

**What is the NZFFA's role in facilitating
well-designed New Zealand Forestry Cooperatives?
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1. Introduction.

Typically, unless they are members of some sort of forestry cooperative, woodlot owners do not access the best advice, do not manage their woodlots well, and do not receive optimal income when their trees are harvested.

2. The international scene and the advantages of co-operatives.

The United Nations Food and Agriculture Organization estimated, albeit before the collapse of communism, that just over one-third of the total world forested area was in private forests and that the great majority of this area was in the possession of people owning less than 20 hectares each. In developed European countries, North America and Japan, where there has been a long history of forest management, most of these owners have formed associations with other similarly-placed proprietors. It is widely recognized in these countries that co-operation provides better profits through economies of scale, including mutually beneficial agreements with the buyers of their wood, and the suppliers of necessary goods and services, such as seedlings, chemicals, and inventory services. Cooperatives can also make substantial gains for their members by scheduling a sustainable cut of timber, and better of the use of capital equipment.

3. What is the history of forestry co-operatives in New Zealand?

The NZFFA is itself a sort of low level forestry cooperative. Members exchange useful technical information, mainly through the 'Tree Grower'.

The Western Farm Co-operative Forestry Company Ltd takes cooperation up to the next, although still basic, level. It has been set up under the Co-operative Companies Act 1996, and is kept going largely through the enthusiasm of two Middle Districts stalwarts, Hew McKellar and Humphrey Rainey, but essentially all it has done is to offer its 60 members the option of a discount if they use the services of a particular harvesting and marketing manager.

In 2003 Wrightsons tried to get cooperation going at an even higher level. It advocated the formation of SAFCOs (single asset forestry companies). Essentially Wrightsons tried to get a number of geographically distinct forest owners, with trees of similar age class, to come together under one entity and have their trees harvested and marketed jointly. The idea was that they would exchange their cutting rights in return for shares in a SAFCO, the shares being proportional to the value of the contributors' trees at the time of joining. The SAFCO's managers would then harvest and market the combined forest to best commercial advantage.

At the NZFFA conference in Wellington that year, Don King provided convincing evidence that a woodlot owner's pre-tax net income under such an arrangement would increase by 15 to 30% however no Wrightson SAFCOs have yet been established.

Rick Osborne and Kelly Coghlan also tried to put together a SAFCO in the lower North Island in the late 1990s. Coghlan says that many private woodlot owners were initially enthusiastic, but when it came to the crunch, these 'supporters' would not sign up.

4. So what are the reasons why well-designed forestry cooperatives have not yet been formed in New Zealand?

(a) Nervousness about being a guinea pig?

Woodlot owners would certainly be a lot more comfortable about joining a SAFCO if there was evidence that one already existed in New Zealand and was working well.

(b) A culture of stubborn independence?

Some believe that there is a culture of stubborn independence among New Zealand rural land owners and that this will prevent forestry cooperatives from ever forming. However the existence Fonterra, a very successful dairy co-operative, invalidates this myth.

(c) A lack of understanding about the net benefits of co-operatives and procrastination?

Coghlan contends that woodlot owners just do not comprehend how much more marketing strength they would have if only they acted collectively. Another factor is that the demands of the daily job tend to take precedence over making decisions about marketing one's forestry block in several years time.

(d). Critical mass?

This could well be a very significant factor. Woodlot owners will become more interested in forming forestry cooperatives as woodlots increase in number, in maturity and in total aggregate area. Such pressure is building up. The total area of privately owned, non-large-company forest has risen from about 80,000 hectares in 1986 to about 900,000 ha today. The peak in the new planting rates associated with this expansion occurred in the period 1992 to 1998. This means that we are on the cusp of great increase in the harvesting of small privately owned wood, and this should trigger off a lot more interest in forestry co-operatives.

(e) A tax that only applies to the forestry sector?

Forest owners labour under a unique tax disadvantage. They must "hold" the expense of buying standing trees in a 'cost-of-bush account' i.e. they can not deduct this expense

against other income at the time of purchase, but can deduct it from the proceeds of the sale of those trees when they are harvested. For example, if someone buys a 15-year-old mid rotation forest and does not harvest it until year 30, the cost of purchase is only deductible against the revenue obtained from that forest in 15 years' time. Say inflation averages 2% p.a. then the buyer's purchase price will decrease in real value by 26% over the 15 years before it can be deducted. Not having the benefit of early deductibility also means that the buyer has to pay more for raising the necessary funds, i.e. he has to pay interest for 15 years on money that he would otherwise have recovered from tax deductibility. In this example it is estimated that, at a 3% real interest rate, the buyer suffers a 17 % penalty arising from the time cost of money on the tax element. This is on top of the 26% loss of deductibility caused by inflation¹.

This means that immature forests are worth much more to a seller than to a buyer, even if the buyer and seller have identical perceptions of the trees' future growth and pre-tax harvest value, and it explains why mid-rotation forests have very seldom been sold.

This disconnection is generally called 'the cost-of-bush' anomaly. Why does it exist? In fact it nearly did not. After winning the 1990 election, the National Party failed to keep the promise it had made in the lead up to that election which was to remove the cost-of-bush completely. Cost-of-bush was kept with respect to the sale and purchase of woodlands because the Government was then still in the process of selling hundreds of thousands of hectares of State forests and was worried about the adverse financial impact that immediate deductibility would have had on Government's short term budgets.

In summary, not only does the cost-of-bush-anomaly stop the consolidation of forests through the buying up of small woodlots, but it also offsets many of the benefits of joining a SAFCO because the exchange of cutting rights in return for shares in a co-operative is deemed by the IRD to be a forest sale.

5. So what needs to be done to form well-designed forestry co-operatives?

(a) The NZFFA executive needs to marshal NZFOA and the NZIF support and lobby the Government to get the cost-of-bush anomaly abolished. This should not be too hard because its abolition would increase Government's revenue. For example, imagine that the cost-of-bush anomaly has been removed and as a consequence almost all the 800,000 hectares of small private forests created since the dissolution of the New Zealand Forest Service in 1986 were in co-operatives that yielded an extra profit of \$3000/ha when they were harvested, then the aggregate extra profit to growers between 2014 and 2035 would be \$2.4 billion¹, and the extra income to the Inland Revenue Department would be \$0.7 billion², assuming an average tax rate of 30 cents/\$.

Government should also be supportive of Forestry co-operatives since they will do much to accelerate the education of individual owners about good forest practice. Among other things, this would result in more owners planting the right species on the right sites,

¹ For more details on these calculations see Levack Hamish 2010 "Current forestry tax laws stop the formation of properly structured forestry co-operatives": NZ Journal of Forestry: March issue.

pruning and thinning being done on time, and better forest protection measures being implemented, all of which would eventually result in even higher profits and even more tax revenue for the Government. Other flow-on benefits include

(i) Co-operatives with the power to guarantee a sustainable supply of wood are essential if investors in further processing in New Zealand are to be attracted.

(ii) Co-operatives provide the necessary scale needed for the effective certification of timber and greater efficiency in the sustainable management of stored carbon.

(b) The NZFFA needs to build a register of all woodlot owners, (not only NZFFA members) and explain to them that it would be in everyone's interest if information on forest crops, particularly the maturity, species and area of these crops, is made available to all participants, so that owners can at least interact and consider the benefits of organizing continual work for logging gangs.

(c) The Executive should seek funding, perhaps from MAF's Sustainable Farming Fund and from volunteer contributions from the NZFFA branches, to investigate and if necessary develop templates of all the legal documentation necessary to set up properly structured forestry co-operatives.

6. What if we can not get the Government interested in abolishing the cost-of-bush?

Some complicated and administratively inefficient structures to get around the cost-of-bush anomaly might work. It is suggested that we should be thinking about woodlot owners not selling their cutting rights to the SAFCO, but selling a proxy for the cutting rights which confers the same rights, and acts as though the cutting rights were sold. Under such a scenario each forest owner would sell to a SAFCO, in return for shares, the right to (a) time the harvest, and (b) market the trees on harvest. The timing right would allow the SAFCO to arrange the sale to provide continuity of supply to mills and work for contractors, while the marketing right would allow it to take a commission on the sale of wood. However each contributor would still own his trees and each would receive the income from selling the trees through the cooperative, when the cooperative chose to harvest them. In this way no cost of bush would be incurred.

The commission would be used as an equalization account to pay co-operative members an adjustment related to the sale of the timing right. All members would receive their stumpage net of commission irrespective of log prices. However those whose wood was cut at times when log prices were good would receive no further distribution, while those whose wood was cut at times when log prices were bad would receive an additional (later) distribution from the commission equalization account. The level of commission and distribution would be designed to equalize, as far as possible, the payments by log grade to each member.

It is understood that arrangements based on pledges re the times when individual forests are to be harvested and the putting in place of a limited form of equalization funding is currently under close investigation by Forestry Enterprises Ltd.

7. Conclusion.

The cost-of-bush anomaly needs to be abolished.

The NZFFA needs to be lobbying hard to achieve this, but that should not be an excuse for delaying activity on other fronts. The NZFFA should be beginning basic work towards the building up of a register of woodlot owners, the provision of relevant information to woodlot owners and doing relevant research.