In 2001 the FPC declared (but did not pay) a dividend of $1.7 million. In 2002 the FPC did not declare a dividend and in fact rescinded the 2001 dividend (I would suggest this is a "first" for any Australian corporation). In 2003 a dividend of $1.6 million was declared (p.75 note 35), a figure almost exactly matched by grants of $1.6 million received from the Government (p. 77, note 42).

In 1920 the dividend paid to the State treasury was small, but even so it would appear to compare favourably with the results achieved over the past three years.

5 CAPITAL GAIN/LOSS

As well as dividends, capital gain is a way of providing a return to shareholders. Capital gains or losses in respect of the forest asset occur each year, but this measure is only useful when considered over a far longer period.

Changes in the value of the forests can occur for a number of reasons. Price variations for logs or changes to costs will alter the value of this asset, but the aspect that needs to be focused on is sustainability. Under conditions of stable prices and costs the only way to achieve capital gain is for the forest to grow faster than it has been cut.

As would be expected, in historic terms, rates of logging have not been sustainable and the forest asset has not experienced capital growth. The original forest estate is considered to have been about 4 million hectares and about half of this has been logged and permanently cleared. In 1920 the area of "merchantable" forest was considered to be 1.2 million hectares of which half was under lease or logging concessions. The amount of forest now available for logging is 850,000 hectares, about 20% of the original forest estate. A further 20% of the original area is in formal reserves, 5% is in informal reserves and 5% otherwise unavailable for logging. Much of the forest in the formal and informal reserves has been logged.

Although I could argue that the value of the forest estate in 1920 was of the order of $600 million in today's dollars and that today our forests are a net liability, the equation is not that simple. The 1920 value would have included large areas which are now national parks and reserves. These are often described as "national treasures" and I unequivocally applaud governments for protecting these areas and, from an emotional if not a strict analytical view, these have vastly increased the value of the total forest estate.

Whereas the value of loggable forests has been eroded due to there being a reduction in the loggable area, a decline in the unit value and to the obligations made to industry, it is not possible to draw meaningful comparisons with respect to the forests that were available for logging in 1920.

The 2004 accounts were not available at the time of writing, but with increased royalties the value of the forest asset may show an increase, and quite possibly a significant one, for that year.

6 CONCLUSION

The logging of our forests has fallen somewhere between selling products from a factory and selling the factory itself. Concepts of viewing the forests as a major capital asset and working to get a return on that capital without eating into it, and concepts of managing this publicly owned resource for the benefits of all its shareholders, do not seem to have been a consideration in forest management. Accounts and functions of various bodies have become progressively more complex, nevertheless, especially from a holistic viewpoint, two conclusions can be drawn: financial returns to the owners of the forests have declined significantly over the past 100 years, and secondly, our loggable forests have been converted from an asset to a liability.

REFERENCES

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