



Forest Industries Association
of Tasmania

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The General Manager
Adjudication Branch
Australian Competition and Consumer Commission
PO Box 1199
DICKSON ACT 2602

Dear Sir

**RE: Applications for Authorisations A90973 and 90974 lodged by the Tasmanian
Forest Contractors Association Ltd**

FIAT opposes the authorisations sought by the Tasmanian Forest Contractors Association. Fiat makes this submission, which includes and relies on the accompanying Symetrics report prepared by eminent economists.

The existing Tasmanian forest industry is complex and varied and depends upon a competitive market for the supply of raw materials. We contend that the existing system creates the situation that encourages innovation and continuous improvement, which has allowed costs to be contained. We note that the harvesting, cartage and silvicultural sectors have attracted and continue to attract capital and investors.

FIAT is a company formed in 1983 (previously the Tasmanian Timber Association) to represent the interests of its members who are predominantly processors of forest products. Those processing activities include producing veneers, hardwood and softwood sawing, production of wood panels, manufacture of pulp and paper and the export of woodchips. Our members are also engaged in a diverse range of forest management activities in both native forests and plantations ranging from site preparation, planting, silvicultural management and harvest.

FIAT would like to provide information to the ACCC regarding the industry structure, and the nature of integrated forest products, so as to advance the understanding of its structure and markets. There are different grades and qualities of log within a tree, which is often not evident until the tree has been fallen.

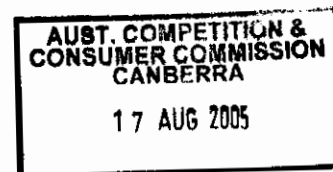
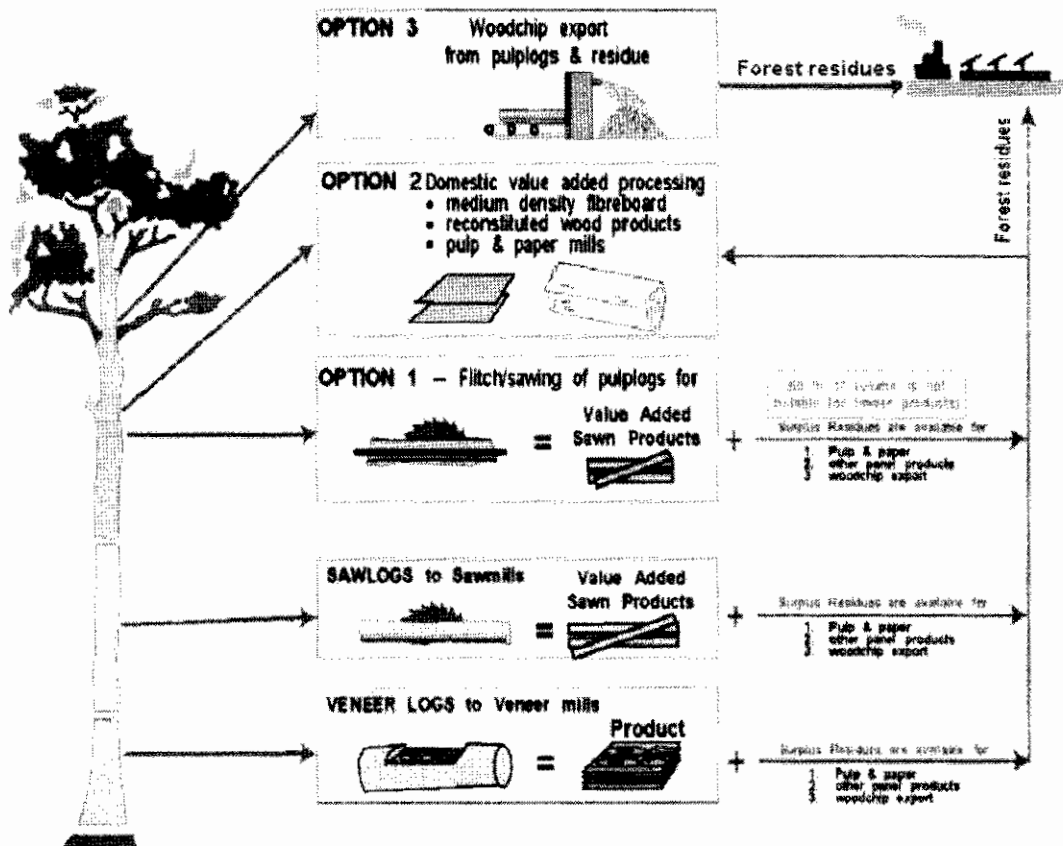


Diagram 1 Different grades of log supply different industry

Wood Harvesting and Integrated Value Added Processing in Tasmania



Manufacturing Industry Structure

The Tasmanian manufacturing industry is complex and economically interdependent. A summary of the major timber processors is as follows;

1. One medium density fibreboard (MDF) mill namely CHH Panels at Bell Bay;
2. Two pulpmills namely Norske Skog at Boyer, Australian Paper at Wesley Vale;
3. Four softwood saw/veneer mills namely Auspine, Frenchpine, Gunns Veneer, and Wynwood;
4. 52 hardwood saw/veneer mills (owned by 43 companies Appendix 1);
5. One timber preservative treatment plant namely Koppers at Longford;

6. Five woodchip export facilities being Artec at Bell Bay, Tasmanian Fibre at Bell Bay and Gunns Ltd with mills at Burnie, Tamar and Triabunna;
7. Three Forestry Tasmania hardwood export peeler log facilities located at Burnie Wharf, Bell Bay Wharf and Hobart Wharf;
8. One export pine log facility at Burnie; and
9. A large number of very small independent regional sawmills.

Most of the wood supply for these processors is arranged through the five major forest companies listed in the TFCA action.

How and why major forest companies coordinate supply to most other manufacturing companies

Two fundamental underlying elements in the wood supply structure are that:

- Industries have been regionally located to best suit their commercial outlook resulting in industries being widely dispersed throughout Tasmania; and
- It is necessary to sort logs into categories mainly in the forest based on quality, grade and destination, to minimise transport cost.

Other key aspects associated with the supply of logs to manufacturing companies are;

1. The landowner and manufacturing company(ies) enter into a contract for supply of forest products of a specific quality, volume and region or area of forest;
2. A principal forest company together with the landowner schedule a defined area of forest (coupe) for harvesting;
3. The principal forest companies engage a harvesting contractor to undertake the harvesting and supply. The agreement may be for harvesting and cartage or may contract the harvesting and cartage separately;
4. The principal forest company, the landowner and the harvesting contractor prepare and agree a Forest Practices Plan. This plan outlines details regarding how the harvesting will be conducted;
5. The harvesting contractor is advised the production rate and destination for the full range of log products, some of the destinations may only represent a small portion of the contractors volume;
6. The harvesting contractor under contract with a principal forest company is expected to supply the log products in a regular, timely manner in accordance with the contract;

7. Harvesting contractors may conduct all of the contracted activities or subcontract components such as falling;
8. The principal forest company and landowner schedules harvesting to meet supply requirements of the manufacturing companies;
9. The principal forest company pays the harvesting and cartage contractor as per their contract.

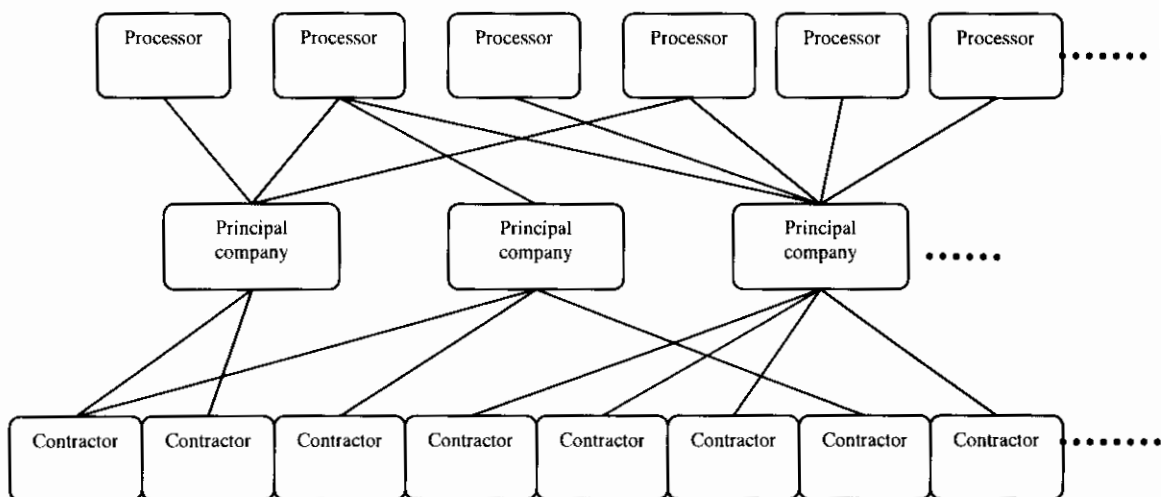
Definitions

Principal forest companies – a large firm that engages staff with skills to prepare and supervise forest practices plans and operation, develop and manage supply contracts with requirements to skill and safety of operation and the supply of logs to a variety of grade and quality to different destinations. Principal forest companies may or may not be engaged in manufacturing.

Landowner – those who can legally authorise forest operations on either public or private land.

Harvesting contractor – a firm that is contracted to undertake the harvest and/or cartage.

Diagram 2 - Processors rely on a complex matrix to obtain sufficient quantity of an agreed supply from one or more principle forest companies and their contracted harvesting contractors.



The above schematic diagram the existing structure whereby a processor may receive logs from several principal forest companies who in turn may have engaged several harvesting contractors.

In Tasmania there are more than 50 independent timber processors that receive logs from the 5 principal forest companies listed in the TFCA action. Should the existing system be changed so that harvesting and cartage contractors could engage in collective bargaining that lead to a boycott, such a boycott would inevitably stop

supplies to a number processing firms not directly involved in the dispute. It would cause considerable consequential damage.

There are a number of country sawmills that engage forest contractors directly and those mills are not named as respondents in the TFCA action.

Silvicultural Operations

Plantations are very important to the long-term viability of the forest industry. Most of the silvicultural activities conducted by silvicultural contractors are associated with establishment and growing of hardwood or softwood plantations. Activities include land clearing, cultivation, planting, fertilizer application, weed control and in some cases pruning and thinning. These activities are closely aligned with agriculture and are often referred to tree farming.

Many of these contractors carry out work for the farming sector such as land clearing or aerial spraying. Unlike the harvesting and cartage operations of supply, the arrangements between principal forest companies and their contractor vary.

The activities are to a large degree dependant upon the ground conditions and the climate as many agricultural activities are seasonal.

Most of the funding of plantation activities comes from private sector investment and if silvicultural costs climb the attractiveness of plantations as an investment, will decrease resulting in less establishment carried out in the short-term and in the long-term less resource for industry.

There is a gap of 15 to 30 years between establishment and harvest of plantations thus the consequential effects of cost and productivity are delayed. However it is still none the less vital that silvicultural operations are extremely cost effective or the processing industries will be ultimately faced with unacceptably high wood supply costs and become uncompetitive.

Tasmanian forest industry is characterised as a price taker in the market

Tasmanian forest industry sells into very competitive markets with most of the product exported to either to mainland or overseas. For many products such as MDF, newsprint and woodchips, international pricing is applied and Tasmanian firms are price takers. Tasmanian firms must match competitors price and quality or lose sales. Sales price has been decreasing in real terms in recent years and margins are slim.

Innovation and Increased Productivity

The current system of tendering creates an incentive for harvesting and cartage contractors to be come more efficient by way of innovative work practice or more effective equipment. Such a system allows forest and harvesting contractors to maintain profitability whilst decreasing cost. For example in recent years there has been considerable improvements in transport efficiency, regulation now allows a

variety of axle and trailer configurations in addition to the original tandem axle semis. These new combinations have greatly increased allowable gross vehicle mass (refer Appendix 2) and trucks have become lighter and more fuel-efficient.

A system based on collective bargaining would see the emphasis change so that harvesting and cartage contractors would seek to lock in capital structures and work methods as a means of justifying increased rates with no incentive for improvement. It will have further serious adverse economic implications as illustrated by the Symetrics report.

Conclusion

FIAT is extremely concerned that should silvicultural, harvesting and cartage contractors be given the right to engage in collective bargaining and should that bargaining be unsuccessful and include the right to boycott, such actions would be seriously detrimental to the viability of many of the forest processing companies and consequently seriously injure the public interest.

Yours truly,

A handwritten signature in black ink, appearing to read 'Terry Edwards', with a long horizontal line extending to the left.

Terry Edwards
Chief Executive

Appendix 2 - Allowable gross mass for different truck and trailer combinations

The allowable gross mass is the lesser of the gross vehicle mass limit (table 1) and sum of the individual axle mass limits (table 2)

This document is a guide only

TABLE 1, Maximum Allowable Gross Mass for:
Route Mass Limits High Productivity Route

			Route Mass Limits		High Productivity Route	
			General Access	Higher Mass Limits	Std Mass Limits	Higher Mass Limits
Tandem-axle Semi Length (inc. load): <19 m						
		Non RFS	39.0	39.0	39.0	39.0
		All RFS	39.0	40.0	39.0	40.0
Tri-axle Semi Length (inc. load): <19 m						
		Non RFS	42.5	42.5	42.5	42.5
		All RFS	42.5	45.5	42.5	45.5
Twin steer Tri-axle Semi Length (inc. load): <19 m ONLY OPERATE UNDER PERMIT						
		Non RFS	47.5	47.5	47.5	47.5
		All RFS	47.5	50.5	47.5	50.5
Tri-axle Semi with single point inker Length (inc. load): <19m ONLY OPERATE UNDER PERMIT (Elph Link)						
		Non RFS	50.0	50.0	51.5	51.5
		All RFS	50.0	50.0	51.5	51.5
B-Double type 2 Length (inc. load): >19 m & <21 m Up to 7 Axle 1. RFS recommended						
		Non RFS	50.0	55.5	55.5	55.5
		All RFS	50.0	57.0	55.5	57.0
B-Double type 2 Length (inc. load): >19 m & <21 m More than 7 axles 1. Only permitted to operate on high productivity routes						
		Non RFS	Not allowed	Not allowed	59.0	59.0
		All RFS	Not allowed	Not allowed	59.0	62.5
B-Double type 2 Twin steer Length (inc. load): >19 m & <21 m More than 7 axles 1. RFS recommended 2. Only permitted to operate on high productivity routes						
		Non RFS	Not allowed	Not allowed	60.5	60.5
		All RFS	Not allowed	Not allowed	60.5	62.0
B-Double type 3 Length (inc. load): >21 m and <25 m 1. RFS recommended 2. Only permitted to operate on high productivity routes						
		Non RFS	Not allowed	Not allowed	59.0	59.0
		All RFS	Not allowed	Not allowed	59.0	62.5
B-Double type 3 Length (inc. load): >21 m and <25 m 1. RFS recommended 2. Only permitted to operate on high productivity routes						
		Non RFS	Not allowed	Not allowed	62.5	62.5
		All RFS	Not allowed	Not allowed	62.5	68.0
Truck & Dog type 1 Length (inc. load): <19 m 1. RFS not compulsory						
		Non RFS	42.5	42.5	42.5	42.5
		All RFS	48.0	49.0	48.0	49.0
Truck & Dog type 2 Length (inc. load): >19 m & <21 m 1. RFS required on all axles other than truck steer						
		Non RFS	Not allowed	Not allowed	Not allowed	Not allowed
		All RFS	48.0	49.0	48.0	49.0
Truck & Dog type 3 Length (inc. load): >19 m & <21 m 1. RFS required on all axles other than truck steer						
		Non RFS	Not allowed	Not allowed	Not allowed	Not allowed
		All RFS	50.0	54.0	53.0	54.0
Quad Dog type 3 Length (inc. load): >19 m & <21 m 1. RFS required on all axles other than truck steer						
		Non RFS	Not allowed	Not allowed	Not allowed	Not allowed
		All RFS	50.0	57.0	55.5	57.0
Quad Dog type 4 Length (inc. load): >21 m and <25 m 1. Only permitted to operate on high productivity routes 2. RFS required on all axles other than truck steer						
		Non RFS	Not allowed	Not allowed	Not allowed	Not allowed
		All RFS	Not allowed	Not allowed	55.5	57.0
Quad Dog type 4 Length (inc. load): >21 m and <25 m 1. Only permitted to operate on high productivity routes 2. RFS required on all axles other than truck steer						
		Non RFS	Not allowed	Not allowed	Not allowed	Not allowed
		All RFS	Not allowed	Not allowed	60.5	62.0

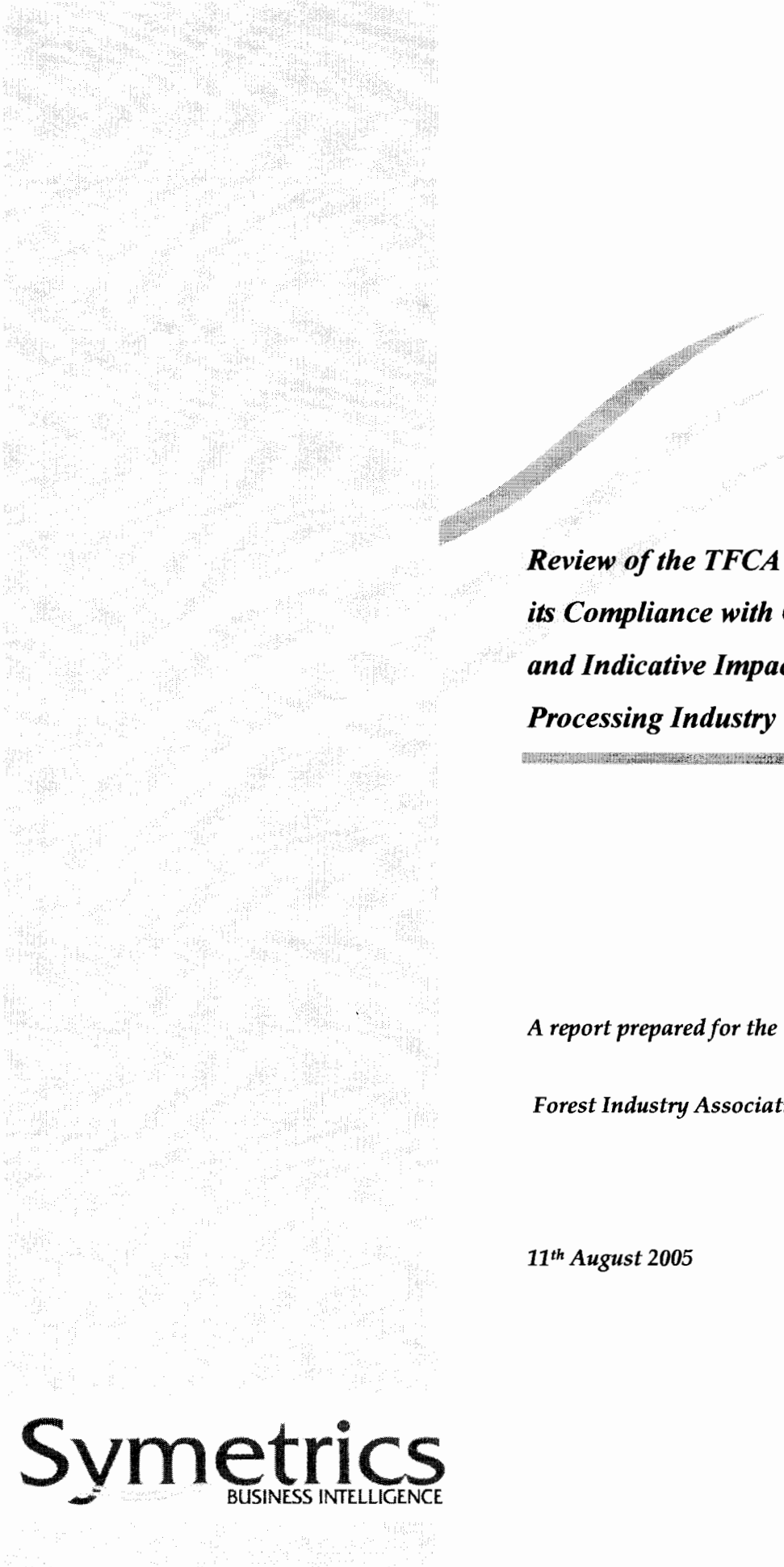
Limits	Spring Suspension (Non RFS)	Road Friendly Suspension (RFS) on HML routes
Single Steer	6.0	6.0
Twin Steer (Load Sharing)	11.0	11.0
Tandem drive axle group (8 wheel L/S)	16.5	17.0
Trailer - Single axle (4 wheel)	9.0	9.0
Trailer - Tandem axle (8 wheel L/S)	16.5	17.0
Trailer - Tri axle (12 wheel L/S)	20.0	22.5

Notes:

- All prime movers and trailers must have a manufacturer's GVM / GCM and or GTM that is appropriate to the operating mass of the vehicle or combination.
- General Access - may operate on any roads that is not subject to sign posted mass or dimension limit that is less than the mass or dimension of the vehicle or combination.
- All operating requirements for the relevant exemptions noted in the Vehicle and Traffic (Vehicle Operations) Notice 2003, No. 92 (Gazette) must be complied with.
- It is assumed that load sharing suspension is fitted to the steer axles of the truck of any combination listed above with a twin steer prime mover or truck.
- High Productivity and Higher Mass Limits routes are specified in the Vehicle And Traffic (Vehicle Operations) Notice 2003, No. 92, Schedules 1 & 4.

Appendix 1 - List of Tasmanian Saw and Veneer mills

Company	Mill Location
1 ARTEC PTY LTD	BELL BAY
2 BAKES, G I	SHEFFIELD
3 BISHOPS SAWMILL	SHEFFIELD
4 BLAIR DJ & SONS	MOLE CREEK
5 BLENKHORN/JORDA	RAILTON
6 BRADSHAW & CO	QUEENSTOWN
7 BRITTON BROS	SMITHTON
8 CARTER RM	GEEVESTON
9 CLENNETT IND	BRIDGEWATER
10 CLENNETT IND	DOVER
11 COOEE TIMBER SA	SANDY BAY
12 CORINNA TIMBERS	COOEE
13 CRAFTWOOD FS	HOBART
14 FRENCH ENTERPRISES (FEA)	BELL BAY
15 FRENCH ENTERPRISES	SCOTTSDALE
16 GILLESPIE TIMBER	BRIDPORT
17 GUNNS AUSTINS FERRY SAWMILL	HOBART
18 GUNNS DELORAINE SAWMILL	DELORAINE
19 GUNNS LINDSAY ST SAWMILL	LAUNCESTON
20 GUNNS SMITHTON SAWMILL	SMITHTON
21 GUNNS VENEERS	SOMMERSET
22 GUNNS VENEERS	BOYER
23 GUNNS WEST JNCT	LAUNCESTON
24 HANSSON AO & BA	MARGATE
25 HARBACK SAWMILL	MIDWAY POINT
26 KELLY I B/J	DUNALLY
27 KNOTTS MORE WOOD	DELORAINE
28 LINNELL R J	HUONVILLE
29 MCCONNON AE/MC/	LEVENDALE
30 MCKAY TIMBER	GLENORCHY
31 MCKAY TRIABUNNA SAWMILL	TRIABUNNA
32 MCKAY ST.HELENS SAWMILL	ST HELENS
33 MIRRAGONG P/L	LONGFORD
34 MORGAN TIMBERS	LAUNCESTON
35 NEVILLE SMITH TIMBER	LAUNCESTON
36 NEWTOWN TIMBER	MOWBREY HEIGHTS
37 PAGE CJ & SON	MIDDLETON
38 PAGE G H	LONAVALE
39 PHILLIPS SAWMILL	GEEVESTON
40 PORTA JW P/L	FAIRFIELD
41 RANSLEY P C & K	ELLEDALE
42 RATTRAY, LES	GOULDS COUNTRY
43 RICE, S P & S E	ST LEONARDS
44 ROBINS CG/BM	MOLE CREEK
45 ROBINSON'S S/MI	LOWER BARRINGTON
46 SINGLETON'S BLD	ULVERSTONE
47 ST PATRICKS RSM	NUNAMARA
48 STHN FOR FARM	CAPE PATERSON
49 STRUCTURED FINA	LONGFORD
50 SWEETWATER P-L	SCOTTSDALE
51 TORENIUS TIMBER	FORCETT
52 W & M TIMBER SA	STOODLEY



***Review of the TFCA Application to the ACCC,
its Compliance with Competition Principles
and Indicative Impact on the Timber
Processing Industry***

A report prepared for the

Forest Industry Association of Tasmania

11th August 2005

Symetrics
BUSINESS INTELLIGENCE


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EXECUTIVE SUMMARY

Symetrics was engaged by the Forest Industries Association of Tasmania (FIAT) to review and comment on the TFCA application and its compliance with competition principles. This included an indicative analysis of the implications of the bargaining/boycott model for the competitiveness of the forest industries.

A summary of the findings and conclusions is provided below.

Collective bargaining processes, of the kind sought by the TFCA, will take the forest industry bargaining process further away from competitive principles by adding a monopoly element on the supply side of the forest contractor market

The collective bargaining/boycott processes proposed by the TFCA reduces efficiency and conformity with competition principles in comparison with the current contracting situation.

Tasmania's timber processing industry is subject to significant declines in real returns in particular sectors and will need to diversify its product base and/or its markets to guarantee its long term survival. The capacity to pay higher contractor rates is circumscribed by current market trends.

The TFCA proposal entertains unrealistic expectations about the sharing of the risk burden with the timber processors. The TFCA proposal, if adopted, will involve a substantial unjustified shift in risk sharing from the contractors to the processors.

The TFCA collective negotiation outcome harbours approaches which are construed as anti-competitive. Two examples are the insertion of minimum revenue target clauses in contracts which constitute an exit barrier and the matching of multiple rate structures with tendered rates which is viewed as price fixing.

Applying the parameters of the TFCA bargaining model would result in a major reduction in traditional sawmilling margins. These reductions may render many sawmilling businesses unviable and create major difficulty in attracting further investment to the industry, at a time when such investment is necessary to implement the Tasmanian Community Forestry Agreement.

The CHH Panels business model demonstrates the challenges facing exporters. The firm has successfully applied a wood purchase model, reflecting the market realities associated with world commodity price and exchange rate variation, to improve the financial performance of a company which value

Review of the TFCA Application and its Compliance with Competition Principles

adds residue and chip material. Introduction of a rigid supply model is totally inconsistent with the viable future of CHH Panels and other like "value adding" enterprises.

The premises underpinning the TFCA submission are outdated, have been shown to be ineffective in resolving questions of business viability and are inconsistent with the economic characteristics of contemporary Australia.

1. INTRODUCTION

In this paper we provide a response to the Tasmanian Forest Contractors Association (TFCA) Application for Authorisation to the Australian Consumer and Competition Council (ACCC) for approval to introduce a collective bargaining/boycott model to base bargaining about in the forest silviculture, harvesting and transport sector in Tasmania.

Symetrics was engaged by the Forest Industries Association of Tasmania (FIAT) to review and comment on the TFCA application and its compliance with competition principles. This included an indicative analysis of the implications of the bargaining/boycott model for the competitiveness of the forest industries.

The paper is structured in three parts, a review of the principles of competition and efficiency, analysis of the TFCA application and an indicative analysis of the implications for the industry based on two case studies. The first case study identifies the impact on the cost structure and margins for the traditional sawmilling sector, the second reviewing the implications for CHH Panels, a company producing MDF panels from pine sawmill residue and pine woodchips.

2. PRINCIPLES OF COMPETITION AND EFFICIENCY

If the world was a perfect place and all of the markets in it of the same ilk then certain competitive principles apply: the absence of monopoly in commodity markets and monopsonic power in factor markets; the absence of collusive behaviour and cartels; no barriers to industry entry/exit, free and equal access to information and other resources while the commodities exchanged by individual firms and producers are uniform in nature. The presence of these competitive attributes will minimise consumer prices and make higher quantities available to consumers. In the longer term commodities are produced at least cost if returns to the scale of production are constant. See Gans, Stonecash, King and Mankiw (2003, p. 284).

A Nirvana of this kind probably does not exist in practice and it is unclear as to whether it is a desirable state entirely. Markets often fail or simply exclude the full dimensions of costs and benefits. These external effects can lead to the frustration of the competitive principles described above. In the presence of competition however, prices and outputs are socially optimal.

2.1 *The Economic Efficiency Applied to Bargaining*

Taken together, these competitive principles represent a situation in which the market mechanism allocates scarce resources to competing uses in the most efficient fashion. In this perfect world, allocative efficiency will deliver maximum welfare benefits so it behoves economic agents to seek a maximum benefit from all markets making up the economy.

The forestry industry is no exception and the question arising in the TFCA application largely concerns this notion of allocative efficiency, in particular, are the bargaining and other provisions of the application consistent with efficiency principles? To answer this question, a benchmark of economic efficiency is required and the principle often applied is the notion of *Pareto Optimality*, a notion consistent with economic or allocative efficiency. The *Pareto* condition is the outcome of a particular economic phenomenon, act or decision making it impossible for all individuals to gain from further negotiation or exchange, negating the premise "If one party to a bargain is made better off, another must be made worse off". The use of *Pareto optimality* as a benchmark is dictated by the fact that *Pareto optimality*

means that neither party is worse off and as a result resources are allocated efficiently as defined above (Miller 1978 (ps. 442-454)¹.

This efficiency/welfare criterion can be applied to the current bargaining practice within the industry as defined in the FIAT submission. Presently, 5 major timber processors negotiate a contract with contractors, having allocated to each of them or groups of them, a particular quota. We argue that although the economic efficiency of these arrangements is not completely *Pareto Optimal*, it goes some way toward that ideal state. There is some research into the efficiency of labour contracts, these have some bearing on this argument. Farber (1986, p.1041) indicates that bargaining between employers and employees is not economically efficient unless the parties (employer and employee) bargain simultaneously about wage rates, hours of work and working conditions. If any one of these is excluded from the bargaining process then the bargaining process is sub optimal in the *Pareto* sense. For example, if the labour contract involves a wage bargain alone, then an employer may be able to vary conditions of work to the detriment of employees and to his own advantage in direct contravention of the *Pareto* condition.

2.2 The Efficiency of Current Bargaining Arrangements in the Industry

The industry structure outlined in the FIAT submission indicates that one of the major principles of competition is met. Tasmania's forest and timber processing industries exercise little if any market power in either the local or international markets for their products, consequently the Tasmanian timber industry displays price taking behaviour and exercises little if any monopoly power in the markets for its products. The current downturn in the forest contracting business is explained entirely by a trough in the Asian demand for timber and not by the exercise of monopoly power by the major forest processors. The price consequences are handed on to the local industry.

The five major timber processing companies are price takers in their commodity markets, but in factor markets, such as the labour market, a concentrated industry such as this could possess a degree of monopsony

¹ The *Pareto* condition was originally related to general equilibrium systems, but is often applied to partial equilibrium analysis.

power in its contract negotiations with contractors. However, it is clear from FIAT's description of the industry's structure that any potential monopsony held by the 5 timber processors is not exercised. The TFCA submission claims in several places that the contractor's bargaining power is weak and that contractors are disadvantaged in negotiation. However, the current structure of the forest industries reveals a strong interdependence between processors and contractors. The processors are reliant upon the contractors investments modernising the way in which the contractors work. The consequence is that the 5 major processors need a healthy supply of contracted services. This can only be ensured if contract rates are adequate. The contractors are as much a part of the forest industry as the timber processors and the health of the industry is no more than the health of the sum of its parts. So the motivation of the timber processors in negotiating with contractors is to maintain the contractors viability and to provide profits for further investment. This investment has occurred on a relatively large scale to the benefit of all parties. The contractors, in particular, have made substantial efficiency gains from this investment in new technologies thereby reducing operating costs and potentially improving bottom lines even if contract rates have remained fairly stable over time. The vision of the timber processors exploiting small contractors in the negotiating process appears to be false.

Are the current arrangements for the bargaining of contract rates in the forestry industry efficient in the Pareto optimal sense? The general principle involved in answering this question is reiterated: the efficiency of the current bargaining process can only be achieved if all aspects of the contract are on the bargaining table. Work is allocated among the contractors and then bargaining about contract rates takes place. However, we note that Pareto optimality is an ideal rarely achieved. In fact the set up involving forest contractors and processors is the normal situation applying to labour contracts in general.

2.3 The Efficiency of Bargaining Arrangements Pursuant to the TFCA Application

We may focus on the real issue here which involves a comparison of the efficiency, benefits and costs of current negotiating arrangements vis-a-vis the process and outcomes inherent in the TFCA application. The TFCA proposal seeks to establish a collective bargaining regime in which case the TFCA negotiates on behalf of its contract members within a framework involving diesel fuel surcharges, an indexing model, new rate matrices, seasonality and

minimum contract revenue targets. The bargaining process is primarily focused on terms and conditions.

Collective bargaining is known to be fraught with important limitations. Collective bargaining still forms the basis of some North American and European industrial relations system and did so throughout the 20th Century. These collective bargaining processes often produced outcomes proving very costly to the parties involved and on occasions, to the general public. Negotiations frequently break down and remain unresolved throughout the duration of strikes. The evidence is indicative when collective bargaining based industrial relations systems are compared with Australia's arbitration underpinnings. Invariably collective bargaining systems are associated with a greater incidence of strike activity and of strikes which are protracted in comparison with Arbitration based IR systems.

The introduction of collective bargaining processes in the Tasmanian forest industries is likely to frequently result in unresolved outcomes. A lack of resolution means the TFCA as a central bargainer seeks authority to take action in the form of collective boycotts. The costs of unresolved contract negotiations will inevitably be high for all parties to the contract and on occasions for the general public.

A second limitation of collective bargaining described in the literature is concerned with the Principal-Agent problem. The agent in this case is the TFCA, seeking to act on behalf of the various categories of forestry contractors. Agency costs are incurred when the agent fails to act to achieve the goals and aspirations of the members, in this case the forest contractors. The following question arises: how can we be sure that the TFCA is acting on behalf of the forestry contractors? The literature about collective bargaining in this Principal-Agent context is that the following applies:

- ❑ If the Principals (in this instance, contractors) are many in number and are represented by a single agent, then the question arises: how are conflicts between the principal members in directing the actions of the agent(s) resolved? There are several attempts in the Principal-Agent literature to resolve such disputes through the application of voter models, for example, the median voter. However, none of those guarantee resolution of disputes among principal members and their agents.
- ❑ Based on the preceding argument collective bargaining processes do not to generally harmonise with efficiency in the Paretian sense

because the preferences of individual members cannot be easily identified and a preference function for the TFCA cannot be specified.

Collective bargaining processes, the likes of which are sought by the TFCA, will take the forest industry bargaining process further away from competitive principles by adding a monopoly element on the supply side of the forest contractor market.

In summary our opinion is that the collective bargaining/boycott processes proposed by the TFCA reduces efficiency and conformity with competition principles in comparison with to the current contracting situation

3. A REVIEW OF THE TFCA APPLICATION

The general position taken by the TFCA is that the current bargaining position of individual contractor(s) is weak relative to the timber processing industries and that terms and conditions should be the focus of the bargaining process with less emphasis given to contract rate negotiation. This follows from the TFCA's concern for the viability of contractors. Hence, the TFCA application presages the introduction of a series of reforms of the current bargaining process. The industry's concern is that several of these are anti-competitive in nature in an economic context. Further, nowhere in the application does the TFCA countenance the prospect of there being too many contractors. Detailed comments on these points follow.

3.1 Market Conditions and the Number of Participants

An important distinguishing feature of the TFCA application is its presumption that monopsony power² is currently exercised in the bargaining process. Anecdotal evidence to support this is provided, however there is no real proof that a degree of monopsony power is exercised by any of the five major processing companies and it is not clear how conclusive evidence can be gathered on this issue. Our argument that the timber processors lack a motive for exploiting contractors is presented above. What is more important for both timber producers and forestry contractors is the status of the interstate and international markets for Tasmanian timber sales. Currently, the Asian markets are recessed affecting the capacity of the industry to engage contractors under historic arrangements. The consequence of the timber companies price taking behaviour is that there are few economic rents to be distributed between the timber companies and the forest contractors. Economic rents, if they exist, may buffer the industry during downturns, however, few rents exist in a competitive market where product suppliers become price takers. This is the industry's dilemma: how does it obtain the required degree of flexibility in relation to both producer and contractor services when sharp declines in the demand for timber occurs. The "too many producers" or "too many contractors" scenarios are unpalatable particularly in situations where there are very large fixed capital to labour ratios and large scale investments locked

² Monopsony refers to a situation in which there is a single buyer, or handful of buyers of forestry contractor services (or labour more generally).

away in equipment. Rationalisation of the industry is then essential, and government involvement inevitable as industry adjustment must be provided. This is the appropriate context for government involvement in the resolution of the existing problems.

3.2 Capacity to Pay

The "capacity to pay" increases in forest contractor rates are supported in the TFCA report by referring to the increased returns to woodchip exporters (Tables on p. 20 and 21). It is unclear if these data are expressed in nominal (inflation unadjusted) or real (inflation adjusted) terms. A 14 percent increase in expected woodchip prices is claimed. If the figures provided are not inflation adjusted then the real increase in export woodchip prices will be much less in real terms as indicated in Table 1.

Table 1: Export Woodchips: Real Prices⁽¹⁾ 1995 – 2005

Year	\$ BDU – Nominal	\$ BDU – Real ⁽²⁾	\$ BDMT – Nominal	\$ BDMT – Real
1995	164.50	164.50	151.11	151.11
1996	169.28	164.20	155.50	150.84
1997	166.01	160.53	152.50	147.47
1998	169.28	162.51	155.50	149.28
1999	158.39	150.47	145.50	138.23
2000	155.67	143.37	143.00	131.70
2001	160.02	138.90	146.99	127.59
2002	162.20	137.06	149.00	125.91
2003	169.82	139.59	156.00	128.23
2004	173.00	138.75	159.00	127.52
2005	177.43	139.93	163.00	127.62

(1) The assumption is that no adjustment has been made.

(2) All real prices are expressed in 1995 prices. Inflation adjustment based on CPI movement weighted average of 8 capital cities: ABS 6401.0 June Quarter 2005: Longer Term Series.

If the woodchip price time series shown in the TFCA report on p. 20 is not adjusted for inflation, then the case for an improvement of the woodchip industry's capacity to pay is overstated. This is evidenced on Table 2 where movements in presumed real prices are indicated.

**Table 2: Adjustments real BDU and BDMT export prices:
1995 – 2005 and 2000 to 2000 to 2005**

Period	BDU \$		BDMT \$	
	Nominal	Real	Nominal	Real
1995 - 2005	+7.86	-14.94	+7.87	-15.55
2000 - 2005	+13.98	-2.40	+13.98	-3.10

From Table 2, the nominal increase in BDU \$ per tonne of woodchips is 13.98% over the period 2000 – 2005 as claimed in the TFCA report. However, the real price adjustment is negative (down by 2.40%) over the period 2000-2005. This real reduction in prices does not indicate any increased capacity of the industry to pay higher contract rates. The same argument applies to BDMT real prices; although nominal values are up by 13.98 percent, real prices have fallen by 3.10 percent. For the extended period 1995-2005, the BDMT real price per tonne has fallen by more than 15 percent although nominal prices are up by 7.87 percent. The BMU real price has fallen by 14.94 percent over this extended period although there has been a nominal price increase of 8.86 percent.

The long term trend in the real value of export woodchip prices is down and on these figures, the export woodchips industry is an industry experiencing an economic decline. There is no additional capacity to pay higher contract rates at least from the export woodchip sector of the timber industry.

A similar analysis is applicable to the prices of sawn timber cited in the TFCA report at p. 19. The Tasmanian country sawmiller example of the costs for F17 timber suitable for building plates and studs suggests that prices rose from \$500 per m³ in 1997 to \$700 per m³ in 2004 – a 40 percent increase over 8 years. If these numbers are converted into real terms, then the real price rises by 16 percent over 8 years. The general evidence used about the costs of local hardwood and presumably the return to forestry processors is presented in a Table on p. 20 of the TFCA submission. The source for these price data is Rawlingson's Australian Construction Handbook and it purports to show that local hardwood prices for F17 and F11 sawn timber prices rose by an average of 52.75 percent over the period 2000 to 2004 for F17 products and by 23.4

percent for F11 logs over the same period. These increases are based on nominal and not real returns. The following Table expresses the percentage change in Hobart sawn timber prices on Rawlingson's nominal prices with percentage changes after allowing for inflation (real prices).

**Table 3: Percent Increase in Hobart Timber Prices:
Nominal and Real Compared 2000 – 2004.**

Timber Class	Sawn Size mm	% Increase 2000 – 2004	
		Nominal	Real
F 17	100 x 25	NA	NA
	100 x 38	48	29
	150 x 38	37	19
	100 x 50	55	35
	200 x 50	71	41
F 11	100 x 25	18	4
	100 x 38	19	4
	150 x 38	18	3
	100 x 50	31	14
	200 x 50	31	14

From Table 3, it is clear that the increase in the price of sawn timber in Hobart over the period in real terms is well below the nominal change in these prices. This weakens the argument that timber producers have increased their return on sawn timber, while contractor rates have remained static. This also strengthens the argument about the effects on costs, returns and margins of smaller log diameters (p. 19 para. 7) going into saw mills. We have not quoted average increases in sawn timber prices because the simple average calculation is misleading. A realistic representation would require the weighted average to reflect the proportion of timbers sold in its various categories, an approach not adopted by TFCA.

Our conclusion is that Tasmania's timber processing industry is subject to significant declines in real returns in particular sectors and will need to diversify its product base and/or its markets to guarantee its long term survival. The capacity to pay higher contractor rates is circumscribed by current market trends.

3.3 The TFCA Proposal (pages 28-30) Submission

The negotiation process envisaged by the TFCA is contained in sections 11 (ps. 28 – 29) under the heading collective negotiating outcomes and section 12 (ps. 29 – 30) the bargaining process. The collective negotiation outcomes (section 11 of the TFCA) constitute an insurance policy for timber contractors which will have the overall effect of moving the burden of risk from the contractor(s) to the forest companies. This arises firstly from the very limited nature of negotiation process in relation to bargaining about rates. This eventuates as a result of contract rate indexing, the payment of a separate diesel fuel surcharge, the redevelopment of rate matrices for harvesting and transport contractors so that differing degrees of responsibility and difficulty in contract tasks can be matched with tendered rates. Further, the risk exposure of seasonal contractors is to be smoothed out in contract provisions which avoid seasonal fluctuations and finally the TFCA envisage new contract clauses which specify minimum annual contract revenue targets and consistent work levels.

The risk burden argument is an increasingly acute issue and is a debate which will be played out in many Australian industries in which real returns are declining and costs are rising. Of particular importance on the cost side of the argument is the escalation of oil prices which puts intense pressure on bottom lines in the transport sector. It is not clear from the TFCA proposal how the diesel fuel surcharge will work to spread the risks of continuing oil price inflation. This issue about oil prices is just one dimension of this risk sharing issue and the overall conclusion is as follows:

The TFCA proposal entertains unrealistic expectations about the sharing of the risk burden with the timber processors. The TFCA proposal, if adopted, will involve a substantial unjustified shift in risk sharing from the contractors to the processors.

The collective negotiating outcomes contain an element of anti-competitiveness. They are designed generally to preserve the viability of forestry contractors at a time when the industry's markets are recessed. In our view this motivates the inclusion of new clauses in contracts to specify minimum revenue targets which might preserve the livelihood of some marginal contractors. However, this is an industry which could make economic losses in the long term which will eventuate in revenue targets not being met and certain marginal contractors quitting the industry. One of the major principles of competition is that barriers to entry and exit should not be contracted. Targeted revenues and returns are not consistent with this principle when they become actual benchmarks.

Further, some of the indexation principles satisfy the description of being anti-competitive. Although the TFCA report does specifically deny it (p. 28, para. 7), the matching of different job tasks with varying degrees of difficulty with a tendered rate is in fact price fixing given the limited nature of negotiations between contractor and wood company envisaged in the TFCA proposal.

The TFCA collective negotiation outcome harbours approaches which are construed as anti-competitive. Two examples are the insertion of minimum revenue target clauses in contracts which constitute an exit barrier and the matching of multiple rate structures with tendered rates which may be viewed as price fixing.

3.4. Productivity

The TFCA submission is silent in relation to productivity effects. Over the past decade major improvements have occurred in Australia's industry productivity and particularly within the forestry and transport sectors. Much of this is embedded in the investments in increasingly efficient new technology and

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process improvement, for example mechanised harvesting and trucks capable of transporting large loads.

This productivity improvement has occurred as a result of competition and is manifest in the growth of GDP, in a low inflationary environment.

This productivity improvement is correlated with the competitive, flexible business arrangements which have been introduced over the past 15 years.

The premises underpinning the TFCA submission are outdated and have been shown to be ineffective in resolving questions of business viability and are inconsistent with the economic characteristics of contemporary Australia.

4. BUSINESS IMPACT OF THE PROPOSAL

The impact of introducing the TFCA proposals in the timber processing sector, is consistent with the price taking behaviour of the processors. The practical consequences of the TFCA approach are identified in the following case studies.

Case Study One identifies the impact of the approach on the traditional hardwood sawmilling sector, while case study two identifies the impact on "CHH Panels", a firm undergoing major restructuring to enable it to achieve a viable business model.

4.1. Case Study One - Impact on the traditional sawmilling sector.

The TFCA Application for authorisation identifies a number of examples where the price of timber to the market has increased. "Rawlingsons", a respected firm providing information to the building & construction industry, is the source of the table on P20 of the TFCA application provides a cross section of price increases for a number of sawn products. A typical sawn product is 100 by 50 F17 framing section, in this case the TFCA identify a 55% increase in nominal prices. It is recognised that lower grade product has increased at a lower rate than this product, while higher grade, large profile sections have increased at a higher rate reflecting their increasing scarcity.

The implication in the TFCA application is that these general increases should be reflective of the increase in input prices. If this were the case, contractors contribution to the "mill gate price", the silviculture, harvesting and transport components would increase by a similar 55%. The estimated effective increase on mill gate price is an increase of 33%, derived from factors affected by the TFCA proposal.

Based on average processing cost structures, increasing the mill gate price by 33% has the following impact on the financial performance across the traditional sawmilling sector.

Table 4 Example of the Impact of the TFC Bargaining/Boycott Proposal on the Traditional Saw Milling Sector

FINANCIAL INDICATOR	% IMPACT OF PROPOSAL ON THE INDICATOR
Mill gate log price	+ 33
Total Purchase, Processing & Distribution Costs	+ 2.3
Selling price	No change
Margin	-26.5

This example of the implication of introducing the TFC model has the effect of reducing traditional sawmilling margins by approximately 26.5%. Such a reduction will render many sawmilling businesses unviable and create major difficulty in attracting further investment to the industry, at a time when such investment is necessary to implement the Tasmanian Community Forestry Agreement.

4.2 CHH Panels

Formed in 1998 and purchased by Carter Holt Harvey in 2002, the firm employs 102 direct employees producing MDF panels, exporting 70% of production. In addition to direct employees the firm also employs some 70 fte personnel indirectly.

CHH Panels has yet to achieve a profit, however on current improvement trends should almost achieve break-even in 2006. The firm is working towards becoming financially viable, any increase in costs will put the plant operations in Tasmania at risk.

Although increased prices have softened the impact to some degree, the firm's viability is sensitive to exchange rate increases, which have appreciated by over 30% since Jan 03. The CHH Panel strategy has been focused on reducing costs of production with the support of suppliers, customers and government and by improving internal efficiency. Wood costs are increasing as a proportion of the "cost of production", an indicator of less support from the sector and an indicator of CHH Panels limited power as a purchaser.

CHH Panels purchases some 330,000 GMT of pine sawmill chip residue and pine pulp logs at a ratio of 2:1 per annum, representing the majority of available pine pulp wood and sawmill residue available in Northern Tasmania.

Recognising suppliers have an alternate market for their wood supply, CHH Panels base most of their wood supply contracts and agreements pricing on "export equivalency value". This provides CHH Panels a partial natural hedge to exchange rate movements and shares both gain and pain with suppliers.

Any increase in input costs will put the CHH Panel Plant in Tasmania at risk. The impact of increased harvest and haulage cost, under the contract purchase scenario, while not always affecting price would potentially reduce the volume of wood supply (trees may be left to grow or be cut to waste) and placing the CHH operation at risk.

"CHH supports the concept of an unrestrained competitive market where market forces lead to the most efficient outcome. Competing businesses operating together to set pricing in a market is clearly uncompetitive and price-fixing behaviour which we believe will inevitably result in reduced efficiency and higher costs". (Carter Holt Harvey 2005)

The CHH Panels business model demonstrates the challenges facing exporters. The firm has successfully applied a wood purchase model, reflecting the market realities associated with world commodity price and exchange rate variation, to improve the financial performance of a company which value adds residue and chip material.

Introduction of a rigid supply model is totally inconsistent with the viable future of CHH Panels and other like "value adding" enterprises.

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