

\$270 M Annual Victorian Native Forest Logging Subsidies

Dear IBAC,

We request an IBAC review of Victorian Auditor General's Office audit 'Managing Victoria's Native Forest Timber Resources' on the following grounds:

In 2013, the Victorian Auditor General's Office made the following statement: **"VicForests does not receive any government subsidies" yet this paper shows that VicForests receives annual subsidies of Approximately \$270+ million dollars per annum.**

The *IBAC Act 2011* (Vic) sets out corrupt conduct as conduct of any:

- **Public officer or public body that knowingly or recklessly breaches public trust**
- **Public officer or public body that involves the misuse of information** or material acquired in the course of the performance of their role or function, whether or not for the benefit of the public body or person.

In 2013, the Victorian Auditor General's Office made the following statement: **"VicForests does not receive any government subsidies"**¹ — this is untrue and misleading and breaches public trust. The limited access the public has to VicForests, and the government's published assistance to the native logging industry, clearly outlines a vast body of subsidies provided to VicForests to allow for continued market operations in order to provide commodity-scale, cheap (fixed priced) wood to the Nippon paper group.

The Auditor's comment fundamentally covered up the subsidies provided by the State Government, and ignored costs to the public purse incurred by native forest logging and legislative benefits only afforded to the native timber industry, such as exemptions from Part IV of the Trade Practices Act. The overall effect of ignoring the subsidies and market conditions permitted *only* for VicForests, its contractors and its customers, has meant that competitive operations like that of the plantation wood sector have been disadvantaged² — and in the west of Victoria, plantation growers are being forced to plough in trees³, with plantations now in decline due to commercial unviability⁴⁵.

The effects of incorrect reporting prevented disclosure on an unfairly advantaged Government Business Enterprise (GBE). The fact that the Audit was about the 'Timber Industry' in itself allowed

¹ <http://www.audit.vic.gov.au/publications/20131211-Timber-Resources/20131211-Timber-Resources.pdf> pg 45.

² <http://m.theage.com.au/business/plantation-drop-spooks-industry-20101031-178u9.html>

³ <http://www.weeklytimesnow.com.au/news/national/traditional-farming-to-return-after-a-decade-of-timber-investment/story-fnkfnspy-1226893171872>

⁴ <http://m.weeklytimesnow.com.au/property/bluegum-properties-failing-to-sell/story-fnkerdg1-1226951805125>

⁵ "The reduction in land under forest plantations is expected to increase over the next five to 10 years as commercially unviable plantations are not replanted and are converted to other land uses, including agricultural uses." Pg 3

http://data.daff.gov.au/data/warehouse/aplnsd9ablf002/aplnsd9ablf0022013/AustPlantationStats_2013_v.1.0.0.pdf

for the costs to manage the native timber industry, held within the Department of Environment and Primary Industries (DEPI), to remain obtuse. The budget costs to manage the logging of state forests by DEPI appears nowhere in the Audit, yet this too should be considered a subsidy, especially on matters of fire management and roading paid for by DEPI to facilitate the logging.

The Audit itself provided no outline of VAGO's costs to generate the Audit and despite this being a mandatory cost⁶ to VicForests, we will assume this was paid for from VicForests' operating revenue, and thus not paid to Victorians by way of forfeiting expected dividends.⁷

VicForests have received \$1 billion dollars in free raw product funded from tax payers since 2004. VicForests have not paid a dividend to the State for the sale of a **total of \$600 million** worth of timber since 2007.

VicForests' Order in Council was changed in 2010 to require it to undertake its commercial activities in a manner that will maximise the long-term economic returns to Victoria. VicForests have not met this objective legitimately as the company operates in a commercial refuge buffered by subsidies to enable cheap pulp contracts to Nippon. The motive for perpetuating the financially unsustainable program is that without the sale of the pulp, the saw log market would collapse as it is financially unsustainable without the subsidies;

"While sawlog sales drive VicForests' commercial operations, VicForests and the industry could not operate financially without complementary pulp log sales." (VAGO 2013)⁸

The misleading declaration to the public that VicForests 'does not receive government subsidies' means that Nippon can continue to enjoy low cost pulp log contracts, essentially subsidised by the public purse. Nippon Paper Industries is responsible for procuring wood raw materials for the **Nippon** Group. Around two-thirds of the wood resources are procured from overseas and one-third sourced from Japan. The Oceania region, including **Australia**, is a main source for overseas hardwood and softwood, and accounts for **48%** and **76% of procurements**, respectively.⁹

In 2009¹⁰ the Nippon Paper Group bought Maryvale Mill, where it receives approximately 800,000 tonnes every year from Victoria's native forests, plus at least 1 million tonnes annually out of South East Fibre Exports (SEFE) in Eden and the previous Midway facility in Geelong. Within 12 months there will be only one wood chip pulp contract left in Victoria — Maryvale Mill.

The concerns around competitive neutrality and competitive pricing arrangements for all pulp sales **that** go to one customer was raised in the URS audit of VicForests in 2010¹¹. Nippon's

⁶ http://www.austlii.edu.au/au/legis/vic/consol_act/soea1992274/s73.html

⁷ http://www.austlii.edu.au/au/legis/vic/consol_act/soea1992274/s49.html

⁸ <http://www.audit.vic.gov.au/publications/20131211-Timber-Resources/20131211-Timber-Resources.pdf> pg 46

⁹ <http://www.nipponpapergroup.com/contents/200224382.pdf> pg 53, 60

¹⁰ <http://www.theaustralian.com.au/business/latest/paperlinx-sells-asset-for-600m/story-e6frg90f-1111118871429?nk=da067b9517ad024390c71daa5e8fb217>

¹¹ <http://www.myenvironment.net.au/index.php/me/Work/Forests/Forest-Resources/URS-Treasury-Report-VicForests-2010> "Competitive neutrality requires that government business activities should not enjoy a competitive advantage over private sector competitors simply by virtue of public sector ownership." Issues - pg 27.

Maryvale Mill will continue to receive cheap logs, enabled by subsidies covered up by the Audit and thus misleading the public on a full disclosure of costs and market distortions generated by the logging of a publicly owned asset. We consider this to be a serious matter and would appreciate a full investigation on whether VAGO were not given the data, or selected what would be in the best interests of the industry and sought not to disclose the facts.

The 'back of the envelope' publicly available subsidies to VicForests equal

VicForests annual subsidies: Approximately **\$270+ million dollars per annum**

And in addition;

VicForests owes the state: Approximately **\$8.4 million dollars in un-regenerated forest debt (current)**

Financial assistance granted to VicForests and the native logging industry (since 2007: **Approximately \$52.88 million dollars**

1. Water Subsidy: \$24.7 million pa (Thomson and Yarra Tributaries) - \$27.4 million (Upper Goulburn) = Total \$52.1 million

Logging takes place in our highest water-yielding forests — the Central Highlands Ash forests. According to decades of peer reviewed science¹²; logging and fire reduce water runoff and this was highlighted in the State Government's own State of the Forests Report¹³ — *The main impacts on forested water catchment yield are fire and forestry activities* (pg 36).

In 2004 Labor commissioned hydrological impacts from logging work, and in 2007/8 released the review in the 'Wood and Water' study, which found that if Melbourne wanted to maximise its water yield, logging should end in catchments by 2009/10¹⁴. The World Bank concurred similarly that if Melbourne wanted to maintain its pristine supply logging, should be removed¹⁵.

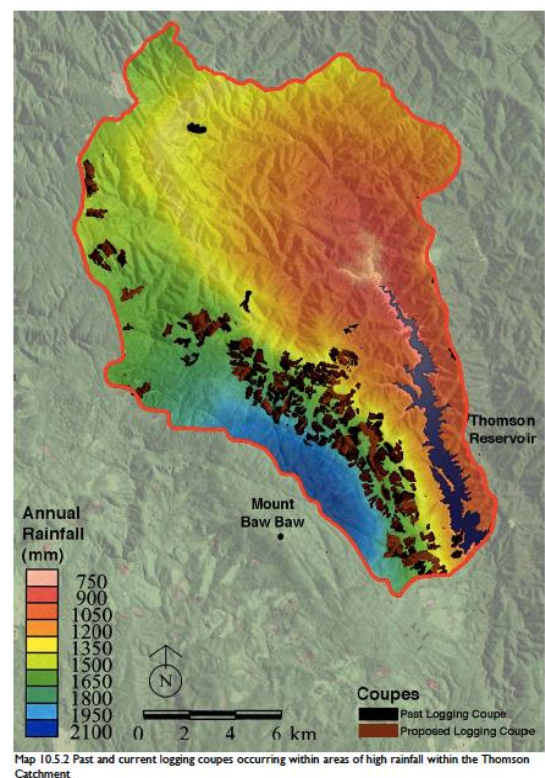
VicForests argue that they only log a small percentage of the catchments each year but this argument is irrelevant. Here's why:

The Mountain and Alpine Ash forests of Melbourne's water catchments are the largest trees in Australia (tallest in history and currently tallest flowering plant in the world), growing to an epic 80 metres in approximately 70 years. Most of the growth occurs between the ages of 30-70 years to reach these epic heights, and this is when the water, otherwise destined for creeks and aquifers, is utilised to grow the tree back after logging or fire. Water runoff is reduced by up to 50% during this period¹⁶.

Standard 50-80 year logging rotations keep the forests young and the catchments thirsty. The full bounty of water is never received, because logging rotations reset forest development at a relatively thirsty, young age.

It's not about how much of a catchment is logged, it's about what species are logged and where the logging occurs.

Mountain Ash grow in the high water yielding areas of the catchments, because they have evolved to need large quantities of water to grow. A catchment does not



¹² <http://www.myenvironment.net.au/index.php/me/Work/Water/Water-Resources/Logging-in-the-Thomson-Catchment>

¹³ http://www.depi.vic.gov.au/data/assets/pdf_file/0008/177587/2008_State_of_Forests_Report_v2.pdf

¹⁴ <http://www.myenvironment.net.au/index.php/me/Work/Water/Water-Resources/DSE-Water-and-Wood-Findings>

¹⁵ <http://awsassets.panda.org/downloads/runningpurereport.pdf>

¹⁶ <http://mickresearch.wordpress.com/2012/12/21/effects-of-timber-harvesting-on-water-yield-from-mountain-ash-forests/>

have a uniform rainfall pattern — refer image of Melbourne’s largest catchment, the Thomson. Therefore if we are concentrating logging of merchantable ash forests that require and consume the most water in growing — in the highest rainfall areas — then we are creating the largest possible impact on water run-off.

Given the long-run margin cost of desalinated water of \$1.37/kl (Partnerships Victoria 2009), stopping catchment logging in Melbourne catchments — even at conservative savings identified under the Wood and Water Study of 20GL p.a., would result in Melbourne taxpayers being \$24.7 million better off — i.e. four times that of the savings delivered under Minister Walsh's 'Melbourne's Water Future'.

Goulburn—Broken water loss is estimated to be upwards of 20,000 ML¹⁷ — \$27.4 million

2. Roads: Subsidy \$23.9 million pa

Whilst VicForests and DEPI share some forestry road costs, the real costs of damage and maintenance of roads from log trucks are expected to be borne by taxpayers. According to the Timber Towns Victoria TIRES report (attached): The total cost of works required to upgrade roads during 2011-2015 to meet the needs of the forestry industry in Victoria is \$95.6 million.

3. Deforestation/reforestation costs unrealised and unsold wood

- a. Unregenerated forest cost: according to VicForests sustainability report¹⁸ 14,000 ha of land is unregenerated (waiting for restocking), equal to \$8.4 million.**

According to The Department of Treasury and Finance audit of VicForests in 2010; The estimated cost to regenerate 7,000 ha is \$13.3 million according to URS auditors. Native forest regeneration that is overdue for logging is as high as 14,000 ha^{19,20}. VicForests report site preparation establishment costs as approximately \$600/ha (VicForests 2009t) . The costs are quite varied depending on land gradient.

“The potential issue of the backlog in regeneration activities mentioned in ToR9 could also have an impact on cash flows and will need to be closely monitored in this respect.” (URS 2010)

¹⁷ http://www.acfonline.org.au/sites/default/files/resources/woodchipping_our_water-Goulburn_Catchment_Report.pdf pg 7

¹⁸ Figure 4: Area of clearfell and seed tree coupes regenerated and submitted to DSE for coupe finalisation - pg 20
<http://www.vicforests.com.au/files/vgnluwvlqg/vicforests-sustainability-report-2012.pdf>

¹⁹ Page 252 - Regeneration backlog URS Treasury Report

<http://www.myenvironment.net.au/index.php/me/Work/Forests/Forest-Resources/URS-Treasury-Report-VicForests-2010>

²⁰ Page 20 <http://www.vicforests.com.au/files/vgnluwvlqg/vicforests-sustainability-report-2012.pdf>

- b. **\$1.27 million was given (independently) to loggers to regenerate forests that should have been paid for by VicForests or DEPI but has come from taxpayers²¹.**

4. Unsold wood left to burn: annual wood value loss of \$16 million (average of annual wood sold \$100 million) per annum.

According to VAGO, VicForests estimated that in 2012–13, at least 250,000 cubic metres of residual wood—16 per cent of the total harvest—was left on the forest floor, and burnt in the regeneration burns.

5. Carbon pollution - Subsidy: \$11 million+ dollars per annum

The emissions from logging the Central Highlands equates to 1.1 million tonnes **\$11 million dollars annually** at \$10 per tonne (ANU Keith et al)²².

Only 2% of forest product (biomass) taken from the forest is stored for any meaningful period, but generally less than 100 years.

6. Subsidies foster commodity industry ultimately geared to low jobs, pulp contracts to Nippon

VicForests log approx 4,500 ha of native forest in Victoria every year. Approximately 500,000 m³ is saw log and 1,000,000 m³ is pulp logs²³. In the Ash forests, the difference is more like 87% of forests cut is being used as pulp²⁴ including wastage collected from the saw mills.

According to the VicForests 2013 Sustainability report, there are 360 people employed in native forestry and the company itself has a direct employment of approximately 114 people.

²¹ http://www.timbull.com.au/index.php?option=com_content&view=article&id=46:127m-funding-forest-jobs&Itemid=3

²² “We estimated that continued logging under current plans represented a loss of 5.56 Tg C over 5 years in the area logged (824 km²)”
<https://dl.dropboxusercontent.com/u/7805810/2014%20Managing%20temperate%20forests%20for%20carbon%20storage%20-%20impacts%20of%20logging%20versus%20forest%20protection%20on%20carbon%20stocks%20-%20Ecosphere%201.pdf>

²³ <http://www.vicforests.com.au/files/aamitulnsj/VicForests-Sustainability-Report-2013.pdf>

²⁴ Lpag Technical report - excerpt

The Schirmer Report generated by VicForests in the MyEnvironment vs VicForests court proceedings²⁵ found that logging pulp wood provides 0.6 jobs per 1000 tonnes whereas logging for saw log provides 1.6 jobs per 1000 tonnes.

7. Fire subsidies: Reimbursements for losses and costs, met by Government: \$24.6 million

The State Government reimbursed VicForests for costs incurred by its fire salvage efforts— totalling \$24.6 million between 2007 and 2011. The fires led to the loss of future timber sales estimated as worth \$600 million in 2009. Normally a business would face these costs independently, but subsidies and grants are made available to VicForests as needed.

8. Species Subsidy: funded action plan to continue logging in threatened species habitat = \$13.86 million

*‘The bushfires significantly changed the landscape of the Central Highlands and have demanded review of how these forests are used and managed, if we are to ensure a future for both the Leadbeater’s Possum **and the timber industry**’²⁶.*

a. \$1.86 million²⁷ — This project is delivering on actions outlined in the Victorian Government’s Timber Industry Action Plan, which was released in December 2011. The Timber Industry Action Plan provides a long-term plan for a productive, competitive and sustainable timber industry for Victoria.

b. The government will invest \$11 million to implement the recommendations from the Leadbeater’s Possum Advisory group — established by government to manage the extinction of the Leadbeater’s Possum under the fire and logging intensity in the ash forests. ²⁸ The funding will be made available to Parks, VicForests and DEPI to facilitate solutions to logging the animals habitat. Ie. Nestboxes and specific silvicultural regimes.

Unlike its commercial competitors VicForests’ essentially has a slush fund to draw money from to experiment with logging in endangered species habitat. A ‘normal’ company would be compelled to pay for an Environmental impacts assessment and an environmental plan and go through due process.

²⁵ <http://www.myenvironment.net.au/index.php/me/Work/Legal/Save-Sylvia-Supreme-Court-Case/Defendant-s-Exhibits/Dr-Schirmer-Report>

²⁶ http://www.depi.vic.gov.au/_data/assets/pdf_file/0007/258217/Government-response-to-Advisory-Group-recommendations.pdf

²⁷

<http://www.ryansmith.com.au/Portfolios/EnvironmentandClimateChange/tabid/88/articleType/ArticleView/articleId/110/186-million-for-research-on-Victorias-threatened-species.aspx>

²⁸ <http://www.depi.vic.gov.au/environment-and-wildlife/wildlife/leadbeaters-possum>

9. Subsidy: Treasury Corporation Victoria low interest loan: annual subsidy \$1.92 million pa

The ACF analysis of VicForests financial statements from 2005 to 2012 found the company has current debts of \$26.8 million to the Treasury Corporation of Victoria — the State Government's financing body — which charges lower interest rates than the commercial market of 2.82% at 23/05/13.²⁹ The Standard borrowing or credit line rates for a business is 10% interest (NAB). Victorian taxpayers are forfeiting repayments of \$1.92 million annually for low interest credit lines to VicForests due to customer and VicForests' delivery problems.

10. Subsidy insurance gift: Treasury indemnified timber contracts³⁰

An initiative (1.4) established under the Timber Industry Action Plan to indemnify VicForests' contracts;

Where changes in Victorian Government policy relating to native forests prevent VicForests from complying with its contractual obligations in regard to the supply of timber resources, the State will indemnify VicForests against any claims arising from its failure to comply with those obligations.

If VicForests were to pay insurance that meets these conditions that would represent the subsidy cost being provided to them by government.

11. Industry contributions: 2012/13 Government gifts to Heyfield and Maryvale Mills: \$13.15 million

- a. Federal Government gift of \$9.5 million — Maryvale³¹
- b. State Government \$3 million — Maryvale³²
- c. State Government \$650,000 — Heyfield³³

12. Benefit: Exemption from Part IV Trade Practices Act

VicForests have been given an exemption from Part IV of the Trade Practices Act:

²⁹ <http://www.myenvironment.net.au/index.php/me/Work/Forests/Forest-Resources/VicForests-Debt-Rich>

³⁰ http://www.depi.vic.gov.au/_data/assets/pdf_file/0011/177707/TIAP_web.pdf

³¹ <http://www.darrenchester.com.au/media-room/archive/2011-news-archive/40-campaigns/protecting-local-jobs/1086-90-million-expansion-of-maryvale-mill-approved>

³² <http://www.russellnorthe.com.au/LiteratureRetrieve.aspx?ID=139007>

³³ <http://www.premier.vic.gov.au/media-centre/media-releases/5944-650000-for-heyfield-mill-expansion-and-upgrade.html>

In regard to the Pricing and Allocation Model, the Parliament of Victoria amended the State Owned Enterprises Act 1992 to authorise VicForests to exempt Part IV of the Trade Practices Act for auction and tender processes undertaken before 1 July 2015. (VicForests 2006 Annual Report)

This means that essentially VicForests may undertake the following anti-competitive activities:

a. Misuse of market power - (definition: taking advantage of substantial market power in a particular market, for one or more proscribed purposes; namely, to eliminate or damage an actual or potential competitor, to prevent a person from entering a market, or to deter or prevent a person from engaging in competitive conduct.)

The absence of the ability to challenge native logging under this provision prevents plantation groups from challenging the cheap market price of native forest wood.

(Wood Pulp Agreement) Act 1996 — anti-competitive

Maryvale is VicForests' largest customer. It has a legislated entitlement to source wood from Victorian State forests at a price that is geared to the market price of office paper (largely determined by the price of imports). The agreement was legislated under the Forests (Wood Pulp Agreement) Act 1996. The Act gives legislative force to a contract between the Victorian Government and Amcor (as it was then) to supply wood to the Maryvale Mill. The agreement guarantees a minimum supply to the mill as follows at a **fixed price** (*Price fixing is an agreement between participants on the same side in a market to buy or sell a product, service, or commodity only at a fixed price, or maintain the market conditions such that the price is maintained at a given level by controlling supply and demand.*)

Selling wood to this Mill that is geared to the price of imports is distorting the market such that plantations cannot meet that price and are unfairly excluded. It is known as a public cartel arrangement.

b. Third-line Forcing

In 2012 VicForests were part of a delegation that put pressure on the Shire of Yarra Ranges Council that if the Council did not buy Reflex paper and drop the 'ethical paper pledge' then VicForests would not build their new offices in Yarra Glen. The Council dropped the pledge and started buying Reflex paper produced from VicForests supplied fibre, but VicForests did not relocate their offices to Yarra Glen as promised.³⁴³⁵

c. No opportunity for investigations by the ACCC — on any matters

VicForests makes claims that can be untrue. The public has no ability to have these claims reviewed by a third party investigation unit — unlike in the conduct of normal business.

³⁴ <http://www.heraldsun.com.au/ipad/council-gags-on-reflex-vow/story-fn6bfm6w-1226059896914>

³⁵ <http://www.myenvironment.net.au/index.php/me/Work/Forests/Forest-Resources/Minister-Walsh-Reflex-Paper-letter>

13. Land cost for arable land to grow trees subsidy – market price \$13.5 million per annum. (DAFF)

If VicForests were leasing or buying the land to grow the trees on, the land price for 4,500 hectares per year of reasonable to high rainfall yielding (between 600-1800 mls per year rainfall)³⁶ land price would be approximately \$13.5 million dollars. This could be higher but this is a conservative price. Catchment map 10.5.2 above is a reference for rainfall calculations in merchantable timber zones.

This subsidy does not include rates to council.

14. Diesel subsidy (rebates) for contractors – haulage and harvest:

This subsidy is not publically available.

15. Subsidy: more than \$100 million in free raw product annually; no dividends, nor legitimate profit for \$1 billion worth of forest gifted since 2004

VicForests has incurred cash losses of \$22.2 million since it commenced operating in 2004³⁷.

Table 2 - VicForests' Operating Profits, Government Grants Received and Dividends Paid

\$000	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total
Profit	8,180	2,085	(17)	538	(5,024)	3,592	2,323	(96)	802	12,383
OP pre-tax	13,135	2,980	(23)	770	(5,751)	1,777	2,062	(91)	997	15,856
Grants	n/s	n/s	868	5,680	1,458	10,860	5,885	0	0	24,751
Dividend	Not finalised	3,024	2,062	0	0	0	0	0	0	

Source: VicForests' published Annual Reports 2006 -2013

For the sixth year running, VicForests paid no dividend to Treasury. It has now only returned a dividend in two years out of nine. The 2011 Report (p 68) foreshadowed a payment of \$1,260,000 in October 2011. This was not paid. Similarly the 2013 Report (Note 25) foreshadows a payment of \$250,000 during the 2013-14 year.

³⁶ http://www.daff.gov.au/__data/assets/pdf_file/0007/37573/plantations_snapshot_english.pdf

³⁷