



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON ECONOMICS, FINANCE AND
PUBLIC ADMINISTRATION

**Reference: The state of Australia's manufactured export and import competing
base**

THURSDAY, 12 OCTOBER 2006

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HOUSE OF REPRESENTATIVES
STANDING COMMITTEE ON ECONOMICS, FINANCE AND PUBLIC ADMINISTRATION
Thursday, 12 October 2006

Members: Mr Baird (*Chair*), Dr Emerson (*Deputy Chair*), Mr Ciobo, Mr Fitzgibbon, Ms Grierson, Mr Keenan, Mr McArthur, Mr Secker, Mr Somlyay and Mr Tanner

Members in attendance: Mr Ciobo, Dr Emerson, Mr Fitzgibbon, Mr Keenan, Mr McArthur, Mr Secker and Mr Tanner

Terms of reference for the inquiry:

To inquire into and report on:

The state and future directions of Australia's manufactured export and import competing base, focusing on, but not limited to:

- Australia's dominance in commodities exports and the impacts of this on the economy following the resources boom;
- the state of the country's manufacturing sector (and the goods and associated services) including opportunities and challenges from the expansion in global trade (in particular by China); and
- policies for realising these opportunities.

WITNESSES

**FISHER, Mr Neil, Chief Executive Officer, A3P Australian Plantation Products and Paper
Industry Council 2**

**PROSSER, Mr Miles, Manager, Pulp and Paper, A3P Australian Plantation Products and Paper
Industry Council 2**

Committee met at 9.45 am

ACTING CHAIR (Dr Emerson)—I declare open this public hearing of the House of Representatives Standing Committee on Economics, Finance and Public Administration inquiry into the state of Australia's manufactured export and import competing base now and beyond the resources boom. The inquiry was referred by the Treasurer, Mr Costello, on 3 May 2006. To date, the inquiry has authorised 40 submissions from various parts of Australia and from a broad cross-section of interested parties. Copies of these submissions are available on the committee's website.

Australia's resources sector is currently experiencing an economic boom with, in fact, the best mineral prices in more than 30 years, driven mainly by unprecedented global demand for raw materials by China. We have now been experiencing economic growth for more than 15 years, which defies the historic economic cycle of having peaks and troughs within such a period. Australia is now operating within a different economic framework from the past, most notably a global one, but the history of our country indicates that high commodity prices cannot be sustained indefinitely. That is why the committee is investigating the robustness and preparedness for the future of our other dominant trade sectors and the impacts of or synergies from the resources boom. This hearing will concentrate on the state of and future directions of Australia's manufacturing sector. We are undertaking a separate hearing on services. Today we will be hearing from representatives of the Australian Plantation Products and Paper Industry Council.

I remind witnesses that, although the committee does not require you to give evidence under oath, this hearing is a legal proceeding of the parliament and warrants the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of the parliament. The evidence given today will be recorded by Hansard and will attract parliamentary privilege. Before introducing the witnesses, I will remind members of the media, if any are here, that they need to fairly and accurately report what goes on. And, of course, they always do that.

[9.47 am]

FISHER, Mr Neil, Chief Executive Officer, A3P Australian Plantation Products and Paper Industry Council

PROSSER, Mr Miles, Manager, Pulp and Paper, A3P Australian Plantation Products and Paper Industry Council

ACTING CHAIR—I welcome representatives of the Australian Plantation Products and Paper Industry Council to today's hearing. Although the committee does not require you to give evidence on oath, I should advise you that these hearings are legal proceedings of the parliament and therefore have the same standing as proceedings of the respective houses. We have received a written submission from you. Would you like to present any additional submissions or make some sort of opening statement to the committee?

Mr Fisher—Thank you for the opportunity to appear before the committee. Our industry is a value chain, extending from plantations to timber and paper products. Our members produce \$4 billion worth of product and employ approximately 13,000 people, predominantly in rural and regional Australia. In many of those areas we are a significant employer, providing relatively stable and skilled work in regional areas prone to commodity and seasonal fluctuations. Our industry is also based on a renewable and recyclable resource. High levels of recycling are already achieved within our industry sectors. Australia currently produces enough fibre to meet our domestic consumption, but we do export low-value fibre—for example, woodchips—and we import high-value fibre—for example, art paper and writing paper. This gives us a balance of trade deficit of approximately \$2 billion per annum.

In the plantation products and paper industry, the market and raw materials are geographically separate. This is true, even when you only consider Australian production and consumption, where plantations are established in agricultural areas but consumption is principally in urban areas. However, the same is true internationally, where major consumption centres such as China are relatively poor in fibre resource and will need to be supplied with fibre from elsewhere.

Australia is demonstrably a good location for investment in wood fibre. We have a history of excellence in plantation growing and healthy establishment rates at present. In terms of processing that fibre into timber or paper products, the scale of operation is critical for manufacturing. For our sector to be internationally competitive, the scale of production would swamp the available Australian market opportunities. It would also be stretching the limits of currently available resource within what are called the viable woodsheds. The location of the manufacture of plantation products and the paper industry is, as for other industries, all about minimising costs over the whole supply chain. Australian manufacturing facilities within the plantation products and paper industry are predominantly owned by companies with an international scope, although their Australian facilities tend to predominantly supply markets principally in Australasia.

Expanding manufacture in Australia requires us to push further into global supply chains, providing processed or partially processed goods into the supply chains feeding into growth

markets in Asia. However, there is intense competition from other locations to take on that role in the supply chain, perhaps even based on fibre that we have grown in Australia.

Energy costs, fibre transport costs, stable politics and investment certainty all help build the case for manufacturing investment in Australia. Labour costs, market size, scale, product delivery costs, environmental standards and regulation and government subsidies all favour manufacturing investment overseas. If we accept that Australia is a source of a significant amount of fibre in Asia—China is the market for a significant amount of the product—the question is where the processing and manufacturing will take place. Currently, we export unprocessed fibre in woodchip. There are proposals to process that woodchip into hardwood pulp, with the Gunns proposal in Tasmania and in Heywood in western Victoria, and there may also be opportunities to process that into final product into paper.

To build the case for manufacturing investment in the plantation products and paper industry in Australia, our submission drew attention to a number of points. We would just like to reiterate those five main points. First, resource expansion. Underpinning the scale of the operation and minimising costs for current and future investment in processing capacity is critical. The plantations 2020 program—to which the Commonwealth and all state and territory governments and the industry are signatories—and the taxation treatment of plantations are both critical in this area.

Second, energy supply and climate change policy. Low energy costs are an important competitive advantage for our industry sector. Energy market reform and measured greenhouse responses are crucial to maintaining this competitive advantage. Third, R&D. Structures to address market failure and the long-term nature of plantation related research is required. If you look at lead times for some of our crops, you will see that it is 30 years. Fourth, there needs to be streamlined regulation, particularly alignment of similar policies and programs of the Commonwealth at the state and local government levels to reduce duplication. This needs to go beyond simple streamlining and lead to the abolition of government programs and regulation that are duplicative.

Finally, as the committee would be aware, skills shortages are exacerbated during boom times in our resource industry. We need to raise the profile of our industry and improve the information available on training opportunities and supply and demand of key skill sets. Thank you for the opportunity to make an introductory statement. We are more than happy to take questions on our submission.

ACTING CHAIR—Can you explain to us the economics. Even if we solved a lot of the regulatory issues, what are the basic economics that determine the level of processing of fibre in Australia vis-a-vis in other countries? What is the cut-off? What advantages do other countries have in the further stage processing that we do not possess and, if there are some, should we be acquiring some of those advantages?

Mr Fisher—Miles and I will both try to answer that. Some things we cannot address, and we mentioned those in our introductory statement. The labour costs, the size of the market, the scale of operation, delivery costs and even environmental standards of some of our competitors, particularly in Asia, are the sorts of things that we have to compete against.

The thing that I think would assist us is more certainty in our production environment because, in producing pulp and paper, a significant investment—towards a billion dollars—is needed towards a pulp mill. For a paper machine, it is approximately \$600 million to \$700 million. Our companies that are operating generally in a global sense—so they have an Australian operation but they also might have an operation in Asia or Europe—are making decisions as to where they are going to make that investment in a competitive environment.

Mr Prosser—Like I said, there are two factors worth pointing out. One is that during the process the product is actually quite expensive to transport at the early stages. Woodchips and logs are fairly heavy, there is a lot of water in them and they are quite expensive to transport. That gives you a natural advantage to process as much as you can before you move away from the resource. So at least some stage of processing in Australia would be—

ACTING CHAIR—There would be a financial advantage in that.

Mr Prosser—That is right. That is why we are looking at projects like hardwood pulp investment in Australia, which takes logs, which are pretty expensive to transport, and turns them into pulp, which then becomes a cheaper product to transport. That is when it is more likely to move offshore. The other factor that favours some investment in Australia is energy costs. Pulp and paper manufacture is a fairly energy intensive process. Australia's energy costs are very good by international competitive standards and that is another factor that favours doing that energy intensive part of the process in Australia rather than overseas.

ACTING CHAIR—I would have thought that labour costs would not be crucial in a modern plant. I am not saying you can have whatever labour costs you want, but it would seem to me that maybe 50 years ago with less sophisticated technology—

Mr Prosser—Certainly, a modern pulp and paper mill creates fairly low employment per value of product it produces, but there is also no doubt that, in countries where labour costs are low, you change your production processes and you probably use greater amounts of labour than you would in Australia.

ACTING CHAIR—Is there any point aspiring to large-scale paper manufacture in Australia, or are you really getting to the point of exporting pulp? Is that right?

Mr Prosser—That is the proposal that is on the table at the moment.

ACTING CHAIR—That is a more natural thing. Is there a cut-off point, if you like, in the value-adding chain? What circumstances would need to prevail for Australia to become a major producer and exporter of finished paper?

Mr Fisher—As I said, a number of our member companies operate in a number of markets. There is a situation in China that puts a big question mark over what sort of investment decisions they are going to make in Australia at the moment. If you talk about putting in a new paper machine, that is \$750 million. They are saying that the life of that is 30 to 35 years, I suppose. They are not sure whether they should invest \$750 million in a paper plant in Australia or whether they should invest it in China, for example. 'Where is this industry going?', and, 'Are

they are going to have a secure resource to have input into that paper machine?', are the sorts of questions that our members are wrestling with at the moment.

ACTING CHAIR—Is pulp itself very expensive to transport?

Mr Prosser—It is cheaper than transporting logs or woodchips. You have taken a lot of the water out of it and you are taking various other things out of it. It is probably more in line with paper. Once you get to the pulp stage, a tonne of pulp pretty much produces a tonne of paper, so further processing is not changing the economics of transport at that stage.

Mr Fisher—The South Americans are very competitive in that same market, though, and they are looking at the same market opportunities that our members are already focusing on in Asia, so we are competing in a global market sense.

ACTING CHAIR—Governments around the world seem to like to subsidise the automotive industry and that affects locational decisions. Is that a reality in your industry or is it more just open market competition?

Mr Fisher—I think it is more of an open market. In terms of providing subsidies, incentives for investment, the decisions are not about whether we build in Tasmania, New South Wales or Queensland but whether we invest in Australia or in Asia. Our view is that it is a very difficult task for governments to try to pick winners.

ACTING CHAIR—I am not advocating it. It is really what you need to grapple with in these circumstances. There seem to be favoured industries that governments like to subsidise. Automotive is one of them and airlines is another.

Mr Prosser—I do not think the pulp and paper industry has the iconic status that the automotive industry does!

ACTING CHAIR—We will produce our own paper and we will decide—

Mr Prosser—Yes, but there are examples in China and South America of where the government has gone about building policies to ensure that it has picked that industry as a winner, if you like. The South Americans have said, 'We've got available land; there's a market opportunity there. We will put a whole set of policies in place to assist that industry to exist.'

ACTING CHAIR—My final question is this: do you grapple with the exchange rate, which is fairly high? Would a more competitive exchange rate make a big difference to your industry?

Mr Fisher—Yes. As an aside, we had a board meeting in Melbourne recently, and one of our members was saying that they have been squeezed out of a market in India just because of the exchange rate. Every six months they get inquiries from this particular market in India asking if they are ready to go back in the market, but they just cannot compete because of the exchange rate at the moment. Talking about iconic status, I think Australian Paper would like to believe that Reflex paper is one of our Australian icons.

Mr Prosser—I want to go back to the earlier question about the potential for paper manufacturing in Australia. We actually have quite a bit of paper manufacturing in Australia at the moment, with the production of Reflex paper, packaging material and tissue paper. The issue is more about the future of that side of things. Can we maintain that manufacturing base in Australia? As mills come up for renewal and new technology has to be put in place, these companies are looking around and asking whether they reinvest in that site in Australia or whether they drop that site and reinvest in China. That is the big issue that is facing the paper side of the industry.

Mr Fisher—Particularly with our \$2 billion deficit.

Mr TANNER—I have three questions. First, given the title of your organisation, do you represent anybody who extracts resource from native forests or is it purely plantation based companies?

Mr Fisher—Given that we are under oath, let me say that we represent the plantation sector. Some of our plantation members have a very, very small sector of native.

Mr TANNER—So it is essentially the plantation side of the industry. So presumably you do not have a particularly strong view about native forest extractions. My second question follows on from the deputy chair's first question. In some of the evidence we have seen, a pattern seems to be emerging that the notion of Australia having a serious future as a processor or value adder of our raw material products is a bit of a mirage and that, although in some cases we have a reasonable prospect of doing that one or two steps up the value chain, the pattern seems to be that basically the dynamics of manufacturing are that it needs to be predominantly located close to the end market rather than close to the original source of the resource. I am interested in your comments as to whether you would see that as another line dynamic that basically makes it very difficult for us, as a nation, to imagine ourselves as much more serious producers and exporters of finished product in those areas.

Mr Fisher—As we have said in our submission, we are a whole value chain industry. The issue for us is to try to have the resource as close as possible to the manufacturing plant and have the plant as close to the market as possible. The domestic market in Australia is relatively small. We would like to remove as many impediments as we can in that value chain in terms of transport and infrastructure to get our logs into a mill and to get the product out of the mill into the market. Having said that, with 22 million people in Australia versus the population in Asia, we believe that we can be a contributor to that international marketplace. We still believe that there are some impediments that we can take out of the value chain, but I am not sure if we are in a position to say, 'Can we still be a significant player in 50 years time?', for example. We just do not know what is going to happen in Asia, particularly in China.

Mr TANNER—But given the way you have put it, where you have said that it is important to have the manufacturing occur as close as possible to the resource origin and it is important to have manufacturing occur as close as possible to the final market, my impression is that, particularly given the small size of Australian's domestic market, in terms of global activity it is pretty much one way: when confronted with a choice between those two desirable things, proximity to final market beats proximity to resource source. Is that a reasonable assessment?

Mr Prosser—I think there is a bit of divergence happening in the pulp and paper industry. There are two distinct stages of the processing. If you went back 20 or 30 years, it was all done on a single site. There were pulp and paper mills. What is happening now is that, more and more, there are separate pulp mills and paper mills. I think your description of the market forces is true for the paper side of things: you all tend to want to locate close to the market. The more you get into recycled fibre, the more that is exaggerated, if you like, because your recycled fibre is available from the market where the paper was consumed. That is going to tend to favour paper mills being located close to the market. But once you separate those two things out, there is a natural economic argument that the pulp mill should be located close to the resource.

Mr TANNER—Which is similar to things like bauxite, alumina and aluminium. But we are not going to have much of a future exporting aluminium window frames to China, I suspect. My final question is: what is your impression of the prospects, if any—I suppose there always have to be some—for high-quality furniture manufacturing in Australia and a potential export dimension based around design characteristics—high-quality timbers and stuff like that? Do we have a significant future in that regard?

Mr Fisher—That is bit hard for us to answer because we do not represent the furniture manufacturers.

Mr TANNER—Sorry. Is that excluded from your—

Mr Fisher—Yes. Our members are the solid wood—

Mr Prosser—Our members will produce, for example, componentry that might go to a furniture manufacturer to put into furniture, but it would leave the operations of our members at the sawn timber stage.

ACTING CHAIR—Can I just tease something out very quickly since other members have questions. That decision about being close to the market with the final product, is that driven overwhelmingly by transport costs or by a need to be very familiar with the market into which you are selling—or both? I suppose it is easier to say both, but what is the relative importance of those?

Mr Fisher—My view is that transport is the biggest component of that.

ACTING CHAIR—That is the big issue?

Mr Fisher—Yes, given that we have to move logs. The smaller the distance that you have to move bulky materials like logs the better it is.

Mr Prosser—I think the other thing that is changing in supply chains is that less and less often customers and wholesalers want to hold stocks. What they are looking to happen is for the manufacturing facility to basically do their wholesaling for them, and the closer you are to the market the more you can meet that customer's demands.

ACTING CHAIR—So if you are saying that pulp and paper essentially have the same volume, then that seems to eliminate the transport cost argument. It might be adaptability and

greater dexterity in operating in the market rather than producing the final product in Australia and then having a branch office.

Mr TANNER—Presumably, that particular point is crucial. If you are purchasing paper in a very large market, for example, and the paper that is being manufactured is four or five weeks journey by ship away, then that means you either have the risk of ending up without product or you have a very large inventory. Presumably, that is a significant element of that.

Mr Prosser—Yes, it is.

Mr Fisher—It is an issue for our solid wood members too because, with the downturn in the housing market in Sydney, they just cannot continue to operate their sawmills at the sort of rates that they normally would because of the logistics of having that sawn timber which has been manufactured just sitting around.

Mr SECKER—I think every piece of toilet paper in Australia is manufactured in my electorate at Millicent. It is not something you really boast about a hell of a lot, but just think of that the next time you go! We are about to have two pulp mills in the region: one at Heywood and one at Penola. They are \$600 million jobs each, which backs up what you were saying about being close to the source. You say that there is a real problem getting it to the major cities where most of the paper will be consumed. It is pretty hard to have forest in the middle of a city anyway, isn't it, so what you really need is something that is efficient from wherever that rural area is. We are talking about \$600 million at both Heywood and Penola: what extra investment would be needed to take that from the pulp mill stage to the paper manufacturing stage? What would be holding us back from doing that?

Mr Fisher—In our submission we talk about transport, and a number of our members in the plantation sector have to make significant investment in roads on their own properties to get the product out to the rural and regional roads. Government, both state and federal, probably does not invest enough in major transport links to the major markets in Sydney and Melbourne, but we believe it is possible to identify key transport routes for key products and that we could have some targeted investment to improve the transport system to get those products to markets.

Mr SECKER—What is holding you back from taking that next step from the pulp to the paper? The transport is the same. Are you saying if we improve our transport corridors, perhaps even get the train lines going again or better roads—whatever—that would be a major factor in taking the next step, or are there other things?

Mr Fisher—I am not sure whether we addressed all the transport problems that would remove all the impediments to us manufacturing everything within Australia, but it would be a step in the right direction.

Mr SECKER—If we made some drastic changes to managed investment schemes or scrapped them, what effect would that have on the paper or pulp manufacturing industry in Australia?

Mr Fisher—I thank the member for his leading question. I think you are well aware of our position. We are a strong supporter of the retention of management investment schemes for

plantation forestry. We believe that many of our investment decisions are tied up in ensuring that there is a resource to actually feed these plants. Australian Paper have made a significant investment in the Maryvale pulp mill because they believe that they have a resource there. We believe without MIS the Commonwealth, states and territories and industry would not be able to meet our targets that we have all agree to under the 20/20 vision, so we are strong supporter of retaining the existing taxation arrangements for plantation forestry.

Mr CIOBO—First, the acting chair and Mr Secker have touched on the issue I also wanted to raise. Turn your minds back to what Mr Secker was asking on moving up the value chain. We have covered transport and I have to say I am a little confused as to its volume is basically the same for pulp as for paper, why transport is such a big factor. If I could get you to tease that out it will be better for me. The second question is that we did not cover what the other inhibitors are to prevent the value chain processing from increasing here in Australia.

Mr Fisher—I will take the first bit and talk through the transport discussion first, if you like. If you start off with—let's say we have four tonnes of logs. That would produce about four tonnes of wood chip. So there is no change there, but the pulp stage, depending on which pulping process you use, may reduce that to a single time. So if you can process that four tonnes to one tonne before you transport it too far you have gained an advantage there compared to someone who has to haul or ship it. But once you get to the one tonne of pulp that can be essentially become one tonne of paper without any sort of changes. So reducing the transport costs really favours where the pulp mill is located because it is the stage that reduces it from four tonnes to one tonne. But outside that stage, it is less influenced by the cost of transport, which is why we are saying that is what tends to lead to the pulp mills being located close to the resource.

Mr CIOBO—Is that the case in Australia?

Mr Prosser—In terms of where pulp mills—

Mr CIOBO—Yes.

Mr Prosser—And the moment in Australia all of the facilities are integrated pulp and paper mills.

Mr CIOBO—Integrated pulp and paper mills

Mr Prosser—Both the pulping and paper making processes are occurring on the same site.

Mr CIOBO—But you are saying that at the end of the day we are still importing \$2 billion worth of paper, high-value product. Why aren't we manufacturing that here?

Mr Prosser—Part of it is that we have not invested in the facilities to do that.

Mr CIOBO—What are the inhibitors, the barriers to that investment?

Mr Fisher—The costs of that investment and whether the opportunities—

Mr CIOBO—That cost of investment is substitutable. Are you saying that the costs are significantly higher to reach that level of Australia or are you saying that the cost—if you're going to invest in a paper mill in China or in Australia, does it involve the same cost or are there differences?

Mr Fisher—The machine is a similar cost, but access to energy, labour costs, environmental standards, skills—

Mr CIOBO—That is what I want to get into.

Mr Fisher—That is the difference between investing in Australia and China and a number of our members operate in the global markets, so when they make a decision to invest they are weighing up those decisions: do they invest in Australia or do they invest in China?

Mr CIOBO—In terms of the hierarchy of those considerations, could you talk us through that?

Mr Prosser—In terms of what subcomponents and costs are the most important?

Mr CIOBO—What is the most important?

Mr Prosser—One thing that tends to favour investment in countries like China is the up-front capital cost of putting the mill in place. In a lot of places there are either explicit or hidden subsidies available, a bit like we were talking about with the automotive industry, to attract investment to occur in a certain place.

Mr CIOBO—Is that taking place in China?

Mr Prosser—It is hard to point to incontrovertible evidence of those sorts of things, but there certainly are suggestions that that is what is happening—

ACTING CHAIR—Could that include common infrastructure, for example?

Mr Prosser—Yes. It could include arrangements for the cost of certain materials over a long period of time as well. There would be all sorts of things going on, I am sure.

Mr Fisher—The two other issues with regard to the China market are the access to fibre, which is coming out of Russia, and access to the market. We talked about being close to the market in China.

Mr CIOBO—I just wonder whether that is a little illusory in the sense that you could achieve, I would have thought, a similar outcome with a storage facility in your consumer market. If you want to talk about controlling inventory et cetera, what we are actually talking about is the location of the paper mill, aren't we?

Mr Prosser—One thing that is probably worth emphasising is that an international-scale pulp and paper mill, which is what you would have to build irrespective of where you built it, would produce a quantity of paper of a particular type that is much greater than the consumption of that

in Australia. If I went and built a brand-new office paper mill, it would produce four times as much as Australia needs. So, wherever you build it, the likely market for it is going to be in Asia somewhere. You are then faced with the question of: do I build that close to the resource or close to the market? It is the transport costs and delivery time issues and servicing the market and the other issues we have mentioned that tend to favour that happening close to the market rather than close to the resource.

ACTING CHAIR—Does Australia get a tick on energy costs?

Mr CIOBO—This is what I am trying to work out—where we are uncompetitive. What concerns the committee are those areas in which we are uncompetitive.

Mr SECKER—Members should be aware that there is actually a much larger blue gum forestry industry in China than there is Australia, which surprises a lot of people.

Mr McARTHUR—I want to raise three issues. The first is the \$2 billion import pulp mills and MIS. Could you clarify for the committee the statement that we have a \$2 billion deficit in wood products. I understand that it is basically in the paper products area. Could you just give us a clarification of the reality of the \$2 billion figure?

Mr Prosser—I could not give you the exact proportion, but more than half of it is a balance of trade deficit on paper products.

Mr McARTHUR—Could you define what you mean by paper products? Is it imported pulp?

Mr Prosser—There is a bit of importing of pulp, but it is predominantly importing finished paper. The biggest component of that would be office paper, whether it is stuff going to printing presses or the Reflex style of photocopy paper. So a big lump of it is that, but there is also tissue paper, newsprint and packaging paper in that mix as well. It also includes the really high-quality fine publishing type papers.

Mr McARTHUR—What type of timber products is the other 50 per cent made up of?

Mr Prosser—It would be a whole range of timber products. A lot of it would be specialty windowsills, door frames, architraves and those sorts of things that tend to be high-value products. There would also be a bit of structural timber coming in, probably less than there was five years or so ago. It is probably also worth emphasising that a reasonable proportion of that \$2 billion is from New Zealand. The Australia-New Zealand market operates almost as a single market, so sometimes some of these numbers can look bigger than they are. It might just be an internal company transfer from one of their operations in New Zealand to a market in Australia.

Mr McARTHUR—There seems to be a lot of confusion about the definition of the trade deficit that maybe you guys might help to clarify a bit more in the public mind. I think there is an impression that it is just all timber, not processed paper products.

Mr Prosser—If I had to summarise it, it would be that it is predominantly high-quality paper.

Mr McARTHUR—I think it is important in this whole debate that people understand that it is actually processed paper rather than bits of timber coming in.

Mr Prosser—Yes.

Mr McARTHUR—The second thing is the pulp mills, which we have had some discussion on. I am interested in your assessment of the Gunns pulp mill and the sorts of arguments that surround it. You have talked about the transport, whether the product is from Asia or is home grown. It seems to me that the argument about the pulp mill on the previous occasion was about pollution and environmental politics. How do you see the debate at this stage? Is it one of straight out investment or environmental politics or the pollution caused by chloride going into the river?

Mr Prosser—That is a tough question. From my perspective on the proposed pulp mill, the biggest question mark in my mind is over the sorts of things we have talked about at this committee hearing. Can it compete in the international market for its final product? It is going to produce hardwood pulp for sale to paper mills that are looking to buy market pulp. Its main competitor in that market is going to be supplies out of South America, which is a very low-cost supply base. Australia has the advantage of being closer in terms of transport to the Asian markets; so that gives us a bit of an inbuilt barrier there, if you like. But the question still remains: can they do it in a way that will compete in that market? And you have to assume that they have done some very thorough analysis. They know that market particularly well and presumably, to get to the stage they have got to, they have got some confidence that they can compete in that market.

A lot of the public discussion, as you say, is about the environmental issues to do with the pulp mill, on whether it meets certain standards and what is going in or out of that pulp mill. Our assessment of what they have gone through is that it is as thorough as anyone could reasonably expect it to be and the proposal for what they are to build is of world-class standard. If I were sitting as judge and jury on the whole thing, I would be much more concerned about the economic side than the environmental side of it.

Mr McARTHUR—I think that in the Gunns proposal they have a dry fluoride process, compared to the wet process in the previous proposition, that got rid of the environmental argument. If you got Gunns up, would that help manufacturers in the establishment of other pulp mills around Australia, in terms of the public debate?

Mr Fisher—I think it would assist.

Mr McARTHUR—What about if Heywood and Penola got up in the south-east? If you have a couple of pulp mills operating in Australia then the public argument would be, 'Well, they're safe and they're okay.' Do you think that would help the whole debate?

Mr Fisher—We think it would assist, but I think the Gunns proposal is slightly different in terms of the process they are going to use there versus the process at the Heywood and Penola pulp mills.

Mr Prosser—I think your point is valid, though. It would do a couple of things. It would help in the public's eyes to show that you can have these mills and they will not be a big ogre on the doorstep or anything like that; they are actually very highly efficient and environmentally sensitive sorts of mills. I think the other thing it would do in the international context is to draw attention to Australia as a potential place for investment in that type of activity. And I think that might be even more critical in terms of attracting future investment.

At the moment, Australia would be seen as a very efficient place to grow fibre. There is lots of land in Australia. There is a long history of plantation growing. So it would be acknowledged internationally as a high-quality place to grow fibre. If you could put something like the Gunns pulp mill proposal forward and the mills at Penola and Heywood then people would start to think about Australia in that context as a place for processing pulp.

Mr McARTHUR—Moving on to the MIS, which is a bit more controversial—

Mr Fisher—In some circumstances!

Mr McARTHUR—My position is well known on this. I have a view that it is driven by tax considerations and not productivity. I am personally a bit concerned about this because I appreciate your concern that you need feedstock for the proposed pulp mills and also I guess you need some woodchips just for exports. I suppose I put the proposition on the table that the MIS is fundamentally tax-driven not productivity-driven. I seek your comment. That is the first point.

Mr Fisher—We strongly support the existing arrangements. The majority of our members are not MIS companies. Our members are looking to secure the resource. In terms of the lead times for our members, particularly for long rotations of 20 to 30 years, we just think that, with the range of opportunities out there for investors to invest in superannuation or real estate in Sydney or whatever, we need to make these arrangements as effective as possible to try and get people to invest in our industry, and that is why we support the MIS arrangements as they are.

Mr McARTHUR—All I would say is that there is a lot of evidence that the industry is totally tax-driven and not productivity-driven and that, in the longer run, you guys might suffer a bit because if the tax concessions are withdrawn or modified then you will not have any investment at all. Would you like to comment on that?

Mr Fisher—We believe that if there are major changes to the MIS that will significantly impact on the amount of investment in the plantation estate and we will not be able to meet our targets under 2020. We agree with you on that point.

Mr McARTHUR—That is good rhetoric but it is not answering the question. The question is that, if you withdraw the very generous tax concessions that are now available, where will the industry get their stock?

Mr SECKER—Overseas.

Mr McARTHUR—No interjection on the side. The Tasmanian operation has basically been able to operate with the stock that has built up over 30 and 40 years. So it is a bit of a furphy to talk about this plantation providing the full stock for future operations. But there are some

interesting judgements on this. You have to address this problem that, if the tax is withdrawn, can the industry be sustainable?

Mr SECKER—You are permitted to totally disagree with that, if you like.

Mr Fisher—I wanted to give the same answer. We believe that, if there are significant changes to the MI schemes, that will definitely have an impact on the plantation estate, because people will not invest in our industry.

ACTING CHAIR—We might have got as far as we can.

Mr McARTHUR—I will leave you with the comment that some of us are very supportive of your industry in terms of plantations taking the residue out of the national forests. I know that there is a public debate on that. I guess all some of us would say is: you need to make sure that in the long term the investment is sustainable in its own right and that the return on the capital and the pulp mill operations is genuinely economically based, not based on some fictitious tax minimisation scheme so that it is good to grow trees and city investors get big tax advantages.

Mr Fisher—We agree with you, and that is why our organisation strongly supports the introduction of secondary markets, because we believe that there is an opportunity for our members to come in and get quality sawlog out of some of these investments. With the establishment of secondary markets we do not think that is a major issue, because we believe that we can turn them into a high-value product.

Mr McARTHUR—That would put some productivity incentive into actually growing trees.

Mr Fisher—Yes.

Mr KEENAN—I want to pick up where Mr Ciobo left off. If you were looking at creating a new paper manufacturing facility and you had the option of going to China or coming here, it is very hard for me to see how Australia could be competitive in that environment on any of it. The acting chair mentioned energy costs, which I was not aware of. But, apart from that, how can Australia actually compete with a paper mill? I suppose we are looking at where Australia might have a competitive advantage in manufacturing and services. It is very difficult for me to see how we could be competitive in that environment.

Mr Fisher—As our submission said, we have a long history of being producers of quality fibre.

Mr KEENAN—So it is more about the product—that they cannot produce as good a quality product as we can?

Mr Fisher—China is sourcing a lot of product out of Russia. We are not sure of the quality of that product, we are not sure who owns that product and we are not sure of the costs of that fibre. We do have a history of quality fibre production, which is a plus. We have a long history of paper production in Australia. So we have had a skills base, which is an issue that everyone is conscious of—that we might not still have that skills base and, with changes in technology, the number of people that we employ in our industry is obviously reducing. But we have a tick on

energy. I think we all acknowledge that that is important. So we do have some comparative advantages. As I said in our submission, the thing that everyone has a question mark over is: where does China go, where does its production go and what is the likely impact on our market?

Mr KEENAN—But is the Australian industry protected by a tariff regime?

Mr Prosser—No. The tariffs are negligible on the pulp and paper industry.

Mr KEENAN—Negligible as in they do not exist at all?

Mr Fisher—There are some very small tariffs.

ACTING CHAIR—And it would not matter that much anyway because a pulp and paper mill would produce four times the Australian market because of the minimum scale required.

Mr Prosser—Going back to your question about what would lead someone to invest in a paper mill in Australia as opposed to China, I would throw in a couple of other points—not that either of them is utterly compelling. One is whether the competitive advantage of China will be maintained over the time frame of an investment. A paper mill is going to be in for 30 years. Are labour costs and all those sorts of arrangements that favour China at the moment going to stay like that for 30 years, or are we going to see a Korea type situation, where living standards and wages rise and you lose that competitive advantage to some extent?

Mr SECKER—That is already happening.

Mr Prosser—The other factor is that most of the major pulp and paper companies in the world that provide that sort of fine-quality paper are European or American based. They do not necessarily find investing in Chinese facilities suits their business model or their style of business. It is not an easy thing for a company like that to invest in a Chinese mill and understand the way that business and government and regulation works. If they were looking around for somewhere that more suited their way of business that was as close to China as they could get and it was close to fibre, that would possibly tend to draw them towards Australia. We are a developed country with stable politics and predictable regulation that sits very close to the Asian markets, with a large and developing fibre resource.

Mr Fisher—With the chair's permission, Miles has touched on regulation. I would like Miles to give an example of some of the regulation that our members have to deal with in terms of reporting to the Commonwealth and the states.

Mr Prosser—There is one—and you may have heard about it in another context—the issue of greenhouse and energy reporting, which we would all agree is information that needs to be out there and needs to be understood. There is a whole bunch of conflicting and duplicative reporting requirements both at Commonwealth and at state government levels. When they go through processes of streamlining those requirements—it is a pretty mild sort of streamlining process—what we are saying is that, for the sake of investment certainty, it would be much more beneficial to go in there and say, 'Let's just have one single program for greenhouse and energy reporting.' Once you have worked out what that program is, you could drop away all the others

and remove all the other state and Commonwealth obligations that are currently overlapping and duplicating.

Mr KEENAN—It seems amazing that that does not exist.

Mr Prosser—What tends to happen is that everyone agrees that it is a good idea to have a single system. They invent the single system and they forget to get rid of the other ones. So you go from having 12 systems to 13 systems. It just keeps growing rather than dropping.

Mr McARTHUR—What would you see as the two major impediments to Gunns and the Penola pulp mills going ahead in Australia?

Mr Fisher—Environmentally, Gunns will still be a major issue. For the pulp mills in Heywood and Penola, I think it is important that they have contracts in the marketplace and that they do not try to operate internationally on the spot market, because they will have to compete with production coming out of South America. At the moment—and this is probably commercial-in-confidence—we have not seen a lot of evidence that they actually have back-to-back deals with key markets for those pulp mills to get off the ground.

Mr McARTHUR—So, in the case of Gunns, you are saying we are back to the old environmental debates about effluent and so on rather than straight economics?

Mr Prosser—I think the two are leashed. The key thing in my mind with Gunns is that we do not make the mistake of loading it with overregulation for the sake of trying to meet those environmental concerns and thereby make it uncompetitive. So it will be operating in a very competitive market with very low-cost suppliers out of South America. We need to ensure that it meets world-class environmental standards, but we cannot afford to put inefficient regulation on that mill and expect it to go ahead.

Mr McARTHUR—So that it becomes totally uncompetitive with China or new emerging countries?

Mr Prosser—Yes.

Mr SECKER—But, on a comparative basis, Heywood and Penola will have serious environmental problems to deal with?

Mr Fisher—One of the issues for Heywood and Penola is transport infrastructure and getting access to Portland.

Mr Prosser—And the basic jolting factor is the same in both cases: can you supply that final product to the market at a competitive price?

Mr SECKER—Just as a matter of interest, do you see rail as very important? There is a line there, but you cannot put the 1½ kilometre trains into Portland because they are too big; you would have to go to 600 or 800 metres and go through Mount Gambier, which has not had trains go through for nearly 20 years, so they will probably be a bit annoyed about these trains going

through. Penola, for example, is right next to the rail line. It would not take much of a spur to get it there. Do you see that as the key or is it still roads?

Mr Fisher—I think rail is the key to the viability of those two proposals.

Mr KEENAN—Just on the issue of regulation, I know you have used the example of greenhouse regulation, but if there are any others that you can readily supply to us then I think that would be really useful. That is probably an important point in terms of when we are looking at Australia's competitive advantage being eroded by some excessive regulations. So if there are other examples, I am sure that we would be able to use them.

ACTING CHAIR—Would you be able to forward that to the secretary?

Mr Fisher—Yes.

ACTING CHAIR—Thank you for your attendance here today. You will be sent a copy of the transcript of your evidence. You can make corrections to the grammar or factual corrections. We are grateful for an illuminating discussion. We appreciate it.

Mr Fisher—Thank you for the opportunity.

Committee adjourned at 10.35 am