



CALM BRIEFING PAPER 2/90

CIRCULATE TO ALL EMPLOYEES

TIMBER ROYALTIES

In response to recent publicity about timber royalties, this briefing note sets out some commonly asked questions and answers. This information can be used to respond to queries from the public.

WHO APPROVES TIMBER ROYALTIES?

The Government, through the Minister for the Environment. Recommendations to the Minister are made by the Executive Director of CALM.

WHAT IS THE DIFFERENCE BETWEEN ROYALTY AND STUMPAGE?

Royalty is applied to timber harvested from naturally occurring old growth hardwood forests, and is shown in CALM's Annual Report under "Territorial Revenue".

Stumpage is revenue from forests (softwood or regrowth hardwood) which the Government (CALM) has grown using capital funds, and is recorded in the Department's annual accounts as "Departmental Revenue".

HOW ARE ROYALTIES SET?

The various costs for growing forests are identified. Royalties are designed to recover these costs and to provide a return to the Government on the capital invested in growing the forest, known as the Internal Rate of Return (IRR). This principle is used to arrive at a target royalty for each timber species and grade of log. For details of the system of royalty calculations see the Timber Strategy (Part 8, pages 67-70).

The IRR is added to the current rate of inflation. Therefore, if the IRR is 5% and inflation is 8%, the interest charged would be 13%.

ARE ROYALTIES REVIEWED?

A major review in 1985/86 established the costs of growing at the time. Royalties being charged at the time were considerably less than the calculated royalty. A set of target royalties was established, to be achieved over time. A substantial increase, particularly for First Grade sawlogs, came into effect on 1 August 1986.

The Government also announced that royalties would be reviewed every three years. New target royalties were set after a review in 1989 and should be achieved by 1 January 1992. The first increases came into effect on 1 January 1990.

ARE ROYALTY RATES INDEXED?

Yes. Hardwood royalties have been indexed annually since 1984 according to movements in the Timber Price Index, an indice produced by the Australian Bureau of Statistics that measures the sale price of sawn timber in WA.

Softwood stumpages are also indexed annually using movements in the Consumer Price Index for Perth. In the future, hardwood stumpages will be treated the same as softwoods.

WHAT ARE THE CURRENT ROYALTY RATES?

Current royalty rates for the major log categories, which will apply from July 1, 1990, are:

	Jarrah \$/m ³	Karri \$/m ³	Marri \$/m ³	Pine \$/m ³
Premium	\$73.20	\$72.97	-	\$74.02
First Grade	\$28.48	\$34.00	\$12.00	\$60.29
Second Grade	\$18.27	\$24.23	\$12.00	\$39.33
Third Grade	\$12.00	\$12.00	-	\$26.91
Small (regrowth)	\$18.27	\$25.87	\$25.87	\$19.54
Industrial	\$ 7.00	\$15.00	\$15.00	\$ 8.39

The target royalty is generally higher than the current rate. Target royalties for First Grade sawlogs by 1 January 1992 are:

Jarrah:	\$30.66 plus annual CPI indexation
Karri:	\$38.50 plus annual CPI indexation
Marri:	\$12.00 plus annual CPI indexation
Pine:	\$64.36 plus annual CPI indexation

In 1984/85, when CALM was formed, the weighted average royalty was \$12.72 for jarrah and \$11.76 for karri (so increases of 123% for jarrah and 189% for karri have occurred).

ARE DIFFERENT COMPANIES PAYING DIFFERENT ROYALTIES?

Yes. When comparing royalties, the following must be taken into account:

1. The same species, and the same grade of log should be compared.
2. Some mills are accepting smaller logs as First Grade logs.
3. In the past, the bigger companies paid the lowest royalties. While the new system has redressed this inequity, they have been given time to adjust. However, the rate of movement towards target royalties is greater for companies that started from the lowest base. All companies will be paying the target royalty by 1 January 1992.
4. Logs allocated under the Timber Strategy attract the relevant target royalty, while logs auctioned or tendered often attract a higher price.

WHY DOES BUNNINGS ONLY PAY \$29 ROYALTY WHEN THE MARKET IS PREPARED TO PAY UP TO \$80?

See answer to the previous question.

In addition, under the auction system some people pay more for small parcels of logs. These people may be "topping up" their log resource beyond that allocated to them at the target royalty, or they are small operators with low overheads. The larger companies carry out research and development, promotion, advertising, sponsorship and other activities which benefit the timber industry as a whole. Eighty dollars is the highest royalty yet bid for Premium Grade sawlogs and, if all logs were tendered, it is unlikely that anywhere near this amount would be obtained.

WHAT IS A MARKET PREMIUM?

The market premium is the difference between the target royalty and the successful price bid at auction or tender. It is not indexed like the target royalty, but is recognised as the price the market was prepared to pay at the time for whatever reason, such as scarcity of resource.

WHY ARE SOME LOGS ALLOCATED TO COMPANIES WHILE OTHERS ARE AUCTIONED?

CALM inherited a permit and licence system which had largely been developed over 50 years ago. In that system several companies had sole rights to timber on Crown land. Other companies had to use logs from private property or occasional parcels of salvage logs.

A massive social dislocation would have occurred in the South-West if all permits were suddenly cancelled and all logs put up for tender. CALM dealt with this situation in the 1987 Timber Strategy by continuing to allocate a large part of the annual cut, but putting up an increasing volume each year for tender.

Allocations were made to mills that already had access to Crown land timber as well as to a large number of smaller mills. The larger mills received between 50% and 90% of their previous intake. The allotment to other mills was based on 50% of their average log intake over the previous three years, regardless of where it came from. The allocation system is detailed in the Timber Strategy (Part 7, pages 57-66).

In 1987, the total allowable cut from the forest was recalculated. Timber not allocated was then sold by open tender or auction.

There have been over 50 public sales of logs. The base price used for these sales is the target royalty. In almost all cases, prices greater than the target royalty have been bid; in one case more than double.

WHAT IS A CONTRACT OF SALE?

A Contract of Sale is a legally binding document between the Executive Director and the buyer. The contract details the amount of timber, the term over which the timber will be supplied and the financial arrangements, including royalty.

WHAT IS THE TOTAL COST OF LOGS TO SAWMILLERS?

The price of logs delivered to the mill landing includes the following costs:

- * **Royalty or stumpage.**
- * **Harvesting and delivery to the mill.**

In January 1990, CALM became the prime contractor for all harvesting operations within State forest (about 1.75 million cubic metres per annum). To fulfill this commitment, the Department invited public tenders called Contracts to Supply (logging contracts) and now employs private contractors to do the work on its behalf. The Department charges the sawmillers this cost.

* **In-forest costs.**

A fixed price per tonne (cubic metre) is levied on all logs sold, to cover work carried out in the bush to facilitate harvesting, including tree marking and supervising contractors.

* **Roading charge.**

CALM also builds and maintains logging roads. Again, a fixed amount, presently \$2.61 per cubic metre for hardwood logs in the Southern Forest Region and \$2.26 per cubic metre in other forest regions, is charged to cover CALM's costs. For softwood sawlogs, the charge is 85 cents per cubic metre.

* **Administration charge.**

A charge equivalent to 7.5% of the direct contractor production charge is levied to cover the cost of administering contracts, rendering accounts and financing logging contracts.

* **Log levy**

This is a voluntary payment for timber promotion made by sawmillers to the Forest Products Association. CALM collects this levy on behalf of the FPA.

* **Security**

CALM requires that companies having Contracts of Sale or Contracts to Supply provide adequate security to minimise the risk to the Executive Director should the company be unable to meet its contract obligations.

WHAT IS THE TOTAL ROYALTY?

The total Government revenue from timber is expected to be \$45.7 million in 1990/91. This compares with \$15.6 million received for a greater volume of timber in 1984/85 when CALM was formed, an increase of around 300%.

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