Naomi Edwards
BSc (Hons) FIA FIAA FNZSA MAICD

Mr Tom Wise
Clerk of Committees
Legislative Council
Parliament of Tasmania

10 April 2011

Dear Mr Wise

Inquiry into Forestry Tasmania Financial Performance

Please find attached my submission into the above enquiry. I wish to address the first three aspects of the inquiry but not the fourth (the abolition of the Mersey District). A summary of my submission is as follows:

1. The financial performance of Forestry Tasmania as reported in the Half Yearly Financial Report.

The half year result reflects a continuation of the broad trend over the last 15 years – a focus on increasing sales volumes with no economies of scale and hence no improvement to cash flow, profit margin or return to the state. By way of example, revenue from forest sales increased by $10.6 million over the half year while operating expenses increased by $9.8 million, showing the extremely low margins generated from native forest exporting and the difficulty of using a volume based approach to generate a decent return.

2. Actions taken by Forestry Tasmania to address the decline in operating cash flows.

Forestry has taken some actions to reduce expenses, through a voluntary redundancy programme. Experience shows that voluntary redundancy programmes are less successful than managed redundancies, as highly employable staff tend to take the redundancy while "deadwood" tend to stick around, particularly if they have a generous superannuation scheme. On the revenue side, Forestry has re-introduced export log sales with very low, if any, profit margins and hence very little impact on net operating cash flows.

3. Factors impacting on the ongoing profitability of Forestry Tasmania

Native forest, whether in the form of peeler logs or chips, is an extremely low value bulk commodity. Neither Forestry Tasmania nor Gunns have been able to operate successfully in this business for the last five years. Before 2006 Gunns was a successful native forest woodchip exporter to Japan but the decline in this market is structural and permanent. Competition from lower cost, higher quality plantation fibre in Latin

America, South Africa and Asia will make it impossible to generate returns to the Tasmanian public from exporting chips or peeler logs. Sales into China will be dependent on the type of price undercutting strategies employed by Forestry Tasmania in 2010 that disrupted global chip price negotiations.

A new strategy is required to restore profitability, and to clearly separate Forestry Tasmania's wood production and non-wood production activities. This could best be achieved by following the precedents of other states where management of reserve zones is shifted to the state environment department or National Parks and Forestry Tasmania can then set strategy to maximise returns in the wood production zones. This would also facilitate the possible sale of some of the business units of Forestry Tasmania, including a possible privatisation of the plantation estate.

Forestry Tasmania is currently in a historically unique situation:

1. A severe, structural and permanent reduction in demand for, and collapse in profitability from, its native forest woodchips; AND
2. Its largest customer for native forest sawlogs (Gunns) no longer wishes to purchase the sawlogs that drive the production of these native forest woodchips.

In normal circumstances this would be viewed as a historic alignment of events and an opportunity to significantly reduce native forest logging and to restore profitability through smaller volume, higher margin and locally based activities. From its response to the 2011 half year results, it is not clear that Forestry Tasmania is capable of grasping this opportunity.

I would be happy to appear before the Committee should this be helpful.

Yours sincerely

Naomi Edwards

1. The Financial Performance of Forestry Tasmania as reported in the Half Yearly Financial Report

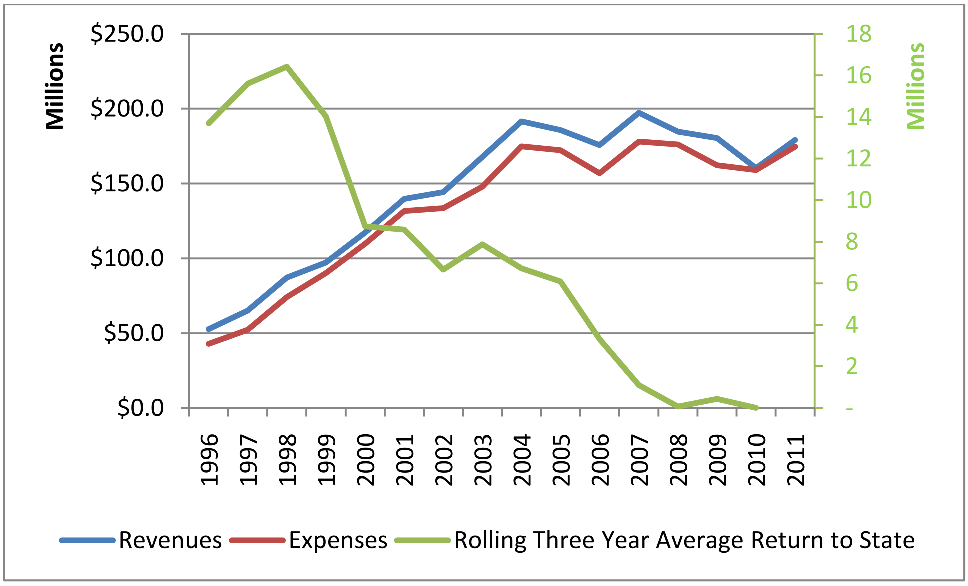
It is extremely difficult to assess an entity's financial performance by examining its performance over a six month period. This is because:

- The accounts are unaudited.
- It is a short period during which one off events (positive and negative) can have undue influence.

In the case of Forestry Tasmania's half year result to 31 December 2010, we can make the following observations:

1. Forestry has continued to focus on increasing export log sales (primarily into China) with extremely low margins, low job creation in Tasmania and little prospect of providing a sustainable return to the state.
2. Timber sales of $89.5 million for the half year (or $179 million annualised) are similar to the peak revenues achieved by Forestry Tasmania over the last 15 years (see Figure 1 below). The problem is not with sales volumes. The problem is with the low profit margin per tonne of fibre. The problem is with the low sale prices and the costs required to achieve those sales – also near a 15 year peak at $175 million annualised (including CSO's for comparison with prior periods).

Figure 1 Forestry Tasmania revenues growing but profit is illusive



The left hand axis shows revenues and expenses rising from about $50 million in 1996 to about $180 million today. The right hand axis shows the total return to the state (using the Auditor General's numbers) falling from about $15 million to zero over the same period. The question must be asked – is it possible any longer to make a decent return to the State from native forest exporting? Forestry Tasmania made reasonable (for a GBE, though not for a commercial entity) returns in the 1990's from a sales base that was less than a third of 2011 (annualised) levels. Gunns made high returns in the early 2000's, though possibly at Forestry's expense. But neither Forestry Tasmania nor Gunns have had any success for the last five years. The reason is a structural change in export markets:

1. Large volumes of plantation timber are now available to Japanese woodchip importers, from the plantation powerhouses of Brazil, Chile, South Africa and also Japanese owned plantations in Australia.
2. The only large volume buyer of export hardwood fibre is now China. China also has a preference for plantation fibre but will buy native forest hardwood if it is paying only for freight and harvesting and haulage. (In other words, if it gets the fibre close to free).

It is not unusual for corporations to experience significant structural shifts in their markets. Successful corporations recognise the shift and move rapidly to change their strategic direction. However it seems from Forestry Tasmania's commentary in its 2011 half year and 2010 full year results that it is unable to grasp the structural shift that has occurred. This failure means that a return to profitability (and an end to the forest conflict) is unlikely any time soon.

Forestry Tasmania is still focused on maintaining or increasing native forest fibre exports while missing the bigger picture of how to make profits in a fundamentally changed environment

- *Mr Gordon said the [1HY 2011] increase in timber sales was due in part to the re-introduction of export log sales. "There are still good prospects for further export sales" Feb 2011*
- *"We will need to find export markets for those woodchips" Mar 2011*
- *"What the modelling will show is that State Forests is not some sort of magic pudding where you can take half the resource away and expect to produce the same amount of timber". Feb 2011*
- *"Our long term strategy is to develop new export markets in the economic powerhouse of China". Oct 2010*

In order to properly assess the performance of Forestry Tasmania, it is essential that:

1. KPI's based on profitability (rather than sales volumes) are developed at the product level.
2. Product lines should include, at the least, peeler sales to Ta Ann, peeler log exports to China, sawlog sales, specialty timber sales, softwood sales and so on.
3. Profit margins should be determined at the product level and include a full allocation of non-CSO costs, including roading and head office overheads.

4. Product lines with negative profit margins should be discontinued. Alternative uses of the resource should be investigated.
5. The stakeholder should review financial progress against KPI's on a quarterly basis at least.

These KPI's are the minimum that a Board of Directors responsible for an entity the size of Forestry Tasmania would expect to see on a monthly basis.

Until the non wood-production activities of Forestry Tasmania are separated into a different entity, as has occurred in other states, it will be extremely difficult to hold Forestry Tasmania accountable against these sort of commercial KPI's. At the least, every non-commercial activity should be separately identified and costed, as per the Auditor General's recommendation.

2. Actions taken by Forestry Tasmania to address the decline in operating cash flows previously reported and noted by the Auditor General

It is not possible for me to know the actions taken by Forestry Tasmania to restore its cash flows. However from information in the public domain, it appears Forestry is focusing its activity in three broad areas:

i. An increase in export volumes
ii. A reduction in staff numbers
iii. Investigating alternative low margin uses for native forests such as biomass, woodheating pellets and laminated veneer lumber.

i An increase in export volumes

I have commented above on the problem of increasing export volumes when, in order to compete with the large volumes of plantation fibre on the market, wood must be sold at or below cost.

ii A reduction in staff numbers

In order to reduce staff numbers, Forestry has used a combination of natural attrition, early retirement and voluntary redundancies. The risks of this approach are well documented, including:

- Losing the best performing and most marketable people to voluntary redundancy. Poor performers stay, contributing to the downward spiral.
- An increasingly top-heavy and bureaucratic organisation as younger people seek opportunities elsewhere.
- A de-motivated workforce that is trying to do the same work with fewer on the ground staff.

A preferable approach is to conduct a full review of strategy in light of the significant structural market changes that have occurred and identify:

- Staff levels and skills necessary to support the new strategy
- Business units or activities that are not core and can be sold or outsourced.

iii Investigating alternative low margin uses for native forest

Forestry Tasmania has stated that it is investigating alternative uses for the native forest estate, including "biomass, woodheating pellets and laminated veneer lumber". It is striking that these three alternative uses are all based on high volume, low value add approaches.

It is self evident that bio-mass and pellets are high volume, low value add commodities. If we consider Ta Ann, we can also see that laminated veneer lumber is incapable of generating significant returns, even if the veneer mills are located here.

i. Ta Ann's Huon operation has been fully operational for over two years and consumed some half million tonnes of peeler logs, but over this period there has been no uplift to Forestry Tasmania's profitability as a result of these sales. While significant profits may have been generated by the mills, these have gone to the mill's Malaysian owners, not to Forestry Tasmania.
ii. The 500,000 tonnes of peeler logs being used at the Ta Ann mills have generated about 120 jobs of which 30 or so are to overseas workers on temporary work visas.

Forestry's long term strategy of sending peeler logs to China in the hope of attracting Chinese veneer companies to set up operation in Tasmania, begs the question of how this will generate profits for Forestry Tasmania, given that it has not profited from Ta Ann's operations here.

Perhaps most interesting are the strategies omitted by Forestry Tasmania in its considerations of how to improve profitability and cash flows. These strategies could include:

i. Separating the wood production and non wood production activities of Forestry Tasmania, as has been done in other states. This would enable the government to manage and profit from the reserved forests as carbon sinks. Research from the ANU suggests that Tasmania's state native forests will be extremely valuable and profitable once a carbon price is operational. Forestry Tasmania could then focus on optimising returns from the wood production zones.
ii. Selling the plantation estate (hardwood or softwood), including the land.
iii. Establishing some business units as privatised consultancies, using a similar model to Hydro's consulting arm.
iv. Increasing high quality tourism activities in the state forests, including adding them to the national parks estate.

v. Supporting the establishment of Engineered Strand Lumber or other new technologies that have strong environmental credentials, are high job creators and use fibre that would otherwise be pulped or chipped.

3. Factors impacting on the ongoing profitability of Forestry Tasmania

This topic has been fully addressed in the attached analysis of Forestry Tasmania's financial performance over the fifteen years to 2010. Please see below.

Attachment – Analysis of Forestry Tasmania's financial performance and factors affecting its profitability

Executive Summary

1. Despite significantly increasing its forestry activities in state native forest over the last 15 years, Forestry Tasmania's financial returns to the people of Tasmania have gone from small to negative.
2. After allowing for government grants to Forestry Tasmania, its commercial activities have generated a negative return to the State in most years and in all recent years. In other words, money is being diverted from hospitals and schools to fund Forestry Tasmania's activities.
3. Forestry Tasmania's cash flow from its operating activities is negative meaning that more government support will be required.
4. Forestry Tasmania's future strategy involves more of the same but with higher volumes and focused on shipping peeler logs (and jobs) to China. The hope is that Forestry Tasmania will succeed in China where Gunns and other Australian commercial operators have failed. Based on its track record, Forestry Tasmania has significantly less commercial acumen than Gunns, with its only advantage being an owner (the Tasmanian Government) that is more content to finance losses for longer.
5. Forestry Tasmania has until recently insulated its own employees from job cuts while employment in the forest industry generally has been savaged. The business of PR has become a major head office focus.
6. Forestry Tasmania's activities in the native forest sector have harmed the softwood sector, the plantation sector, many country saw-mills and treatment of forest contractors has been poor. This is likely to become worse under Forestry Tasmania's vision to become a large scale direct exporter of peeler logs to China at cut throat rates.

Background – the aims of Forestry Tasmania

Forestry Tasmania ("Forestry") has four legislated aims:

1. Optimise the economic returns from its wood production activities
2. Optimise the benefit to the public and the State of the non-wood values of forests
3. Maximise job creation in state forests
4. Deliver 300,000cum of sawlogs and veneer to industry each year

This analysis examines how well the aims are being met, from a financial and economic perspective.

Aim One: Optimise economic returns from commercial activities

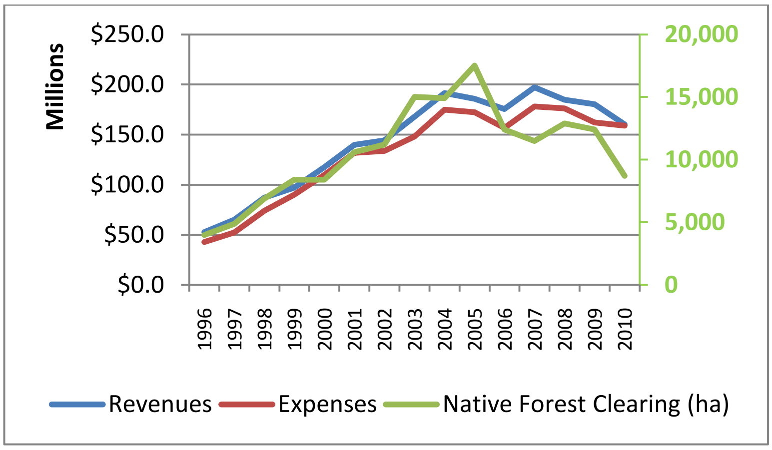
As a GBE, Forestry has a mandate to engage in successful commercial activities. For companies engaging in commercial activities, their success can usually be measured in four different ways:

1. *Are they generating profits (cash or dividends) for their shareholders?*
2. *Are they growing the equity (value) of the business?*
3. *Do they have a strong cash-flow and a healthy balance-sheet?*
4. *Do they have a clear strategy for profitable growth?*

Forestry also has non-commercial goals but these are considered separately under Aim Two which examines the cost of Forestry's Community Service Obligations.

Forestry's commercial activities have expanded enormously over the last 15 years, from a cost base of under $40 million in 1995 to $160 million in 2010. This fourfold increase in activity has largely been driven by increased clearing and conversion of state forest and increased sales of pulpwood to Gunns for woodchip export.

Figure 1 Forestry Revenue, Expenses, Native Forest Clearing – Source FT Annual Reports



The sharp dip in 2010 reflects the severe decline in Gunns' woodchip exports to Japan in 2010 and resultant reduction in demand for native forest pulpwood.

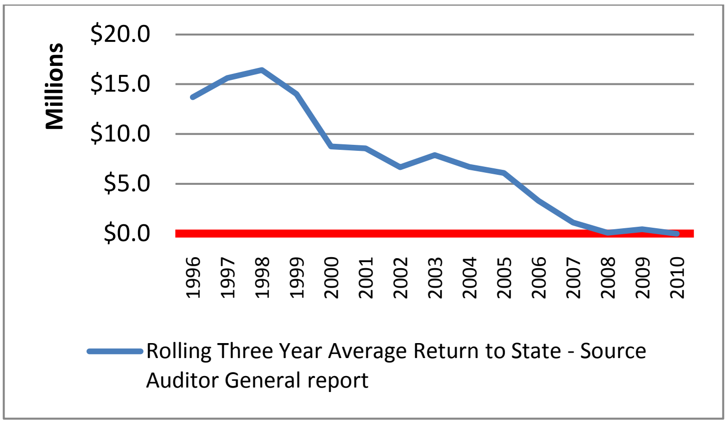
Question one: Is Forestry Tasmania generating profits (cash or dividends) for its shareholders?

Although commercial activity rose fourfold from 1996 levels, Forestry has not been able to generate profit or cash for the State from its activities. The Tasmanian Auditor General measures Forestry's 'Total Return to the State' as:

Total Return = Dividend Paid + Income Tax Paid

This is a simple measure that shows the cash paid back to the State as a result of Forestry's commercial activities in the state forests. The graph below shows the returns generated (as a rolling three year average return) over the last 15 years.

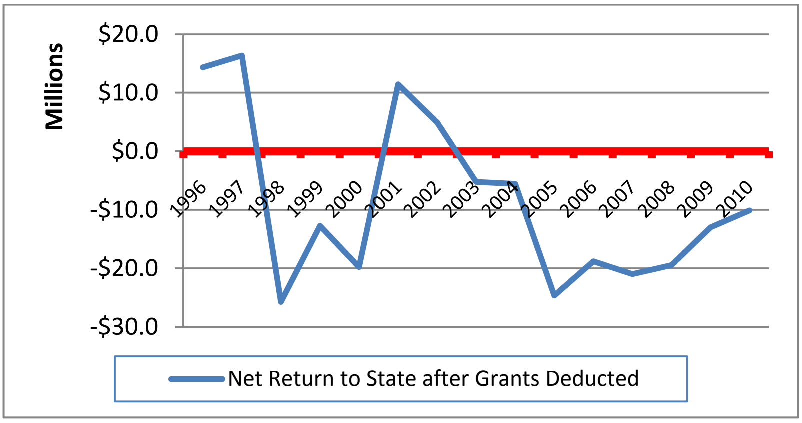
Figure 2 Return to the State from Forestry using Auditor General Definition



To quote the Auditor General's 2010 report "Apart from equity returns to the State in 2006-07 *there has not been any return from Forestry to the government* over the [four year] period of review".

The graph only tells part of the story. In 13 of the last 15 years, Forestry has been the recipient of grants from State and Federal government to assist it carry out activities. Over $230 million has been paid to Forestry during these 15 years. Figure 2 above shows the payment of monies from Forestry to the public, but not the payment of money from the public to Forestry. If we include these amounts, Figure 3 below shows the net return from Forestry's activities.

Figure 3 Net Return to Public reflecting direct State and Federal Grants to Forestry

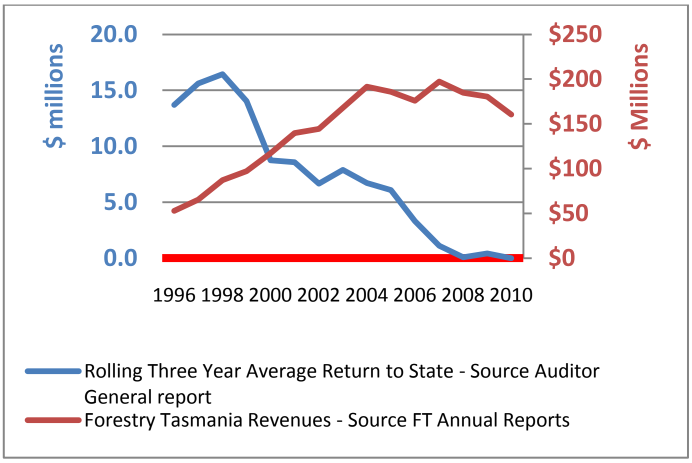


For the last 15 years Forestry's operations have been a net cost to the Tasmanian and Federal governments of $130 million. A start-up commercial business may cost its owners money for some period but Forestry's commercial operations have been costing the public for longer than 15 years. This report does not go back more than 15 years but the situation before 1996 is similar with Helsham grants to Forestry of $31 million in 1988 and accumulated debt of $272 million transferred to general government debt when the Tasmanian Forestry Commission was corporatised in 1990.

It would be impossible for a private commercial enterprise to generate this level of losses and remain in business. At some point the business owners or lenders (in this case the state and federal governments) would turn off the tap and sell the business or declare bankruptcy.

The question is: Why has increased commercial activity failed to generate additional returns?

Figure 4 Forestry Revenues (Commercial Activity) graphed against Return to State

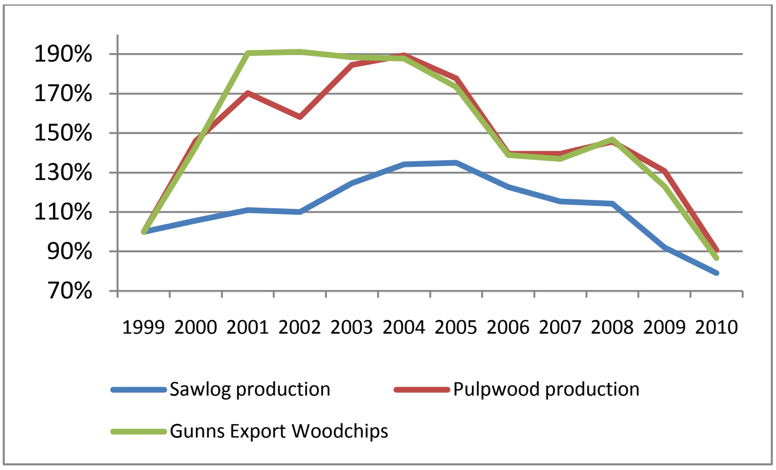


Native forest pulpwood is a low quality product that can only be sold cheaply. It has a rapidly reducing potential range of buyers. Real prices of native forest hardwood have reduced steadily over the last 15 years. Be it Japanese paper companies, Tasmanian pulp mills or Chinese cardboard manufacturers, plantation wood is preferred. As Australian, South African and South American hardwood plantation resource comes on line, Tasmania's native forests must be sold cheaper and cheaper.

Since Gunns' purchase of North Forest Products in 2001, there has been a monopsony between Forestry Tasmania and Gunns. Monopsony arises when a firm (in this case, Gunns) captures the ability to dictate price and volume to its suppliers (in this case, Forestry Tasmania), because the suppliers have no real choice other than to deal with that buyer. Since 2001 Gunns have purchased between 60% and 80% of all native forest harvested. This means that Gunns' focus (for example on woodchip exports to Japan between 2001 and 2005) had to become the focus of Forestry.

The graph below illustrates this, showing the relative growth, since 1999, of Forestry's production of high quality sawlogs and veneer versus its production of pulpwood.

Figure 5 Forestry's production shift to pulpwood as Gunns' needs expanded



Forestry's production figures are from its annual reports, as are Gunns' export woodchip volumes. The direct correlation between Forestry's pulpwood production and Gunns woodchip needs can be seen, as well as the lack of correlation between Forestry's pulpwood and its sawlog production. For example, pulpwood production rose 90% between 1999 and 2004 while sawlog production rose only 30%.

This focus on pulpwood production for Gunns failed to generate returns to the state even at its peak. The stumpage paid by Gunns for state pulpwood (averaging about $12/tonne over the period) was inadequate to deliver appropriate returns to the state.

Forestry's supply of cheap native forest pulpwood to Gunns also created other economic distortions in the forest sector over the last ten years. These distortions, covered comprehensively in the book 'The Forest Wars' by Dr Judith Ajani, include:

- Plantation owners and growers being forced to compete in price with native forest woodchips.
- Forest workers being shifted from manufacturing and processing jobs to harvest and hauling work dependent on short term contracts that have been repeatedly cancelled or changed by Gunns and Forestry at short notice.
- Non extractive uses of the state forest, such as tourism, recreation, carbon sinks or water catchments have been subordinated.

Finally it is notable that the most reliable source of profit for Forestry for the last 11 years has been its share of the GMO Joint Venture. This business, which is managed by the joint venture partner GMO Renewable Resources, has generated a healthy operating profit every year since its inception 11 years ago. The difference between making money from softwood plantations, versus trying to make it from native forests, is stark. It also raises the question as to whether the difference in management personnel is a factor.

Question two: Is Forestry Tasmania growing the equity value of its business?

Forestry has 685,000 ha available to it for commercial activities (i.e. logging). Most of this is native forest (580,000 ha) with the remainder in plantation.

Forestry therefore owns two major assets: the future stumpage value of these trees, and the roads into those areas. As at June 2010 the stumpage was valued at about $250 million and the roads at $115 million. It is very difficult to judge the progress of Forestry's equity through its balance sheet, because the valuation methodology used to value its forestry assets changes almost every year. At a simplistic level, the total equity recorded on Forestry's balance sheet had fallen from $892 million as at June 1998 to $275 million by June 2010. However over that period there have been several changes to equity valuation, including:

- The value of state land is no longer included as equity (impact $277 million)
- The cost of providing future years' Community Service Obligations is deducted from equity (impact $66 million)
- Forest valued at $68 million was reserved under the Regional Forest Agreement in 1998.

Excluding these items, equity has fallen by $206 million over the last 12 years. There are some accounting and valuation changes over the period that make this analysis simplistic, but there is certainly no question that equity has fallen, not grown, over recent years.

Question three: Does Forestry Tasmania have a strong cash-flow and a healthy balance-sheet?

Without ongoing government support, Forestry Tasmania would be technically insolvent. This is an area of significant concern. Forestry's commercial model of high volume / low margin operations perpetuates a system of continuing cash flow crises. To gives a few examples:

1. Over 2010 Forestry breached a financial leverage covenant with TASCORP, requiring a letter of comfort from the state Treasurer that the state would support Forestry.
2. In 2010 Forestry generated a cash *outflow* of over $12m from its operations.
3. Forestry's unfunded superannuation liability has increased to $118 million over 2010, a very large liability for a company with equity of only $275 million. Forestry's 2010 Financial Statements states "To achieve [a better credit rating] the Organisation is working with the shareholder on options to reduce the unfunded superannuation liability." In other words, the state may provide further grants to Forestry to assist it meet the superannuation liability.

The situation in regard to Forestry's cash flow position is best summarised by the Auditor General in his October 2010 review:

> "It is not sustainable for Forestry to generate negative cash from its operating activities, a situation management and the Board must address... We have concerns over Forestry's long term liquidity."

Question four: Does Forestry Tasmania have a clear strategy for profitable growth?

Forestry's 2010 publications list its key strategic initiative as being 'export market growth'. This appears to have a number of strands:

1. Sales of native forest peeler (unprocessed) logs to China.
2. Sales of native forest woodchips to China or other countries.

Both of these initiatives involve direct exposure to highly competitive global commodity markets with minimal value-add, the export of jobs offshore and extremely fine margins, if any. They are also areas where competent Australian firms (e.g. Gunns) have been unable to make a commercial return in recent years in competition with the low cost producers in South America and South Africa.

The question arises as to why Forestry is likely to succeed where Australian companies have failed. This question can be answered by examining Forestry's exports in 2010. RISI is the world's most respected commentator on pulpwood. It publishes the *International Pulpwood Trade Review* annually. The 2010 Review summarised events in the international hardwood market as follows [my italics]:

> "If China is the center of attention on the market side, Australia is certainly the big story to watch on the supplier side. The MIS fiasco last year has resulted in some major restructuring of woodchip suppliers, and was an important factor in delaying the key Port of Portland project. The decision on whether to proceed with the Gunns pulp mill will finally occur in 2010, and given that Gunns is by far the world's largest woodchip supplier, their customers in Japan and China are watching this decision very carefully. ***Finally, Forestry Tasmania, a state-owned entity, announced in February 2010 they were offering an additional 800,000 green tonnes of native eucalyptus pulpwood at apparently very competitive prices -- just as woodchip exporters from South Africa, Chile and Brazil were trying to push through significant price increases.***"

It is unusual that a state forestry organisation would make it into the annual summary of a global commodity market. The reason that Forestry has attracted RISI's attention - its attempt to sell pulpwood at rates below that offered by low cost South American and African producers – is indicative of its export strategy. Namely, that it will use the fact that it does not have to generate commercial returns to undercut both Australian and worldwide markets.

Similarly, in respect of its direct peeler log exports to China in 2010, Forestry appears content to require no payment for the wood stumpage – see for example this analysis from the Auditor General again.

2009-10 Export Margin from Peeler Log Sales of 75,000 tonnes to China

Export Sales	$6.4 million
Harvest and Haulage costs	$2.4 million
Freight costs	$3.9 million
Margin	$0.1 million

The only costs included in determining the margin on the exports are harvesting, haulage and freight. The stumpage for the state native forest, it appears, is zero. The analysis also excludes the likely capital costs of roading expended to access the peeler logs.

Forestry state that such strategies may eventually lead to Chinese companies deciding to move their laminated veneer lumber mills to Tasmania, a strategy that they believe may succeed "not [in] one year, or even five years ahead, but 10 years hence". All of the economic signals from China suggest that it is extremely unlikely to move job intensive manufacturing away from China to Tasmania any time soon. To base a key growth strategy on the possibility that this may happen in the future seems unwise.

A second growth strategy that Forestry has is Newood – attracting an investor to build a wood fired power station at the Huon Wood Centre. Considerable expenditure has already been made at Newood (using TCFA grants). Newood has reported a net loss in each year of operation and its financial viability depends on an investor being found who will construct a wood fired power station. To date no investor has come forward. Should such an investor emerge, then the wood fired station will, as with Forestry's export markets, require wood at extremely low prices or free. Forestry continue to carry Newood at its unimpaired value in its balance sheet, leading the Auditor General to comment that the Board should conduct an impairment review that considers actual profitability versus the original business case profitability, with a view to impairing the Newood investment.

Aim Two: Optimise the benefit to the public and the state of the non-wood values of forests

This part of Forestry's role is often called its Community Service Obligations ("CSOs"). It includes such activities as:

- Conservation of flora, fauna, land forms and cultural heritage;
- Management of forest reserves for conservation;
- The provision and maintenance of forest roads and other facilities for public access;
- Provision of public information and education programs.

This paper does not consider whether Forestry is meeting its CSOs. Rather it looks at the cost of the CSOs and interaction with other objectives.

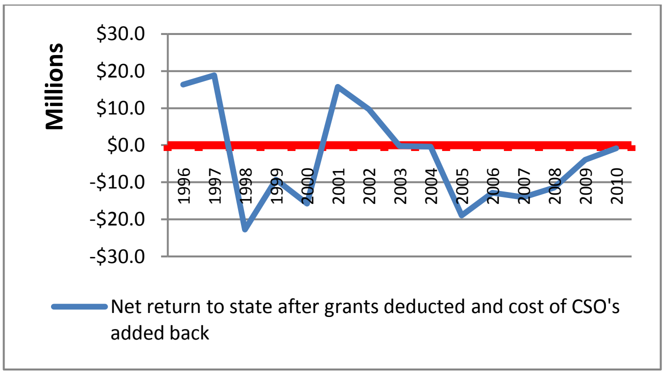
In some years Forestry has received explicit grants for its CSOs and in other years it has met these out of general expenditure. The table below shows some Forestry estimates of the costs of meeting its CSOs (these are published only periodically).

Forestry Estimates of the Cost of Meeting its CSOs

2010	$9.3 million	*2004*	$5.2 million
2009	$9.1 million	*2003*	$5.0 million
2005	$5.7 million	*1997*	$2.5 million

In assessing the net return to the public from Forestry's commercial activities (Figure 3 above) we need to add back the cost of these CSOs to the numbers. This is shown in the table below, with unknown years extrapolated from the numbers above.

Figure 6 Net Return to Public reflecting State and Federal Grants and allowing for CSOs



After full allowance for the cost of meeting CSOs the return from commercial activities is still negative in 11 of the past 15 years. Note that in most other states of Australia the funding and expenditure on CSOs is separately identified, funded and managed so that this complex analysis is not necessary.

In its 2010 Financial Statements, Forestry has quantified the present value of all future spending that is needed to meet its CSOs in non-commercial forest zones as $65.8 million. In other words, a single payment today of $65.8 million would be enough to meet all future CSO costs in the 520,000 ha managed by Forestry for non commercial purposes. This can be considered in the context of the $230 million assistance given to Forestry by state and federal governments in the last 15 years and raises the question whether direct funding of CSOs combined with curtailment of commercial activities would generate higher financial returns to the public.

Aim Three: Maximise Job Creation in State Forests

Under the Forestry Act, Forestry "must treat the level of employment deriving from the use of public forest resources as an important consideration when examining options for competing claims for Crown wood, including the provision of wood supply agreements."

Employment in the Tasmanian forest industry has fallen significantly since 1990. In 1990 ABS statistics said there were 9,190 employed in the Tasmanian forest industry – by 2002 this was 4,780.

Jobs in the industry and jobs at Forestry Tasmania, 2006 to 2010

	Industry Employment (Source J Schirmer CRC for Forestry)	**Employment at Forestry Tasmania (FTE's)** (source Auditor General reports)
2006	6,000	516
2010	4,340	461
Change over 4 year period	28% fall in job numbers	11% fall in job numbers

The statistics are interesting – while job numbers have declined overall, Forestry's own staff have largely been insulated from the decline. The table above only shows recent trends, but going back to 1997 Forestry employed 548 people and this stayed very constant to 2006 (with 516 still employed at Forestry Tasmania in 2006) while job losses in the forestry industry outside of the GBE over that time have been well documented. See for example the 2004 paper on job losses by the group Timber Workers for Forests. 2010 was the first year that Forestry made significant cuts to its own job numbers, with 50 job cuts announced in January 2011. The major areas of job loss in Tasmania have been in the manufacturing, processing, harvest and haulage areas. These are all downstream industries from Forestry Tasmania, which outsources the actual work of harvesting, hauling and processing its native forest to private companies. These are the companies that have borne the brunt of the declining employment.

Forestry's primary contribution to employment outside its own staff has been in the assistance given to Malaysian company Ta Ann to establish two rotary veneer peeling mills in Tasmania at a cost of $65 million. When fully operational, the two mills are expected to employ 120 Tasmanians, though fewer than this are currently employed and anecdotal evidence is that many Ta Ann employees are Malaysian. Ta Ann has already been the recipient of a $10.4 million grant from the TFCA. This makes the jobs created at Ta Ann an expensive investment for the state.

The real issue, however, is how job numbers can have declined from over 9,000 in 1990 to their current level of around 4,500, given the fourfold rise in revenues and costs from state forests. Again, this relates to the focus on high volume, low margin raw commodity export growth. Forestry's current key strategic initiative - to grow export volumes of unprocessed logs into China at very cheap prices – will perpetuate the loss of jobs from our state native forests.

Aim four: Deliver 300,000cum of sawlogs and veneer to industry each year

Under the Forestry Act and the Regional Forest Agreement, Forestry must supply 300,000cum to industry of high quality eucalypt sawlog (Category I and III logs) and veneer to industry. Forestry have met this aim in most years except for 2009 and 2010 when demand fell due to the GFC.

Forestry view this requirement as a commercial restraint on the operation of its business, restricting its ability to log the forest on short rotations. Forestry have also stated that the high levels of pulpwood being produced from state forests (for example, at the woodchip export peak in 2004, 2.9 million tonnes of pulpwood were sold from state forests compared to 360,000 cum of legislated sawlog and veneer) is a by-product of sawlog production. In other words, legislated sawlog production drives pulpwood volumes and is a responsible use of the by-product.

However as we have seen in Figure 5 above, it has been Gunns' export woodchip requirements that have driven the higher volumes of native forest pulpwood produced.

In meeting its requirement to deliver high quality sawlogs, Forestry's policies have favoured its monopsony customer and three large sawmills, while leaving the majority of Tasmanian sawmills without secure log supply and with inferior quality logs. Between 60% and 80% of all Category I and III logs have been supplied to Gunns' sawmills. This has been neither value optimising nor job optimising, for the following reasons:

1. Smaller sawmills are more efficient users of timber, achieving 40% sawn timber out of logs, compared to 25% at Gunns' mills.
2. Smaller sawmills tend to be boutique operators, manufacturing a broader range of products (doweling and other value add products) and with higher job creation and margins.

Thus while Forestry has met its legislated requirement, the interests of small business and job creation have not been optimised.

Forestry Tasmania and Softwood Plantations

This paper has focused on Forestry's role in native forest logging. However it is also worthwhile to consider the impact of Forestry's actions and policies on the softwood sector. Before Forestry sold its 50% share of the state softwood plantations to GMO Renewable Resources, Forestry dominated softwood log sales in Tasmania with most of these logs going to two Scottsdale sawmills – then Auspine and French Enterprises.

Subsequent rationalisation in the industry, the purchase of French Enterprises by Auspine and Gunns' subsequent purchase of Auspine and the FEA mill at Bell Bay has resulted in both Scottsdale sawmills no longer operating and the loss of a large number of jobs.

Since management of the softwood plantations has been taken over by GMO, as described above, profitability and management of the plantations has improved. However severe reductions in Tasmanian softwood harvest in 2008-10 have contributed enormously to job losses. ABARE Forest and Wood Products Statistics for the March and June quarters 2010 show a reduction from 1.4m cum softwood logged in 2007-08 to 0.8m cum in 2008-09.

The fate of softwood plantation sawmilling in Tasmania is extremely important given that it is 40% greater in volume terms than native forest sawmilling. Forestry's involvement with competing against this sector through its native forest logging, as well as poor governance of the sector, has contributed to the extreme problems now facing the softwood sector in Tasmania.