

Report

Jaakko Poyry Consulting

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**FOREST INDUSTRY CONSULTATION:
FUNDING FOR INDUSTRY GOOD ACTIVITIES**

**Industry Consultation Relating to Proposed Forest Grower
Levy**

Prepared for the

**New Zealand Forest Industries Council
New Zealand Forest Owners Association
New Zealand Farm Forestry Association**

Preface

The New Zealand Forest Industries Council (FIC), the New Zealand Forest Owners Association (FOA) and the New Zealand Farm Forestry Association (FFA) [**the Client**] have engaged Jaakko Pöyry Consulting to undertake a forestry industry consultation process. The aim of this assignment was to determine attitudes and opinions of stakeholders in the forestry sector relating to the possible introduction of a commodity levy to be used to promote the development of the industry [**the Study**].

The report contains the opinion of, and the assumptions made by, Jaakko Pöyry Consulting. This report is issued by Jaakko Pöyry Consulting to the Client for its own use. No responsibility is accepted for any other use.

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Abbreviations

FFA	New Zealand Farm Forestry Association
FIC	New Zealand Forest Industries Council
FIFA	Forest Industry Framework Agreement
FOA	New Zealand Forest Owners Association
TIMO	Timber Investment Management Organisation

1 INTRODUCTION

1.1 The Assignment

The New Zealand Forest Industries Council (FIC), the New Zealand Forest Owners Association (FOA) and the New Zealand Farm Forestry Association (FFA) have requested proposals to undertake an industry consultation process. The purpose is to determine attitudes and opinions of stakeholders in the forestry sector relating to the possible introduction of a commodity levy under the Commodity Levies Act (1990) to be used to promote the development of the industry.

The consultation process requested comprehensive contact with industry leaders and potential levy payers and collectors in relevant locations around New Zealand relating to the proposed levy concept. The assignment objective is to determine the level of support for a possible compulsory grower levy.

If the industry is broadly in accord with the proposal, the next step would be the development of a fully scoped and tested proposal leading to an industry-wide referendum which could be undertaken in the first half of 2005. No levy can be implemented without the clear support of potential levy payers. The forestry industry in New Zealand has no current commitment to a centralised programme of funding for “industry good activities” such as research and development and market development. Increased funding for these activities is considered vital if the industry is to meet its bold vision for future development.¹

1.2 Context

Background and overview leading to the assignment taken from background papers produced for the Forest Industries Council & Forest Owners Association.

Why the need for industry good funding?

1. FIC’s strategic vision aims to establish New Zealand as the leading international source of innovative and environmentally excellent forest products. Vision 2025 would see the industry:
 - Contribute 14% of GDP (4% today)
 - Employ 60 000 New Zealanders (25 500 in 2002)
 - Become the largest export sector (third largest today)
 - Have a turnover of NZ\$20 billion (currently around NZ\$5 billion)
2. Despite progress in some areas, there are increasing signs that it will not be possible to meet many of the targets in this Vision unless the industry as a whole takes some bold steps. Consider the following:

¹ According to a recent report by FIEA between 1993 and 2002 New Zealand’s investment in wood processing totaled NZ\$1.8 billion compared to Chile’s total of US\$3.8 billion between 1991 and 1999.

- The rate of new planting is slowing.
 - Exports of forest products have declined as the exchange rate has appreciated
 - Rate of investment in wood processing has fallen well behind that in Chile¹
 - The uncertain outlook for electricity pricing and supply, ongoing
 - Infrastructural challenges and regulatory disincentives will further discourage investment in processing facilities, especially in pulp and paper.
 - Returns to shareholders in forestry companies are poor.
3. A number of “common good” forestry sector activities are currently funded through voluntary levies raised from members of a number of sector organisations. These include some research activity, programmes in areas such as forest health, fire training, fire prevention and control, etc. However, as with all voluntary levies, the costs are not evenly spread across the industry, although benefits are received by all. Increased fragmentation of ownership within the sector in recent years has created more opportunities for individuals and companies to opt out of the payment of voluntary levies, whilst still receiving the benefits funded by others. Increasingly the industry risks becoming even more fractured and uncoordinated.
4. The forestry sector has developed a good working relationship with the Government, particularly through the Wood Processing Strategy and in the negotiations on the Forest Industry Framework Agreement (FIFA) under the Kyoto Protocol. Under FIFA, the government is proposing to fund and jointly manage with the industry, a series of activities aimed at:
- Protecting and expanding forest sinks.
 - Expanding a commercially viable and sustainable forest industry.
 - Accelerating development of additional sustainable energy sources.
5. Ministers have indicated that they are not prepared to fund the initiatives unilaterally. They expect that the forest industry will make a substantial financial contribution in addition to the funds to be put in by Government.
6. In the absence of other equitable funding models it is proposed that FIC should support and agree to promote to the sector as a whole, the seeking of an order under the CLA to impose a commodity levy or levies on forestry products. The aims of the levy would be to:
- Ensure the industry can deliver on Vision 2025.
 - Progress WPS and FIFA initiatives.
 - Access and leverage available government funding.

- Spread the industry's costs fairly over all those in the sector that will benefit from these initiatives.
- Replace existing voluntary levies.

What could the funding be used for?

1. There are a number areas where funding from a levy could be used to benefit all participants in the forestry sector:

- Skills development and training: Various voluntary levies are imposed to cover aspects of skills development and training. Companies that are involved in this activity are often penalised for the efforts they put into developing a skilled workforce when non-participants entice trained employees away from the entity that funded their training. Again, a compulsory levy could assist in the development of a more skilful and trained work force, available to all participants in the industry and spread the costs more equitably.

- Research and Development: It is estimated that the forestry sector spends approximately \$38 million annually on research and development. Most of this spending is proprietary in nature with the results passing back to the entity that commissioned it. It will also be directed largely at solving particular (short-term) problems rather than being of an "industry good" nature. The Government has signalled that research funding is moving in the direction of the private sector meeting a greater proportion of the cost of research and has introduced the research consortium model in which government funding is dependent on an equal industry contribution. The forestry industry has been an early beneficiary of this model through the establishment of WQI Ltd but even then the available industry funding was insufficient to access and leverage the total government funding available.

- Industry Positioning and Public Image: The forestry sector in New Zealand is suffering from a poor public image. For example, corporate restructuring conveys an image of instability, logging trucks on roads are an annoyance to other road users, industry accidents deter young people from seeking a career in forestry and spraying for painted apple moth in Auckland and gypsy moth in Hamilton has received bad publicity. A campaign to increase public awareness of the benefits from the forestry sector is likely to assist recruitment, encourage investment and lead to greater acceptance and tolerance of any adverse effects that the sector has on the general public. A compulsory levy would spread the cost evenly amongst all those that would benefit from such an initiative.

- International Market Development: There are a number of international market activities that are critical to the success of the industry's vision. Better access to markets through the removal of tariff and non-tariff barriers would have significant benefits for exporters of forest products, and particularly for the export of higher value processed products. The Government is funding much of the initiatives in this area through its participation at World Trade Organisation and other

international forums. The industry needs to ensure that it is appropriately represented at these events and that it is able to contribute to the government's position. Through the WPS the Government has also funded priority market access projects aimed at overcoming non-tariff barriers in key markets. This funding has been matched by FIC, although the benefits spread beyond the immediate FIC membership. To date the Government has been less involved in funding the positioning of radiata internationally, including the development of branding for New Zealand grown radiata, development of new export markets and similar initiatives. Under FIFA the Government is now signalling that it is prepared to provide significant funding for market development but only if the industry is prepared to contribute. The Government also considers there is a case for funding at a level above the normal requirement for at least 50% industry funding. Generic market development is essential to increase New Zealand's market share in export markets and it will directly benefit all forest growers and processors. A compulsory levy would be an appropriate funding mechanism for such activity.

2. It has also been suggested that a compulsory levy could be used to fund industry associations such as FIC and FOA. On the other hand, it may be that these organisations are better viewed as voluntary organisations that provide benefits primarily for those who choose to join them and pay the relevant membership fees. A compulsory levy must be seen as a means of funding activities that will provide benefits to all in the sector, irrespective of their desire or otherwise to join an industry association.

1.3 The Commodity Levies Act 1990

The Commodity Levies Act (CLA), 1990, is the legislation enabling an industry organisation, representing a distinct group of prospective levy payers, to impose a compulsory levy on a commodity to cover the costs of the 'industry good' activities which potential levy payers agree should be undertaken. A prospective levy payer would be a producer of the commodity to be levied.

The Act permits levying only on those who produce 'commodities' and is not applicable to added-value products along the value chain such as sawn timber.

Safeguards in the Act

It is recognised that compulsory levies can have the potential to impact adversely on aspects of liberty, equity and efficiency. Consequently, safeguards were included in the Act to avoid or reduce these adverse affects on levy payers. These safeguard provisions are:

- a. Restriction on the uses of compulsory levies
- b. Prescribing the requirements to be met before government will authorise a levy
- c. Prescribing the practices to be carried out by groups that are recipients of compulsory levies
- d. Conscientious objector provisions

- e. Provision for the resolution of disputes
- f. Provision for keeping records and accountability to levy payers
- g. A sunset clause on levy orders
- h. Levy order confirmation requirement
- i. Provision for compliance audits.

Users Guide to the Commodity Levies Act 1990

Commodity Definition

The clear identification of what the levy would be based on is an important aspect of the Act. The Act states that a ‘commodity’ means any agricultural, farmed, forestry, horticultural, mineral, or wild product. The forest industry would be dealing with a “forestry product” which, according to the Act, means a product that is, or is part of or produced by, trees. A commodity can belong to two or more of the classes - thus it could be an agricultural product, a farmed product, a forestry product, a horticultural product, a mineral product, or a wild product. Whilst there can only be one commodity in an order, it can have several classes.

Setting of Levy

Two key decisions which must be made are (a) the basis of a levy; this can be volume, value or area; and (b) the rate at which a levy would be set. There are two parts to the latter: the annual rate and the maximum rate (set every 6 years).

Levy Collected Comparison

Organisation	Levy collected (as a % of commodity sales value)
NZ Vegetable Federation (Veg-Fed) e.g. Tomato sector	1%
Foundation for Arable Research (FAR)	0.4 – 0.6%
Wool Board	2% in 2001
NZ Seafood Industry Council (Sea FIC)	0.52% - 5%
Avocado Growers Association	1%
Dairy Insight	0.8% (estimate)

Levy Collection

Levies are collected either by direct payment by payers to the organisation charged with administering the levy, or by using levy collectors.

Applications

There are a wide range of activities that a levy can be spent on including research on the commodity, market research, market development, promotion, quality assurance, education and training, and administration of the industry organisation. The Act is quite clear that a levy shall not be spent on any commercial or trading activity. However, with written approval from the Minister, the legislation does provide the opportunity for industry organisations to use levy funds for purposes precluded by the Act.

Who Pays?

The producers of the commodity are generally primarily responsible for paying the levy. What must be considered is whether all producers, even those producing only a

small amount of the commodity, or have a small area of production should pay, and should it include both exporters and importers?

Government Agency Involved

The Minister of Agriculture and Forestry is responsible for the Commodity Levies Act (1990). Over the years this Ministry has worked with a wide range of industries and has built up considerable expertise in working with industries in preparing their applications. To date, 24 organisations have been successful with levies ranging in size from \$11 000 pa to \$37 000 000 pa. A number of organisations are currently working through the process.

The Process

Consultation is a key element of the process. Without adequate consultation, it is unlikely that approval will be given. These efforts must include attempting to contact everyone who could be affected by a levy order.

Referendum

A referendum must be conducted giving all potential levy payers adequate time to consider the proposition and utilising a ballot paper that is deemed as being 'Competently devised'. The ballot paper will have three sections: viz (1) a full description of the levy, details of payees, payments, the basis of the levy, exemptions, collection, penalties, what it will be spent on, (2) voting information, and (3) the voting paper itself.

To get approval to make application for the imposition of a compulsory levy, an industry association must be able to convince the Minister that 'considerably more than half the persons who would be primarily responsible for paying the levy support its imposition on the particular commodity, and that persons who in any year produce considerably more than half the commercial production of the commodity in New Zealand support its imposition on the commodity.

Timing

Obtaining the authority to impose a compulsory levy is a complex process usually taking about eighteen months to complete.

Application

On completion of the very rigorous process, the application must be made to the Minister for approval to implement a Commodity Levy. Sufficient evidence must be supplied to satisfy the Minister that all of the requirements of the Act have been fulfilled and the application must be accompanied by documentation on the following:

1. The industry organisation
2. Benefits and disadvantages of a compulsory levy
3. Necessity for a compulsory levy

4. Levies on imported produce
5. Consultation
6. The referendum
 - potential levy payers were informed and had the opportunity to participate
 - the support referendum was competently devised
 - considerably more than half of the members on a numbers and weighted basis support the levy
 - overall the benefits outweigh the costs
7. Financial and accounting systems
8. Other matters

Approval and the Role of Government

If the relevant Minister is satisfied that all the conditions have been met, an Order in Council would be signed by the Governor General. Once the levy order has been made, the role of Government is restricted to receiving annual reports on levy expenditure and evaluating and acting upon any requests for compliance audits. By international standards, this is considered a very low level of state intervention.

After a period of five years, an industry organisation must go back to its members to seek a mandate for continuation of the levy. This provides an opportunity to reconsider all aspects of the levy in the light of changing market conditions, costs, institutional arrangements, product coverage, and benefits to payers.

Management

A levy instituted under an Order in Council is payable only to an industry organisation which is a body corporate. It is required to adhere to all provisions of the act and provisions relating to administering the act. One key aspect is the preparation of a report, which is tabled in Parliament.

1.4 Summary of Terms of Reference for Jaakko Pöyry Consulting Assignment

- Undertake broad consultation with the industry about the prospect of introducing a compulsory commodity levy under the Commodity Levies Act (1990). Information gathering would include personal interviews, questionnaires and structured focus groups.
- Identify the priorities for New Zealand industry good funding.
- Clarify the options for applying a commodity levy on plantings, the standing forest or logs or a combination of these.
- Make recommendations as to possible rates of levy.
- Identify issues arising for collection, whether by sellers or buyers.
- Identify issues relating to the stakeholder base and make recommendations on the preferred methods of outreach.
- Identify issues relating to the establishment and governance of industry structures required to manage the levy's collection and the dispersal of levy funds.

2 METHODOLOGY

2.1 Industry Consultation

A list of a widely representative group of senior forest industry participants was drafted and presented to an executive committee from the FOA, FIC & FFA for approval. The major emphasis was placed on forest growers who were envisaged as being the prime contributors to any levy. In addition, other forest industry participants with a weighting towards major domestic processors were included to broaden the perspective gained from the assignment.

On establishing agreement as to the parties to be approached, 55 interviews were undertaken. The majority of these interviews were conducted on a one-on-one basis ranging from 30 to 60 minutes. The range of industry organisations surveyed is set out below. Where it was not possible to arrange face-to-face interviews, appointments were set up to conduct these by telephone.

In addition, a series of focus groups were undertaken with the objective of further exploring the attitudes of farm foresters and members of the institute of forestry to open discussion to determine input on other options that may influence the process going forward.

Key influence groups surveyed

Major forest owners	17
Farm forestry representatives	36
Maori forest owners	2
TIMO forest owners - representing North American	
Pension funds	4
Vertically integrated forest companies	5
Major NZ based processors	15
Log traders	2

Interviews and focus groups were undertaken in;

Whangarei, Auckland, Rotorua, Napier, Fielding,
Wellington, Nelson, Christchurch and Dunedin.

3 INTERPRETATION

3.1 Concept Only

The assignment brief was limited to discussing the concept of a grower levy and was intended as a first step in determining the attitude of growers towards this idea. A number of other key industry groups were also interviewed to determine how the domestic users of fibre would view the possible introduction of a levy and to determine attitudes relating to the possible collection of such a fee.

It was recognized from inception that requesting opinions in the absence of specific proposals was not an ideal starting point. However, such an initial engagement process is necessary to satisfy the requirements of the Commodity Levies Act (1990). It also provided an opportunity to alert the industry to the prospect and to secure initial input in relation to the broad concept and provide a basis to move to the next stage.

As required by the Act, the essential next phase is the requirement to present definitive proposals to the proposed levy payers and collectors for discussion and input, followed by an approved polling process.

3.2 Interview Process

It should be noted that while each interview was guided by a series of prompts, the process was essentially informal so as to encourage participants to contribute extensively to the notion of a grower levy.

The interviews were then reviewed in order to establish a measure of support for key issues. The results detailed in this report therefore represent a qualitative perspective.

4 OUTCOMES

4.1 Support for Levy Concept

4.1.1 Agreement on Overall Concept - Forest Growers

We can draw from the process a very substantial level of agreement to the concept of the introduction of a compulsory levy. This consensus is subject to the participants having the opportunity to participate in and contribute to the next stage - the presentation of specific proposals for the deployment and governance of a levy.

Growers were most comfortable in relation to the redeployment of current voluntary levies in support of industry good spending attributed to areas such as training, forest health and bio security. The notion of using a levy in support of market development and R&D was also supported by the majority of growers but with the qualification of having the opportunity to evaluate the supporting rationale to justify any proposed expenditure. However, despite the broad range of support from within the growing sector, two of the TIMOs representing quite significant forest holdings expressed reservations and on balance were against the levy concept.

The TIMO's objections included:

- Any increased costs arising from a compulsory levy would be seen by US investors as another disadvantage to investing in NZ Forestry.
- Belief that a compulsory levy deployed to explore market opportunities could be considered counter to US anti trust legislation.
- Any requirement to develop market related opportunities could be better undertaken internally by individual forest owners.
- A levy would be agreed by one TIMO if it took the form of a GST styled surcharge that would also include processors and would ultimately be passed on to the final user.

4.1.2 Agreement on Overall Concept - Forest Users

While forest users were less supportive than growers a majority gave qualified support subject to the same request by growers to have the opportunity to consider detailed proposals. One pulp and paper user volunteered the prospect of additional voluntary contributions provided the collective funds were deployed to support initiatives with the Pulp and Paper Research Association (PAPRO) and Forest Research (FR) related to advancing the pulp and paper sector.

The main objections from processors were:

- Concern that the levy would be passed on in the form of increased product cost.
- Concern that any industry funded activity could adversely affect the prospect of individual firms developing competitive advantages that may otherwise be open to their exclusive use.

- A number of sawmillers appeared sceptical at any grower led cooperative action and suggested that plans to initiate similar action within their own user organisation was a better way to promote their specific goals.

4.2 Collection Options

The majority of participants supported a levy on sale of logs as being the most logical and convenient stage from a grower and buyer perspective. The participants also supported the concept of any levy being applied for a five year term as required by the Act even though this would exclude some growers currently contributing to levies if the levy was not extended beyond the initial term.

While a levy based on sale of logs was agreed as being the easiest option to take up other options need be kept open including a basis to work with possible voluntary contributions from associated industry participants. There was no objection to the payment of a commission to parties collecting the levy, as provided for under the Commodity Levies Act.

4.3 Levy Range

The extent of the levy was difficult to discuss in the absence of specific plans. A number of parties expressed concern that the process going forward should be driven by the defining of objectives with cost/benefit expectations, rather than working back from a consensus of an overall levy amount. With this qualification in mind support for the levy was in the range of 20 - 50 cents per m³ of logs extracted from the forest.

Growers were most comfortable with a levy of around 20c per m³/logs. Most growers saw 50 cents per m³/logs as the top end of their comfort level but would consider this subject to cost/benefit proposals.

It was assumed that any levy would take account of the variable value of various log grades with pulp qualifying for a lower levy than pruned logs.

The opportunity to merge Government funding in proportion to industry contributions was considered very positively by all growers.

Growers were asked to express a view on the balance of any levy spend between activities that related directly to growing and harvest on the one side and market development and promotion on the other. When faced with this option the majority of respondents expressed a willingness to commit the balance of any levy slightly in favour of supporting market development and promotion.

Processors were concerned that any levy would be passed on in the form of increased costs and, in the absence of any definitive plans, were dubious as to how this would be advantageous to their operations.

4.4 Governing Structures

4.4.1 Need to establish one industry organization to coordinate the forest industry

There was a strong sentiment from growers and processors that current organisation structures were considered too diverse and divisive for industry good and that it was time to consider rationalisation. A number of issues underpin this desire to rationalise sector representation:

- Concern at demand/price levels relative to impending harvest.
- Concern at lack of new substantive processing investment within NZ.
- Desire by growers to participate in supporting improvement at all levels of the forest value chain.
- A belief that one forestry organisation supporting subsidiary interest groups would be more effective in promoting the global aspirations of growers and in the coordination of market development opportunities
- Concern at the impact of high energy, exchange rate and freighting costs and the need to have a single voice to represent industry views.

4.4.2 Leadership emerged as a significant issue to advance the industry future

While there was an almost universal call for “leadership” within the industry this was not clearly defined. Leadership seems to reflect a number of industry frustrations and is not a direct reflection on industry spokespersons.

Many within the industry are frustrated with the lack of unity within the industry and hope that a well organised and funded programme through an industry wide levy might assist here. The levy system would require all parties to participate. The present wood processing strategy is seen very much as a vision, but requires a number of very clear and well defined industry segment strategies to put development pathways in place to achieve the vision. An organisation that would represent all interests could be a strong advocate for this development.

4.4.3 The concept of deploying levy funds together with any government assistance as in the FIFA proposal²

The offer by the Government to increase its ratio of assistance to the forestry sector for deployment to advancing market development as proposed in the FIFA proposal was strongly supported by growers. This illustrated the willingness of growers to participate in understanding and advancing their own interests with log marketers and processors to achieve advantage across the value chain.

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² The Forest Industry Framework Agreement (FIFA) is a package of measures under negotiation between the Government and the industry to recognise the contribution of the forest industry to climate change policy and to provide market based incentives for the planting of further forest sinks.

4.5 Stakeholder Outreach

The diversity of forest growers was recognised as a particular challenge in advancing the levy concept to the next stage. While there is substantive support for the concept, this is qualified with the clear expectation that any proposals will be open for discussion and input by the various sector interests.

This will need to include provision to meet with representative groups during the next planning stage as well as dissemination of detailed proposals for debate and further input.

Farm foresters and investment syndicate members represent an increasingly diverse group of industry participants and special endeavours will need to be made to address their specific interests. Jaakko Pöyry Consulting suggests this could be assisted by setting up a specific web site and widely promoting this via communication with sector group organisations and advertising the site in national newspapers. The web site could also be used to solicit views and support etc relating to specific issues.

Leadership will also be a critical issue and any proposal to move forward with a levy should be driven by the elected parties representing the grower interests. Jaakko Pöyry Consulting envisages that meetings and focus groups will need to be undertaken throughout the country in order to ensure all interested parties contribute to the process.

5 CONCLUSION

Jaakko Pöyry Consulting's conclusions are based on a comprehensive and systematic interview process with a wide cross-section of industry representing the majority of leading forest growers and processors.

From the summary of responses to key issues we can conclude positive endorsement in principle to the concept of compulsory levies from the majority of growers. This response from growers would appear to indicate a willingness by the forest owners to become more proactive in advancing the productivity, marketability and profitability of the impending harvest and is not contingent on support from processors. While there were a number of concerns expressed at the lack of any definitive plans for the application of the proposed levy, the participants were willing to proceed to the next stage – the preparation and discussion of specific proposals.

While support from processors was somewhat more equivocal than from the growers, a levy related to the sale of logs would not impose any direct cost to them. It should be noted that while processor attitudes were canvassed during the assignment it is not intended that processors would be involved in any compulsory levy contribution other than acting as collectors. There was no objection encountered to this role. However, this does not preclude processors contributing to any grower led initiative by way of a voluntary levy or otherwise.

Leadership and organisation structure were considered immediate and serious hurdles facing the sector from both grower and processor perspectives. These two issues appear somewhat interwoven and will need to be addressed together with the specific plans for the use and application of the levy funding as part of the next stage of engagement with the forest industry.

Notwithstanding the widespread level of support from growers, the sector will need to address the concerns of a number of US-based TIMOs who now own a substantial proportion of the New Zealand forest estates.

The next crucial stage of this process requires the development of a strategic framework to justify the levy proposal. This will need to detail specific plans, cost/benefit analysis and recommendation of an organisation structure to coordinate the sector. Given the response to this initial phase there is reason to believe that forest owners are prepared to give support to a proposal that can enhance the future value of its forest assets.

This next step will be contingent on the growers' decision on whether to allow the sunk investment in plantations to be determined by market forces impacting on its global position in the commodity log trade. Alternatively, whether a strategic framework developed around an acceptable levy rate can offer the prospect of improving growers' market opportunities and returns. The answer to this will need to be reviewed following the development of such a strategic framework to establish a basis for quantifying and qualifying the cost/benefit and potential actions that could be influenced by the adoption of a grower levy.