

The more things change, the more they stay the same – lessons from the past

During a chat with Manufacturers Federation executives about the country's investment needs, the forest sector popped into consideration. It was cited as a sector that has been pushing hard for investment money from overseas. But the driving force behind the investors who respond is their own business interests in their home countries, not the national interest of this country, and there is a danger this national interest may be harmed rather than promoted.

The overseas investors are interested essentially in tying in a dedicated supply of raw materials. Whether they process logs here or there is entirely a matter of their discretion and has nothing much to do with the best interests of the New Zealand economy.

So those who sold them their cutting rights – for the most part our Government – ignored important lessons from our economic history.

The lessons are found in our meat industry. Only in comparatively recent times have we regarded a carcass as something to which much greater value could be added here. Our freezing works were built by British businessmen who owned cold stores and built butcher shops to keep their cold stores full.

Then they wanted regular supplies of meat to sell in their butcher shops, preferably at the lowest cost possible. That's why they invested in our meat industry and built huge freezing works.

Obviously, since they were their own customers, there was no need to go look-

ing for new markets in California, the Middle East, or anywhere else; nor did they have to develop fancy cuts or otherwise engage in adding value. They had an army of butchers back home to do that and all they wanted was the raw carcass.

It's looking suspiciously like the same thing is happening with today's forestry investment, or what the conventional wisdom calls "investment".

Actually, it's not really investment – not new investment – unless it produces new plant and equipment or generates new jobs. In other words, new investment should add to the country's gross capital formation. Much of the "investment" we have attracted simply is money spent on buying an existing asset. Nothing happens except the asset changes ownership.

At least, nothing much happens to benefit the nation's economy, although the deal might be hugely beneficial for seller and buyer. To the contrary, as we are seeing, selling a forest can be detrimental to the nation's economic well-being by encouraging over-cutting.

How come?

Well, chances are the new owners have borrowed to buy their forest – or cutting rights – and have incurred a debt. Naturally, they will be anxious to be rid of the debt burden as quickly as possible, which means they must crank up a cash flow.

That's done by chopping down trees, mature or not. There's talk of trees only 16 years old being cut down in some places during the recent export boom.

If these trees had remained in the hands of their previous owners – for the most part, this means the Government – there wouldn't have been the same urge to reduce debt levels.

The State's forests, furthermore, were sold over the past two years when the market was in a trough. Prices started firming only toward the end of last year. Therefore expectations were lower when it came to fixing a sale price at the time the rights were sold.

Alternative strategies, such as a 50/50 joint venture, were ruled out basically – it seems – because of the prevailing doctrine that the Government should be rid of its business interests.

To cap it all, Labour's Finance Minister David Caygill treated the money as current income and blew the lot in one glorious year of budget balancing that nevertheless never quite got rid of the budget deficit.

Among other things, the low sale price means the Japanese and Korean purchasers have capitalised in a very low raw material price. They have it hooked in for ever, or so long as they own their forests, and if you have a raw material for a low price, you have less incentive to do much more processing with it.

So if they are not exporting their trees as logs, they make plywood or something similar at the low end of the value-added spectrum.

Basically, the rights to cut these logs have been sold to people smarter than us, wanting a low-cost raw material for use back in their home countries. Like the meat moguls of before them, they aren't impelled to maximise the value of the wood.

Rising Prices

As incomes go up round the world, of course, demand goes up, but the supply isn't going up as fast. The result is rising prices.

Most wood still comes from standing native forests and if you want more of this, you must go into more difficult country and travel greater distances. The result of this is higher costs per cubic metre.

So if you happen to be sitting on a pine plantation in New Zealand with a fixed cost of production, you'll cash in on the phenomenon of rising prices and rising costs by increasing your economic rent

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each time the fellow overseas has to go further into his forest and incur higher cutting costs.

What's more, if anything, you should be increasing your productivity and reducing your production costs while the real price overseas is rising.

Flexibility

But to make the most of this, you must keep flexibility in the way you use your material. If your use is locked in – specially to a low-value-added item like plywood – then your; and the national, economy doesn't get the optimum economic rent.

Or to put it another way, as with the old meat industry, we are not adding as much value as we can, although to some extent this can be blurred by figures showing – for example – an 18 per cent increase in sawn timber exports in the past year. When you compare the volumes involved with log volumes, it becomes clear the economics encourage our flogging logs as commodity exports rather than turning them into products with value added in this country.

Kel Sanderson, at BERL, has taken the best stab he can at analysing what's happened in recent years.

His methodology – limited availability of statistics, he concedes, means it's not perfect – measures products for which data are published.

Sawn timber export volumes doubled between 1988 and 1992, while log volumes increased almost four-fold.

But the Sanderson model goes further, adding up a sample of logs, sawn timber, particle board, medium density fibre board, pulps, kraft paper and coated paper, and so on, and treating each as if it were measured the same way. The data from this show exports of 1.8 million metres or tonnes in 1988 became 5.5 million tonnes in 1992. But the average price per tonne was \$402 in 1988 and just \$246 in 1992 – a whopping decline.

Only Difference

Figures like these tell us we aren't processing the same percentage of forest product as we were four years ago. The only difference between now and the old days of the meat industry is that today's butchers cut loose in forests with chainsaws and the commodity doesn't need chilling during its journey to the work-force where value will be added.

Bob Edlin

Rising log prices – an industry living in interesting times

In February and March of this year increasing log prices produced a rash of stories in the New Zealand media. Many of these concerned tensions between local processors and log exporters over the availability and price of logs for domestic processing. Some, particularly representatives of smaller independent sawmillers, expressed concern that despite being prepared to pay fair prices, employment-creating, value-adding processors were unable to get reasonable supplies of logs. This was blamed on large forest owning companies being interested only in exporting unprocessed logs to Asian markets. (With the national unemployment rate in excess of 10 per cent and log exports up yet again to some 4,117,000 m³ for the December 1992 year the predicament of these processors quite naturally attracted interest.) As might be expected in these days of a market-driven world not all of the comment was completely sympathetic to plight of the small processor.

The argument that export logs are themselves a value added product was once again dusted off. Exponents of the free market were also quick to point out that if log exports provided the best return on the investment in forest growing, taking steps that would inhibit the trade would be detrimental to forestry's long-term interests. In his weekly National Business Review column Gareth Morgan even suggested that instead of complaining about log availability and other countries' barriers against imports of processed forest product local sawmillers could benefit both themselves and New Zealand by considering shutting up shop here and investing in processing in Japan or Korea.

There's no denying that log prices have risen in the last few months. The NZ Forest Owners are on record as saying that in the six months since September 1992 the price of 'C' grade logs went up 77%, 'K' grade 30% and 'A' 39%. As well the Ministry of Forestry's Market Report for February 1993 states that at-wharf prices for pruned log have reportedly increased by 80%. These days (March 1993) one can, without too much difficulty, find reports of FOB prices of the order of \$290/m³ for (some) pruned logs. This price is well up on the \$130/m³ used in a number of recent forestry investment

proposals, or for that matter on the \$150/m³ that one would get from taking the 1988 BERL report forecasts and simply adjusting them into 1992 dollar terms. But so what?

What's behind the log price rise?

For some the current rise in log prices is nothing more than the growing pains of an industry in the process of reaching its rightful place on the world stage – a painful but necessary adjustment to the real world where New Zealand radiata pine will be green gold. Moreover, as claims about the log supply problems diminish as the result of what Wayne Coffey describes as "a lot of positive discussion" between processors and growers, it is very easy to dismiss a lot of hoo-ha of the last couple of months as simple posturing by two sides about to enter into new supply contract negotiations. Is that all there is to this story?

Like most stories with an economic twist, the answer to that question really depends on the future and people's expectations as to whether or not the current log price level will prove to be sustainable. However, before tackling that question it might not be a bad idea just to look at what has happened to export log prices, but rather than the last six months it is perhaps wiser to take a slightly broader perspective and look at say the last six or seven years.

The MOF graph (Page 8) shows that over the seven years from 1986 the delivered cost of 'A' grade logs has been steadily rising in NZ dollar terms by about 5 per cent per annum. But the graph also gives the log price in Japanese yen and this reveals that much of the increase has been due to depreciation of the New Zealand currency rather than an improvement in the Japanese price for radiata pine logs. It is only in the last couple of months that prices have really taken off in both yen and NZ dollar terms. Another point that is perhaps a little worrying, from the point of view of the longer-term stability of the current price levels, is that as one looks at the graph one can see other examples, e.g. in 1986, 1987/88, 1988, where prices started to take off as they have at present only to rapidly collapse back. Could history repeat itself yet again?