



Tasmanian Round Table for Sustainable Industries Project

Response to criticisms of Report 1

Prepared by
Launceston Environment Centre

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DISCLAIMER: This information is provided as a contribution to the current public debate on Tasmania's future, specifically the sustainability of its various development options. Sources are provided, and personal enquiries should be made to verify all facts. If you wish to call attention to any inaccuracies in this report please contact the LEC. This document is intended to inform policy makers, not as the basis for investment decisions.

Introduction

In a recent speech on the Gunns pulp mill proposal in the House of Representatives, Premier Lennon said that 'the debate ... is about whether we as a community are prepared to accept a future with a vibrant timber or mining industry, or whether we want to turn the clock back to the pre-industrial age, or even 20 years, when the Tasmanian economy was far too reliant on industries that required big subsidies'¹.

It is the contention of the TRSIP report that, contrary to the impression that might be given by Mr Lennon's statement to the House of Representatives, Tasmanian forestry and the proposed Gunns pulp mill are heavily subsidised.

Further concentration of Tasmanian economic activity in such a heavily subsidised industry will not maximise the welfare of Tasmanians. Indeed, in a full employment environment such as presently exists in Australia, promotion of a particular industrial development by way of subsidy may well result in a welfare loss.

The TRSIP report also identifies significant upstream and downstream risks, and attempts to identify the economic consequences of those risks as part of a broader assessment of the economic impact of the proposed pulp mill project.

The TRSIP has made a presentation to the Tasmanian parliament, and extended invitations to a number of interested parties to promote public discussion of these important issues. To-date no positive responses have been received.

In the interests of promoting debate, this document is intended to address comments which have been privately conveyed to authors of the report or made in other forums such as during parliamentary debate.

The document has been structured around a series of criticisms which have been made about Report 1 which are presented in bold, followed by the TRSIP response to them.

¹ Tasmanian parliamentary Hansard, 28 August 2007.

Criticism 1

‘[The TRSIP report] fails to recognise MIS scheme are about trying to reverse the rather disastrous negative trade balance that Australia has in timber, timber related products, paper and pulp’².

TRSIP Response

The argument that industry policy should be directed to achievement of a particular international-trade outcome in specific products has been thoroughly discredited.

It is almost universally accepted that the welfare of Australians is best served by policies that exploit Australia’s comparative advantage – that is, to export products for which Australia has relative cost advantage, and to import products for which Australia has relative cost disadvantage. This implies that Australia will have trade surplus in some products and a trade deficit in others.

It is also well understood that industry assistance, leading to trade patterns not in accord with comparative advantage, diminishes the welfare of Australians. This principle has underpinned Australia’s industry policy in the last few decades, leading to tariff reductions, withdrawal of subsidies, and removal of restrictions to competitive behaviour.

To repeat, the TRSIP report argues that Tasmania’s forest industries in general, and the proposed pulp mill in particular, are heavily subsidised by both Commonwealth and State governments.

Further expansion of this heavily subsidised industry will not achieve the best welfare outcome for Tasmanians.

Criticism 2

On stumpage: ‘One seller and one buyer does not make for an open market ... this is not a subsidy’³.

TRSIP Response

The principles of National Competition Policy make it clear that competitive neutrality requires that government business enterprises compete with private-sector suppliers on an equal footing. If a Government Business Enterprise sells product for a lower price than is offered to private sector suppliers of the same product, then that amounts to a subsidy to the purchaser.

² Sue Napier MHA, Liberal member of State parliament, draft notes on pulp mill speech circulated to constituents, dated 7 August 2007.

³ *ibid.*

Hence, if Forestry Tasmania sells pulpwood to Gunns Ltd at a price less than Gunns Ltd is prepared to pay other private-sector suppliers, then that price difference constitutes a subsidy by Forestry Tasmania to Gunns.

For this purpose it is immaterial whether the market is characterised by a large number of buyers and sellers or a small number of buyers and sellers – the latter case being applicable to the Tasmanian forest products industry.

It is also immaterial whether the subsidy is specifically approved by Parliament, or established as a result of contract negotiations between Forestry Tasmania and Gunns Ltd.

Criticism 3

On stumpage: ‘If there is a stumpage subsidy to Gunns from Forestry Tasmania, it relates to woodchips generally, and not specifically to the proposed pulp mill’.

TRSIP Response

The stumpage subsidy calculation in the TRSIP report relates specifically to supply scenarios under the recently-concluded long term supply agreement between Forestry Tasmania and Gunns Ltd.

The TRSIP report does not attempt to evaluate the larger question of subsidies by Forestry Tasmania to the whole of the private forestry sector (which includes Gunns as a woodchip exporter and as the pulp mill proponent).

The Heads of Agreement between Gunns Ltd and Forestry Tasmania dated 5 March 2004, makes it absolutely clear that the purpose of the supply contract is ‘to provide security with respect to future wood supply from Forestry Tasmania for both the period up to the commencement of the proposed pulp mill and for the period after it commences’. The supply contract developed from this Heads of Agreements also sets the terms of sale, including price.

Clearly, any subsidy calculations based on scenarios for this supply contract relate specifically to the proposed pulp mill.

Criticism 4

On Stumpage: ‘Any native forest timber price discount should be applied to the total cost of timber arriving at the mill (after harvesting and transport and other costs are included) rather than, as in the TRSIP Report, the ex-forest price’.

TRSIP Response

The TRSIP report explicitly recognises a lack of access to confidential price information in the supply agreement. The firm data quoted in the report is from

Mr. Rolley's statement that the stumpage of native forest pulpwood is \$12-\$14, and Gunns floor price for plantation timber in the Woodlot Project 2006 project, which for year 13-year clear-fell plantation pulpwood is \$36 per cubic metre.

Illustrative budgets published by the WA Department of Agriculture assume there are 1.060 tonnes per green cubic metre of blue gum pulpwood. As a small approximation, the TRSIP report assumed that 1 tonne = 1 cubic metre.

The 'Adviser Edge' investment analysis cited as part of the GPL Woodlot Project 2006 project quotes an 11% price premium for plantation pulpwood over native timber so, dropping the ex-plantation price from \$36 to \$30 per tonne was thought to represent a conservative allowance for the plantation premium.

If instead the Adviser Edge premium is applied to mill-door prices, it is necessary to assume a mill-door price. For example, suppose the mill-door price for plantation timber is \$70 and that this premium includes all the mill-door disadvantages of native timber (i.e. it includes differences in lignin content, take-up of chemicals and so on).

At an 11% premium, the mill-door price for native timber would be \$63. Transport and harvesting costs for plantation timber are, using the Gunns floor price, $\$70 - \$36 = \$34$. If the same transport and harvesting costs apply to native timber then the appropriate stumpage for native timber is $\$63 - \$36 = \$27$.

Conclusion: Applying the price premium at the mill-door has only a minor effect on the TRSIP subsidy calculation. Assuming

- Mr Rolley's quoted stumpage price of \$12-\$14 (midpoint \$13),
- equal transport and harvesting costs,
- and taking the premium-adjusted stumpage for native timber to be \$27,

the revised estimate of per-tonne subsidy from Forestry Tasmania is $\$27 - \$13 = \$14$.

Referring to Table 3 (p.44) of our report, the TRSIP's preferred estimate of the NPV of the subsidy under scenario A is based on a per-tonne subsidy of \$15 giving an NPV of \$434.6m.

If instead, a per-tonne subsidy of \$14 had been used, the NPV of subsidy under Scenario A falls from \$434.6m to approximately \$400m.

Criticism 5

On Managed Investment Schemes: 'Because Managed Investment Schemes have been in place for some time, they do not constitute a subsidy to the proposed pulp mill'

and

'the [TRSIP] report discounts the value of the pulp mill by \$241 million to take account of the Australian Government's Managed Investment Scheme (MIS) tax policy. Once again this policy is not contingent on the development of the pulp mill'⁴

TRSIP Response

It is well-recognised that MIS provide a substantial subsidy to plantation forestry. Recently the Federal Minister for Agriculture, Forestry and Fisheries argued, in an article headlined 'MIS just a tax dodge', that tax-driven MIS schemes in forestry are having a major distorting effect in Australian agriculture⁵.

This view was reinforced by Liberal Senator Bill Heffernan who said recently that 'the facts are that MISs are the greatest tax rort that's confronted Australia in a long while'⁶.

The TRSIP report did not attempt to evaluate the amount of subsidy provided by MIS to Tasmanian forestry as a whole – that calculation would include subsidies to include softwood plantations, longer rotation veneer hardwood, as well as pulpwood plantations established by private sector suppliers other than Gunns.

Instead, the TRSIP calculation is based on development scenarios for existing and future pulpwood plantations managed by GPL over 2007-2030⁷.

The commonsense approach to the question of whether MIS is a subsidy to woodchips or to the proposed pulp mill is to note that if it is a subsidy to the major input to the mill, it is a subsidy to the mill itself.

However, it may be more persuasive to note that the TRSIP analysis suggested that the financial viability of the mill is contingent on continuation of MIS schemes. This view was well-recognised during the recently-completed review of MIS schemes⁸.

⁴ Letter from TCCI to LEC Coordinator, 31 August 2007.

⁵ *Weekly Times*, 21 February 2007.

⁶ *ABC Landline*, 25 February 2007.

⁷ GPL is the wholly-owned subsidiary of Gunns Ltd that manages plantation forestry.

⁸ The Review of Plantation Forestry was conducted by the Departments of Agriculture, Fisheries and Forestry, the Treasury, and Prime Minister and Cabinet. Consequent on the Review, new taxation arrangements for plantation forestry came into effect on 1 July 2007.

The argument that MIS were pre-existing the Gunns pulp mill proposal overlooks the fact that major pulp mill investment proposals were an important determinant of the outcome of the recent review of MIS arrangements. In the review the decision to extend these MIS arrangements was to make them more attractive by establishing secondary markets for MIS projects.

This view is supported in a recent publication of the Commonwealth Department of Agriculture, Fisheries and Forests which, when reporting on the new taxation arrangements for forestry MIS, states that

A number of planned key project proposals, valued at several billion dollars, **depend directly on further expansion of the MIS plantation sector.** They include the **Gunns pulp mill in Tasmania**, the Protavia pulp mill at Penola in the Green Triangle, expansion of the Visy pulp mill at Tumut in NSW and the PaperlinX pulp mill upgrade at Maryvale in Victoria.⁹

If the viability of the Gunns pulp mill is contingent on continuation of MIS for plantation forestry, and that was taken into consideration in the recent review of MIS arrangements for forestry, then MIS should properly be viewed as a subsidy for that activity.

It also follows that if MIS is a subsidy to the pulp mill, calculation of the cost of lost agricultural output due to the MIS-subsidised conversion of agricultural land to plantation forestry is a relevant cost of the proposed pulp mill.

It is the contention of the TRSIP report that the MIS subsidy and the consequent cost of land diversion should have been estimated in both the AC and ITS Global reports.

The TRSIP report includes scenarios designed to provide a range of estimates for the NPV of the MIS subsidy and of the cost of land diversion. For the former, the preferred estimate is \$241m, and for the latter it is \$403m.

Criticism 6

On RFA and CFA: RFA and CFA payments should not be counted as a subsidy because 'It is a fact that the Regional and Community Forest agreements would be in place irrespective of the pulp mill development'¹⁰.

TRSIP Response

The figure included as a subsidy in the TRSIP report is the present value of payments over the period 2007-2010, the end point being the expiry date for contracted payments under the CFA.

⁹ Taken from 'Forestlinks', Department of Agriculture, Fisheries and Forests, August 2007 (emphasis added).

¹⁰ Letter from TCCI to LEC Coordinator, 31 August 2007.

The CFA was signed in May 2005 as a supplementary agreement to the earlier RFA. The date of the agreement is some time after Premier Lennon 'went looking for an investor who was prepared to invest the sort of dollars necessary to build a pulp mill in Tasmania'¹¹, and some time after stage 1 of the RPDC approval process for the proposed pulp mill was commenced.

In Fact Sheet No 1 describing the CFA, it is stated that 'The [CFA] will build a firm foundation for the Tasmanian forestry industry going forward **and underpin resource security for the proposed new pulp mill at Bell Bay**'¹².

The TRSIP report recognises that payments under the RFA and CFA over the period 2007-2010 are directed to a variety of purposes, including that of underpinning the Bell Bay development. For this reason, only half the payments were allocated as a subsidy to the proposed pulp mill.

Criticism 7

On the welfare calculation: 'The TRSIP welfare calculation, that there is only a 0.47% increase in per capita consumption over the base case, does not adopt the AC report's assumption as the change in working hours induced by construction of the pulp mill'.

TRSIP Response

The TRSIP report explicitly states that the welfare calculation departs from the AC assumption, which is that the employment increase of 2% is made up of an increase of 0.7% in persons employed, and a 1.3% increase in average hours worked¹³.

The reason for the departure is that the AC result regarding the long-run change in average hours worked (which amounts to around 30 minutes per week averaged over the whole Tasmanian workforce) is implausible. There are large sections of the Tasmanian economy where there will be no impact on employment at all. For example:

- in some sections of the forestry industry there is no scope to increase hours of work, whether because of legislative restrictions in the case of transport operators or the length of daylight hours in the case of harvesters;
- the explicit modelling assumption is public service employment is unchanged;
- for many export industries there is no reason why increased economic activity due to the pulp mill will change standard working hours - examples which come to mind include Zinifex, Boyer, Comalco, Incat, and so on;

¹¹ ABC 7.30 report, 30 August.

¹² Tasmanian Community Forest Agreement, Fact Sheet No.1. at <http://www.premier.tas.gov.au/publications/forest/fact-sheets.pdf>

¹³ TRSIP report, fn 3, p.39.

- in some industries (agriculture, for example) the AC modelling suggests output and employment will probably fall.

So the AC modelling assumption is that, for those workers whose hours of work will change, the change could be an increase of several hours per week.

It may be reasonable to propose this as a cyclical or short-run adjustment in hours worked, but the TRSIP report regards this as highly implausible in the long-run.

So the TRSIP report assumed that there is no long-run change in hours worked, while recognising that this may lead to some bias in the welfare calculation.

Criticism 8

On Tourism: ‘The TRSIP report bases its estimates of tourism impacts on a survey which includes questions on general impact, and which may be biased’

and

‘The fundamental error of the report is that it relies on qualitative analysis to draw quantitative conclusions. While it is certainly valid to survey local business and tourism operators of (sic) their perceptions about the impact of the proposed pulp mill, it is erroneous to draw quantitative conclusions from what is essentially an opinion poll’¹⁴

TRSIP Response

The TRSIP report was conducted using a limited budget and relied on publicly-available information. The ITS Global report did not collect detailed qualitative information on this issue. Also, despite the fact that the pulp mill proposal has been under scrutiny for several years the Department of Tourism does not appear to have any detailed information on tourism and related industries in the Tamar Valley.

On the question of possible bias, it is noted that the tourism impact survey was not conducted by TRSIP, but by EMRS, which is a reputable firm of long standing in the conduct of business surveys.

It is standard statistical practice to base economic analysis on sample-survey data. It is also long-standing practice to convert qualitative responses to sample surveys into quantitative data¹⁵. In any event, the TRSIP report explicitly states the assumptions underlying the quantification of **risks to tourism**, and does so by providing a number of alternative scenarios.

¹⁴ Letter from TCCI to LEC Coordinator, 31 August 2007.

¹⁵ Although quite technical, the paper by d’Elia provides a good survey of the issues – see E.d’Elia ‘Using the Results of Qualitative Surveys in Quantitative Analysis’, September 2005.

It should also be noted that the main thrust of the TRSIP report was to identify areas not covered by the AC and ITS Global reports. The AC report identifies a 3.7% increase in Tasmania-wide Trade and Accommodation services in 2008 (most of which is presumably concentrated in Launceston). The welfare benefits of this activity have been taken into account in the TRSIP representation of the increase in per capita consumption implied by the original AC report, of a 0.47% increase in per capita consumption.

Criticism 9

On the method of analysis: ‘The validity of any government subsidy is certainly worthy of analysis, but it is incorrect to apply it to specific projects such as the pulp mill.’¹⁶

TRSIP Response

The TRSIP report disagrees with this proposition in a fundamental way and so, we presume, would bodies such as the Productivity Commission. The Productivity Commission and its precedent bodies have a long history of analysing the effects of subsidies on specific industries. To take one of many possible examples, analysis and recognition of the distorting effect of the implicit subsidies provided by tariff protection is the reason why tariffs on motor vehicles have been dramatically cut over recent times, with resulting efficiency and welfare gains to the Australian community.

The TRSIP does not argue that the analysis of subsidies be confined just to forestry and the pulp mill – all government expenditure, tax and subsidy policies should be subject to the same sort of scrutiny.

Criticism 10

On financial modelling of profitability of the proposed pulp mill: ‘Sadly [the TRSIP report] used ancient data, not current prices for pulp. As of 7 August 2007, the Hardwood spot price is \$706.28/tonne, and was even \$588.97 on 3 Jan 2006.’¹⁷

TRSIP Response

The TRSIP report (section 12) provides a ‘live model’ which has the stated aim of enabling users to input their own data and assumptions on pulp prices and exchange rates, and to test the sensitivity of the TRSIP conclusions as to the profitability of the proposed project.

The report clearly states that for long-horizon projects such as the proposed pulp mill, financial-market brokers base their profitability forecast on long range predictions about costs, pulp prices and exchange rates.

¹⁶ Letter from TCCI to LEC Coordinator, 31 August 2007.

¹⁷ Sue Napier MHA, Liberal member of State parliament, draft notes on pulp mill speech circulated to constituents, dated 7 August 2007.

The TRSIP report provides a sensitivity analysis to various financial institutions' forecasts, with market 'consensus' long range pulp forecast prices being in the range of \$500 to \$550/ADT.

These forecasts are based on a significant amount of information, including the historical average prices for pulp. Given pulp prices are volatile and change daily, it is not plausible (and shows a significant lack of understanding of how financial markets operate) to make a long-term investment in such a project on the basis of a current spot price.

Criticism 12

On health costs: The Roundtable report for example p 18 re human health the predicted increase in particulates is .5 micrograms, not the .94 micrograms that they use...(a ten fold overestimation...., noting that 90% of pm 2.5 in Launceston are caused by wood fires, cars, and backyard burnoffs (70% wood heaters).¹⁸

TRSIP Response

The TRSIP calculations on human health impacts were based on submissions made to the RPDC by Dr Andreas Ernst and the AMA. These documents are publicly available from <http://www.rpdc.tas.gov.au/>

While Gunns' model predicts that the addition to particulate pollution will be 0.5%, their model, when compared to actual pollution levels, has been found to be up to 600% inaccurate.

In other words, if their model predicts that air pollution levels will increase by 0.5%, it could be up to 600% more than that.

Gunns has said additions to particulate pollution will be 0.5 micrograms. We say 0.94 micrograms, that is not "out by a factor of 10" but less than a factor of 2.

Therefore, the potential range, given the poor predictive capability of Gunns modelling, is anywhere from 0.5 - 3 micrograms.

As a result, our figures (risk scenarios ranged from 0.89 to 2.83 micrograms) are at the conservative end of the possible range.

Further, the Gunns models under predicts PM10 for Launceston by 500% and fails to meet US EPA acceptance criteria for class 1 pollutants 10 times out of 12, i.e. 90% of the time.

¹⁸ Ibid.

Therefore, one can firmly conclude that the model presented by Gunns gives wrong predictions.

Criticism 13

On opportunity costs: ‘The [TRSIP] report also fails to adequately account for ... what would happen if the pulp mill were not to proceed. ... Failure to gain approval for the pulp mill would have a severe economic impact. In competitive global capital markets Tasmania would be viewed as a greater risk, which would lead to a loss of future capital investment into the State’¹⁹.

TRSIP Response

The Allen Consulting report does not quantify this risk, and neither does the TRSIP report.

In the case of the TRSIP report, the reason is that it is not clear where the risks actually lie. Contrary to the view put by the TCCI, some have argued that the failure to follow pre-announced RPDC approval procedures means that potential investors face greater sovereign risk – they will now be uncertain as to the ‘rules of the game’ as they apply to their own project or to proposals by possible competitors.

Additionally, the failure of the Wesley Vale Pulp Mill proposal is an instructive benchmark on the above criticism. At the time this proposal failed it was heralded by some as the end of investment in the state, and the beginning of a long term decline in Tasmanian economic growth and employment due to the ‘negative’ investment signals it sent to the investment community. No such thing has happened in Tasmania – in fact quite the opposite has occurred over the past decade, with increased investment and growth in sectors such as IT, Tourism, ship building, manufacture of mining equipment, business services, construction and healthcare underpinning strong GSP growth and record levels of employment²⁰.

¹⁹ Letter from TCCI to LEC Coordinator, 31 August 2007.

²⁰ A snapshot of Tasmania’s economy, Launceston Environment Centre, May 16th, 2007.