

GETTING MORE FROM OUR FORESTS

Ten Proposals for Building Stability in BC's Forestry Communities



By Ben Parfitt

DECEMBER 2005



CCPA
CANADIAN CENTRE
for POLICY ALTERNATIVES
BC Office

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Summary

In recent years, British Columbians have witnessed a dramatic transformation in the way the province deals with forest companies logging public forestlands. There has been a marked shift away from telling companies how they should conduct their affairs on the land base, and an abandonment of the practice of granting companies access to Crown timber in exchange for the companies operating milling facilities in specific communities – the former practice known as appurtenancy.

Less and less encumbered by prescriptive rules, companies operating in today's deregulated environment increasingly do as they see fit. And the results, from a community stability and resource use perspective, are disquieting to say the least.

Over the last few years:

- Numerous sawmills have closed their doors without any public reviews to determine whether opportunities existed to keep the mills operating.
- Major forest company mergers have happened without public review or comment.
- Wood-based value-added exports have stagnated and begun to decline.
- Coastal communities have witnessed rapid rises in whole raw log exports, while the same communities have lost logging and milling jobs.
- Interior communities have experienced mill closures as new “mega” mills are built, yet value-added mills in the same communities are told they no longer have access to Crown timber.
- Rules on wood waste have been relaxed to the point where droves of usable logs are being left to rot or later burned on logging blocks – wood that could fuel economic enterprises here in the province.

These are just a few of the consequences of recent forest policy changes, changes that largely abandon the idea that in return for access to public timber companies have some obligations to the general public and resource-dependent communities in particular.

This report aims to reinvigorate debate about public policy directions regarding our vitally important, publicly-owned forestlands. It argues that the province has a duty to articulate a clear vision for how our forests are to be managed and to whose benefit. It concludes with 10 recommendations aimed at ensuring that members of the public get a fair return in exchange for turning their forest resources over to an increasingly small number of forest companies.

The recommendations call on the government to:

- Enact new “partnership sales” that award public timber to teams of primary and secondary manufacturers. Such sales would increase the prospect for more value-added manufacturing in the province, by making it a condition of timber sales that primary sawmills share some of their output with local value-added mills that take that output and add further value to it, thus generating more jobs.
- Impose a “fee in lieu of further manufacturing” on all low-grade lumber. At present, much of this lumber is bound for the United States and subject to countervailing and anti-dumping duties. In fact, about 1.5 billion board feet of low-grade lumber leave BC for further processing in the US. By imposing a fee in lieu of further manufacturing on such wood, domestic lumber producers would have greater access to wood supplies and could, according to one estimate, generate thousands of new jobs in BC.
- Grant new tenures to companies that have clear proposals to add further value to the logs and lumber they handle. This recommendation can be easily accommodated given the large amount of public timber under the province’s direct control. At the same time, the government should reconsider how it sells public timber under its direct control. Other models for auctioning wood on the public’s behalf may deliver greater social benefits.
- Move to quickly complete and publish the findings of a province-wide “competition review.” At present, 10 entities in the province control 60 per cent of the wood logged annually. The concentration in milling output is even greater, with just 10 companies controlling 75 per cent of all solid wood manufacturing. In particular, concern is being expressed about the large amount of public timber controlled by just three companies in the Interior. A clearly stated finding by the province on what constitutes an acceptable level of forest tenure concentration is both timely and necessary to ensure that the public gets fair value for its forestry resources.
- Immediately review the prospects for further forest product manufacturing in BC and publish the findings. As part of an effort to encourage more manufacturing and value-added output, the province should work with the federal government to ensure there are refundable tax credits for new capital investments in the forest sector and allow R&D expenditures to be written off as well. All of this would help to reverse the sorry trend that has seen BC’s value-added forest product exports stagnate after 1999, and finally drop by 14 per cent in 2004.
- Transfer a portion of stumpage fees to forestry-dependent communities to assist them in economic diversification initiatives, similar to a recently announced program to turn money over to municipalities in BC’s energy patch (in recognition of the exploitation of that region’s fossil fuel reserves).

- Immediately declare what constitutes an acceptable level of wood waste, and begin a stepped-up program of monitoring and enforcement to ensure company compliance with the rules.
- Make the on-the-ground results expected of forest companies clear and unambiguous, ensure that company forest practices are regularly monitored, and impose financial penalties that are sufficiently high enough to deter infractions.
- Clearly state the acceptable minimum level of investment in milling operations. Companies should not be able to amass forest tenures and operate no processing facilities at all. Therefore, it is incumbent upon the provincial government – particularly when mergers and mill closures occur – to state what, exactly, it expects of companies by way of wood manufacturing requirements and to make it clear that failure to comply with such requirements constitutes grounds for loss of forest tenures.
- Ensure that a greater portion of public timber under the province’s direct control is made available to First Nations’ communities to assist in economic development opportunities, or use that power to direct logging activities away from areas for which First Nations have expressed concern. This recommendation is not meant to address outstanding issues around the long-overdue resolution of land claims, but is meant to provide some interim relief.

The report concludes that BC’s forest industry faces serious challenges, with unique problems confronting Coastal and Interior producers. On the Coast, mill closures have become common. There is widespread fear that as more milling operations shut down, there will be renewed calls for higher log exports, encouraging a sorry trend of “value-subtracted” from our publicly-owned forest resources. In the Interior, investments are being made in some of the largest, most efficient sawmills in the world. But the backdrop against which those investments are occurring is disturbing, to say the least. A precipitous drop in logging rates looms thanks to today’s highly inflated logging rates – a response to the ongoing Mountain Pine Beetle outbreak that is expected to kill 80 per cent or more of the Interior’s mature pine trees. There are limited opportunities to extract value from today’s inflated harvest and generate wood-based manufacturing jobs throughout much of the Interior. If those opportunities are foregone now, they will not present themselves again for decades to come.

Now, more than ever, there is a need for BC to clearly define the rules of the game. As landlord, acting on the public’s behalf, it is incumbent on our government to lay out a vision for how our forest resources are to be managed to ensure maximum public benefit. British Columbians deserve to know that when it comes to harvesting one of their most precious natural resources, there are adequate and equitable returns.

Introduction

When it comes to forest policy in Canada’s most forest-rich province, arguably the greatest challenges and opportunities lie in the fact that so much of what we are dealing with is publicly owned. Unlike other jurisdictions, almost all of British Columbia’s vast and diverse landscape is Crown land.

From a public policy perspective, this can be viewed as both a blessing and a curse. On the one hand, BC’s forests generate significant ecological, social and economic benefits. Keeping them in public hands affords opportunities for the provincial government, acting on our behalf, to play an active role in policies that both protect those forests and ensure that when portions of them are logged maximum benefits are derived.

But what does the greater public good mean? How do we get there? Ideally, such questions should be asked and constantly reconsidered – all of which constitutes an ongoing challenge to the provincial government, which must devote adequate human and financial resources to wrestling with these issues and to ensuring that the resource is properly managed.

This document is informed by the views of many people who have wrestled with these questions. Their thoughts are captured throughout the following pages, although in some cases they remain anonymous for reasons having to do with their ongoing reliance on contract work or employment in the industry. The driving thinking behind the report and its recommendations is that most British Columbians would agree that there are certain givens when it comes to the public benefits that should ideally flow from management of their forests. Broadly speaking, most people would agree that:

- Our forests are a vitally important natural resource that should provide lasting ecological, social and economic benefits.
- There is a link between healthy, biologically-diverse forests and plantations and a reasonably healthy and robust sector of the economy that is forestry-based.

- Our provincial government, to the fullest extent possible, should actively oversee the management of public forest resources; work hard to ensure that when those resources are exploited maximum jobs, wages and benefits are derived; and that adequate resource royalties and taxes are collected.
- Forestry operations should generate certain social benefits – jobs and healthy communities being the most obvious, particularly for First Nations communities.
- Getting more value from the trees we own generates more jobs, which in turn means a stronger economy, which in turn means more revenues to the Crown, which in turn means more adequately funded social programs.
- Companies logging public forestlands should perform in an environmentally responsible manner, pay a reasonable amount to the Crown for the trees they log, and prevent unnecessary waste.

These beliefs, however, collide with certain harsh realities. This is a challenging time for BC's forest industry. Notwithstanding record net profits for some forest companies in 2004, there are dark clouds on the horizon. Consider the following realities on the Coast:

- Leading forest analysts speculate that many Coastal and some Interior pulp mills are vulnerable to closure.¹
- Numerous sawmills have closed in recent years.
- Log exports from both privately and publicly-owned forestlands have skyrocketed and, among some in the contract logging community, there are calls for increased exports of raw logs from public forestlands and lower stumpage rates for certain species, particularly hemlock pulp logs.
- Markets for hemlock, the most dominant tree species on the Coast, are poor. Only 15 per cent of the notoriously water-heavy wood species is kiln-dried following processing, meaning the wood has less than optimum value in the marketplace.
- Energy costs are rising, making further kiln-drying of hemlock by conventional energy sources less practicable.
- There is a growing second-growth forest on the Coast, again much of it hemlock, but no sign that investments will be made any time soon to log and process that wood – investments that could result in new mills working with smaller logs.
- Land-use processes involving large areas of Coastal old-growth forest remain unresolved.
- Settlement of land claims, treaties and/or meaningful co-management arrangements with First Nations remain long overdue – a reality equally applicable to the Interior.

Consider the following as it applies to the Interior:

- An unprecedented beetle attack continues, with the likely outcome that four out of every five pine trees will be killed, the majority never to be logged before they lose their economic value.
- “Super” or “mega” sawmills are sprouting up, in part a response to the beetle, but more an inevitable consequence of commodity production, spelling big trouble for less efficient smaller and medium-size mills, especially as competition for a dwindling resource (thanks to the beetle and today's heightened logging activities) continues.
- Production of value-added wood products has flatlined for five years and in fact declined last year, a reality that likely flies in the face of public perception and certainly in the face of public expectations. There is a likelihood that the drop may continue due to existing

forest tenure arrangements and the continued export of marginally processed materials that could be further processed here.

- Huge logging increases in response to the beetle have resulted in a surge in wood chips, causing chaos in both the Interior and Coastal wood pulp sectors.
- A looming beetle-related “fall down” in future logging rates is perhaps five to 10 years away, a drop that could cripple the Interior forest-based economy, not to mention wreak havoc on tourism and other “non-timber” enterprises.

On top of all this, both Coastal and Interior companies continue to pay a hefty 20 per cent duty on exports of softwood lumber to the United States. Worse yet, the duty hurts some value-added producers even more than their commodity lumber producing counterparts because the duty applies to the value of the finished product, and value-added boards such as finger-jointed studs cost more to make and have a higher selling price and therefore generate higher duties. This despite successive rulings by panels convened under the World Trade Organization and the North America Free Trade Agreement that ruled against US allegations that Canadian softwood lumber producers were subsidized.

All of this is important when considering the task at hand – how to increase the social return from our publicly-owned forestlands. For decades, governments on both sides of the political spectrum in BC placed their faith in clauses embedded in long-term tenure agreements between the province and various forest companies. One of the major features of such agreements was that in exchange for getting guaranteed access to sizeable chunks of public forestland, companies had to build and maintain mills in communities near where the timber was logged. These provisions became known as appurtenancy clauses, and played a vital role in expanding forest industry activities in BC. Indeed, appurtenancy was a key aspect of industrial development in the province.

What was perhaps not foreseen was that as logging activities expanded, new areas of Crown forest that were once deemed too remote became accessible. New hinterland tenures were offered and often later acquired by existing companies who then expanded their operations. The opening up of new areas, combined with subsequent company mergers and acquisitions, resulted in a concentration of forest tenures in the hands of relatively few companies. Over time, this concentration intensified as well as shifted geographically. Where once Coastal forest companies had the greatest volume of tenured public timber, today’s major tenure holders are clearly in the Interior, a point we will turn to momentarily.

The other development, one that many argue was inevitable, is that the appurtenancy requirements began to crumble. While there are many reasons for this, three are particularly important.

First, while it may seem almost impossible to imagine, the combined processing power of the province’s mills has often exceeded what our forests can provide. This has come to be known in industry and government parlance as the “overcapacity” problem. Simply put, too many mills chasing too little wood.

Second, the makeup of the timber in BC’s forests continues to change dramatically, not the least because of all the logging that has taken place. But other significant factors have also profoundly altered the so-called “timber profile.” The most obvious present-day example is the massive Mountain Pine Beetle outbreak that continues to sweep through our Interior forests. An earlier and somewhat related example was white pine blister rust, an exotic fungus that killed just about all of the province’s Coastal and Interior white pine trees – at least those that had not already been logged. Not coincidentally, a major sawmill

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once operating on the Lower Fraser River and owned by former BC logging giant MacMillan Bloedel was called the White Pine mill.

Third, much of what is produced by BC's forest industry is in the form of commodities. Producing commodities competitively demands continued investments, investments that usually do two things. First, they increase the number of pieces produced. And second, they lower the overall costs of producing each piece, usually through technological advances, but also through increased worker productivity. Such investments are inevitable if producers hope to remain profitable in major markets where lots of commodities are sold and where buyers don't distinguish an eight-foot length of two-by-four spruce produced in Finland from an eight-foot length of two-by-four produced in British Columbia. Both fetch the same price. Thus, the seller squeezing the most costs out of producing each board gains the upper hand, until, that is, someone builds a bigger, even more efficient mill.

While commodity lumber products have long been derided in BC and elsewhere for lacking "value," the fact is that two-by-fours and other lumber products are used by the drove every day and in many different applications. We use them because they work. They also often serve as the raw material for remanufactured products of far greater value. So commodity lumber has an important place in any value-added strategy pursued by the industry or the province. The critical issue is the overall *scale* of commodity production. Too much of any one thing is invariably bad. It undermines the ability of other sectors of the industry – let alone other enterprises – to operate or expand. This is particularly true when noted forest industry analysts point to present-day opportunities to capture far greater market shares in lucrative value-added wood products markets such as the giant US home building materials market.

There is a pressing need at this critical juncture in forest policy for the province to clearly articulate its vision for the future of forestry in BC.

Given the reality of older, less efficient mills, finite pools of investment capital, changing timber profiles and other issues, it becomes easier to see why successive provincial governments backed away from exercising their option to cancel timber tenures when "appurtenant" mills were closed.

The end result is that from Hazelton in the northwest Interior, to the banks of the Fraser River in South Vancouver, to Youbou on the shores of Cowichan Lake on Vancouver Island, mills were closed and the companies who operated them were allowed to retain their tenured Crown timber holdings. Such developments, while occurring throughout the province, have been particularly pronounced in recent years on the Coast, leaving many communities reeling (see *A Steady Decline: Recent Sawmill Closures on the Coast*).

If the notion of appurtenant mills is a thing of the past in BC, interesting questions arise. Just what should British Columbians expect in return for handing over one of their most precious natural resources to an increasingly small number of very large and, in some notable recent cases, extremely profitable companies? Should the government on our behalf attach *any* social or environmental conditions to the tenure arrangements reached with such companies, particularly when they merge with one another and forest tenures are concentrated in fewer hands? What might those conditions be? Are their other mechanisms available to the landlord – the province – that might achieve certain broad social and environmental objectives pertaining to our public forestlands? What might they be?

The rest of this paper provides some general answers to these questions. It concludes that there is a pressing need at this critical juncture in forest policy for the province to clearly articulate its vision for the future of forestry in BC. If that vision includes value-added and healthy communities, what does the province propose to do to ensure a greater social return from the use of one of our most precious natural resources? This paper does not answer all of these questions, but it does point to some of the elements that could comprise such a new vision.

First, however, we need to provide context. What are some of the important changes to the face of forestry in BC over the past decade? What are some of the trends? How have provincial government policies changed? How has the trade environment changed and what are its implications?

If forestry in BC is at a crossroads – and there are strong indications that it is – we need to start to talk to one another about the paths we want to take. This paper concludes with two “value-driven” alternatives and a number of suggestions aimed at strengthening the social contract – a first step, it is hoped, in rejuvenating public debate on the future of what has been – and still could be – one of our province’s economic mainstays.

A STEADY DECLINE

Recent Sawmill Closures on the Coast

When Darryl Wong begins to list the sawmills that have closed since 2000, the magnitude of changes underway in BC’s Coastal forest industry starts to hit home.

Gone are Bayside Sawmills near Gibsons, Doman’s Silvertree Mill in Vancouver, Western’s VanDiv sawmill in Vancouver (subsequently re-named Silvertree), the West Coast Cellulofibre mill in Howe Sound, Interfor’s mill in Squamish, the North Coast Timber mill in Prince Rupert, Weyerhaeuser’s Canadian White Pine mill in Vancouver and Weyerhaeuser’s K-3 Panelboard operation, also in Vancouver.

All of this and more has happened in just five years in an area stretching along the Mainland Coast from Crescent Beach to Prince Rupert, from Rupert inland along the Skeena River to Moricetown, and a section of Vancouver Island from Courtenay north along the Island’s scenic East Coast.

And don’t even get Wong, president of the United Steelworker’s Local 1-2171, started on logging division closures, shift reductions at remaining sawmills, or the scuttlebutt on what other closures may be in the offing.

“Why all the closures?” Wong asks rhetorically. “Quite frankly, it’s the industry’s lack of investment. When the government eliminated the appurtenancy provisions and mandatory provincial mill closure reviews, the industry no longer had any requirement to reinvest on the Coast. Weyerhaeuser, Interfor and TimberWest all came out with a New Era document in 2003 when we were negotiating our last contract. And they said they were going to collectively invest \$1 billion on the Coast. And you’d be hard-pressed today to find \$50 million between all of them invested since that time. They haven’t lived up to any of that commitment. It was all just smoke and mirrors.”²

Wong and other long-time woodworkers say the closures are but one aspect of an as-yet-far-from-over story that has seen all manner of “social contract” provisions ripped apart. These include:

- Major mergers and/or acquisitions such as the recent takeover of Weyerhaeuser’s Coastal forest assets by Brascan without public review or comment.
- The shredding of “cut control” provisions, which stipulated that forest companies had to be within an acceptable range (plus or minus 10 per cent) of their logging quotas over a five-year period and never more or less than 50 per cent in any single year. Such provisions were meant to provide certainty to loggers, mill workers and contractors alike, not to mention stability for local communities.
- The ability of companies to sell parts of their forest tenures, without consultation and essentially walk away from some operations. ►

- ◀ • The elimination of mandatory “mill closure reviews,” a process that Wong and others attribute to keeping certain mills running for years longer than would otherwise have been the case had the companies wishing to close them had their way immediately.
- Restrictions on the amount of wood that could be logged and left to waste on the ground.

Wong calls the latter issue one of great concern.

“A significant amount of the pulpwood is being left in the bush right now...because of the relaxation of standards,” Wong says. “The amount being left is outrageous and our members are really unhappy about it. The companies say ‘We can’t make any money at it, so we’re leaving it.’ The government allows them to do it. And I believe it won’t be long until we see another boycott of BC wood products because of the logging methods that are being employed.”

Wong says there are positive lessons to be learned on the Coast in what is happening in parts of the Interior. While the industry there is confronted with its own challenges, investments have been and continue to be made in at least some milling operations. And not just by big companies with vast forest tenures. Smaller companies have also made major investments and expanded their operations.

“They’ve invested significant money in the Interior,” Wong says. “But on the Coast they’ve got older mills and they haven’t kept up with investments. Now they [the Coastal companies] will argue that the profile of the wood has changed. And that’s true. There’s more second-growth and smaller logs. But they’re not investing money in processing those logs either. And all we’re seeing is increases in log exports.”

In the absence of appurtenancy provisions, as more mills close, the pressure is certain to rise to export even more logs than the 20 per cent or so of the current Coastal log harvest that is shipped out of BC without being processed.

Wong and others have a phrase for the phenomenon. They call it value-subtracted. And they see no sign of the trend reversing any time soon.

The Interior

Company Mergers, Bigger Mills and the Decline of Value-Added Production

Companies with expansive coastal timber holdings once dominated BC's forest industry. They do no longer.

Of the five significant mergers to occur in the industry in 2004 and 2005, three involved companies with major Interior forest tenure holdings and one resulted in what is now, by far, the largest forest company in the province. That occurred on April 1, 2004, when Canadian Forest Products (Canfor) acquired the assets of Slocan Forest Products – the most important assets being Slocan's Crown forest tenures and nine sawmills – in a deal that created one company with a combined annual lumber output of four billion board feet.³ Under new rules established by way of the provincial Liberal's first mandate, none of these major mergers were subject to public review and comment. This meant there was no opportunity for individuals, workers, municipal councils or others to raise concerns about the job and community stability implications associated with the transfers. Moreover, the government revoked a law requiring ministerial approval for tenure transfers, except under the narrowest of circumstances. In effect, a conscious decision was made to remove government from even *considering* the public implications of such transfers.

Today, Canfor operates the largest production softwood lumber mill in the world at Houston, BC.⁴ The company had record profit in 2004 of \$420.9 million, and is in the process of building another lumber mill in not-too-distant Vanderhoof that will rival the Houston mill in output.⁵ The Houston mill's high efficiency helped propel Canfor into the upper echelon of the world's top-performing forest companies in an index that measures financial returns on capital employed.⁶ The company's acquisition of Slocan also made it the biggest producer of oriented strand board or OSB in the province. With large OSB mills in Fort Nelson and Fort St. John, Canfor will be a major logger and processor of hardwood aspen trees in the province's northeastern boreal forest for some time to come.

Joining Canfor as one of the largest forest tenure holders in the province is West Fraser Timber. West Fraser acquired the assets of Weldwood of Canada Ltd. on December 31, 2004. At the time of the acquisition, Weldwood owned four sawmills (two under the name Babine Forest Products), along with two veneer and plywood mills. Like Canfor, Weldwood is building a new state-of-the-art lumber mill in Quesnel.⁷ West Fraser was also a strong financial performer in 2004, with profits of \$212 million.⁸

An hour's drive to the south of Quesnel, Tolko Industries Ltd. has emerged as a dominant player in the economic life of Williams Lake, where it owns the city's largest sawmill, formerly owned by Lignum Ltd. Only months earlier, Riverside Forest Products had purchased the Lignum mill before it was swallowed

up by Tolko in October 2004. At the time of Tolko's acquisition, Riverside owned five Interior sawmills, three integrated veneer and plywood mills and one stand-alone veneer facility.⁹

It should also be noted that two major deals occurred on the Coast during this time. The first, completed in July 2004, saw Western Forest Products emerge with control of financially troubled Doman Industries, which had begun a restructuring process months before with Brascan Financial Corporation. Today, one of Western's principal shareholders is Brascan, which took over Weyerhaeuser's Coastal operations in May, 2005. Weyerhaeuser's six Coastal sawmills and its forest tenures are now

operated under the name Cascadia Forest Products. (Significantly, Brascan does not have a history as a forest products company, and built much of its recent business success around real estate developments. Weyerhaeuser's Coastal assets include a lot of prime, privately-owned forestland on the Coast that may ultimately be viewed by Brascan as more suitable to non timber-related developments.)

These big mergers have significantly altered the lay of the land in terms of which entities control what amount of Crown forest in the province.

The word entities is used in place of companies because in one notable case a very large amount of public forestland is directly controlled by the provincial government through BC Timber Sales, a branch of the provincial Ministry of Forests. And BC Timber Sales' influence will only grow as more public timber

The new rules reflect a conscious decision to remove government from even *considering* the public implications of tenure transfers that come about because of corporate mergers.

Company or entity	Volume of public timber controlled (millions of cubic metres)
Canadian Forest Products	11.47
BC Timber Sales	10.58
West Fraser Mills Ltd.	6.67
Tolko Industries Ltd.	4.46
Cascadia Forest Products	3.84
Western Forest Products	3.34
International Forest Products	3.13
Weyerhaeuser Company Limited	2.14
Pope & Talbot Ltd.	1.66
Tembec Industries Inc.	1.48
TOTAL	48.77

Source: British Columbia Ministry of Forests. Apportionment System, Linkages and Licences. August, 2005.

is amassed in its hands. As we explore later in this report, this reality provides the province with an enormous amount of leverage should it wish to use it.

Today’s “Top 10” list of tenure holders in BC is shown in Table 1.

The combined tenure holdings of the Top 10 account for just shy of 60 per cent of the “allowable annual cut” or AAC, which is the cut level established by the provincial government for logging on public forestlands.

Another important aspect of control relates to the concentration of milling power. Important, because in the absence of changes to the forest tenure system in the province, it will likely be from these players that many of the products needed to fuel the existing, let alone an expanded value-added manufacturing sector, will come.

As previously mentioned, some companies have or are in the midst of expanding their production by building bigger, more efficient mills that turn out greater volumes of commodity lumber products. It is a trend that has been underway for quite some time, along with the previously mentioned mergers.

In the 10 years ending in 2004, BC’s Top 10 lumber companies increased their overall production by 29 per cent, with the end result that today – led by Canfor, West Fraser and Tolko – they can produce 12.5 billion board feet of lumber annually or 75 per cent of the total (Table 2).

Year	Annual capacity	Per cent of total capacity
1995	9.3 billion board feet	58 per cent
2004	12.5 billion board feet	75 per cent

Source: British Columbia Ministry of Forests. Major Timber Processing Facilities in British Columbia. July, 2005.

Stagnating Value-Added – a Province-Wide Phenomenon

At the same time that forest tenures have been concentrated in fewer corporate hands and companies have invested in increased and more cost-efficient commodity lumber mills, the overall level of value-added wood products output has stagnated. After a seven-year period during which made-in-BC value-added products increased as a percentage of the overall solid wood pieces produced and exported by the province, the sharp upward trend dipped slightly in 2000, essentially flat-lined for three years, and then took a disturbing drop last year. Oddly, the onset of stagnation coincided with reports of realistic prospects for BC producers to capture a far greater share of the US building materials market.

The statistics contained in Table 3 capture the last 15 years of value-added wood product exports from the province, revealing both their dollar value and their percentage share of overall wood products made in the province and destined for export markets. The value-added share has never matched what it was in 1999 and dropped between 2003 and 2004 by 14 per cent. Measured in dollar terms, the value also peaked in 1999. The stagnation noted over the past five years is even more disturbing when considered in the following context.

In November 2000 Peter Woodbridge & Associates in association with Ernst & Young Consulting Services Ltd. released a report stating that BC had a 16 per cent share of North America’s \$35 billion primary wood products or commodities business. Yet the province’s overall share of North America’s value-added wood products market, then estimated at \$200 billion, was less than one per cent.¹⁰ The same report

said that BC's forest industry should be capable of capturing five per cent of that giant market, in other words a \$10-billion slice of the pie, a figure that if achieved would exceed by 10 times the maximum value-added sales recorded by the province over the past 15 years.

Such optimistic estimates on what could, with serious effort, be achieved are not pie-in-the-sky projections. Rather, they are based on serious analysis of a huge market that is in a state of considerable evolution and where growth opportunities clearly lie. More importantly, long-established value-added producers in BC believe significant job growth could occur in the province in response to capturing a greater share of the US building materials market. If, that is, the political will is there to do so (see *On the Brink: Could Thousands More be Working in BC's Value-Added Industry?*).

Later we will return to the topic of value-added, in particular a discussion of what a more vibrant, growing value-added sector in the province could look like. For now, however, we note one thing. There was, for a period in the 1980s and 1990s, a specific provincial government program to provide value-added wood products manufacturers with secured supplies of public timber. The timber was advertised for sale through what was known as the Small Business Forest Enterprise Program (SBFEP), which was run by the Ministry of Forests. The program put a portion of the timber it controlled up for sale with awards made on the basis of specific manufacturing proposals by value-added producers. Various criteria were considered in determining who got what, including where the value-added manufacturing would occur and how many workers would benefit. The program was considered by many value-added producers to be crucial to securing supply agreements with commodity lumber producers, because the commodity

Table 3: BC's Value-Added Wood Exports – Growth, then Stagnation

Year	Value-added sales	Overall solid wood sales	Percent value-added
1990	\$291 million	\$4.72 billion	6.2
1991	\$273 million	\$4.49 billion	6.1
1992	\$294 million	\$5.69 billion	5.2
1993	\$337 million	\$7.73 billion	4.4
1994	\$425 million	\$8.92 billion	4.8
1995	\$503 million	\$8.84 billion	5.7
1996	\$585 million	\$9.39 billion	6.2
1997	\$831 million	\$9.77 billion	8.5
1998	\$919 million	\$8.60 billion	10.7
1999	\$1.15 billion	\$10.19 billion	11.3
2000	\$1.04 billion	\$9.65 billion	10.8
2001	\$957 million	\$9.37 billion	10.2
2002	\$973 million	\$9.28 billion	10.5
2003	\$915 million	\$8.23 billion	11.1
2004	\$952 million	\$10.06 billion	9.5

Source: BC Stats. BC Origin Exports of Selected Value-Added Products and Solid Wood Products. 2005.

producers controlled the bulk of the forest tenures. Also, it was the raw, partially processed lumber products made by the commodity mills that value-added manufacturers most needed to make their higher end products. The SBFEP sales were regarded by at least some value-added manufacturers as indispensable to their ability to reach supply agreements with commodity mills.¹³

The SBFEP was succeeded by BC Timber Sales, which does not have a value-added focus, but rather accepts straight competitive bids for allotments of timber. Later we will look at BC Timber Sales, its emergence as a major player in the provincial forestry sector, and prospects to use it as a vehicle for promoting more value-added production in BC.

But before doing that, we need to briefly look at the Coast and the many challenges confronting the industry there.

ON THE BRINK

Could Thousands More Work in BC's Value-Added Industry?

After 30 years in the forest industry, John Brink, who emigrated to Canada from his native Holland, knows a thing or two about what the prospects are for increased value-added forest products sales from BC.

He just wishes the province would do what needs to be done to see that the sector of the forest industry with the best growth potential flourishes.

Owner of Brink Forest Products in Prince George, Brink was an early pioneer of finger-jointed lumber in Canada, helping to push the emerging product into new markets such as the Dallas-Fort Worth area.

In Texas, Brink recalls, prefabricated house builders were increasingly frustrated by the poor quality of southern yellow pine shipments. Too many boards had twists and other defects.

Brink's boards were not only consistently straighter and defect-free, but structurally stronger because they were made of short pieces of clear wood that had been cut and then glued and pressed together end-to-end.

Brink contends that there are ways to increase BC's share of the US value-added building materials market. Two ways would be to regulate an end to exports of low-grade lumber, or establish some kind of fee-in-lieu of manufacture that acts as an incentive to BC lumber makers to first make their low-grade products available to remanufacturers here. (Critics might argue that such a fee would simply exacerbate the US softwood dispute. But as we recommend later in this report, if such a fee were applied across the board – regardless of where lumber was destined – such arguments would be undercut.)

"What could our government do?" Brink asks. "They could simply say in a very open way that 'access to timber in this province is a privilege, and there is an expectation that we will remanufacture low lumber grades in the region.' That would make available almost immediately 1.5 billion board feet of low grade lumber for remanufacturing in the Central Interior region north of 100 Mile House and would be enough raw material to create 5,000 jobs in local communities."¹¹

Like many in the lumber remanufacturing business, Brink, who was forced to cut 100 jobs at a remanufacturing plant in Prince George earlier this year after Canadian Forest Products cut off a supply of low-grade lumber, is frustrated by government inaction on the value-added front. ►

◀ “In the last four years, changes in forest policy have put us on a road that has been extremely punitive to value-added producers and secondary manufacturers,” he says. “Secondary manufacturers used to have access to standing timber through Section 21 sales.¹² That’s been eliminated, as well as any other incentives for value-added producers to access timber. Consequently, there really is no access to round wood (logs or timber) or preferred licences for secondary manufacturers any more.”

Brink, however, is not giving up. Instead, he’s moving ahead with building a sawmill at a cost of \$5 million. If the existing sawmills won’t give him the raw material he needs to make his re-cut, value-added boards, he’ll do it himself. The new mill, Brink says, will produce 150 million board feet a year – a far cry from the 600 million board feet produced by the region’s biggest mill. And of that 150 million, fully half will be sent to Brink’s remaining finger-jointing and remanufacturing plants, where 300-plus workers will increase product value.

Brink believes his new sawmill could easily feed off a diet of beetle-attacked pine logs for the next decade or so. And he hopes that the province will see the value in what he is doing and give him assured access to timber through a long-term licence agreement, similar to the licences held by the major companies in the region.

The other choice, Brink says, is to enter into the market and compete for logs sold through BC Timber Sales. But it is a market that is not truly open, Brink says, because a few big companies competing in it have large pools of secured timber of their own, while companies like his have none.

The Coast

In Transition and Less and Less Competitive

The Coastal forest industry predates that of the Interior by several decades. Its maturity means that it has different challenges ahead of it. The success of the industry has historically hinged on the unsurpassed quality and high dollar value of the Coast's large, old-growth trees, particularly Douglas fir, Sitka spruce, western red cedar and yellow cedar. Over time, the richness of the resource was responsible for a booming plywood industry, centred on the Lower Fraser River, and with significant outposts in communities such as Port Alberni. The sawmill sector was at one time huge as well, which gave rise to a large number of market pulp and paper facilities. In fact, about half the pulp mills in the province are still found on the Coast despite the fact that the volume of timber logged annually on the Coast is less than a third of that in the Interior.

But as old-growth supplies were depleted, sectors of the once vibrant Coastal industry began to wither and die. The production of plywood, for example, depended on a readily available supply of large diameter Douglas fir trees, with a premium placed on logs with few knots. By the 1970s those logs were becoming scarce and the plywood industry began a steady decline. By the end of the 1980s, it was virtually dead. As we will see in a moment, the trend of old-growth depletion and the challenges posed by a vastly different forest resource are contributing to numerous challenges for the industry today.

Conflict over forest use, for example, remains very much a present-day reality. Two significant examples are the Mid and North Coast areas, dubbed The Great Bear Rainforest by some conservation organizations, and Haida Gwaii, or the Queen Charlotte Islands.

In the former case, lengthy conservation campaigns and provincial land use planning processes are widely expected to result in a major provincial government announcement that would see millions of hectares of Coastal old-growth forests ruled off limits to logging. Still more old-growth forest in the area would likely be subject to a form of “ecosystem-based” forestry that essentially eliminates clear-cut logging. In parallel to those processes, Coastal First Nations themselves are busy determining what they believe is best for the area. Recently, the Heiltsuk Tribal Council unveiled its own land-use plan for its traditional lands, one that called for 8,000 square kilometres to be protected as natural and cultural areas.¹⁴ Of particular concern to the Heiltsuk is the future of Western red cedar – a culturally and historically important tree species for Coastal First Nations.

In the latter case, the Council of the Haida Nation has filed a legal petition seeking a declaration of Haida title to the entire archipelago. Whatever the outcome of that endeavor, the Haida Nation has vigorously challenged companies and the province in recent years over the transferring of forest tenures from one corporation to another following sales. And it has succeeded in cutting by half the amount of logging taking place on the Haida’s traditional lands.

As these and other unresolved disputes continue, the Coastal forest industry finds itself buffeted by other challenges. Patricia Marchak, a noted University of BC sociologist who has written extensively and influentially on the forest industry both inside and outside of the province, long ago predicted that northern jurisdictions would find it increasingly difficult to compete with southern producers. Marchak argued that large transnational companies would increasingly move investments into regions where labour costs were low and favourable climates allowed for the rapid and comparatively cheap growth and cultivation of plantations.¹⁵

This is happening. The end result is that people within both BC woodworking unions and forest company associations predict that the outcome could be the closure of many pulp and paper facilities on the Coast and, quite possibly, portions of the Interior. The most vulnerable facilities are likely to be those where significant capital investments have not been made, particularly in the market pulp and commodity lumber sectors.

Northern Bleached Softwood Kraft pulp or NBSK, from North America and northern Europe, has always been an expensive pulp to produce. But historically it commanded high market share and a price premium because it was a quality product with few readily available replacements. That has changed, says one industry analyst, who argues that as a result the industry is losing its competitive edge. “There’s replacement pulps from Brazil and Argentina. China’s producing pulp with wood fibre that is legally and illegally obtained from Russia. Indonesia and Costa Rica are also sources.”

At the time this report was written, one pulp mill in Prince Rupert was down and another in Port Alice had been down for more than a year, with plans to reopen the troubled mill just announced. In addition, Norske Canada Ltd. (now Catalyst Paper Corporation), the dominant pulp and paper company on the Coast with facilities in four communities, had halted pulp production in Powell River and Port Alberni. And other older Coastal pulp facilities where significant investments have not been made in new technology may be vulnerable. These developments play out against a backdrop in which powerhouses in the global forest industry, such as International Paper, are getting more and more out of the pulp and forestry end of things to concentrate on their core strengths – paper production.

On the pulp and paper side, one forest analyst said that a model that may be emulated by BC is Finland. Beginning 15 years ago, Finnish forest companies began scaling back market pulp production and focussing much more on papermaking. “They began producing paper from the pulp they made and not selling pulp in the market,” the analyst said. “Much the same could be in store for BC. We’d make a whole lot less pulp, perhaps even import much of what was needed, get out of low-grade papers such as newsprint, and concentrate only on producing higher value or specialty papers.”

A great challenge in such a scenario, however, would be what happens with all the “residual” products left over from sawmills, if fewer pulp mills are there to accept the sawmills’ chips. Assuming, that is, that we actually *have* a sawmilling sector on the Coast. According to a recent statement by Rick Jeffery, president of the Coast Forest Products Association, the Coastal industry is considering closing all of its sawmills producing lumber for the Japanese market, a move that would have profound implications for what remains a highly integrated industry.¹⁶

Less than half of the wood in a typical log – about 47 per cent – actually makes it out the other end of sawmills as finished boards. Sawmills, which account for nearly 80 per cent of primary log use in BC’s forest industry, are the major players in the industry. The fallout from their lumber production comes in the form of wood chips (37 per cent of the log), and sawdust and shavings (16 per cent).¹⁷ The residual chips are of huge importance in the making of wood pulp. In fact, only about three per cent of the primary log use in BC’s forest industry is for logs converted directly into chips in pulp mill wood rooms or whole log chipping facilities.

If, as some forest analysts predict, we are on the cusp of a decline in pulp production on the Coast and in parts of BC’s Interior, huge challenges emerge in terms of what is done with the byproduct from the remaining sawmills in both regions. Already, we are witnessing incredible stresses in BC’s forest industry as a glut of wood chips flood the market thanks to dramatic increases in Interior logging rates in response to the Mountain Pine Beetle infestation. So great has been the surge in availability of cheap pine chips that Coastal logging contractors are calling for reduced stumpage rates on Coastal hemlock pulp logs so that they are on par with the nominal 25-cent-per-cubic-metre stumpage rates that apply to many beetle-attacked pine trees in the Interior.

It is possible that other uses for residual wood chips may emerge. For example, they could be used in engineered wood products or wood panels. It is also possible that on parts of the Coast where new sources of electrical power are constrained – Vancouver Island for example – wood-fired electrical co-generation plants could be built.

Either way, if the pulp industry on the Coast is reconfigured in a significant way, there will be a ripple effect throughout the entire industry. Just as there will be if more sawmills close.

Another major challenge confronting the Coastal forest industry is the changing forest “profile.” What made the Coast so attractive to forest companies for so long was the quality and diversity of tree species found there – trees that the companies paid not a cent to grow. Mixed old-growth forests provided a stunning array of very large trees with extremely valuable, clear wood. Douglas fir, western red cedar, yellow cedar, white pine, Sitka spruce and western hemlock were the main species. But there were others too.

As satellite images reveal, many of these old forests are long gone. Some tree species such as white pine are almost entirely absent. Others, like Douglas fir, are extremely rare in their old-growth form.¹⁸ Still others, like red cedar, are proving to be extremely difficult to re-establish in logged areas for reasons that continue to confound and worry foresters and First Nations alike. Despite this, high-grading (the targeted logging) of cedar continues. Finally, species like Sitka spruce have been high-graded from many areas where they were once common, leaving remnant patches of the commercially valuable tree species in widely dispersed, small pockets.¹⁹

The upshot of all this is that hemlock, a prevalent species in Coastal forests throughout the industrial forestry era, is assuming ever more importance today in terms of what is available to log. In fact, about

Some in the industry suggest that hemlock would be an ideal feedstock for a host of new sawmills and engineered wood product mills on the Coast. But massive amounts of new investment would have to happen for such facilities to materialize.

60 per cent of everything there is hemlock. Only a small portion, about 15 per cent, of the notoriously moisture laden lumber produced from hemlock trees is currently dried. And there is precious little to indicate that with rising energy costs more drying capacity will be added any time soon.

Hemlock and its ultimate role in a reinvigorated Coastal forest industry remains a big question mark, as does the future of logging in much of the region's remaining old-growth forests. One recent study surmised that if the industry moved overnight from logging Coastal old-growth to logging Coastal second-growth, the drop in annual logging rates would be on the magnitude of 56 per cent, in other words from about 19 million cubic metres per year to somewhere around 8.3 million. Many options in between might be considered as the transition was made from one to the other. But the numbers serve to give some idea of what could be in the offing.

But again, hemlock would be a big part of the equation in such a transition. And what would be done with it? Some in the industry suggest that hemlock would be an ideal feedstock for a host of new sawmills and engineered wood product mills on the Coast.

But massive amounts of new investment would have to happen for such facilities to materialize.

The plus side of things like new sawmills processing Coastal second-growth logs is that second-growth logs are generally of a more uniform size and smaller than the big, old-growth behemoths that fed the

industry for generations. And smaller hemlock logs, turned into things like two-by-fours, would be much more easily dried, thus increasing their value in the marketplace and increasing their attractiveness to value-added producers who could take the commodities and further process them.

Again, though, big investments would be needed to a) shut down older mills built around processing a shrinking amount of old-growth logs and b) investing in the new mills to cut a completely different profile of wood.

One industry analyst familiar with the present-day challenges confronting the industry says the time is rapidly approaching where industry, government and labour have to accept that there is a need for fundamental change in how the Coastal forest industry is configured. The pulp industry faces enormous challenges. Wood profiles are changing. Land-use processes, long overdue treaty settlements and land claims remain unresolved. Energy costs continue to climb. And the industry is losing money with little to indicate a timely turnaround.

Because the financial performance of BC's forest industry is usually reported on a company by company basis, with many holding both Coastal and Interior forestry assets, it is often difficult to get a firm handle on the exact financial position of one segment of the industry or the other. But clearly on the Coast it is not good. A recent estimate by PricewaterhouseCoopers for the Coast Forest Products Association found that seven Coastal companies lost a combined \$77 million in the first six months of 2005, representing a negative 1.4 per cent return on capital employed, and that only in the event that the same companies could post returns of plus 10 per cent would they be viable.²⁰

It's time, said the analyst, to ask a simple question: "Do we really want an industry here?" And if we do, he says, "we better take our blinders off and get at it."

Later in this paper we propose that it is indeed time for the provincial government, as landowner, to articulate its vision for a Coastal forest industry. If, indeed, the trends briefly outlined here continue, what represents a reasonably promising way forward? Is there a "value-driven" vision for Coastal forests that government, industry, Coastal communities and workers can buy into and move forward with? What would the cornerstones of such a vision be and how might government facilitate making it a reality?

One industry analyst familiar with the present-day challenges confronting the industry says the time is rapidly approaching where industry, government and labour have to accept that there is a need for fundamental change in how the Coastal forest industry is configured.

Clearly, one impediment to realizing that goal remains the ongoing dispute with the United States over the alleged subsidization of softwood bound for the American market. At present, domestic softwood producers must pay anti-dumping and countervailing duties on goods shipped to the US. The duties, essentially an ad valorem, or a percentage of value, tax, apply equally to conventional lumber producers and numerous lumber remanufacturers – companies that make products that may *look* like conventional building materials, but are, in fact, stronger boards that have had a great deal of value added to them, for example, “finger-jointed” boards.²¹

The duties have proven to be a most daunting challenge to BC value-added producers, who sometimes find themselves paying the duty twice: once to acquire the raw material they need from lumber producers who build the duty into their domestic sales prices, and a second time on the higher-value product they make and subsequently ship to the US (see *Caught in a Bind: The Jackpine Story*).

In the next section, we will look at one area where opportunities to spur further value-added production might be realized.

CAUGHT IN A BIND

The Jackpine Story

In 1999, after investing \$15 million in a new building and equipment, Gian Sandhu opened the second of two value-added wood-processing plants in Williams Lake, BC.

The new plant had two product mainstays: made-to-length, tension-tested floor joists and rafters, and laminated panels and boards for wood furniture and shelving.

The joists and rafters are made in a process called finger-jointing and tension-testing, which involves taking high grade lumber products, cutting out the defects, and then re-assembling higher grades of wood into longer boards made by gluing and then pressing the shorter pieces end to end, after which the newly assembled boards are tension-tested.

Jackpine Engineered Wood Products’ opening was big news in the community. Between it and Sandhu’s other company, Jackpine Forest Products (JFP), 300 local people were employed. And while the workforce wasn’t unionized like some of its sawmill counterparts in town, workers made close to union wages, while turning out higher quality, more expensive to produce products.

Sandhu is a man used to adversity. In addition to competing for wood in an environment where a select few companies control so much of the public’s timber assets, he rebuilt his first company, JFP, at a cost of \$7 million after it was destroyed in a fire in 1993.

But the adversity Sandhu faces today is far worse than he foresaw when he committed to the dramatic expansion of his business in the late 1990s.

In the last few years, the Jackpine Group of Companies has paid \$23.5 million in countervailing and anti-dumping duties on US-bound products, as well as an untold amount more in added charges for the raw lumber it requires to make its products. In effect, Jackpine is paying the duty twice: once for the lumber from BC producers who bill him a “duty in” price even though he is on the Canadian side of the US-Canada divide, and once again when he ships his value-added product into the US housing market.

“That reality has taken years to sink in with the provincial and federal governments,” Sandhu says. “We have told them a number of times ‘Just help make us competitive. We don’t mind paying the duty once, but not twice. And if we do have to pay, let us pay on the raw material, not the ►

◀ value-added.’ The governments, in my opinion, have failed miserably to take up our fight. They have not pushed the US, saying our remanufacturers have nothing to do with this dispute.”²²

Sandhu also expresses grave concern about what lies ahead for companies like his. At present, Jackpine is working through the last of the wood it received under timber sales specifically geared toward fostering value-added manufacturing in the province. Those sales are now gone, replaced by straight competitive bid timber auctions through BC Timber Sales – auctions in which anyone can compete.

Sandhu and others have long contended that in a semi “open” bidding environment, big forest companies with secured forest tenures will always be at a competitive advantage – particularly if the stumpage fees they pay for their tenured timber are less than what they pay for the relatively small amount of additional timber they procure through auction.

“Open-ended sales don’t work because the big boys always win against us,” Sandhu says. “And why wouldn’t they? If they pay \$20 a cubic metre for 10 per cent of their wood and 25 cents for 90 per cent of it and I must pay \$20 for everything, who’s going to win that game?”

Sandhu believes that only through true competition for logs or a secured fibre supply of his own can he fairly compete. In September 2005 he told the province so, saying he would invest \$11 million in another value-added mill – this one geared to making an engineered wood product known as I-joists – if the government offered him a long-term timber-cutting licence, similar to those held by some of the big forest companies in the region. He asked for a licenced allotment of 500,000 cubic metres of timber a year – a request he said should be easy to meet given the huge increases in logging activities that have been approved in the region to “salvage” trees attacked by mountain pine beetles.

He has yet to receive an answer, an answer that if it were yes would help secure another 100 woodworking jobs in the region.

BC Timber Sales

Government, the Single-Largest Tenure Holder

Over the next few years, an arm of BC's Ministry of Forests will become the single-largest forest tenure holder in the province, well exceeding the largest forest company in terms of the volume of publicly-owned timber it controls.

That entity is BC Timber Sales. And it is considerably different in structure and in the role it plays in public forests than its predecessor, the Small Business Forest Enterprise Program.

The first major task of BC Timber Sales is to identify and develop tracts of timber on public forestlands for sale. The trees, not the land, are placed for auction. Companies or individuals wanting to do the logging then bid on the rights for the timber, with the highest bidder getting access to the wood.

Related to the first task is the overarching objective of the program, which is to maximize financial returns to the province. This comes in two forms: first, in terms of the money paid for the timber, which is subject to competition, and second, to use the "bid prices" established under auction to determine the stumpage fees companies will pay to the province for the timber they log under the long-term forest tenures. This model is what the province calls a "market-based" timber pricing system.

At present, the objective of a market-based pricing system remains unrealized, in large part because the prices paid through BC Timber Sales auctions in the Interior of the province are not being used to set the stumpage prices companies pay for timber cut under their forest tenure agreements. This is of special concern in the Interior at this time because of the large amount of timber that is being logged

– much of it in response to the Mountain Pine Beetle infestation – and which is being assessed the most nominal stumpage charge of just 25 cents per cubic metre.²³

BC Timber Sales is growing in importance as more timber, once held under tenure to forest companies, is transferred into the program. Companies have received or are scheduled to receive compensation from the province for the so-called “takeback.”

According to the most recent BC Timber Sales Service Plan, the organization is preparing for a dramatic ramp up in the amount of publicly-owned timber it auctions.

In 2003–2004, the amount of timber put up for auction was listed as 11.2 million cubic metres. The projected increase in volume over the next four years is more than 47 per cent (Table 4).

A major departure for wood auctioned through BC Timber Sales is that currently no “social” provisions are attached to it beyond the fact that the government takes the highest bid for whatever timber it sells. Until fairly recently, this was not the case. Under BC Timber Sales’ predecessor, the Small Business Forest Enterprise Program, there were actually two forms of timber sales. The first was very similar to the straight bidding process now employed by BC Timber Sales. Areas of public forestland were identified for prospective sale. The costs associated with developing the site and doing the subsequent reforestation were built into a minimum or “upset” stumpage rate. Companies and individuals were then invited to make “bonus bids” over and above the upset rate, which essentially covered all of the government’s costs. These were known as Section 20 sales. Timber auctions under BC Timber Sales are essentially the same.

However, under the old program, allotments of timber were also put up for sale on the basis of bid proposals. These timber sales were not subject to competitive bid, but were awarded on the basis of the added value individuals or companies could bring to bear on the wood they bid on. Known as Section 21 sales, these timber allotments were geared solely toward encouraging the value-added sector.

The big question is whether these sales demonstrably improved the output of value-added products in BC. Bearing in mind *Table 3: BC’s Value-Added Wood Exports – Growth, then Stagnation* – there was a rapid run-up in value-added wood product production from the early to late 1990s. During those years there were at least two additional government programs in place that may have assisted in that growth.

In addition to Section 21 sales, the Crown Corporation Forest Renewal BC was also in existence. One of FRBC’s core mandates was to improve the prospects for increased value-added production in BC. During its mandate, FRBC did a lot of marketing work aimed at increasing the profile of BC’s value-added wood products. One forest products analyst interviewed for this report says that the program was well regarded in the industry. FRBC also created a wood fibre network that informed value-added producers where they could obtain the raw or semi-processed material they needed. FRBC contributions, in addition to the Small Business Forest Enterprise Program, may have played decisive roles in the rising importance of value-added wood products at that time.

Fiscal year	Volume of timber sold (millions of cubic metres)
2003–2004	11.2 (actual)
2004–2005	11.8 (projected)
2005–2006	14.8 (projected)
2006–2007	16.2 (projected)
2007–2008	16.5 (projected)

Source: British Columbia Ministry of Forests. BC Timber Sales: Service Plan 2005-06 – 2007-08.

Another explanation for the increasing strength of the sector during this time may, ironically enough, have been the dispute with the US over alleged Canadian softwood subsidies. Under the quota system put in place as a result of that dispute, once US-bound shipments of Canadian softwood exceeded certain thresholds a duty kicked in. As a result, there was incentive for BC forest companies to make lumber and other raw materials available domestically. Local value-added producers then took that wood and in many cases remanufactured it into materials that also crossed the border. But in this case, the materials were not subject to the duty.

Another forest industry analyst who is also very familiar with government forest policies said, however, that while an upswing in value-added production may have occurred during that time, it does not necessarily follow that the “return” to the province was any greater. It all depends, he said, on how you define value. The province could take the view that policies encouraging secondary and tertiary manufacturing in BC is a good and socially desirable thing. Or it could take another view: that the highest price paid for the timber through auction, no matter what its end use, is the best social return because it ensures that the public gets maximum *dollar* value from a publicly-owned resource. It also doesn’t interfere in any way with the movement of goods or services, presumably resulting in a situation where the wood makes its way to its most logical and best end use.

“The Section 21 program did, undoubtedly, support more value-added. But were the benefits of that value-added really more than the costs of it?” the analyst said. “But if you go back and compare the price of the Section 21 sales and what was paid for Section 20 wood, the Crown was getting less per cubic metre under Section 21 than if they sold it through the auction process. Well let’s say the difference was \$10 a cubic metre. Was the extra value-added production really worth more to BC than the additional money it could have collected per cubic metre through straight competitive sales?”

In the absence of a thorough, well-documented cost-benefit analysis it is hard to know the answer. And even if an answer were arrived at, it would undoubtedly be subject to wildly varying opinions. Some people might argue, for example, that less money into the province in stumpage payments is a reasonable price to pay if more people are working in the final analysis. Others would argue that anything that interferes with a true and functioning marketplace is wrong and simply serves to distort the value of raw resources. If the marketplaces really is open, if the playing field is level, not only will the province realize the highest financial returns, but the high prices paid for the raw material will demand that optimum value is extracted in order to justify the purchase price.

What is perhaps the most striking thing posed by the analyst’s question, however, is the very fact that the question can be asked in the first place and foster a stimulating public policy debate. What makes the question possible is that the wood being discussed is publicly owned, a point noted at the outset of this report. The optimum benefits derived from a publicly-owned resource should, in a perfect world, be the subject of intense public interest and debate.

In upcoming sections of this report we will return to the issue of BC Timber Sales and the unique opportunities it affords on the value-added front and elsewhere. For now it is time to turn to what opportunities exist to reinvigorate the contract between the province – landlord of our public forests – and the companies.

A major departure for wood auctioned through BC Timber Sales is that currently no “social” provisions are attached to it beyond the fact that the government takes the highest bid for whatever timber it sells. Until fairly recently, this was not the case.

At the Crossroads

Ten Proposals for Building Stability in BC's Forestry Communities

Cliché though it may be, *at the crossroads* is an apt way to sum up where British Columbians find themselves today in terms of the public benefits derived from publicly-owned forest resources. Much has been lost by way of what might be called the social provisions in licence agreements and forest policy in this province. But it is not clear what, exactly, has been gained. And if little has been gained, what might we reasonably expect be done to increase social benefits?

As documented earlier in this report, in particular in the sidebar *A Steady Decline*, the direction in forest policy over the past five years has clearly been to remove rules and regulations that were seen as being a drag on forest company profitability. Overall, there has been a move away from prescriptive rules embodied in such things as the former *Forest Practices Code Act*, and a “freeing up” of companies to choose how they meet vaguely defined and largely unenforceable regulations. Companies are also completely unhindered now in terms of which regions or communities of BC they operate processing facilities in. The end result is that many mills in numerous communities have closed, with nothing taking their place.

In light of all this, what might constitute a socially progressive move forward? Are there modest things that could be done to increase worker and community returns from the utilization of one of BC's most important natural resources without unduly hamstringing company performance and tying up too many government resources? What might constitute a new way forward, one that offers greater long-term stability and economic opportunity to forestry-dependent communities?

The following 10 recommendations are intended to stimulate debate about forest policy in BC and how it might be changed to better achieve desired social, economic and environmental outcomes.

The focus is squarely on extracting more value from the wood processed in the province and on increasing prospects for a more diversified and healthy industry that generates more benefits for local communities and the wider community as a whole.

PROPOSAL ONE

Partnership Sales

As the single-largest holder of Crown timber in British Columbia, BC Timber Sales is uniquely positioned to encourage more value-added manufacturing in the province by providing the essential ingredient without which forest product manufacturing is impossible – wood. It is a market maker, providing companies access to a valuable raw material supply.

With existing wood product manufacturers in BC saying that great potential exists to increase value-added shipments into major housing markets such as the US, what can the government do to encourage this outcome?

One idea would be to promote what this report calls “partnership sales.” Such sales could be run through a new program administered by BC Timber Sales and would allow for open, competitive bids provided that the bids were submitted jointly by a primary manufacturer of dimensional lumber and a secondary manufacturer who would add further value to the wood. There would be no price discounting in such sales. Just as with existing timber sales, a minimum stumpage fee or “upset” rate would be set, and all interested parties would have to bid that price or more if they hoped to win the rights to that timber.

In addition to submitting a bid price, partnerships would have to demonstrate that in return for a primary mill getting access to public timber, a secondary mill would get a guaranteed volume of lumber from that primary mill at fair market value for purposes of making a value-added product. Under such sales, both the primary and secondary manufacturer would benefit. Such an arrangement would almost certainly help to encourage more cooperation between the sectors in the industry.

Unlike the old ‘bid proposal’ sales administered under the former Small Business Forest Enterprise Program, partnership sale bids would not have to go through a review to determine the number of new jobs created or in what community the jobs would be. The screening process would be streamlined and focussed solely on ensuring that a portion of timber sales were geared toward encouraging partnerships and assuring that a portion of the commodity lumber output from sawmills was further manufactured, moving domestic production up the value chain.

Critics of such a proposal might argue that by placing limits on who could bid for timber BC would run the risk of aggravating tension with the US over alleged subsidization of softwood producers. After all, it was precisely because of the ongoing disputes with the powerful American softwood lumber lobby that the BC government moved to its “market-based” timber pricing system in the first place. The intent of the BC Timber Sales system is to set overall stumpage rates based on timber that is auctioned. However, rulings by two panels, one convened under the North America Free Trade Agreement, the other under the World Trade Organization, both ruled in Canada’s favour, finding that there was no demonstrable subsidy. Furthermore, both rulings applied to timber pricing policies that were in place in BC and in other Canadian provinces between April 1, 2000 and March 31, 2001, before the BC Timber Sales Program had begun to kick in. What this means is that BC continues to have wide latitude in how it goes about selling – and pricing – public timber supplies, irrespective of its moves with BC Timber Sales.

PROPOSAL TWO

Low-Grade Lumber for Domestic Remanufacturing

Earlier in this report, a long-time and respected member of BC's lumber remanufacturing sector estimated that there is currently about 1.5 billion board feet of low-grade lumber leaving BC's Interior each year for re-cutting and further processing in the US. All of that lumber is currently subject to countervailing and anti-dumping duties and could be re-cut here.

One way of maintaining some or all of that low-grade lumber output in BC for further processing before export would be to announce that companies wishing to ship minimally-processed products would pay a fee in lieu of further manufacturing. The fee would apply to all production, regardless of whether it was destined for domestic or export markets, and would be waived in the event that the low-grade lumber was sold at fair market value to secondary manufacturers in BC. The fee would have a sliding scale with higher fees paid on low-grade commodity lumber and much lower fees on wood products higher up the value chain. A similar fee in lieu of manufacturing applies to companies exporting whole logs from BC and that originate from timber logged on Crown or public forestlands. The fees collected could be targeted to assist forestry dependent communities with economic transition strategies, and would bolster a community assistance fund discussed in Proposal 6.

To be effective, this recommendation would require clearly articulated definitions for what constituted value-added and the fees triggered for certain products.

PROPOSAL THREE

New Tenures for Value-Added Producers

Earlier, this report profiled the operations of two substantial value-added wood products manufacturers, Brink Forest Products and Jackpine Group of Companies. These companies and others have shown a willingness to take risks that the major forest tenure holders in the province have not. They have made investments without assured supplies of timber. This is also happening in some notable cases with independent primary mills, such as the Dunkley Forest Products mill near Prince George. In Dunkley's case, the company has a long term forest tenure, but the tenure comes nowhere near providing the total log supply it needs to maintain its output. As a result, the company enters into the market to bid on the additional timber or logs that it needs.

Such operations would clearly benefit from having more secure access to timber to be either processed directly into logs and later into value-added products, or used for the purposes of trading for what is needed.

The inevitable question here is why such companies cannot simply enter the market for what they need. It is a reasonable question to ask, and there is a compelling argument that the market is exactly where such players should go for their wood needs. Competition for logs ensures that the highest price

is paid for a resource owned by the people of the province. But what kind of market do we have in BC? Is it truly open? If it is not, what are the immediate prospects for opening it further and what might be the consequences of a radical and rapid re-ordering of existing tenure arrangements?

At this point in time, there is not a truly open and competitive log market in the province. The majority of forest tenures continue to be held in large, volume-based or area-based allocations by a relatively small number of comparatively large companies. And while moves have been made toward more of a “market-based” timber pricing system in BC, whereby bid prices set at BC Timber Sales auctions dictate the stumpage prices forest companies pay for their tenured wood supplies, only Coastal companies are so affected. And even there, questions abound about the functionality of that market. The Interior remains under an administered timber pricing regime, with market sales having little discernible influence on the stumpage rates established by the Ministry of Forests on the province’s behalf.

What is the consequence of this?

With major companies holding forest tenures under which they pay as little as 25 cents per cubic metre for Crown timber – including beetle-killed timber – it is comparatively easy for those same companies to enter an “open” market, bidding up timber prices to points where their competitors cannot compete. If the market is skewed in favour of a disproportionately small number of companies, there is justification in suggesting that the playing field could be made more level by granting new forest tenures to smaller players, particularly those who are engaged in value-added production. There is room within the present system to do so given the greatly expanded BC Timber Sales program and the additional reality that in the Interior logging rates have been raised to levels never before seen in response to the ongoing Mountain Pine Beetle infestation. Rather than putting all its timber up for auction, a portion of the wood now held by BC Timber Sales could go, instead, into longer-term and likely non-replaceable licences that would at the very least give value-added producers some assurance of supply over several years.

If the market is skewed in favour of a disproportionately small number of companies, there is justification in suggesting that the playing field could be made more level by granting new forest tenures to smaller players, particularly those who are engaged in value-added production.

An obvious challenge in so doing would be to ensure that public timber supplies are not over-allocated, and that allocations are tied to the fullest extent possible to companies that have demonstrated a strong commitment to investing in their processing facilities. The over-allocation issue remains a serious one, compounded, no doubt, by the incredible run-up in Interior logging rates in response to the beetle. But if the province is determined to keep logging rates up in the short term – and it appears that that is *exactly* what it intends to do – then at the very least the public deserves to know that there will be an attempt to maximize job opportunities. Companies with a proven track record of generating more jobs because they create a higher-value product should have access to some of that wood through long-term tenures, even if the tenures are non-renewable.

Moreover, such allocations should be made with a careful eye to ensuring that there is a robust diversity of companies holding forest tenures.

As one forestry analyst with a breadth of knowledge in provincial forest policy observed, there are parts of BC where an unhealthy number of forest tenures are concentrated in the hands of just a few companies. Competition is being stifled and with it opportunities for new business relationships that could help to diversify and expand the range of forest products being produced in BC.

“The level of consolidation in the Quesnel, Prince George and Houston strip has become too much. One of the things I would think you should put into the new social contract is making sure there is enough competition for fibre,” the analyst said.

PROPOSAL FOUR

A Declaration on Forest Tenure Concentration

At present, there are federal rules and regulations governing competition. Such rules have been used in recent years to compel some forest companies in the province to divest themselves of certain assets following their acquisition of another company's forest tenures and wood processing facilities. But such decisions are generally the exception to the rule.

Less well known is that the province has the power to declare that there is too great a degree of forest tenure and milling concentration. Under the *Forest Range and Practices Act*, companies can also be ordered to sell or relinquish certain assets.

At present, just three companies – Canfor, West Fraser and Tolko – control the lion's share of forest tenures in the Central Interior of the province, and a significant percentage of the primary milling capacity in the region. The concentration of milling capacity, in particular, will become even more pronounced in the near future as Canfor and West Fraser complete new sawmills in Vanderhoof and Quesnel respectively. The new mills will be among the biggest and most efficient in the world and will result in the closure of existing mills that process less wood.

Given the vital importance that forest industry activities play in the region, and the certainty that upheaval lies ahead as logging rates fall after the beetle infestation and related salvage logging run its course, a timely, published provincial government review of forest tenure and milling concentration is in order. This is most germane to the Interior where the bulk of present-day logging activities take place. The review should be circulated for public comment. Following it, the province should be required to publish a decision on what constitutes a reasonable degree of forest tenure and milling concentration with a rationale for its decision.

Such a review might pave the way for future mergers occurring only in the event that the merged companies divest some of their holdings, with the government then reallocating those resources to smaller players, communities, First Nations, or, perhaps, worker co-ops.

PROPOSAL FIVE

A Value-Driven Vision for BC

“Value added” is one of those value-laden terms that will always mean different things to different people, nowhere more so than when discussing products made from wood.

The array of manufactured goods made possible from the wood fibre in a tree are dizzying in their diversity and range widely in dollar value depending on the product made. In British Columbia, the value extracted from wood fibre runs the gamut from world-renown guitars, violins and mandolins on the high ‘artisan’ end of the value-added chain to the oft-maligned two-by-four, without which the wood frame houses and apartments in which many of us live would not be possible.

On the commodity end of the value-added chain, making two-by-fours and further value-added building materials such as finger-jointed boards, trusses and beams, requires capital investments. Generally, but

not always, such investments increase outputs while reducing per-unit labour costs. Often such reductions translate into job losses. This is almost inevitable. Commodity producers operate in an extremely tough business environment, one in which markets are often oversupplied. Constant investments must be made to ensure that producers retain their competitive edge, or they run the risk of losing their business. Seen from this light, newer, bigger and more efficient sawmills are a good thing and, arguably, add value by keeping primary mills competitive with producers elsewhere and hence staying in the game.

In BC's Interior, in particular, there has been a demonstrable increase in investments at some major commodity lumber mills. Canfor, which recently purchased Northwood and acquired that company's major sawmill at Houston, BC, subsequently upgraded the mill, making it the largest of its kind in the world. The company is also investing more than \$100 million in a new mill in Vanderhoof, and West Fraser is making an investment of a similar magnitude in Quesnel. Smaller, independent companies such as Dunkley have also recently invested in state-of-the-art sawmills and, much like their bigger counterparts, are expected to retain their competitive edge for some time to come in what remains an extremely daunting business environment. The two major challenges here are the ongoing premium that Canadian softwood lumber producers pay in countervailing and anti-dumping duties on US-bound lumber, and a much stronger Canadian dollar, which affects sales remunerated in US dollars. Offsetting the latter point, however, is that equipment for mill upgrades is frequently valued in US dollars, so a rising Canadian dollar helps to lower such purchase costs.

These investments have been mirrored by other companies who add further value to wood products. A step or two or three removed from commodity lumber production, these companies are, nonetheless, reliant on the "commodity end" of the value-added chain for the semi-finished products to which they then add further value. Earlier in this report we profiled two such companies, Brink Forest Products and Jackpine Group of Companies. While the ongoing investments made by these companies are encouraging, there are troubling signs that they remain vulnerable to supply constraints, either because they have little or no forest tenures of their own, or as a result of major commodity lumber producers cutting off supplies, or a combination of the two.

In the absence of a clearly articulated value-added strategy by the landlord – the provincial government – it is a certainty that such companies will be constantly confronted with raw material supply concerns. Despite such concerns, however, it is encouraging to see companies such as Brink, Jackpine and Dunkley making significant investments and plotting an expansion of their businesses. For the same cannot be said on the Coast.

On the Coast these days, value-subtracted is the defining theme. Drove of sawmills have closed. Market pulp production continues to decline. And there is no demonstrable investment in new primary mills, despite bold promises of \$1 billion in new investments by three of the Coast's leading forest companies just three years ago. Raw log exports account for approximately 20 per cent of the total log harvest on Coastal Crown forestlands. If more mill closures ensue, and no new facilities emerge in their place, it appears inevitable that calls for increased raw log exports will grow, thus potentially accelerating the value-subtracted trend.

As landlord of public forestlands, the province has seemingly given in to the view that market forces should prevail and if market forces dictate fewer mills, less value-added facilities, and a heightened flight of unprocessed logs from BC, then so be it.

As landlord of public forestlands, the province has seemingly given in to the view that market forces should prevail and if market forces dictate fewer mills, less value-added facilities, and a heightened flight of unprocessed logs from BC, then so be it.

At this report's outset it was argued that most British Columbians, if asked, would oppose such developments. In fact, they would argue that the present worrying trends need to be reversed; that to the full extent possible more value needs to be added to forest products here in the province.

Making such an objective a reality, however, requires leadership. And that properly begins with the provincial government, which sets forest policies and can encourage certain outcomes from public forestlands.

Government can, if it wishes, make a simple and direct declaration of what it wants. If it says its priority is to increase the value extracted from our public timber resources and that it is prepared to work with the industry on a number of fronts – forest tenures, pricing, wood allocation and stumpage – to make that happen, the industry will feel compelled to respond.

If asked, most British Columbians would argue that the present worrying trends need to be reversed; that to the full extent possible more value needs to be added to forest products here in the province.

The trick, at least initially, is not for government to get too hung up on what the instruments of change might be, in other words to resist being too prescriptive. Rather, it must focus on the objective, and, by working with a diversity of interest groups – primary and secondary producers, communities, labour and First Nations – foster an environment in which that can happen.

Now, more than ever, we need the province to simply and forthrightly explain its vision for our forests. Promoting an increase in value-added manufacturing in BC is not only a socially and economically desirable objective, but it is one that leading forest analysts believe is possible. To that end, BC should work with the federal government to ensure that a program of refundable tax credits is put in place on new capital investments in the forest sector and that future research and development expenditures in the value-added area can be written off.²⁴ But not, as noted momentarily, at any cost.

Two Possible Value-Driven Visions: One for the Coast, one for the Interior

The following short descriptions are intended solely to stimulate discussion and are but one way that the government could begin to encourage an evolution of the forest industry on the Coast and in the Interior, an evolution that would encourage value-added.

Why the emphasis on value-added? The most compelling reason is that there are tangible prospects for increased growth in this area. Again, just to focus on one example, consider the giant US building materials market. Respected forest industry analyst and consultant Peter Woodbridge has done just that. In a recent report on BC's value-added prospects in the North American context, Woodbridge made the following observation:

Canada has the potential to become a large scale, efficient producer of many high quality, low unit cost engineered wood and building components for the US market. Why produce these in Canada? There is an overwhelming reason ... the existing and intensifying shortage of skilled labour in the United States for site-building construction. This is well documented. Numerous surveys identify skilled trades and semi-skilled labour shortages as being among the top concerns of many homebuilders and industrial/commercial construction firms in the United States.²⁵

Woodbridge goes on to say that there is an evolution in the way houses are being built in the US, an evolution that favours more off-site building of standardized and hence highly reliable building materials. To the extent that more value-added, wood building materials can be made, and in sufficiently large numbers for timely delivery to building sites, the happier builders will be because it cuts down on time and waste. BC has only a small share of this market at present, Woodbridge says, adding that there are big opportunities to capture a greater share of it, in particular with increased production of specific products.

Among the most rapidly growing sub-sectors of the value-added wood products industry on the west coast [of North America] are structural engineered wood products (EWPs), structural systems and factory-built homes. These three wood component groups are capturing market share from traditional lumber products, such as solid sawn 2x10s, and are improving the on-site productivity of homebuilders by saving labour and providing a better product.

Typical structural EWP products include I-joists, glulam beams, laminated veneer lumber (LVL) and various finger-joint lumber products. Structural systems include roof and floor trusses as well as whole building systems. Factory-built homes include pre-cut, panelized and modular homes. None of these products is subject to US tariffs at the present time.²⁶

Woodbridge's take on value-added is that BC and Canada need to seize on the province's historic strength in moving wood products into new markets, much as occurred a few decades ago when it pioneered the use of timber frame housing in countries like Japan. At present, this is not happening nearly to the degree it should with respect to the US homebuilding market.

Canada seems to lack a national vision of how to achieve global excellence as a manufacturer of wood products. In contrast, several strong competitors in this business, such as Finland, Sweden and Chile have a clear national sense of their wood industries' core competencies and support them with appropriate policies such as targeted R&D tax write-offs, marketing promotion and trade development.²⁷

To highlight just how far BC lags behind other Canadian jurisdictions in its value-added output, the province at present produces only about 31 cents of value-added products for every one dollar's worth of commodity wood products made. In Ontario and Quebec, by comparison, for each dollar's worth of commodity wood products made an average of one dollar and 50 cents' worth of value-added products are made (Table 5).

To be fair, Canada's two largest provinces by population are also ideally situated near the major Eastern Seaboard states as well as big markets such as Chicago. But it must be remembered that BC is not that far removed from California, a state whose population equals that of Canada's. And the province, as Woodbridge notes, has some inherent advantages over value-added producers in the US West because its energy costs are comparatively lower. It also has at present lower overall wood costs. And were it not for anti-dumping and countervailing duties, which tack another 20 per cent onto the cost of exporting materials to the US, BC's lumber remanufacturers would be extremely competitive with many of their US counterparts.

A second and compelling reason to increase value-added production is that it is labour-intensive, providing more jobs and economic stability for forest communities. Given the increased size and efficiency of many primary commodity mills, job losses in this sector need to be offset by job gains in value-added. Moreover, value-added products are less susceptible to the boom and bust swings that characterize prices for basic commodities, and that forever buffet the fortunes of resource communities.

So what could a value-driven evolution of the forest industry look like in BC's two main regions?

Table 5: Lost Opportunities: The BC Story	
Jurisdiction	Value-added per every dollar of commodity lumber made
British Columbia	\$0.31
Ontario/Quebec	\$1.50

Source: Peter Woodbridge and Associates. Manufacturing of Value-Added Wood Products in Western North America: How Competitive is BC? A report to the Interior Value-Added Wood Association. March, 2003.

The Coast

As stated earlier, the Coastal forest industry is in a state of great change and the trend lines are not encouraging.

With so many sawmills having closed and prospects looming that large areas of Coastal old-growth forest will remain off-limits to conventional clear-cut logging, there is likely to be an inevitable ratcheting down in logging rates, particularly in remaining old-growth forests. There is, however, a growing stock of second-growth forest on the Coast. And of the remaining areas of old-growth forest that might be logged much of it is dominated by a tree species that is, to say the least, challenging to work with. Hemlock, the species in question, is a notoriously water-laden wood and is at its optimal value only after it has been processed and dried, the latter requiring significant amounts of energy. Currently, only about 15 per cent of the hemlock logged on the Coast is kiln-dried and therefore fails to command the price premiums in the marketplace it otherwise would.

As mentioned earlier, the Coast Forest Products Association recently predicted that more sawmills on the Coast would close. It went on to say that in light of continuing financial losses, the Coast industry needs financial help, specifically \$150 million in cash and financial incentives from the federal government, which is in the process of trying to come up with an assistance plan for forest companies across the country. The Association has also asked the provincial government to reconsider its timber pricing policies, particularly for second-growth hemlock logs and pulp logs.²⁸

The Association went on to say that its member companies need such government “encouragement” before they are prepared to look at re-investing. The industry would need to find funds to invest in the construction of as many as six new sawmills at a cost of \$80 million to \$120 million each (the sawmills would turn out dried lumber, primarily from second-growth hemlock logs). And it would look at building up to six new plants turning out a range of engineered wood products, each priced between \$130 million and \$150 million.²⁹

Under the circumstances, there is no doubt that the province could promote – and greatly assist in facilitating – an ecologically and economically responsible shift to second-growth logging and sawmilling, with sawmilling being promoted as the first step in a new value-added chain of Coastal wood products.

Unlike the Interior, the Coastal sawmilling sector has divested itself of mills and shown little or no inclination to invest in new milling technology. A transition of the kind suggested here would require significant new investment in primary sawmills, mills moreover that process smaller, more uniform logs. The government could assist in such a transition by doing a few things.

First, it could reverse a sorry trend of deep cuts to provincial forest inventory staff (those public servants in the Ministry of Forests that count and analyze available forestry resources on the public’s behalf). This would better enable the province to get an accurate read on Coastal forest resources, in particular second-growth hemlock.

Second, on the basis of forest companies shutting down sawmill after sawmill, it could declare that existing forest tenures or portions thereof will be hived off to make way for new tenures that are subject to bid and awarded on the basis of companies building new milling facilities.

Third, it could look carefully at preparing for bid through BC Timber Sales suitably large volumes of hemlock timber specifically geared to encouraging the emergence of a Coastal hemlock wood-processing sector.

What would the advantages of such a transition be?

First, it would take pressure off the logging of remaining and highly contentious old-growth forests where, because of the traditional focus on logging the best and easiest to access stands first, the cheapest wood is long gone anyway. However, there would have to be some significant restrictions placed on a

new second-growth-focussed logging program, not the least being concern for ecosystem health and restoration.³⁰

Second, it would allow for the rehabilitation and expansion of other pockets of Coastal forest where previous logging activities have endangered ecosystems, such as Coastal Douglas fir forests.

Third, well prepared and well managed forestry activities in second-growth might be far more easily certified as sustainable by independent forest certification bodies such as the Forest Stewardship Council, which in turn would open up new markets for such wood, whether value-added boards or commodities.

Fourth, it would create a new primary wood products sector built around lumber production at new mills that are cost-competitive.

Fifth, a rejuvenated sawmilling sector focussed on hemlock could become the raw material supplier for further value-added forest products, two potential end uses being engineered wood products such as laminated beams and dried hemlock flooring.

Finally, with a coming collapse in Interior logging rates and fibre costs for wood pulp rising on the Coast, a rejuvenated hemlock-focussed Coastal sawmilling sector would produce lots of residual wood chips, which could provide a needed furnish for Coastal pulp and paper mills. Currently, the sale of waste chips to pulp mills is a critical income source for sawmills. Without it, in fact, most sawmills could not survive. New uses for wood chips could, of course, emerge. The most likely candidate would be their use as “fuel” in electrical co-generation plants. But the big question is whether sawmills selling masses of chips to co-generation plants, which then burn the chips under high heat to generate electricity, would fetch sufficient prices for their wood waste. Would chips sold for this purpose be as beneficial a revenue source as is the case when they are sold for pulp production? In addition, without access to chips, pulp machines will shut down. There is already a disquieting trend to mothball pulp machines in BC, putting pressure on newsprint and paper makers to find new supplies – so much so, that some operators are talking about an inevitable trend toward importing pulp to use in their paper machines. If this continues, and all pulp is imported, there will be further pressure on the sawmill sector. Clearly, the key here is balance. Viable sawmills and viable pulp and paper mills require a balance of wood use and price. Without one, the other is invariably in trouble.

Provincial government failure to promote the evolution of the Coastal forest industry along this line or some other would appear to be a risky proposition given current trend lines. Divestment is the order of the day on the Coast. In the absence of new mills being built to replace some of the existing old, inefficient and largely old-growth focussed mills that have closed or are vulnerable to closure, there will almost certainly be rising prospects for further increases in whole log exports – value-subtracted, not value-added.

But there is a big difference between assisting in such a transition through implementing new policies, and outright acquiescence to forest company and association demands. If indeed the Coastal industry faces a profound and disruptive transition, with the slate being wiped virtually clean, there is no better time than now to say what is expected of companies holding forest tenures. There should be no extension of outright grants, tax breaks, R&D investment credits or breaks in stumpage rates without clearly defined expectations about what is required by way of new investments. If all that is to be done over the foreseeable future is to close mills, then forest tenure takebacks are in order.

Under the circumstances, there is no doubt that the province could promote – and greatly assist in facilitating – an ecologically and economically responsible shift to second-growth logging and sawmilling, with sawmilling being promoted as the first step in a new value-added chain of Coastal wood products.

The Interior

Unlike the Coast, significant investments have been made in new primary sawmills in the Interior in recent years, such as the two new large sawmills slated to open in 2006 in Vanderhoof and Quesnel.

But there is an absence of government policies that encourage primary producers to work more closely with secondary wood product manufacturers in the province. In the absence of such policies, what would compel primary lumber producers to share a portion of their output with local companies who add further value to the products?

One vision for the Interior, particularly in communities where significant lumber manufacturing already exists, would be to promote value-added “clusters.” This idea has been suggested by Peter Woodbridge as well as others to expand value-added opportunities in BC.

For example, in February 2002 a forest consulting firm submitted a report to the Thompson-Nicola Regional District outlining the value-added wood products manufacturing opportunities that existed in and around the City of Kamloops.

The report noted that “industrial clusters” – collections of businesses tied to a particular products group – have been highly successful in elevating business activities in particular regions – think southern California’s Silicon Valley.

Another Model For Selling Wood

To say the least, manufacturers of wood products have very specific needs.

Not all wood pieces, let alone logs, are suitable for conversion to desired end products.

One idea tried briefly in British Columbia in the 1990s was a regional log market run out of the community of Lumby, near the Okanagan city of Vernon.

The distinguishing characteristic of the market was that all wood logged in the region’s then Small Business Forest Enterprise Program was delivered to the yard for meticulous measuring, grading and sorting.

From there, very specific parcels of logs were placed on the auction block for open bidding by all interested parties – major companies and highly specialized small wood artisans alike.

Many people, including government foresters, conservation groups, community organizations and businesses saw the market as an example worth replicating. It provided jobs at the local level. It generated high prices for auctioned wood. And because of the up-front sorting and a diversity of sales – some for large volumes of wood, some for small – a host of end users were enticed to bid on the wood.

One thought is that such markets could be replicated in a number of communities around the province, with timber now held by BC Timber Sales serving as the raw material to get the markets off the ground.

A very specific benefit of such markets would be that they could be used to very aggressively promote the production of value-added wood products – production that would have significant social benefits.

To give just one example, in 1996 the log home and timber building industry in BC had sales of \$114 million. That industry employed 1,800 people and added, on average, \$270 dollars in value to every cubic metre of wood processed. For every 110 cubic metres of logs used in log home construction, one person was on average employed – about a tenth of what is needed to generate the average job in the industry today.

The log home builders in the province are currently conducting a survey to update the situation today, a decade later.

In some Interior communities, the report suggested, attracting an “anchor investment” such as a large, ready-to-assemble homebuilder, would have positive implications for a range of commodity and value-added producers. Such an investment would compel companies to work more closely together on such things as making wall, floor and roof systems, along with doors, windows and cabinets. In short, many of the things that are required to build the average home.³¹

Clusters such as these would likely be far easier to achieve in communities where existing relationships between primary and secondary wood product manufacturers were healthy and where they showed prospects of growing. Furthermore, such clusters could be encouraged in their growth through such things as regional log markets, a concept that has been tried in British Columbia with historic success, but never allowed to flourish as some suggest (*see Another Model for Selling Wood*).

There is a compelling case to be made for thinking that now, more than ever, such relationships need to be fostered. Why? Because there is a one-time opportunity over the next decade or so to process large quantities of lumber and value-added products as a result of the elevated logging activities taking place in response to the ongoing mountain pine beetle infestation. Encouraging healthy wood flows between primary and secondary manufacturers is essential at this time of heightened raw material supply. If not acted upon today, it is safe to say that it will be even harder to act tomorrow. As mayors, council members and economic development officers in numerous Interior communities know all too well, logging rates are expected to fall precipitously in a decade or so when beetle-attacked trees have lost their commercial value and commercially viable timber supplies come crashing down. This inevitable decline will pose challenges for all forest industry players. However, value-added producers will likely face fewer problems than their counterparts in the commodity lumber business for the simple reason that commodity lumber mills require far greater volumes of wood to stay in business. Big declines in logging rates are more likely to hurt them than businesses requiring less wood to meet their business needs.

A value-added vision for the Interior could simply be stated as doing the utmost possible to encourage either the direct awarding of new forest tenures to companies that are prepared to add increased value to the wood they process, or to encourage new partnerships between the primary and secondary sectors.

There is a one-time opportunity over the next decade or so to process large quantities of lumber and value-added products as a result of the elevated logging activities taking place in response to the ongoing mountain pine beetle infestation.

PROPOSAL SIX

Stumpage Funds to Communities

With clear signs that many “timber-dependent” regions of BC are facing a rocky road ahead, there is a need to empower communities to chart new and more diversified economic courses.

One of the ways that the province could assist communities in doing so would be to turn a portion of the revenues that flow to the provincial government through such things as stumpage payments back to communities themselves.

Rules would have to be established for how communities would receive such funds and what they would be eligible to spend the money on. But it could include such things as infrastructure improvements that help attract new businesses, or seed money for new business ventures.

There is already recognition by the province that in energy-rich northeast BC, for example, local governments are not sharing adequately in the revenues generated by the oil and gas sector, which is the major economic player in the Peace River region.³²

The argument may be made that forestry dependent communities are not in the same bind as those in the northeast, that they have sawmills, pulp mills and panel mills within their municipal boundaries that are contributing substantial tax dollars. While this is true, it is equally true that there are threats to that tax base. First of all, the province recently amended the Community Charter, making it possible for municipal governments to lower corporate tax rates. Already, one forestry dependent community has felt compelled to do so in order to encourage a major forest products company to build a new mill in town. That decision will cost the community \$6 million in foregone tax revenues over the next decade.³³

In addition, with the loss of appurtenancy provisions, forest companies are closing many milling facilities with the end result that municipal tax rolls are being eroded further still.

Finally, in many Interior communities the projection is for future logging rates to fall dramatically as timber supplies dwindle. As they do, there will be less wood available to go around. This will inevitably lead to more mill closures, which will erode local tax rolls further still.

A funding source that the province could justifiably dip into to fund community economic diversification would be a portion of the added stumpage revenues that it now collects from companies “salvage logging” in response to the mountain pine beetle. In the absence of separately published financial data on just how much stumpage revenues are being generated as a result of today’s inflated logging rates, it is difficult to know how much money the province is making on the back of the beetle. But it is safe to say that it is a lot. More than 11 million cubic metres of timber per year is being logged in response to the beetles at present and it is questionable whether any of that money should be going into general revenues when the province knows the funding source is temporary. Moreover, as this author recently argued in another CCPA report – *Battling the Beetle* – BC should be collecting more than the nominal 25 cents per cubic metre it is currently charging on beetle-killed timber. The added stumpage that should be charged would provide yet more money to capitalize a community diversification fund.

One former senior civil servant that is very familiar with government forestry revenues said that in his opinion it is “imprudent for the government to treat the [stumpage derived from] beetle wood as general revenue.”

“Rather than have it go into general revenues,” he said, “the government should accept up front that it’s a transitory thing, and put it away in a trust or some kind of thing, for the communities that are going to be most affected.”

The former civil servant went on to say that a trust, or a series of trusts, for various timber-dependent communities could be used to help them pursue “economic opportunities other than working with wood. If we provide them with funding, they are free to find a portfolio of activities that they think best diversifies their economic base.”

Already, one forestry dependent community felt compelled to use the recently amended Community Charter to lower corporate tax rates in order to encourage a major forest products company to build a new mill in town. That decision will cost the community \$6 million in foregone tax revenues over the next decade.

PROPOSAL SEVEN

An End to Wood Waste

In years past, photographic images depicting large amounts of usable timber being stacked and burned following logging triggered outcries from conservation and labour groups alike. There is a general feeling that when it comes to publicly-owned natural resources, companies receiving the right to harvest them have a duty to see they are fully utilized.

With woodworkers sounding alarms over a rise in the amount of usable logs being left in the bush and later burned, the provincial government should publicly declare the acceptable level of waste left behind following logging. Leaving logs to waste that could be converted to lumber or pulp is socially unacceptable. The government should dedicate sufficient resources to ensure that Ministry of Forests personnel can conduct a stepped up program of monitoring and enforcement to ensure that utilization standards are adhered to, and when they are not that companies pay sufficiently high penalties that they are discouraged from doing so again.

PROPOSAL EIGHT

Simple and Enforceable Standards

Public expectations remain high that in return for gaining access to the timber on public forestlands, companies must perform to high environmental standards. The knock in some quarters against the old Forest Practices Code Act, however, was that it was too prescriptive in setting out how companies were to meet their environmental obligations.

Whether this was true never really had a chance to be analyzed, however, because the old Act was of relatively short duration. And what replaced the old Act was a new piece of legislation that many critics say saw the pendulum swing way too far the other way.

Not only are prescriptions largely absent from today's *Forest Planning and Practices Regulations*, but the "results" against which companies are to be judged are vague and hopelessly compromised by caveats. Many "environmental" objectives, for example, are qualified by language saying that they should be met "without unduly restricting the supply of timber."

The objectives are simply too vague. What does it mean to say "maintain riparian function" and in the next breath qualify it by saying "without unduly restricting" the amount of timber available to log? Either riparian forests – those tracts of trees adjacent to streams and rivers and where plant and animal diversity is high – are important in and of themselves, or they are not. And if they are important, the language around protecting them needs to be specific, scientifically rigorous and defensible, and the results to be met must be clearly defined and reasonably easy to measure.

This is not to say that there needs to be a lot of "red-tape" and "unnecessary bureaucracy" involved in meeting the regulations – phrases often used to criticize the old Code. But it seems a reasonable starting point to say that in the new "results-based" regime in which we find ourselves, the expected results should at the very least be clear. By all means if the feeling is that companies should be free to meet the results in their chosen way, let them. Just as long as everyone is clear on what the expectations are and that companies will be held accountable when they fail to deliver the expected results. Which in a nutshell means that the results must be clearly stated and easily measured; that there is increased capacity to

monitor and enforce company compliance; and that companies are held to account when they fail to meet the rules they are told to abide by.

PROPOSAL NINE

Minimum Investment Requirements

Earlier in this report it was suggested that the old appurtenancy clauses in forest tenure agreements that compelled companies to operate certain mills in certain communities might have outrun their usefulness. If, in order to remain competitive, companies must upgrade existing mills or build new ones, and if investments trigger higher fibre consumption at bigger, more efficient facilities, the realities of a finite resource base dictate that some mills must close. There are only so many trees to go around, after all.

But if appurtenancy is an outdated concept, what should replace it? Should companies holding forest tenures in BC be allowed to walk away from *all* of the mills they operate without losing forest tenures? Should they be allowed to keep their tenured forest holdings without processing *any* wood in the province? What would constitute an acceptable level of investment in milling facilities? Currently, there is no clear provincial policy that answers these questions. And in its absence, there are renewed calls for significant overhauls of the existing forest tenure system, including taking back up to half of all tenured wood and putting it up for auction and/or a complete separation of harvesting rights from processing rights.

In the absence of such sweeping changes, however, there needs to be at the very least some contractual language in licence agreements that outlines what is expected of companies that are granted Crown tenure holdings. This is particularly necessary when company mergers or sales occur. This might take the form of requiring new capital investments in areas where companies have closed a facility or facilities, which clearly would include much of the Coast these days. Or it might take the form of requiring ongoing investments at existing facilities to ensure that assets are not depreciating so quickly that they become outdated, unable to compete, and therefore prone to closure. Call it the new appurtenancy if you will.

PROPOSAL TEN

Sharing Wood with First Nations

As a player with direct control over sizeable areas of Crown forest, the BC government is in a unique position to allocate timber to First Nations' communities. It also has leverage to redirect proposed logging activities so that they do not place forest companies or the province in conflict with First Nations in areas where First Nations clearly do not want logging at this time. This is made possible through the large amount of public forest that is now directly controlled by BC Timber Sales. This is not to say that BC Timber Sales is necessarily the vehicle through which future timber allocation decisions should be made. But it is to say that at this point in time the province, through BC Timber Sales, directly controls a vast area of Crown forestland. Moreover, that area of forestland is expected to grow in the years ahead as "takebacks" of timber from forest companies are completed and the companies are compensated for what has been removed from their control and placed in the BC Timber Sales portfolio.

This recommendation is made solely as an interim step as First Nations and the governments of BC and Canada forge ahead with what until now have been painfully slow treaty, land-use and co-management negotiations. And it is hoped that it could provide some immediate relief as those negotiations continue.

Conclusion

Throughout this paper, several disquieting trends have been noted with regard to declines in the social return from the logging of BC's publicly-owned forestlands.

While there are many things beyond the ability of the province to control and which bear directly on the profitability of forest companies in BC (for example, the rising Canadian dollar), government can do much to encourage greater social returns from the logging of publicly-owned timber resources.

Forestry operations in BC always have been and are always likely to be a partnership between government and industry (unless, that is, there is a radical alteration of the present land ownership regime by privatizing many publicly-owned forestlands). As such, when the province turns over large areas of public forestland to companies to log it has significant power at its disposal to set the terms whereby that logging will be permitted to take place.

In years past, it has been suggested that the province wielded too heavy a stick in this regard, making it difficult for companies to operate profitably. The critique was that the province was asking too much in terms of forest practices and placing too many constraints on companies in terms of what mills they had to operate where in return for Crown timber logging rights.

But with the pendulum having now swung quite far in the opposite direction, questions are being raised about whether the social return from logging activities on public forestlands is near what it should be. This paper concludes that some simple, not overly onerous or prescriptive policy changes are at the province's disposal, policy changes that would increase returns to workers and resource-dependent communities, while still giving companies room to do what they are good at doing.

Given the high number of recent mill closures, continued export of large numbers of unprocessed logs, rapid rises in Interior logging rates and declines in value-added manufacturing, the time has come for an expeditious review of forest policy in BC. It is time to implement new policies that increase public benefits from one of our most important publicly-owned resources.

Notes

¹ Woodbridge 2005.

² Wong 2005.

³ British Columbia 2005e.

⁴ Tice 2004. Available at www.timberprocessing.com.

⁵ Canfor Corporation 2005. Press release available at www.paperloop.com.

⁶ PricewaterhouseCoopers 2005. The article, available at www.pwcglobal.com, notes that in terms of return on capital employed (ROCE) Canfor ranked third highest on a list of 100 surveyed companies, with an ROCE of 16.2 per cent.

⁷ British Columbia 2005e.

⁸ West Fraser Timber Co. Ltd. 2005.

⁹ British Columbia 2005e.

¹⁰ Woodbridge 2000.

¹¹ Brink 2005.

¹² Section 21 sales were common under the now defunct Small Business Forest Enterprise Program or SBFEP. Similar to BC Timber Sales, SBFEP was run by the provincial government. Unlike BC Timber Sales, however, it made a portion of the publicly-owned timber it sold available on a very specific basis only to value-added wood products manufacturers.

¹³ M'Gonigle and Parfitt 1994. In particular, see pp. 76–77.

¹⁴ Hume 2005.

¹⁵ Marchak 1995.

¹⁶ Hamilton 2005a.

¹⁷ British Columbia 2005e.

¹⁸ Glavin 2005.

¹⁹ Vaillant 2005.

²⁰ Hamilton 2005a.

²¹ Finger-jointed boards are actually made up of several pieces of board that have been glued together. The boards are made from the “clear” pieces of wood cut out of low-grade boards that may have a lot of defects, such as knots. Trim ends from good boards are also a common stock. When the good pieces of wood are recovered they are cut in a zigzag fashion along the ends. The zigzagged ends are then glued and pressed into one another to form a longer board such as a two-by-four. Finger-jointed boards not only meet stress test requirements, but are usually much stronger than conventional boards made from a single piece of wood.

²² Sandhu 2005.

²³ For more on this, see Ben Parfitt’s earlier CCPA study, *Battling the Beetle*, 2005.

²⁴ Hamilton 2005b. Such developments would help to stimulate the transition of the industry and would be in keeping with a recent presentation to a House of Commons committee by the Forest Products Association of Canada. At the mid-October presentation to Cabinet committee members in Vancouver, FPAC officials noted that Canada’s forest industry is in dire straits, facing a “perfect

storm” of events including the rapidly rising Canadian dollar and ongoing anti-dumping and countervailing duties on US-bound lumber that are rapidly eroding profitability.

²⁵ Woodbridge 2003.

²⁶ Ibid.

²⁷ Ibid.

²⁸ Hamilton 2005a.

²⁹ Ibid.

³⁰ Any moves to dramatically increase logging of second-growth forests would, however, have to take outstanding biological diversity concerns into account. As a result of significant logging of old-growth forests in places such as Vancouver Island, more advanced (older) second-growth forests are of looming importance in protecting a range of environmental values, including rebounding plant communities, winter range for various ungulates, and hydrology. In some of these forests, ecosystem restoration would have to take priority over logging. On the other hand, there is a possibility of selective logging in second growth forests, because such forests have more uniform trees that don't pose the same kind of worker hazards as is the case in old-growth forests. This could address, and in some cases even enhance, biological diversity and habitat concerns. But it would have to be done carefully, with an eye to ensuring there is adequate tree-re-growth in areas logged, and that the surrounding trees left unlogged do not sustain too much damage during the logging phase.

³¹ Bell 2002.

³² Under an agreement reached with communities in the region and unveiled in March 2005, the provincial government set out a plan that would see approximately \$20 million transferred to the region's communities, including Fort Nelson, Fort St. John, Dawson Creek and Chetwynd, in each of the next 15 years. The region's municipal governments had argued for quite some time that because of the nature of the industry, which has drilling rigs, pipelines and processing facilities spread over a vast area and often well outside municipal boundaries, local communities were not capturing an adequate share of industrial tax dollars. The same was not true of the provincial government. Last year, for example, the province collected \$2 billion in royalty and land rights from oil and gas companies operating in the Peace Region.

³³ City of Quesnel 2005.

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