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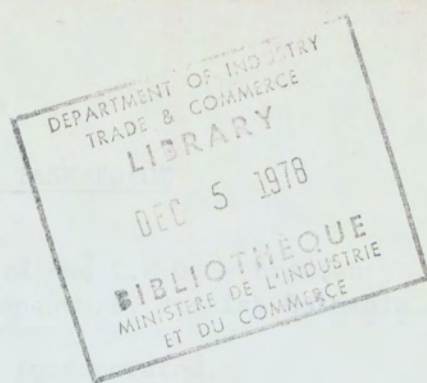
A REPORT BY *Canada.*  
THE SECTOR TASK FORCE ON

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THE CANADIAN FOREST PRODUCTS INDUSTRY

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Chairman Ian A. Barclay



REPORT OF THE  
CONSULTATIVE TASK FORCE  
ON THE  
FOREST PRODUCTS INDUSTRY

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June 1978

THE FOREST PRODUCTS INDUSTRY CONSULTATIVE TASK FORCE

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\* Representatives of these provinces participated on the basis that they or their respective governments were not to be considered as necessarily endorsing any of the recommendations contained in this report.

\*\* Subsequent to the final meeting, Mr. L.H. Lorrain advised with regret that he was unable to agree with substantial parts of the Report as many of the recommendations are in conflict with economic and social policies of the Canadian Labour Congress.

## GENERAL COMMENTS

Forest products, Canada's largest manufacturing industry, has the potential to contribute in a substantial way to the achievement of both national and regional economic and social goals far into the future. This Task Force welcomes the opportunity to offer recommendations for action by governments which would increase the chances of realizing that potential.

Some of our recommendations concern general policies having broad impact on the Canadian economy. Others are oriented specifically to forest products. They include measures to encourage greater co-ordination of policy formation amongst federal government departments and between the federal and provincial governments; to bring greater stability to the economic environment for more rational medium and long-term business planning; to create an economic climate favourable to investment and growth; and to strengthen the ability of the forest products industry to compete, in Canada and around the world.

The members of the Task Force have included representatives of primary and converted forest products of every variety, and of organized labour, the academic community, and eight of the ten provincial governments. The federal Department of Industry, Trade and Commerce provided the secretariat, and representatives from six other federal government departments have been present as observers.

The Task Force held three meetings. Each was marked by a high degree of enthusiasm for the job, and co-operation and hard work in getting it done. We believe that if it leads to the adoption of constructive measures to improve the performance of the Canadian economy, then it will have been a most useful innovation in the field of public policy.

Our work has benefited from the analysis of the industry made by the Forest Products Group of the federal Department of Industry, Trade and Commerce. Their studies drew conclusions with which, generally speaking, the Task Force members agree. Accordingly, we accepted the Forest Products Sector Profile<sup>1</sup> as the starting point, without necessarily endorsing each one of its conclusions.

Changing economic circumstances, especially the fall of the Canadian dollar, have altered some of the relationships described in that analysis. But the more deep-rooted competitive

<sup>1</sup> Attached as Appendix I.

difficulties of Canadian industry will not be solved, though they may be eased, by exchange rates. The concerns expressed in the Sector Profile are still very much with us.

The Task Force considers that as a first priority the following four broad areas of concern, or if you like, challenges, must be addressed:

- the cost disadvantages to which most Canadian forest products producers are subject in relation to their competitors in the United States. These have been well documented in the various detailed studies of the industry conducted over the past few years by federal and provincial governments, and forest industry associations.
- the investment climate, and more specifically, the present unattractiveness of Canada for major new forest industry investment, again in relation to the United States. Unfortunately, this is illustrated most dramatically by the fact that five new machines for the manufacture of newsprint, the product on which Canada's pulp and paper industry was founded, are being built in the U.S. There are none being built or, to our knowledge, planned in Canada.
- the difficulties of generating adequate capital to do all of the things which should be done to improve productivity and reduce costs, while at the same time meeting environmental obligations and pursuing opportunities for expansion. These difficulties have been caused partly by inflation, including its effects in distorting real earnings, as reported in recent studies by leading accounting firms;<sup>1</sup> and partly by the low levels of profitability and return on investment which have characterized the Canadian forest products industry during most recent years.<sup>2</sup>
- forest resource problems, especially the concern that unless a more intensive level of forestry is practised, the resource will not for many more years be able to play its traditional role as the foundation of so much of the nation's economic growth. This problem was examined in a recent study for the federal government by F.L.C. Reed and Associates, of Vancouver.

These matters are complex and difficult, especially in a large country of divided political jurisdictions and uneven distribution of resources. We are confident, however, that effective responses can be developed. Forest products is not an industry

1 Several studies commissioned by the Canadian Pulp and Paper Association have examined the impact of inflation on earnings and the financial health of corporations.

2 See Appendix III, attached.



which must inevitably slip away to other parts of the world. In terms of its potential for generating income and exports, and new employment and investment in primary and secondary manufacturing and the service industries, it is one of Canada's strongest industrial cards.

This is its place in the Canadian economy today:

- Direct employment in forest products represents nearly one in eight jobs in manufacturing in Canada. Total employment related to forest products, direct and indirect, is estimated at one million, or 10 per cent of Canada's employed persons.
- The importance of the industry in terms of value-added is equally high, representing 15 per cent of the total for all Canadian manufacturing.
- Forest products account for about one-sixth of Canada's exports and make a net contribution to the balance of payments that is far greater than for any other industry.
- The direct and indirect federal tax revenue from the forest resource sector is roughly \$1 billion.<sup>1</sup>
- Outbound traffic of forest products comprises one-eighth of the railway carloadings in Canada.
- Forest products manufacture has been a major factor in stimulating the development of other Canadian industries, such as chemicals, machinery, hydro-electric power, engineering, and construction.
- In terms of geographic diversity, every region in Canada depends, to a significant degree, on the forest products industry. It is a major source of economic activity throughout vast areas outside the metropolitan centres.

In summary, forest products is one of the chief elements of Canadian economic activity, stretching across the nation into remote constituencies and resting on Canada's major renewable resource.

Management and labour have a heavy responsibility to see that the industry continues to contribute to Canada's economic well-being and that Canada is in a position to serve a reasonable share of the coming increases in world demand for forest products. They will have to work hard and effectively, and negotiate their differences from a common perception of economic reality. But governments also have a

<sup>1</sup>Hon. Romeo LeBlanc, Minister of Fisheries and the Environment, statement to the House of Commons Standing Committee on Fisheries and Forestry, April 26, 1977.

most important role. Their policies help not only to shape the general social and economic environment in every corner of the country but to determine the actual level of many business costs.

Nevertheless, given conditions which we should be capable of achieving, Canada can do well in forest products, worldwide, in the years to come.

The Task Force has searched for consensus on government policy measures which would not only be constructive but responsible. Our list indicates that there is a great deal to be done, and that it will take the best effort of all of us in Canada (and perhaps a little bit of luck) if we are to achieve the federal government target of an average annual increase of 5.5 per cent in the real gross national product over the next few years.

Half-hearted efforts are simply not going to be good enough. In forest products, growth in world demand in the future will be slower than in the past, and there will be intense competition from producers in many countries. Furthermore, in its major markets outside Canada, the Canadian industry is a residual supplier and as such, tends to take the widest swings in production and shipments. This means that we must be, above all, a low-cost, high-quality, fully-dependable supplier.

The mandate of the Task Force was largely to make recommendations for action by all levels of government. We have confined ourselves to that, and in the short run at least some of the measures we suggest would either reduce tax revenues or increase some kinds of expenditures. That may seem a paradox at a time of public concern with government budgets and government deficits. But for the longer run we see it as one of the essential elements in the creation of a stronger, more internationally-competitive forest products industry, which will make the kind of contribution to the economy that Canadians have a right to expect.

Our first recommendation is general in nature, and suggests a method for ensuring that the momentum generated by this new approach to consultation is maintained.

- About a year from now, and thereafter every two years, a formal audit or assessment should be made of progress and of measures actually taken in response to the recommendations of the Sector Task Force.

Our other recommendations are on the following pages, under nine subject headings: Investment, Modernization and Taxation; Forest Resource and Management; Environmental Control and Pollution Abatement; Energy; Transportation; Research; Market Development; Competition Policy; and Labour/Management Relations, Unemployment Insurance, and Manpower.



## INVESTMENT, MODERNIZATION AND TAXATION

Taxation is one of the most important elements in the industry's costs and competitiveness, and is linked inextricably with investment decisions. Indeed, taxation policies - federal, provincial, and municipal - are the principle instruments of public policy to encourage or discourage investment and thus modernization, expansion and job creation.

If it is to modernize and expand, the Canadian forest products industry must be encouraged and not discouraged by the tax policies of government. Moreover, stability and consistency of tax policy is an important element in a capital intensive sector where the physical reality of a new or expanded plant lags the actual investment decision by as much as two or three years.

Tax changes enacted in recent years, while moving in helpful directions, continue to fall short of what is needed, and indeed it should be noted that integrated forest products companies in Canada are still operating at a significant tax disadvantage in relation to integrated forest products companies in the United States.<sup>1</sup> Earnings have increased, but risk-reward ratios in the Canadian industry are still unfavourable, and cash flow is inadequate for the very large capital expenditures that are required.

We recognize that a certain level of government revenues from taxation is necessary to support government requirements. But it must also be recognized that tax policy is a major influence on the investment decisions on which future tax revenues will depend. It is this latter aspect which is crucial to the future of the forest products industry in Canada.

Our goal must be to achieve an environment in which the risk-reward ratio is improved. Tax policy can contribute to the achievement of that goal, and in the opinion of this Task Force should be directed to the encouragement, first, of modernization, productivity improvement and expansion of existing operations; and then to new green-field operations; in that order. We therefore have the following tax policy changes to recommend:

- The investment tax credit of 5 per cent (higher in certain slow growth areas) on qualified assets really works out to  $2\frac{1}{2}$  per cent net of the offset against capital cost allowances. This compares to a rate of 10 per cent, which may go as high as 12 per cent, in the U.S., our major competitor. Further, in Canada a limitation in the carry-forward period often

<sup>1</sup> See Appendix IV, attached.

erases much of the benefit, considering the lengthy construction period and cyclical nature of earnings which are characteristic of the forest products industry. Our recommendation is that the U.S. system of investment tax credit rates and time span be implemented, with suitable regional differences, and that logging equipment be included in the category of qualified assets.

- Our inability, in Canada, to consolidate or group income for tax purposes, as is permitted in the U.S., is a major disadvantage, which should be corrected in the Canadian system.
- The introduction of an inventory tax credit of 3 per cent on opening inventories has been beneficial in combating a portion of the inflation-related inequities in taxation, and should be continued. In addition, consideration should be given to the use of the LIFO method of valuing inventory for tax purposes, as is permitted in the U.S. and other countries.
- The fast write-off for manufacturing and processing assets is important in offsetting the effect of inflation on replacement costs. However, the exclusion of logging equipment from the fast write-off provision is grossly unfair, considering the importance of increased mechanization to cost reduction in this segment of the industry. We recommend extension of the fast write-off to logging equipment.
- The six percentage point reduction in the income tax rate provided in 1972 for manufacturing and processing was very welcome. But it continues to be discriminatory in that, for no explainable reason, it excludes logging income. Generally speaking, for an integrated forest products company, the net effect is to increase the tax rate by about two percentage points from that for manufacturing and processing, and for an independent logger the discrepancy is 6 per cent. This anomaly in the Income Tax Act should be corrected. Logging is an integral part of the manufacturing and processing operation, and should be classified as such.
- The threat of reduced tariffs for some sectors of the forest products industry deserves special consideration. Special investment allowances should be considered for the

replacement or modernization of facilities threatened by tariff reductions:

- first, tax-exempt financing,
- second, relief from income tax, provided the income thereby retained is invested in new facilities or modernization in Canada.

Note: See also tax and investment incentive recommendations with regard to forest management, on page 8; pollution abatement on page 10; energy on page 11; and research on page 13.

### FOREST RESOURCE AND MANAGEMENT

Within industry and government a broad consensus has developed that Canada must intensify its forest management. Through silviculture, the annual allowable harvest must be increased. Otherwise Canada will be in no position to share for many more years in serving the increase in world demand for forest products. We shall not have sufficient wood available in economic locations.

This extremely important issue must be faced now. Because more than 90 per cent of the Canadian forests are publicly-owned, it is an issue in which industry has a role but only government can take the lead.

There are other forest resource issues, related directly to the competitive position of the forest products industry in the world today, and the attractiveness of Canada for major forest industry investment. Greater security of wood supply is required, to encourage investment, and effective measures to deal with serious threats to the health of the forest, most notably the spruce budworm. Wood costs in some regions are the highest in North America; that must be changed, for in forest products production wood accounts for some 30-40 per cent of total manufacturing costs.<sup>1</sup>

These are our recommendations:

- There should be closer co-operation and co-ordination of effort amongst industry, labour and the federal and provincial governments in dealing with forest problems in order to maximize the social and economic benefits of the resource base.
- There should be a co-ordinated effort by the federal and provincial governments and industry aimed at:

<sup>1</sup> Analysis of Manufacturing Costs in the North American Forest Products Industries, published by the Department of Industry, Trade and Commerce. ●

- a) completing a survey of economically accessible forest reserves;
  - b) encouraging intensive forest management on public and private lands;
  - c) carrying out research required for the implementation of these measures.
- The following specific actions should be taken to stimulate intensive forest management:
- i) Provincial governments should adopt policies providing for long-term security of tenure.
  - ii) Cost allowances and taxation benefits should be made available. Industry should be permitted the right to offset forest management costs against stumpage fees for wood harvested. In order to encourage intensive forestry practices beyond those eligible for the stumpage offsets, a tax credit of 150 per cent should be provided for these additional forestry expenditures.
  - iii) The provincial governments and the federal government must begin to plow back into forestry a larger share of the revenues they derive from the forest. After all, we are dealing here with a public resource.
  - iv) DREE-type grants should be provided for greatly expanded tree improvement programs and nurseries.
- Forest areas assigned to companies should be geographically defined to assure proper planning for harvesting. Together with other reliable sources of fibre supply, they should be capable of meeting each company's wood requirements under sustained yield management.
- Aerial spraying to combat budworm infestation should be continued, subject to the proviso that research be continued into alternate methods of control which are more effective, as well as environmentally acceptable. An assessment should be undertaken to determine the appropriate levels of budworm research expenditures to deal with this very serious on-going problem.
- The status of government forestry services should be upgraded, to reflect the more important role which they must play in intensified forest management.

## ENVIRONMENTAL CONTROL AND POLLUTION ABATEMENT

Environmental control is a major concern of forest product companies. No figures have been compiled for the industry as a whole, but the pulp and paper sector spent, from 1960 to the end of 1976, some \$604 million on water and air pollution abatement and solid waste management. In 1977, it is estimated that pulp and paper's pollution abatement expenditures totalled about \$156 million, or some 19.5 per cent of its planned capital expenditures. For 1978,<sup>1</sup> more than 30 per cent of pollution abatement investment anticipated in Canadian manufacturing will be accounted for by the forest products industry.

As this large and complex effort continues important problems must be resolved, and all involve government. There is, in the industry, concern that federal and provincial authorities will develop excessively costly environmental protection standards. There is uncertainty about the application of environmental legislation and its effect on industry planning and investment. There is worry about the cumulative effect of a multiplicity of environmental regulations, and their application in an unco-ordinated and disjointed way by federal and provincial governments. And there is concern that governments, in designing and putting in place environmental protection requirements, will fail to recognize that the capital required for implementation reduces the capital available for modernization and other cost-efficiency programs that are urgently needed. As the federal government noted in a recent paper<sup>1</sup>, "the return on investment has not been sufficient in recent years to provide required funds for plant expansion and modernization to achieve productivity gains, and a significant share of investment has been diverted to meet pollution standards not directly contributing to productivity improvement".

Our recommendations suggest ways to facilitate the retention of scarce capital for investment in projects required by the industry to regain competitiveness in world markets; correct jurisdictional overlaps between governments; assist industry in planning for future environmental requirements; and provide mechanisms for a federal and provincial legislative framework of uniformity and realism.

They are as follows:

- Both levels of government should apply the test of socio-economic impact assessments to determine whether the anticipated benefits of existing or proposed environmental legislation and regulations outweigh the costs.

<sup>1</sup> Canadian Competitive Performance, published by the Department of Industry, Trade and Commerce

- the "two-tier" system of umbrella prohibition, under which emission penalties can be imposed even where there is no proof of a deleterious effect, should be replaced by legislation and regulations which prohibit environmental emissions only if they exceed specified standards.
- There should be, in each region of Canada, a single authority whose function would be the orderly and efficient conduct of environmental management, including the harmonizing of federal and provincial environmental regulations. In view of Canada's constitutional make-up, this authority would logically be provincial.
- The pollution aspects of the federal Fisheries Act should be separated from aspects having to do with the control of fishing. Industrial water pollution should be dealt with under a separate regulatory framework, without the threat of arrest and jail sentences which are applicable under the general prohibition section and other sections of the Act.
- The two-year write-off for pollution control expenditures, currently scheduled to expire at the end of 1979, should be extended indefinitely to recognize that pollution abatement is a continuing responsibility where long-term planning and commitment is essential.
- Application of the U.S. system of tax exempt financing for pollution control expenditures would fill an important gap in capital funding of these mandatory outlays.

#### ENERGY

The forest products industry is the largest industrial user of energy in Canada. Energy costs are extremely important to its ability to compete, and in recent years forest product companies have directed increasing attention to energy conservation, and projects to reduce purchased energy requirements.

It should be recognized that the forest industry is in the unique position of being able to obtain a large portion of its energy needs by burning its own waste products. In fact, many companies are in a position to become net producers of energy. The increased use of fuel produced from waste materials generated by the manufacturing process will enable the industry to become more self-sufficient in energy, reducing the demand on Canada's

non-renewable energy supplies. But these benefits are being reduced by restrictive and/or expensive air emission requirements related to the burning of wastes as opposed to "clean fuels".

It is important that the industry's efforts to reduce energy requirements and protect its current energy cost structure not be negated by energy intensive techniques of environmental control. It is also important that the industry's research facilities be sufficiently funded by government and industry to ensure that research projects intended to optimize energy consumption are given the required priority.

We have the following recommendations:

- Governments should re-examine their priorities in terms of trade-offs between air emission control systems and waste fuel utilization.
- Capital intensive energy conservation and generation programs, including the use of wood waste, should be eligible for special incentives by the government to encourage their adoption.<sup>1</sup>
- There should be adequate government funding of research and development programs related to the increased energy self-sufficiency of the forest products industry.
- A national program to establish energy conservation goals would be enhanced if co-ordination of efforts between energy suppliers and users at the national level were possible.

#### TRANSPORTATION

The forest industries account for about 20 per cent of the total freight volume hauled by the Canadian railways, and are their largest single source of revenue. And transportation is one of the largest elements of cost for the industry, ranging between 10 and 40 per cent of the delivered price, depending on the product.<sup>2</sup> Inbound wood and other raw materials, and outbound finished products move in enormous quantities, often over great distances. Thus, deficiencies in the transportation infrastructure - roads, railways, rolling stock, port facilities - and in the regulatory machinery for controlling transportation rates and services can have an important impact on the industry's ability to compete.

<sup>1</sup> Since this report was completed, the federal government has announced new programs to encourage development of energy from the forests. Some of these appear to be in accord with recommendations in this section, but full details were not available at this writing.

<sup>2</sup> The Canadian Forest Products Sector Profile, published by the Department of Industry, Trade and Commerce.



We support the need for an efficient and profitable transportation industry in Canada. Nevertheless, where that industry is obliged to provide services mandated by government legislation, such as the Crow's Nest Pass grain rates, government should have the responsibility for any revenue losses that are involved. The carriers should not be left to recover such losses from other traffic.

Because of the need to be cost-competitive with competing mills located in the United States, and because transportation is a major cost factor, the objective must be that transportation costs be competitive on a per-ton-mile basis with similar costs in the United States. This cost competitiveness should apply to movements of both raw materials to mills and finished products to markets.

To promote this, we have these recommendations:

- To make negotiations between shippers and carriers more equitable, there should be a more effective and faster working mechanism for the redress of grievances on transportation rates than is now available through the Canadian Transport Commission.
- The interpretation of "captive shipper" in the National Transportation Act should be broadened to include those who are only "substantially captive".
- A formal procedure should be established between the Canadian Transport Commission and the U.S. Interstate Commerce Commission, for co-ordinating the consideration and decisions of the two Commissions in matters relating to international rail freight rates.
- A more deliberate attempt should be made to establish what the transportation equipment requirements of the forest products industry will be, and to provide for them. This would help to avoid equipment shortages which occur periodically.
- Transportation policy should be utilized as a tool for regional development. But any revenue losses incurred by the carriers in so doing should be borne by the federal government and not left to the carriers to recoup as best they can from other traffic.
- Provincial governments should continue to look at the cost benefits which can result from improved roads, in reducing and making more competitive truck hauls for shorter distances.

- Establishment of a forest products terminal on the St. Lawrence River, to improve the facilities in Eastern Canada for the handling of exports, should be considered.

## RESEARCH

There is an urgent need to improve the competitiveness and productivity of the forest products sector. The development of new technology can help to meet this need, but in Canada the total research effort related directly to the forest industries is small as compared with our major competitors, the U.S. and Scandinavia. The level of research and development spending by government and by industry is inadequate. Indeed, government research and development funding in real terms as a percentage of Gross Domestic Product, and industry funding as a percentage of sales, have been declining. Moreover, of the research and development that is performed, too great a proportion is government-directed and too small a proportion market-directed.

The fact is that not only the so-called technological industries but also the mature industries are dependent for their survival on the development of superior process technology and product innovation. If they rely solely on purchased technology, they sacrifice to competitors an initial advantage which can be very important.

The need for a more effective and intensive research effort in Canada should in our view be addressed by:

- the recognition that product-related research is best done by industry. There should be a review of such research being done by various government agencies, to determine how available government resources can be re-directed to the private sector.
- increased funding by government of existing government/industry co-operative research efforts, such as the Forest Engineering Research Institute of Canada and the Pulp and Paper Research Institute of Canada. This must be coupled with an assurance of continuity of government policy and funding commitments.
- greater financial incentives for industrial research, applied through the tax system. The measures proposed in the recent federal budget are not adequate, and should be modified to provide a significant stimulus not only to start-up but also to ongoing research and development expenditures. Further, because major innovations are so

often a long-term proposition, there should be the assurance that these incentives will be available for at least ten years.

- a high level of public funding for fundamental research which is in the national interest, such as, for energy conservation, and pollution abatement.

#### MARKET DEVELOPMENT

A recent report sponsored by the Food and Agriculture Organization of the United Nations forecast a growth in world consumption of paper and paperboard of approximately 3½ per cent a year to 1990. Similarly, world consumption of lumber, plywood and other structural wood products is forecast to grow at between 2 and 3 per cent per year. If, partly as a result of the acceptance of recommendations elsewhere in this report, the Canadian forest products industry could become sufficiently profitable, then the availability in Canada of raw materials, technology, human skills and infrastructure is sufficient to provide the industry with the opportunity to match and perhaps even better these worldwide rates of growth.

Of course, the Canadian market itself is relatively small, and if the industry is to achieve a high growth rate the impetus must come largely from exports. Moreover, because the worldwide growth in newsprint is not expected to be as rapid as for paper and paperboard as a whole, it follows that we must seek ways to expand our export capabilities in the other grades as well. That means the creation of world-competitive production facilities for such grades.

We have these comments and recommendations:

- Canada could benefit from easier access to the major world markets for forest products. Lower duties or duty-free entry into the United States, the European Community and Japan for all grades of paper, paperboard and wood products would enhance the opportunities for export in the years to come.
- For newsprint, pulp and lumber, which comprise some 90 per cent of the industry's exports, there is virtually free trade in the major world markets, including Canada. On the other hand, government must recognize as a fact of life that reductions of Canadian tariffs on the remaining products of the industry, such as fine and tissue papers,

plywood, packaging papers and boards, and converted wood and paper products, would be very damaging. The Task Force recommends that such reductions not be made by Canada. If, in spite of this position, Canada makes reductions, the following should be considered, to help permit those segments of the industry which would be affected to try to adapt to the new and more difficult competitive situation.

- 1) Reductions should be phased in over as long a period of time as possible, and only after the industry has been given the earliest opportunity of taking advantage of the easier access to export markets, in order to give Canadian companies time to adjust to the U.S. scale of operations.
- 2) The forest industry has developed in response to the conditions that existed at the time, and governments have a special responsibility to assist in adapting to changed conditions. Specific recommendations on this point are contained in the section on Investment, Modernization and Taxation, pages 6 and 7.
- 3) Competition law should be modified to permit companies to consider specialization agreements.

We also have recommendations pertaining to two other aspects of market development. The first has to do with government product promotion efforts:

- We recommend the continuation of government support for market acceptance activities on export sales, particularly as related to lumber.

The second has to do with the activities of the federal Export Development Corporation, which have been a source of considerable concern within the Canadian forest products industry recently. It appears to us absurd that Canadian funds are used in a way which encourages forest product production outside Canada, when such financing is not available to encourage modernization and expansion within Canada.

- 1) EDC funds should not be used for the development of forest product industries in countries that are within Canada's traditional market area for forest products.
- 2) The provision of funds by governments to finance exports at concessional rates can be considered an export subsidy and, in effect, a non-tariff measure. It should be dealt with as such at the current GATT multilateral trade negotiations.

## COMPETITION POLICY

Three times in recent years the federal government has introduced new legislation on competition policy, a subject which is important to the forest products industry. Each time, the bill has met widespread criticism and has not passed Parliament.

This is, without doubt, one of the most complex of public policy issues. But it must surely by now be apparent that on some of the most important elements of competition law a profound difference of opinion exists between the drafters of the legislation and the private sector.

We believe that the government has not responded adequately to the concerns expressed by many business groups, including the forest products industry. Further, we believe that the philosophy inherent in each successive attempt at legislation - in such sections as those pertaining to joint monopolization, mergers, specialization agreements, and international exchanges of information, for example - is at odds with efforts to improve the investment climate and strengthen the manufacturing sector.

It would serve no useful purpose to repeat here the detailed comments that have been made on this legislation, since they are a matter of record.<sup>1</sup> Rather, we propose that:

- before yet another competition bill is brought forward, a committee from the private sector be recruited by the government, and given a mandate to study this matter and in a very short period of time make recommendations to the Prime Minister. The Skeoch Report was a major effort of a somewhat similar kind. Unfortunately, the two bills introduced subsequent to Skeoch did not reflect adequately either its conclusions or its spirit.

## LABOUR/MANAGEMENT RELATIONS, UNEMPLOYMENT INSURANCE, AND MANPOWER

The Forest Products Task Force has included representatives of both labour and management. So we have had the opportunity to discuss labour/management relations, and there is agreement amongst us that this is an area where a better performance is required, in the interests not only of the industry and its workers and shareholders, but of the Canadian economy as a whole.

<sup>1</sup> See, for example, a submission made by the Canadian Pulp and Paper Association to the House of Commons Standing Committee on Finance, Trade and Economic Affairs, May 1977.

We also feel that this better performance must be achieved largely through the efforts of labour and management, with government in a secondary role. We really have to solve these problems ourselves, and indeed, considerable progress has been made over the past three years in building better and more constructive relationships.

We have the following recommendations:

- Governments should play a secondary role in the search for solutions to labour problems. They should be a catalyst to encourage and ensure that the parties work out their own solutions. A common purpose for the forest products industry must be sought, through dialogue and consensus, rather than confrontation.
- The federal and provincial governments should take responsibility for ensuring a broad understanding amongst Canadians about the standards of living that the economy can sustain.
- A group of economic advisers with specific expertise in the forest products industry should be appointed to produce short-term and long-term economic forecasts, and analysis of current economic matters relating to the industry. It should provide meaningful industry data that could be used as a basis for industry/labour discussions.
- Governments should undertake joint consultation with management and labour prior to the enactment of legislation affecting the forest products industry.
- Governments should relate increases in public sector compensation to those in the private sector.
- Governments should study industrial certification as a method of reducing the possibility of a multiplicity of unions representing employees at the same operation.
- The federal government, perhaps by initiating a conference with provincial Labour Ministers, should investigate the possibility of achieving more uniformity of labour codes across Canada.
- Schools should place added emphasis on basic economics and the particular factors which affect the Canadian economy.
- University and technical school graduates should have more practical experience before ending their courses. The system where students alternate study and field work for periods of four months seems to be very efficient.

- Because of the complexities of the problems it is recommended that a government/industry/labour task force be established to study improvements in unemployment insurance and manpower programs.
- There are no simple solutions to the complex problems that result from plant shutdowns. Clearly, obsolete plants cannot be subsidized indefinitely. Equally clearly, the human problems must be minimized, as well as the economic problems for the municipalities in which the plants are located, which often are single-industry communities. A high degree of labour/management co-operation is required to ease the very real disruptions that such situations cause, and this must be reinforced by specific government programs to encourage manpower training and mobility.

#### CONCLUSION

The recommendations in this report are designed to strengthen the Canadian economy by improving the ability of its largest manufacturing industry to compete, to attract new investment, and to share in serving the future growth in world requirements for forest products of all kinds. In the opinion of the Task Force, their implementation would greatly increase the contribution of the industry to Canada's future economic development and thus, directly or indirectly, to the welfare of every Canadian.

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**SECTOR PROFILE**

**THE CANADIAN FOREST PRODUCTS INDUSTRY**

Review of the operations of the project is  
conducted by the Board of Directors/Trustees  
and the Board of Directors/Trustees are  
responsible for the management of the project.

There is a clear distinction between the  
roles of the Board of Directors/Trustees  
and the Board of Directors/Trustees. The  
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# THE FOREST PRODUCTS INDUSTRY

## DEFINITION

The forest products sector consists of those manufacturers engaged in the harvesting and processing of Canada's forest resource into a wide variety of wood, paper and other derivative products (SIC Division 5, Major Groups 8 and 10).

## STRUCTURE

### Industry Size and Significance

The forest products industry is one of Canada's leading industrial sectors in terms of sales, employment, export earnings and regional dispersion. Moreover, it is the economic mainstay of numerous single-industry communities located throughout Canada. For some communities, there are virtually no other industrial options. The sector is unique in that it is based on a substantial renewable resource, which in addition to providing the basic raw material for the various wood-using industries, confers significant social and environmental benefits to the country as a whole. It incorporates increasingly high levels of technology, providing a significant market base for Canadian producers of machinery and electronic control systems. Products such as pulp, newsprint, lumber and panels represent significant value added.

In 1974, shipments of the forest products sector amounted to \$12.4 billion, of which 45 per cent, or \$5.6 billion, was exported. Imports of forest products for 1974 totalled \$650 million. The sector's net exports of \$4.9 billion were almost three times Canada's trade surplus in energy commodities in 1974 and close to the expected deficit in the petroleum account forecast for Canada in 1985. The 238,000 workers employed in the manufacturing sector of the industry earned wages and salaries of \$2.6 billion in 1974. An additional 60,000 workers were directly employed in logging operations. For comparison of forest industries with all other manufacturing, see Chart 1.

### Industry Components

This profile focuses primarily on the pulp, paper, lumber and panel products industries which are the major users of Canada's forest resources. The other major components of the forest products industries include the manufactured wood products industries and the converted paper industries.

The 1974 shipments of the forest products industries by product group are as follows:

		Shipments (\$ Million)	Per cent
<i>Group 8</i>			
SIC 251	Sawmills	\$ 2,453	19.8
252	Veneer and Plywood	505	4.1
254	Millwork	893	7.2
256-9	Other Wood Industries	367	3.0
	Total Wood Industries	\$ 4,218	34.1
<i>Group 10</i>			
SIC 271	Pulp and Paper Mills	\$ 5,993	48.5
272-4	Converted Paper Industries	2,151	17.4
	Total Paper and Allied Industries	\$ 8,144	65.9
	TOTAL SECTOR	\$12,362	100.0

Source: Statistics Canada

## Regional Significance

The general operating characteristics, product mix and market opportunities of the forest products industry vary widely across the country. While manufacturing facilities are located in virtually all accessible forest regions in Canada, the forest products industry is concentrated in those provinces with the most abundant economic forest resources.

British Columbia accounts for almost one-half of Canada's softwood annual allowable cut and the forest industry, as shown in Chart 2, is by far the major industrial sector in the province. British Columbia produces about two-thirds of Canada's softwood lumber and the bulk of its softwood plywood. Its pulp and newsprint industries are relatively new, highly integrated and increasingly significant. The forest industry in Ontario and Quebec traditionally has had a strong pulp and paper orientation although production of softwood lumber has grown rapidly in this region over the last decade. Ontario and Quebec currently account for about two-thirds of Canada's total production of newsprint and for about one-half of Canada's total wood pulp and other paper and paperboard. The forest industries in the Atlantic and Prairie provinces, although not dominant in share of total Canadian production, are a major factor in their provincial economies and in the case of New Brunswick, Newfoundland and Nova Scotia, are among the leading industrial sectors in these provinces.

## Regional Forest Resources and Shipments

	<i>Softwood Annual Allowable Cut %</i>	<i>1974 Forest Industry Shipments %</i>
Atlantic	8	9
Quebec	20	28
Ontario	14	6
Prairies	10	6
British Columbia	48	31
CANADA	100	100

Source: *Statistics Canada*

*FLC Reed and Associates Ltd.*

As available timber supplies continue to tighten in existing utilization centres, the potential for further industrial expansion, and in particular newgreen field development will be increasingly limited to the more northern and remote regions of British Columbia and the Prairie Provinces, and to a lesser extent, Quebec and Ontario. The difficulties in attracting and maintaining an adequate work force are likely to become more acute as the industry expands northward.

The impact of regional considerations and federal/provincial relations are described in a section under Issues.

## Integration and Scale

Integration of logging, manufacturing and marketing operations in the forest products industry is accelerating as the industry seeks to reduce fibre costs, improve overall production efficiency and achieve better product and market diversification. Efficiency derives primarily from improved resource utilization, allocation of wood fibre to its most economic end-use, and higher rates of capacity utilization through greater control over the production and marketing functions. Smaller, independent companies are also becoming functionally integrated in fibre supply and co-operative marketing arrangements. While both horizontal and vertical integration is further advanced in British Columbia, movement towards a more efficient industrial structure is also evident in Central and Eastern Canada.

Large-scale operation is also becoming increasingly important, particularly in pulp and paper due to lower capital costs per unit of product, operating efficiencies, environmental regulations, and the need to remain competitive in world markets. For example, the minimum economic size of a new kraft pulp mill has increased from 350 tons per day in 1965 to the current 1,000 tons per day costing some \$300 million. At current capital costs, a new kraft mill requires a capital outlay of \$344,000 per employee, making pulp one of the more capital-intensive industries in Canada. While the trend to larger-scale production facilities and increased integration is well established, particularly with the larger companies, the sector is still

characterized by a large number of non-integrated operations, particularly in wood products. Moreover, many segments of the industry, such as secondary wood manufacturers, remain highly labour-intensive.

### Concentration

Concentration of production varies by product, but in general the industry has remained fairly fragmented over the last decade. The degree of concentration is shown below for the major products.

#### Share of Production by the Top 5 Firms, 1964-74

	1964	1974
Lumber	21%	23%
Newsprint	54%	62%
Market Pulp	44%	30%
Paperboard	67%	60%
Printing and Writing Paper	80%	79%

Source: *Canadian Pulp and Paper Association, Industry, Trade and Commerce.*

The size of individual companies varies widely within the sector. The sawmill industry, for example, is characterized by many firms ranging in size from small independent to large, fully diversified companies. At the other extreme, the more capital-intensive pulp and paper companies tend to be larger in scope, and in many cases, their operations are world wide.

The larger Canadian forest products companies, although large by Canadian standards, are relatively small on an international basis. Of the largest 100 forest products firms ranked according to 1975 world sales, MacMillan Bloedel (Canada's largest forest products producer) was 11th, followed by Domtar 17th, Abitibi-Price 21st, Consolidated-Bathurst 26th and British Columbia Forest Products 68th. The top ten companies in the world are mainly American, several British firms, and all have subsidiary operations in Canada. These Canadian subsidiaries, if included separately, would also figure in the listing of leading companies. Canadian International Paper would rank 23rd, Reed Paper 50th, Crown Zellerbach Canada 61st and Weldwood of Canada 70th.

### Government Involvement

The impact of government policy on the forest industry is extensive. Provincial governments have direct responsibility for the management and use of practically all forest lands within their respective boundaries. Their policies on resource pricing, fibre allocation, environmental guidelines, forest management and industrial development are critical to industry progress and competitiveness. Municipal regulations and taxes also have a significant bearing, particularly when the forest industry is the primary source of revenue in the local community. In addition, the industry is highly exposed to federal government policies in such areas as regional development, the environment, transportation, trade, taxation, energy pricing, and competition.

Total federal expenditures in areas related to forestry and forest industry development are well in excess of \$120 million per year.

### Foreign Ownership

In the sector as a whole, foreign ownership accounts for about 40 per cent of shipments. Most of this control is held by U.S., and to a lesser extent, European and Japanese multi-nationals which have invested for the most part in integrated primary operations, such as wood pulp, newsprint, panel products and lumber. Major takeovers of Canadian controlled companies have not been significant in recent years.

### Raw Material

The forest industry is unique in comparison with other resource-based industries in that its forest resource is renewable and, if properly managed, will provide the base for indefinitely sustained manufacturing activity. More than 80 per cent of Canada's timber reserves are softwoods. Most of the

hardwoods are not suitable for manufacturing given today's markets and level of technology. Because of its importance, Canada's forest resource is described in a section under Issues.

## MARKETS

### Structure

The Canadian forest products industry is highly export-oriented. About \$5.6 billion of product, representing about 45 per cent of all industry shipments, was exported in 1974. The proportion exported is much higher for lumber, pulp and newsprint, of which Canada is the world's leading exporter, than for further processed paper and wood products. These three commodities represent the bulk of the sector's export shipments and generally face minimum trade restrictions in Canada's major export markets although important tariff and non-tariff barriers do exist in some markets.

Further processed paper and wood products generally tend to have more of a domestic orientation and are subject to varying degrees of tariff protection in world markets. In fact, some industry segments such as plywood and fine paper have faced increased import competition from U.S. producers in recent years.

Improving Canada's competitive position in further processed products will require in some cases improved market access and major adjustments in existing industry, manufacturing, marketing and distribution structures, and operating environment.

Despite large volumes of exports, Canadian pulp, newsprint and lumber producers compete in international markets with little, if any, control over the basic economic factors that affect demand in those markets. Commodity pricing is generally responsive to these economic factors, although the captive nature of some Canadian capacity and the trend to longer term supply contracts in pulp and newsprint are also significant.

The impact of cyclical fluctuations in the United States economy is compounded by the residual supply aspect of the Canadian industry. The newsprint industry, for example, is particularly susceptible; the independent producers who account for 60 per cent of Canadian capacity are the first to lose volume in soft markets and the last to regain it during recovery. Newsprint mills in the U.S., publisher-owned Canadian mills, and to a lesser extent, foreign-controlled subsidiaries, all maintain a higher operating ratio during these periods.

Exports are heavily weighted towards the U.S. because of proximity and market accessibility, but opportunities for major export sales, mainly pulp and lumber are developing in Japan, Western Europe and other offshore areas. These offshore exports will be of significant long-term benefit to the Canadian industry. The highly cyclical characteristics of traditional markets in North America have led to distortions in industry performance and have demonstrated the importance of market diversification for bulk commodity products.

Recent forecasts indicate a slackening of the rate of growth in world demand for all forest products because of reduced population growth and overall economic performance, particularly in the industrialized countries. This means that the average annual growth in world pulp and paper consumption, which was about 5.5 per cent in the 1960's will likely be reduced to about 3.5 per cent between now and 1990. World consumption of newsprint, lumber, plywood and other structural wood products will likely experience more modest rates of growth, at two to three per cent per year over this period.

### Ratio of Exports to Total Shipments for Selected Forest Products, 1974

	Total Shipments (\$ Million)	Exports	Percentage Exported
Lumber	\$1,878	\$1,290	69
Plywood	311	62	20
Manufactured Wood Products	1,260	81	6
Market Pulp	2,205	1,865	85
Newsprint	1,855	1,726	93
Other Paper and Paperboard	1,371	389	28

Source: Statistics Canada

## Competition

Canada's share of world forest products exports declined from 25 per cent in 1961 to 19 per cent in 1974 due to increased export capabilities of other countries, such as the United States, Scandinavia and certain developing countries. The capacity for domestic supply has also tended to increase in many industrialized regions and in certain developing regions. As illustrated in the following table, Canada's share of world production in the protected grades, wood-based panels and "other paper and board" are significantly below that for lumber, pulp and newsprint which are dominant export products.

### 1974 World Production

	Plywood		Softwood Lumber		Wood Pulp		News-Print		Other Paper and Board	
		%		%		%		%		%
	'000 Cu. Metres				'000 Metric Tons					
Canada	2,085	6	31,034	9	19,214	15	8,661	38	4,379	3
U.S.	15,172	41	56,177	17	43,746	36	2,924	13	49,215	38
E.E.C.	1,634	5	15,864	5	5,826	5	1,685	7	21,836	17
Japan	7,443	21	32,513	10	10,017	8	2,237	10	13,412	10
U.S.S.R.	2,160	6	101,500	31	8,182	7	1,334	6	6,862	5
Other	7,656	21	89,968	28	33,050	28	6,091	26	33,803	26
WORLD TOTAL	36,150	100	327,056	100	120,035	100	22,928	100	129,507	100

Source: Food and Agricultural Organization

The Canadian industry faces competition from local producers in foreign markets (international trade accounts for only ten to 15 per cent of world consumption), as well as from exporters in the United States, Scandinavia, the U.S.S.R. and to a lesser extent, developing countries. Competition from developing countries is expected to intensify in the future as many countries in Southeast Asia and Latin America have undertaken a concerted drive over the last decade to more fully develop their sizable forest resources, often with considerable assistance from international aid organizations.

## ISSUES

### Competitive Situation

#### World Resources

Softwood species account for about three-quarters of the wood used in the manufacture of forest products throughout the world due to the concentration of production facilities in the industrialized and softwood-predominant northern hemisphere and also to inherent economic and physical advantages of softwoods over hardwoods. The economic availability of global softwood supplies to satisfy a growing world demand, particularly for structural wood products is expected to continue to tighten in the foreseeable future.

The three major softwood producing regions in the world are the U.S.S.R., North America and Europe as set out in the following table.

	Annual Growth Increment			Annual Production of Industrial Roundwood (Average 1969 to 1973)
	Softwood	Hardwood	Total	
Canada	13	3	8	9.1%
United States	21	17	20	25.2%
Latin America	1	29	14	3.9%
Africa	—	8	4	3.2%
Europe	15	11	14	20.5%
U.S.S.R.	38	21	29	22.8%
Asia and Pacific	12	11	11	15.3%
	100%	100%	100%	100.0%

Source: Industry, Trade and Commerce

Note: Comparative estimates of annual growth increment, although only approximate, provide a more meaningful indication of the annual volume available for harvest than does inventory of standing timber.



The Canadian forest industry has a strong resource base and is in a favourable position to supply increased long-term demand for products using softwood fibre. The cost of harvesting this resource, especially in the undeveloped Canadian forest regions, however, has escalated rapidly in recent years and has become a dominant factor determining the future growth prospects of the industry in Canada.

In the United States, particularly in the southern regions which account for about one-half of the country's annual timber growth, available softwood timber volumes have the advantage of access, more favourable terrain, established infrastructure, more productive forest land and a high potential for increasing the forest yield through intensive forest management. Despite these advantages, however, the industry in the United States is facing strong competition for alternative uses of its forest land, rising land costs, and the United States will likely depend on imports for an increasing proportion of its domestic requirements.

The other major softwood producing area of the world, Western Europe including Scandinavia, has comparatively high wood costs and is approaching the upper limit of resource capability to meet growing industrial requirements despite an impressive record in intensive forest management.

The U.S.S.R. controls more than one-third the world's softwood growth but is a major world supplier only of lumber and roundwood. Its potential for increased supply of all forest products in world markets is limited because of growing domestic requirements and the necessarily high development costs in Siberia and the Far East where most of its undeveloped resources are located.

Regions in Latin America and Asia similarly offer potential for low cost, large volume industrial wood enabling increased forest development. These comparatively low wood costs are however, offset somewhat by the high costs associated with developing basic infrastructure in these regions. Although a high proportion of Latin American forests are at present unusable hardwood species, governments and multinational companies are rapidly establishing softwood plantations, harvestable within 15 to 20 years. In addition, the quality advantage obtained from Canadian tree species is being steadily reduced by technological developments in the use of lower grade fibre.

#### *Productivity and Costs*

The competitive position of Canada's forest industry is determined by the productivity and cost performance of Canadian producers relative to other major competitors. This is particularly significant vis-à-vis U.S. manufacturers who have a built-in transportation cost advantage over Canadian suppliers and ready access in the dominant U.S. market. Moreover, the U.S., with a high proportion of newer plant capacity combined with inherently lower cost structures has become a formidable competitor in offshore markets and even in the Canadian market for some forest products.

The Canadian industry has some fundamental competitive strengths including experienced and skilled personnel at all levels, strong technological capabilities, relatively large-scale facilities in pulp, newsprint and to a lesser extent lumber and plywood operations, a sizable and developed timber base, established marketing and distribution organizations and increasing levels of integration.

Notwithstanding these positive industry characteristics, comparisons of productivity and cost indicate that some major forest industry sectors are not competitive with their counterparts in other producing regions. Many existing mills were built more than 25 years ago, and these have to be consistently maintained and upgraded to keep pace with productivity and cost improvements being made elsewhere. An older mill does not carry a heavy burden of capital-related expenses but this advantage is often offset by lower efficiency and higher maintenance and operating costs.

Sector cost comparisons are set out below. New and ten-year-old pulp and newsprint mills in Eastern Canada are compared with new mills in the U.S. South, the main region of competition. These comparisons indicate that new capacity is considerably less profitable in Eastern Canada than in the U.S. South. On the other hand, a ten-year-old mill can be as profitable as a new U.S. mill largely due to low capital charges. The B.C. Coast and Interior softwood plywood industries are compared with their counterparts in the U.S. Pacific Coast region. While the B.C. Coast industry has a relatively high cost structure, the Interior producers compare favourably because of low wood costs. The direct cost of producing softwood lumber varies widely across North America because of the great diversity in wood costs, sawing methods, plant scale and vintage. Manufacturing costs (net credit for chip sales) for a typical dimension lumber mill range from \$120 to \$160 per thousand board feet. In general, sawmills in the B.C. Interior and the U.S. South are in the lower part of this range while Eastern Canadian sawmills are in the upper part of the range.

### Comparative Pulp and Newsprint Manufacturing and Distribution Costs, 1976\*

	NEWSPRINT			BLEACHED KRAFT PULP		
	U.S. South	E. Canada	E. Canada	U.S. South	E. Canada	E. Canada
	New Mill	New Mill	10-Yr. Mill	New Mill	New Mill	10-Yr. Mill
	<i>(Per Cent of Sales Dollar)</i>			<i>(Per Cent of Sales Dollar)</i>		
Selling Price (3rd Quarter 1976)	100.0	100.0	100.0	100.0	100.0	100.0
Mfg. Costs						
– Wood	14.0	24.6	24.6	20.8	31.9	31.9
– Purchased Chemical) Pulp)	12.6	13.0	13.0	–	–	–
– Labour	7.4	9.1	9.8	6.4	6.9	7.2
– Energy	15.8	14.0	13.3	7.8	6.4	7.0
– Other	5.6	7.0	7.3	12.5	13.9	14.4
	55.4	67.7	68.0	47.5	59.1	60.5
Overhead, ) Selling) Admin. )	5.6	6.3	6.3	4.4	5.0	5.0
Transportation	5.3	12.3	12.3	4.2	8.3	8.3
Capital-Related	20.4	24.9	8.1	23.9	29.2	6.7
Pre-Tax Earnings	13.3	(11.2)	5.3	20.0	(1.6)	19.5

Source: *Industry, Trade and Commerce*

\*Calculated on the basis of \$1 Cdn. = \$1 U.S.

### Comparative Softwood Plywood Manufacturing Costs, 1975

	U.S.	B.C.	U.S.	B.C.
	Pacific Coast <i>(Sanded/Sheathing)</i>	Coast	Pacific Coast <i>(Sheathing)</i>	Interior
Mfg. Costs				
– Labour	100	148	100	120
– Wood	100	112	100	48
– Resin	100	118	100	142
– Energy	100	133	100	91
Interest and Depreciation	100	126	100	100
Overhead and Administration	100	143	100	159
Total Costs	100	128	100	91
Net Selling Price	100	128	100	124

Source: *Price Waterhouse & Co.*

Major cost disadvantages also exist with the other paper and board grades, where the markets are mostly domestic and where fragmentation and small scale of operation significantly diminish performance. The fine paper industry is a case in point and requires urgent attention.

Although Canadian companies are at a disadvantage in transportation, labour and other cost categories which reflect mill efficiency, wood costs are the most significant. They represent about one-half to two-thirds of manufacturing costs for lumber and about one-third of plywood, pulp and newsprint costs. The following table provides a range of world pulpwood costs by province and region.

**Delivered Pulpwood Costs by Region, 1971-76**

(\$/Cunit)	1971	1976
B. C. Coast (chips and roundwood)	22	50-60
B. C. Interior (pulp chips)	17	35-45
Alberta	26	35-40
Ontario	40	60-90
Quebec	38	55-80
Atlantic Provinces	30	50-60
Newfoundland (excluding Labrador)	35	70-80
Canada	35	35-90
U.S. South	35	45-55
Sweden	42	90-110
Brazil	NA	30-45
Southeast Asia	NA	35-50

Source: *Industry, Trade and Commerce*

*Management, Manpower and Labour*

Although not dynamic by reputation, Canada's forest industry management is experienced and generally competent in comparison with the management of major competitors. A general criticism in the past has been a strong production orientation and a lack of forward planning and aggressiveness. While this image may have been detrimental to the industry in the financial community, there has been progress towards better budgeting, financial control, planning and marketing.

Although a large portion of the labour force is competent, highly trained and among the best paid in the world, the industry faces high turnover, recurring labour shortages and increasing skill requirements in their manufacturing and harvesting operations. These problems are particularly acute in isolated communities and in woods operations. Many of the manpower difficulties relate to the hiring and retention of workers and reflect relative wage rates, working conditions and quality of life in the community. While it is anticipated that manpower requirements in the forest industry will grow moderately (three-five per cent) over the next five years, reflecting continuing productivity improvements and lower rates of growth in industrial output, future expansion may be limited unless the problems associated with seasonal and cyclical work and lack of amenities in the outlying areas are resolved.

Strained labour-management relations have become a critical issue, both within Canada's forest products industry and in those industries on which the forest industries are dependent. The significant number of man-days lost due to strikes, lockouts and related labour-management problems which reached epidemic proportions in 1975 and 1976 creates uncertainty about the reliability of Canadian supply and could seriously affect our export position and employment over the longer term. The high incidence of work stoppages has resulted, in part, from the generally high level of worker expectations and forceful union leadership vis-à-vis the financial capabilities of the forest industry sectors to support significantly higher labour costs and maintain their position in the market. In comparison with other industrial countries, there seems to be considerable scope for the reconciliation of worker and management attitudes and industry objectives in the Canadian forest industry. Both labour and management have placed a high priority on finding ways and means to reduce industrial conflict and to improve the process by which collective bargaining is conducted in the industry. Based on the preliminary stages of the current round of bargaining, it would appear that there has been considerable improvement in the industrial relations climate in the industry.

### *Research and Development (R & D)*

Research and development in the forest products industry is an essential ingredient for longer term increases in productivity and profitability. While benefit cost analyses have been difficult to apply, there are a number of examples of R & D projects such as small log-processing systems that have greatly contributed to industry development. In general, the quality and level of research in the forest products sector can be improved significantly through greater co-ordination of effort, the establishment of specific objectives, and greater emphasis on R & D within the framework of government programs.

Research on pulp and paper is carried out by the Pulp and Paper Research Institute of Canada (an organization financed primarily by member companies of the Canadian Pulp and Paper Association) as well as by individual companies and machinery suppliers. A great deal of applied research is also carried on in the woods and mills by operating and maintenance people who not only conduct formal pilot studies but also work continuously to innovate wherever opportunities can be found. Pulp and paper is a high technology industry and Canada has been among the world leaders in the development of new technology in the past. R & D spending in recent years, however, has not kept pace with inflation, increased sales or expenditures by other countries as many Canadian companies have sharply reduced their research budget and staff since 1971 for austerity reasons. Consequently, R & D expenditures as a proportion of pulp and paper sales has fallen from more than 0.8 per cent in 1967 to less than 0.4 per cent in 1974, whereas expenditures in the United States have been maintained at the 0.8 per cent level. Moreover, pollution abatement has consumed an increasing portion of available resources for research and development with little if any contribution to profits.

In addition, while the industry has been active in adapting major technology improvements, either of Canadian or foreign origin, there is further potential for commercial application of new developments in Canada. The close affiliation between equipment manufacturers and operating and research personnel of pulp and paper companies in Scandinavia and to a lesser extent in the United States, is a significant factor in the successful commercialization of technology in those countries.

Wood products research is particularly fragmented and is limited to a few large companies, machinery suppliers, trade associations and federal laboratories. While there is a need to improve and consolidate R & D efforts in the wood products field, Canadian equipment suppliers and producing companies have remained in the forefront in the development and application of new processing technology. Research in mechanized logging and transportation systems to reduce delivered wood costs is being undertaken by the recently established (1975) Forest Engineering Research Institute of Canada which is jointly funded by the federal government and industry.

Priority areas for research and development and its commercial application in the forest industries include the development of new pulping methods, smaller scale operations, automatic control systems, energy and pollution adjustments, reduction of wood costs, transportation systems and product standards. Changes in market demand and available fibre supplies will also require a greater R & D involvement in the area of new product development and new end-use applications for existing forest products. The ability to specialize in certain market segments has become increasingly important to the smaller companies in the industry.

### *Transportation*

The cost of transportation is an important factor in the competitive position of the Canadian forest products industry in domestic and international markets. As a percentage of delivered price, it usually varies between ten per cent and 40 per cent, depending on product. The industry is, therefore, highly dependent upon an efficient rail, highway and water transport system, including adequate equipment and terminal facilities to move its raw materials and products at competitive rates and with reasonable delivery schedules.

About half of Canadian forest products are shipped by rail, mostly to U.S. markets and the remainder goes by water and truck. Forest industries account for about 20 per cent of the total freight volume hauled by the Canadian railways and are their largest single source of revenue.

In some cases, international joint rates for both truck and rail are higher from Canadian origin to U.S. destination on a cost per ton mile basis than within the United States. Appeals against the level of rates are subject to the jurisdiction of the separate regulatory authorities in each country and perhaps there is some merit for establishing some formal joint consultative mechanism. On domestic shipments, the CTC has been slow to resolve rate problems, making it impossible to resolve other related issues.

### *Taxation*

A study of taxation practices related to the pulp and paper industry was undertaken by Price Waterhouse & Co. for the Government of Canada in 1973. It analyzed the impact of the total tax burden on the pulp and paper industry in Canada, the United States, Sweden and Finland and concluded that the overall Canadian tax system imposes a significantly higher burden than in other jurisdictions. The consultants qualified this conclusion because of limitations inherent in their analysis and because the study applied only to direct tax burdens and not to the total fiscal, regulatory and assistance environment in which the industry operates.

The relatively adverse impact of the Canadian tax system was due in large part to the comparatively heavy burden of sales taxes, municipal real estate taxes and capital taxes. In comparison with other jurisdictions, these taxes imposed an inflexible burden on the Canadian industry's cost structure which was particularly disadvantageous in years of low profits or major capital expansion.

Reported profits in the U.S. industry were especially assisted by the immediate tax advantages available under the capital gains treatment afforded a portion of timber income, the effect of the investment tax credit and DISC rules.

In the last few years, however, there have been beneficial changes in Canadian income tax legislation for industry investment. These include accelerated capital cost allowances and the investment tax credit; the latter was not in place at the time of the study. Also, the deduction of three per cent of opening inventory values assists the industry in offsetting the effects of inflation.

### *Summary*

The successful development of export markets for bulk commodity forest products has enabled Canadian producers to expand and to achieve economies of scale and specialization that would not have been forthcoming if operations had been restricted to the smaller domestic market. This strong export orientation has, of course, subjected the sector to the strong discipline of international competition. While significant progress towards an efficient industry structure has been made in recent years, it is clear that further improvements in manufacturing efficiency and productivity performance will be required to offset the increasing cost disadvantages outlined above and to achieve a better balance between existing conversion capabilities and available fibre supplies. For some product sectors, such as fine papers, that have more of a domestic market orientation, reorganization or restructuring of existing operations on an industry wide basis is essential if they are to remain viable over the longer term. The achievement of effective rationalization in these product sectors requires accommodation under the proposed changes in Canada's competition policy.

## **INVESTMENT AND RETURN**

Although investment and profitability in the forest industry are closely related to the industry's competitive position, particularly its productivity and cost structure, the various aspects of this issue are set out separately.

As illustrated in chart 3, total industry capital expenditures have increased erratically in current terms during the period, but overall investments in pulp, newsprint and a large segment of the plywood industry have declined in real terms. Investment in the capital-intensive pulp and paper industry in recent years has been concentrated on harvesting equipment, pollution abatement, and increasing capacity of existing mills through machine speedups and equipment replacement rather than on the construction of new mills. There has been a significant increase in productive capacity in lumber and wood-based panel products since the early 1970s, in many cases with government support, but much of this increased capacity results from an attempt to reduce costs through integration with pulp manufacture and improved utilization of residual byproducts. In terms of future capital investment intentions, there have been recent and encouraging indications of large scale corporate modernization programs within a number of key Canadian forest industry firms.

As illustrated in chart 4, return on capital employed (defined as net profit after tax as a per cent of long-term debt plus equity) for the total forest industry sector has fallen well below the Canadian total manufacturing industry average in all years since 1965. Moreover, the cyclical aspects of market price and demand result in considerable yearly fluctuations in profits and returns. The improved performances in 1973 and 1974 were largely offset by the impact of inflation on inventory and fixed asset replacement.

Canadian forest industry profits are also significantly below those of the industry in the United States. Between 1962 and 1975, the average annual return on equity for the sector in Canada was 8.6 per cent, while in the United States the comparable figure was 10.1 per cent.

Problems associated with investment have contributed to losses in relative productivity, high costs and foregone markets. Inadequate and uncertain rates of return have compounded the problem by generally retarding the flow of capital into the industry. The erratic nature of earnings adds significantly to uncertainty in the areas of planning, development and investment. Substantial levels of investment are required to maintain a competitive position and to provide for sound industrial development.

Escalation of capital costs and, in the case of the pulp and paper industry, the size of single mill investments have also contributed to declining investment. A kraft mill of economic size may cost \$300 million today compared to \$60 million less than a decade ago when economic sizes were smaller. These single large investments are not only risky from the point of view of continued corporate solvency but are also difficult to finance, especially with the size of competing requirements anticipated in capital markets. In addition, the scale of new production can present major marketing problems.

Economic mill sizes in the pulp and paper industry are increasing (1,000 tons per day for a pulp mill is now recognized as the minimum economic size) and a reduction in this size is a major objective of R & D in the industry. Scale of operation in sawmilling, on the other hand, is important but far less critical.

The rapid escalation of capital costs has created a structural shift in the return on investment process, particularly within the pulp and paper industry. With rising product prices, the older facilities providing they are efficient, yield higher returns on their relatively lower book values than do newer, more expensive facilities. This partly explains the decline in investment for new mill and major replacement facilities and the emphasis on upgrading existing facilities. The benefits of investment in existing facilities are (1) greater returns from productivity improvement and reduced operating and maintenance costs and (2) new capacity increments at lower capital costs and in amounts which more reasonably correspond with increased market demand.

Estimates of the capital requirements for modernization of the pulp and paper industry can differ widely, depending on the extent of the program envisaged. The Department of Regional Economic Expansion and several provinces are currently examining this question but the results of these studies are not yet available. An update of an earlier estimate by the Department of Industry, Trade and Commerce indicates the cost of implementing known opportunities for modernization and associated incremental capacity expansions may be \$1 to \$1.5 billion in 1976 dollars. It is important to note that this does not include replacement of mills or major equipment. In addition, total capital cost for the pulp and paper industry to meet federal air and water pollution abatement guidelines was estimated at about \$1.25 billion in 1976. In practice, modernization and pollution abatement are often inseparable, and the actual method employed may alter the cost distribution between the two. The total cost of \$2.25 to \$2.75 billion in 1976 could be regarded, however, as a minimum. It is hoped that the more detailed studies now under way will indicate whether the expected return could justify greater investment in the modernization of the Canadian pulp and paper industry.

In addition, the pulp and paper industry, which is the largest single consumer of purchased energy in Canadian manufacturing, has pledged to reduce its outside purchases of energy by 12 per cent by 1980, and that will require substantial capital expenditures in energy conservation projects.

Industry spokesmen have indicated the difficulty in financing externally and suggest that heavy reliance will have to be placed on retained earnings, capital cost allowances, and measures that might enhance their ability to raise capital. Industry capital structures are heavy to debt and short term financing is excessive.

Although there have been statements of lack of confidence on the part of industry because of its weakening competitive position and because of uncertainty arising from changing government policies as well as the general economic climate, recent policy statements by governments would suggest an increasing emphasis on stability and improvement of the economic environment. The need for this emphasis is underscored by the fact that Canadian and foreign firms with investments in Canada have indicated their intentions to acquire new capacity, particularly in upgraded products outside of the country or to avoid Canadian investment in new facilities in certain industry sectors, such as newsprint and other paper grades. The Canadian fine paper industry has not invested in a single, new paper machine in the last decade and there is no indication of new capacity in the foreseeable future.

The trend to invest outside of Canada, particularly to improve the industry's foreign market position, may strengthen and diversify certain Canadian firms. It is recognized, however, that major movement of investment capital outside of the country would have unfavourable implications at this time with respect to employment, balance of payments, regional development, resource utilization and the tax base. These considerations reinforce the importance of maintaining a suitable investment climate in Canada.

Variation in the rate of exchange in the Canadian dollar, particularly vis-à-vis the U.S. dollar, significantly affects sales and profits of the Canadian forest industry. The recent downward adjustment provides some relief from competitive pressures and expands the opportunity for increased investment from higher cash flows. At the same time, this advantage in world markets could be eroded over the longer term through rising costs.

## **Forest Resources**

Canada's forest resources provide the base for sound industry growth and are critical to the sector's future but must be viewed in light of the serious forest management problems that are emerging across the country.

There is a growing concern in Canada that the economic availability of timber could pose a real constraint to future development of the industry despite the presence of a sizeable apparent surplus timber reserve. Canada's annual allowable cut, which sets the upper limit of timber available for harvesting under the principles of sustained yield management, has been calculated at about nine billion cubic feet. This compares with an annual harvest of about five billion cubic feet. However, much of this apparent surplus timber reserve is located in remote areas distant from existing infrastructure and processing facilities and would be uneconomic to harvest at present cost/price levels, or consists of low grade species such as poplar that, for a number of reasons, have not been fully utilized. Local supplies of timber, particularly in the large diameters and upper grades, are becoming increasingly tight in many producing regions across the country.

A significant part of the more accessible forest land is inadequately stocked due to the failure of logged and burned-over land to regenerate itself properly. Vast amounts of timber are also lost through disease and insect infestation, particularly the spruce budworm in Eastern Canada.

Moreover, the basic resource information on which allowable cuts are calculated is in many cases outdated, inaccurate, or incomplete and there is little if any consistency or comparability of available data across the country. Principal deficiencies are lack of data on timber quality and growth, losses due to fire, insects and disease and economic accessibility. Such information is essential for effective long-term planning in forest management and industrial development.

On a more positive note, there is believed to be considerable scope for extending timber supplies through better utilization of existing stands and improving access to the more remote areas. But the greatest potential for increased output from Canada's forest land may lie in more intensive management practices. Among these are rapid regeneration of cutover and burned acreages, juvenile spacing, fertilization and protection from insects, disease and fire. Competing softwood regions in the United States, Northern Europe and elsewhere are investing relatively large sums in their forests.

Transition from exploitation to intensive forest management has been a slow process in Canada but most provinces with the aid of DREE sub-agreements are devoting more funds to forest protection and regeneration programs. However, substantial and more consistent forestry investments of manpower and financial resources are required over and above current levels if forest resources are to continue to be a major source of income and employment in Canada.

In addition to the industrial use of Canada's forest resource, there are growing demands for non-industrial uses such as recreation and a greater appreciation of the environmental and social aspects. These factors have increased harvesting costs and have resulted in withdrawals of prime forest land from industrial use, further diminishing the industry's resource base. The solution to this dilemma lies in policies which encourage multiple or sequential use of forest land.

Forest land ownership in Canada is heavily weighted towards provincial Crown ownership with 90 per cent of the non-reserved forest land allocated to wood production. Private ownership is only important in the Atlantic provinces and southern Ontario and Quebec. Federal forest lands are located for the most part in the far North.

The various tenure arrangements that have evolved across Canada have been a prime vehicle for implementing the forest management and industrial development policies of the various provinces. Present provincial forest management policies and corresponding systems of timber allocation are currently under review in most provinces in Canada. The trend is definitely toward greater participation of provincial governments in the management and administration of forest land than in the past and in some cases a more direct control over the allocation of wood and wood residues to the various wood-using industries. While the stated objectives of these major policy changes are to improve the level of forest management on Crown



land and to obtain a greater return from provincial forest resources, the uncertainty created by a sudden change in policy direction has the potential to adversely affect business confidence and investment in the forest products sector.

### **Regional Considerations and Federal-Provincial Relations**

The forest industry, with its unique characteristics, offers an excellent vehicle for achievement of regional development objectives.

The provincial governments have the responsibility for the forest resources including allocation of wood fibre supplies and requirements for forest management activity. There are considerable variations in policy objectives, relative resource strengths and characteristics of the forest industries between provinces.

The federal government is closely involved in many government policies which are particularly critical to forest industry development including trade, industrial development, fiscal, monetary, regional development, competition, environmental and transportation policies.

This sharing of the responsibility for the basic elements of government policy towards the forest industry requires close co-operation between the provinces and the federal government. Implementation of federal government plans affecting the forest industry will in most cases require provincial co-operation and recognition of provincial priorities. A number of provinces place special emphasis on social and economic aspects of forest industry development based on primarily local issues. For these reasons, there are benefits from bringing provinces together for exchanges on policies and procedures, and there are areas where joint federal-provincial activities are useful.

There are consultative mechanisms in place involving all provinces and on the federal side, primarily the Departments of Industry, Trade and Commerce, Regional Economic Expansion and, Fisheries and Environment. The Federal/Provincial Forest Industries Development Committee (FIDC) was established in 1974 and consists of officials of provincial departments and of seven federal departments. The objective is to encourage and facilitate an exchange of views on policies affecting the forest industries, and projects include a pilot study on the rationalization of the New Brunswick forest industry.

There have been extensive consultations on forest industry concerns across Canada, both formally and informally, through the FIDC, the regionally balanced Forest Industries Consultative Committee, and with many industry associations and companies.

A federal-provincial Council of Resource and Environment Ministers (CCREM) includes the Department of Fisheries and Environment and is examining the feasibility of a national forest policy.

### **Trade Situation**

A growing world and domestic demand for forest products, coupled with diminishing world softwood timber supplies and a Canadian base of resources and industrial strength, provides longer term opportunities for growth. The United States will continue to be our major market, but diversification to Western Europe, Japan and other offshore markets will help to avoid cyclical distortions which occurred during past years.

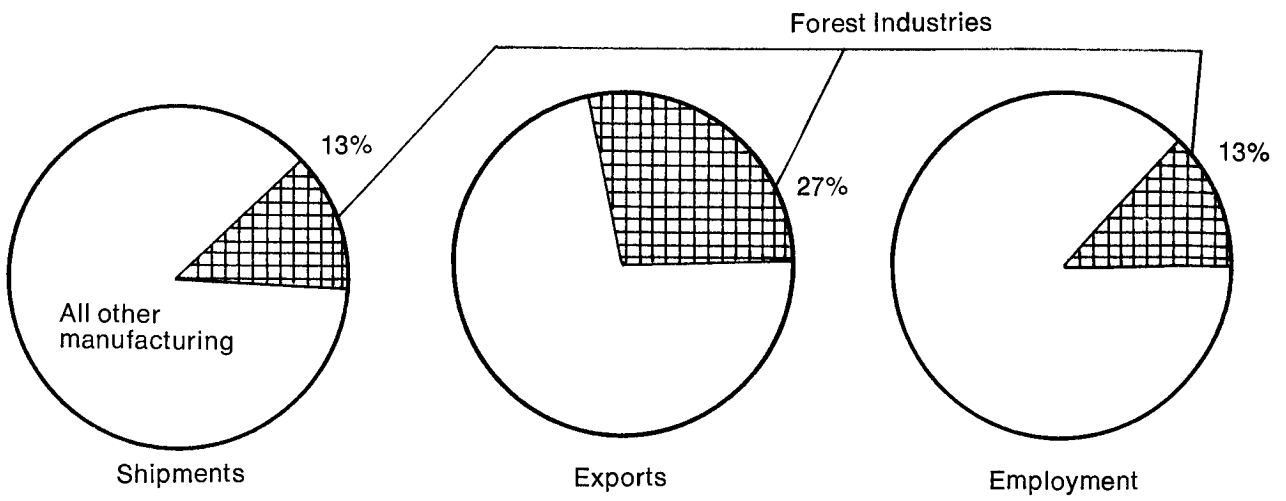
Notwithstanding this increasing demand for forest products in world markets, future rates of growth in consumption in the industrialized countries are expected to be considerably below those of previous years. There is some uncertainty about the Canadian industry's ability to maintain its share of these markets.

Various promotional instruments have been used in developing and diversifying markets abroad for forest products. While pulp and paper sector requirements tend to be related to marketing services, technically based promotional efforts in offshore markets and in the United States have been particularly effective in the lumber and plywood sectors. These initiatives are significant in providing an expanded market base on which to develop new production capacity. Most notable is the Co-operative Overseas Market Development Program which is jointly funded by the Department of Industry, Trade and Commerce, the Province of British Columbia and the Council of Forest Industries of B.C. A prime consideration in Eastern Canada is the development of marketing co-operatives or consortia which will enable the smaller to medium-sized companies to participate more effectively in export markets.

For lumber, pulp and newsprint, foreign trade barriers are generally minimal, although there are important exceptions such as Japanese tariffs on whitewood lumber, pulp and newsprint. Major problems are also created by non-tariff measures such as building codes and standards and product specifications. Tariffs on plywood and 'other paper and board' generally range between five and 20 per cent and preclude or hinder exports in major markets.

Elimination or reduction of remaining tariff and non-tariff barriers in the current round of multinational trade negotiations would benefit the pulp, lumber and newsprint industries. For some domestically-oriented forest products such as plywood, fine paper, and boxboard, reductions of Canadian tariffs would require major adjustments in industry structures and employment patterns. The degree of which these adjustments are successful in improving the internationally competitive position of these industries over the longer term will depend on the success of resolving the underlying structural problems referred to above and the nature of adjustment policies by governments. Providing certain of these sectors with assured access to larger markets will contribute to improved efficiency by enabling larger scale operations, but this must be accompanied by appropriate industry restructuring with emphasis on productivity improvements.

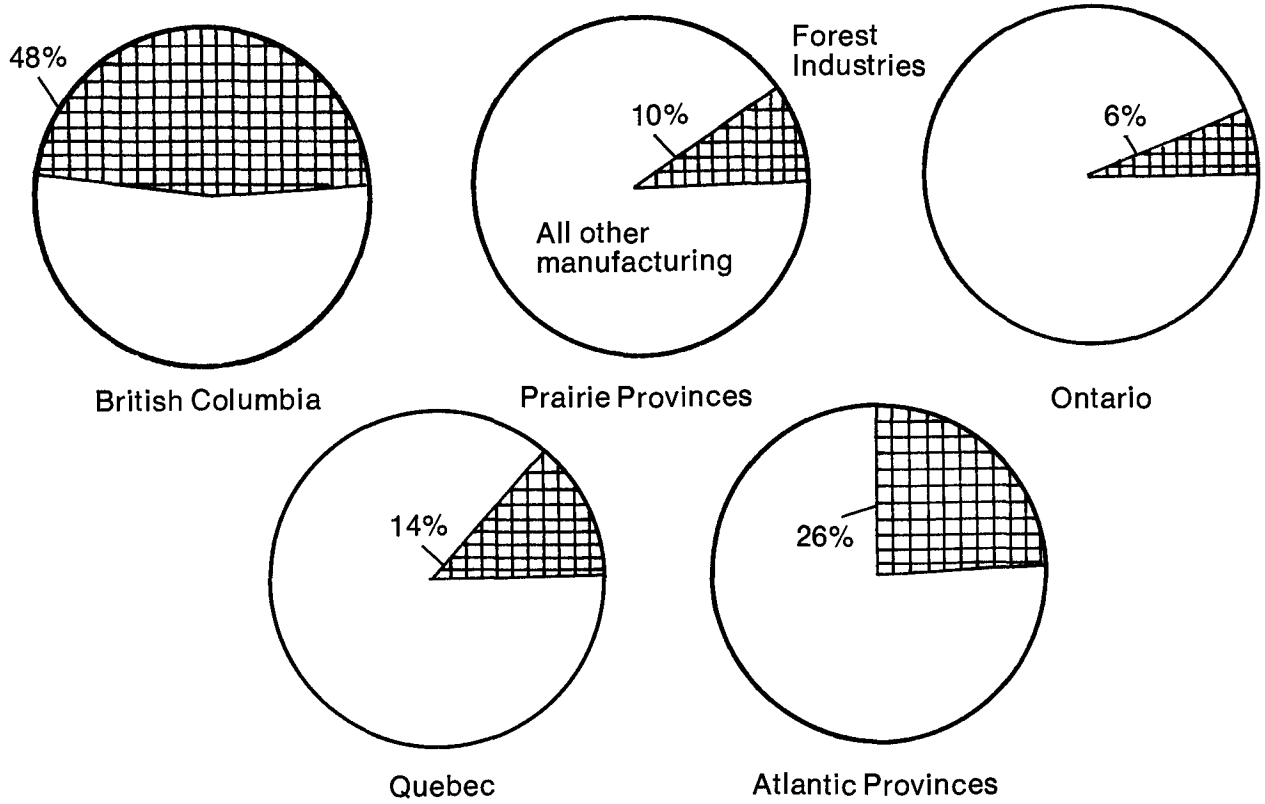
**CHART 1**  
**NATIONAL SIGNIFICANCE OF FOREST INDUSTRIES**  
Sector as share of total manufacturing 1974



## CHART 2

### REGIONAL SIGNIFICANCE OF FOREST INDUSTRIES

Sector as share of manufacturing shipments 1974



**CHART 3**  
**CAPITAL SPENDING BY FOREST**  
**INDUSTRIES 1962-1976**  
(\$ million)

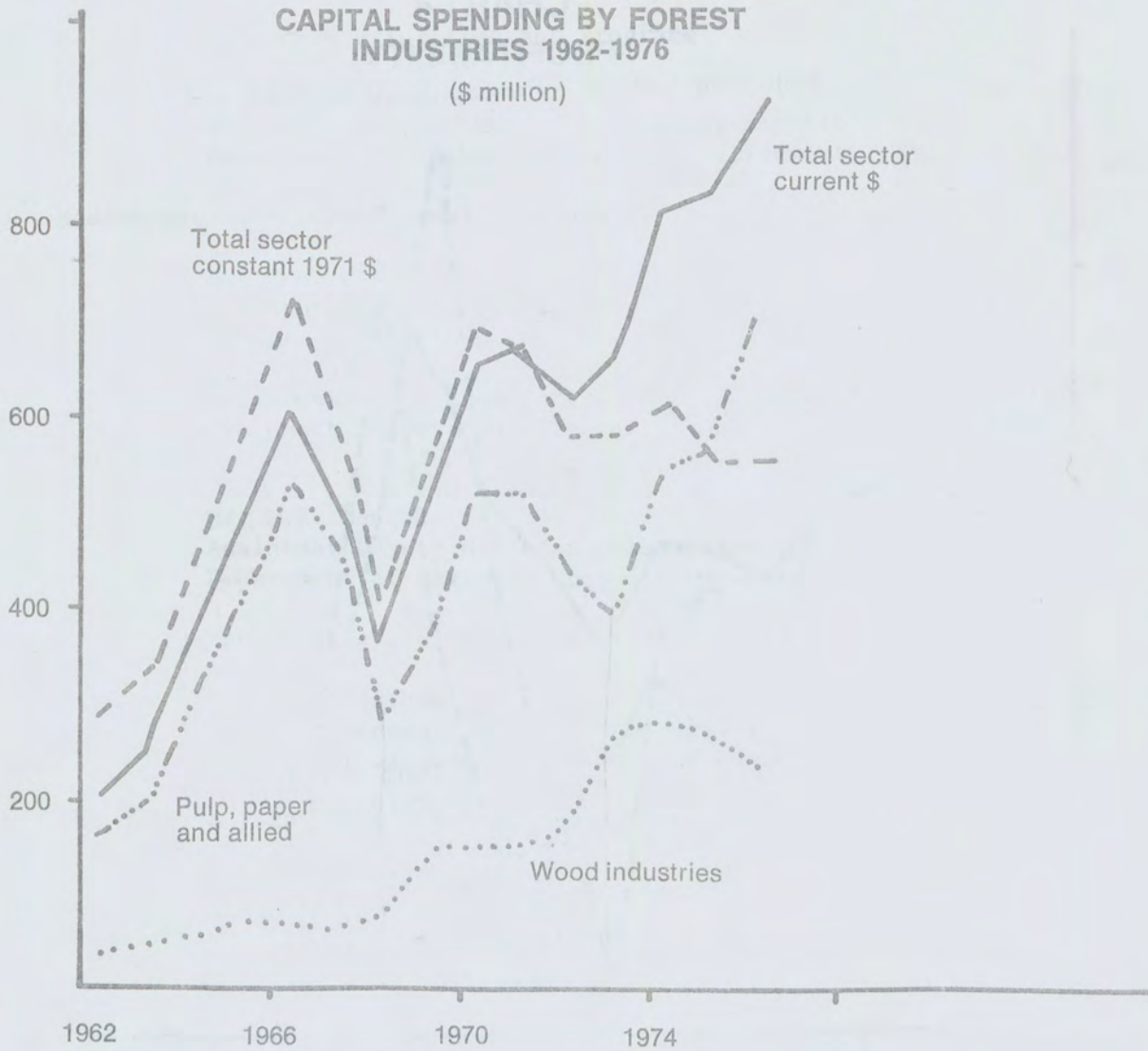
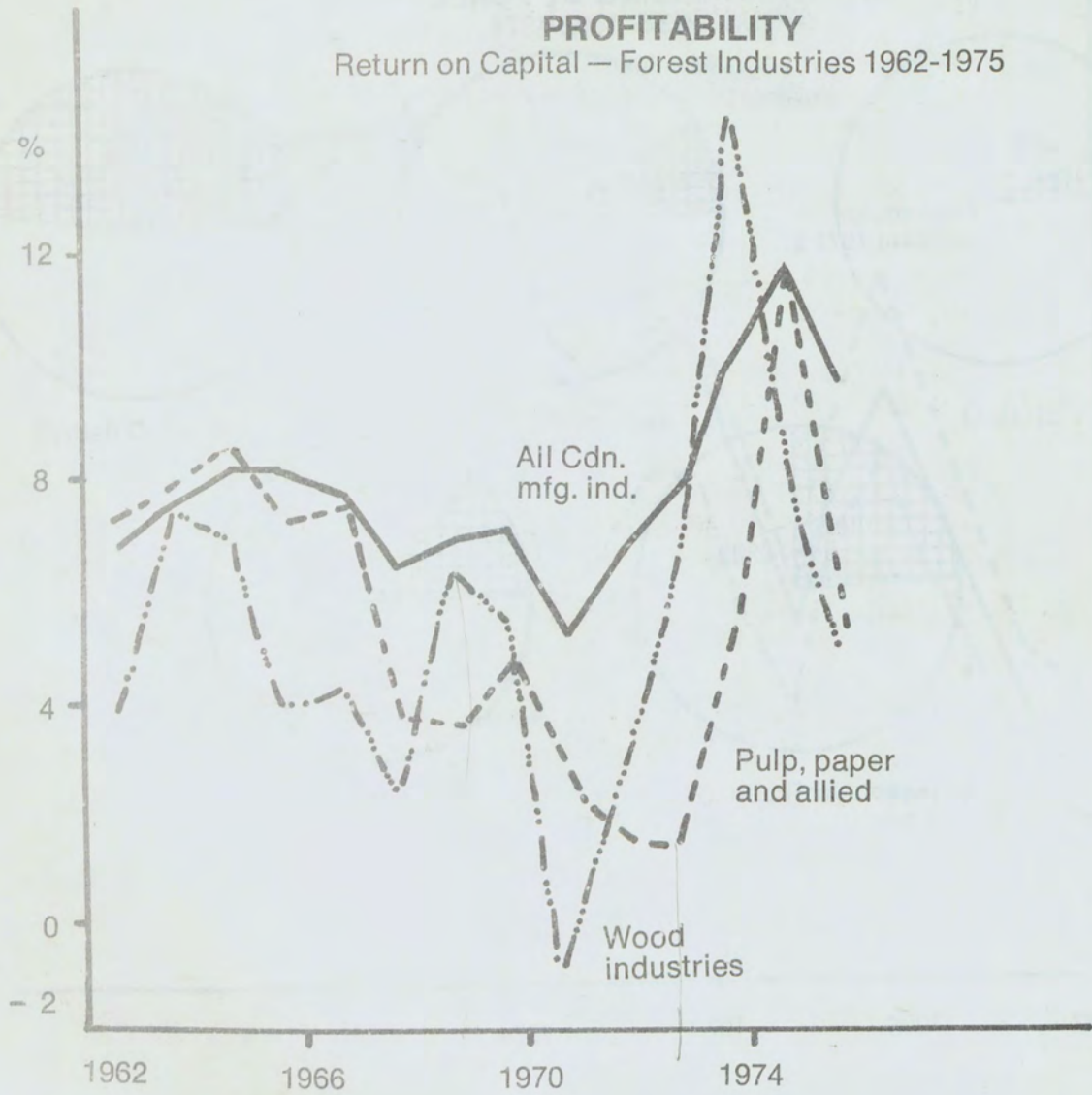


CHART 2

### CHART 4

### PROFITABILITY

Return on Capital — Forest Industries 1962-1975



List of Presentations

1. Competition Policy

Mr. R.J. Bertrand  
Assistant Deputy Minister, Bureau of Competition Policy and  
Director of Investigation & Research  
Department of Consumer and Corporate Affairs

2. Forestry Research - Priorities and Programs

Dr. R.J. Bouchier  
Director General, Canadian Forestry Service  
Department of Fisheries and the Environment

3. Medium and Long Term Economic Outlook

Mr. W.E. Clark  
Director, Structural and Long Range Analysis Division  
Department of Finance

4. Progress Report on DREE's Examination of the Desirability and Implications of Government Support for Modernization of the Pulp and Paper Industry

Mr. M.R. Daniels  
Assistant Deputy Minister, Planning & Co-ordination  
Department of Regional Economic Expansion

5. Update on the Multilateral Trade Negotiations

Mr. P.T. Eastham  
Director General, Office of General Relations  
Department of Industry, Trade and Commerce

6. The Ontario Pulp and Paper Industry - Status and Outlook

Mr. A.J. Herridge  
Assistant Deputy Minister  
Ministry of Natural Resources  
Province of Ontario

7. Background to Briefing Notes Provided to Industry Sector Consultative Task Forces

Mr. G. Ritchie  
Director General, Policy Analysis  
Department of Industry, Trade and Commerce

8. Objectives, Funding & Operational Procedures of EDC

Mr. R.H. Sumner  
Vice-President - Operations, Europe and the Americas  
Export Development Corporation

Appendix III

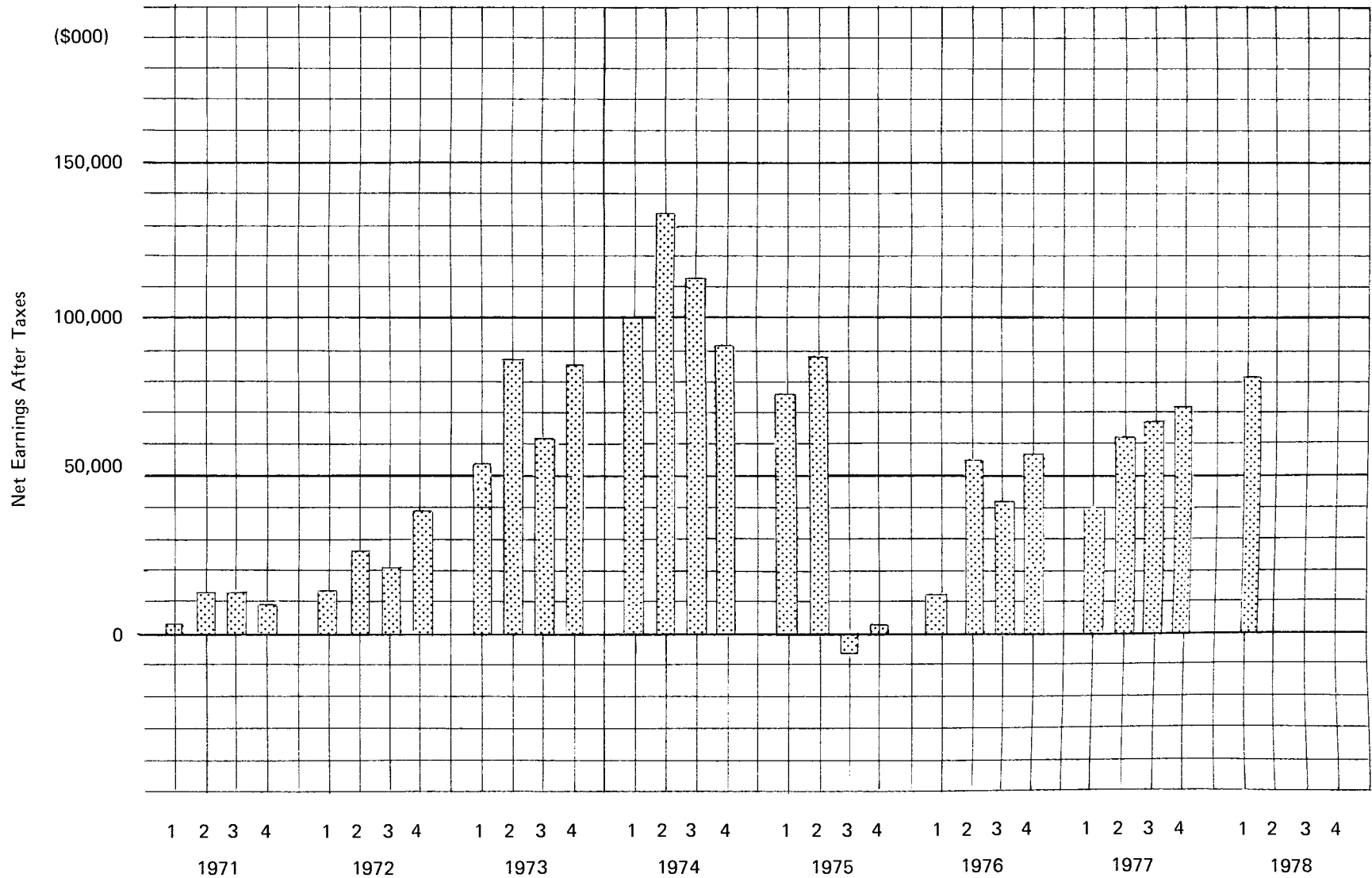
Net Earnings After Taxes

and

Return on Capital Employed

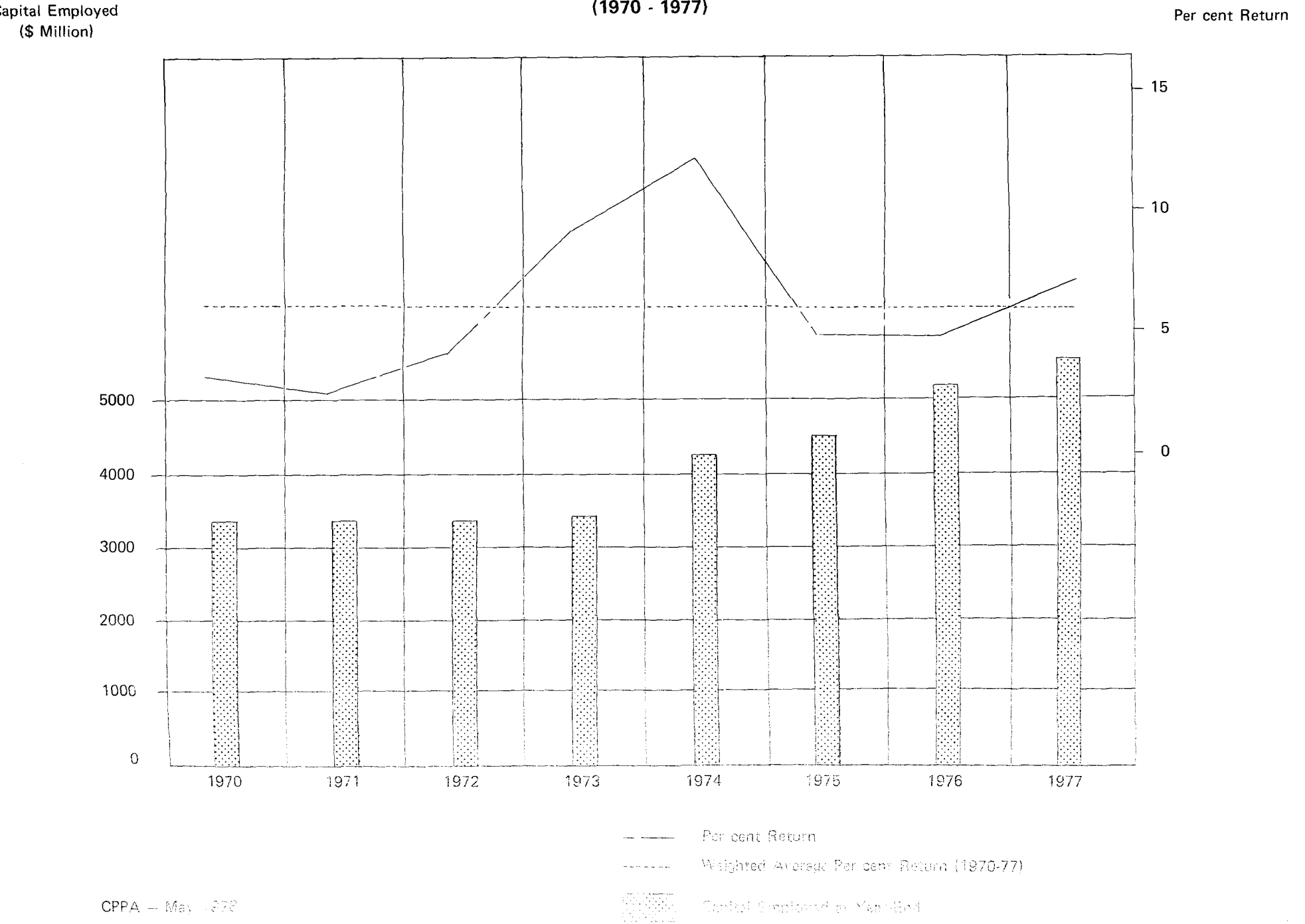


## Net Earnings After Taxes Forest Products Companies



Source: Based on the 16 forest products companies which report their financial results publicly each quarter.  
CPPA - May 1978

# Return on Capital Employed Eighteen Canadian Forest Products Companies (1970 - 1977)



CPPA — May 1978

Source: Based on the 18 forest companies listed in the 1977-78 Annual Report of the Canadian Forest Products Association.

RETURN ON TOTAL CAPITAL EMPLOYED

COMPARISON OF FOREST PRODUCTS INDUSTRIES  
WITH ALL MANUFACTURING COMPANIES  
CANADA AND THE UNITED STATES

1966 - 1977

	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1966-</u> <u>1977</u>
Paper and Allied Industries					
Canada <sup>1</sup>	12.9	6.4	5.4	5.4	5.6
United States <sup>2</sup>	12.8	9.5	10.3	9.5	N/A
Wood Industries					
Canada <sup>1</sup>	8.7	6.2	9.8	11.8	7.0
United States <sup>2</sup>	N/A	N/A	N/A	N/A	N/A
All Manufacturing					
Canada <sup>1</sup>	12.6	10.4	9.5	9.7	7.4
United States <sup>2</sup>	11.7	9.0	10.9	11.0	N/A

Note: Figures in this table are not the same as those indicated in the Return on Capital Employed chart on the preceding page. For one thing, "Paper and Allied Industries", is a statistical classification, used in Canada and the U.S., which includes not only primary pulp and paper production but also paper and paperboard converting operations. In addition, the chart on the preceding page shows only the results for the Canadian companies which report publicly, and they account for only a portion of the industry's total shipments, including about 55 per cent of the pulp, paper and paperboard.

<sup>1</sup> Derived from Statistics Canada: Industrial Corporations - Financial Statistics; Catalogue 61-003

<sup>2</sup> Derived from U.S. Federal Trade Commission: Quarterly Financial Report from Manufacturing, Mining and Trade Corporations (Data not available for 1966-73).

TAXATION

A comprehensive study of taxation practices related to the pulp and paper industry undertaken by Price Waterhouse for the government of Canada in 1973 concluded that the tax system in Canada imposed a higher burden than in the United States, Sweden and Finland. Since the publication of the study the following major tax incentives were put into effect in Canada:

- (1) Two-year write-off for all machinery and equipment purchased for use in manufacturing and processing
- (2) Reduction from 46% to 40% in the corporate income tax rate on profits from manufacturing and processing (effective for 1976-77)
- (3) An investment tax credit varying from 5% to 10% depending on the designated region in Canada.
- (4) a 3% inventory allowance applicable as deduction in calculating business income.

However, as shown in the Tables attached, the pulp and paper industry in Canada still finds itself at a disadvantage. This situation exists partly because of the following reasons"

- (a) In the United States the tax rate applicable to capital gains treatment of timber income is 30% while the statutory income tax rate is 48%.
- (b) A higher investment tax credit rate i.e. 10% and the DISC rules are additional advantages to the U.S. industry.
- (c) In Canada, the federal reduction in the rate of tax applicable to manufacturing and processing does not include "logging" income. Therefore, the combined effective tax rate of companies having logging operations is increased by approximately 2 to 3 percentage points.

A comparison of the significant aspects of the Canadian and U.S. tax structure affecting the pulp and paper companies is further outlined in the attached tables.

Based on a comparison of the financial results of 6 Canadian and 7 United States integrated forest produces companies, the income tax rate in Canada in 1977 was 6 percentage points higher than in the United States. The average rates were: Canada 42%; United States 36%. This gap is considerably narrower than in the early 1970's when the average Canadian rate was 47%, the United States rate 36% and the difference was 11 points.

Comparison of Canadian and United States Tax Structure  
Affecting Pulp and Paper Companies

	<u>CANADA</u>	<u>UNITED STATES</u>
1. Corporate Tax Rate	Federal income tax rate 46.0%	Federal statutory tax rate 48.0%
2. Manufacturing and processing allowance	Less 6% for the 1976 and subsequent taxation years. This federal reduction in the rate of tax applicable to manufacturing and processing <u>does not include logging income.</u>	Not applicable
3. Investment tax credit	5% - 7½% or 10% depending on the designated regions in Canada.	Investment tax credit 10%
	(a) Credit reduces cost of property for determination of capital cost allowances	(a) No reduction of cost of property
	(b) Unused credit carried forward 5 years	(b) Unused credit carried back 3 years and forward 7 years
	(c) Credit limited to \$15,000 plus half of tax otherwise payable in excess of \$15,000	(c) Credit limited to \$25,000 plus half of tax otherwise payable in excess of \$25,000
4. Capital gains	One-half of realized gains (losses) of certain capital assets in excess of values established at Dec. 31, 1971 are taxable at ordinary rates.	Tax rate applicable to capital gains is 30%.
5. Depletion of timber	At cost.	At fair market value. Difference between cost and market is classed as capital gain for tax purposes.
6. Logging taxes	Provincial taxes - Quebec 10% and B.C. 15% While the Quebec logging tax is fully creditable against corporate tax, the B.C. logging tax was not.*	No logging taxes.
7. Consolidated returns	Not available in Canada	Available to group companies
8. Net operating losses	Carried back one year, forward five years	Carried back three years, forward seven years

\* The B.C. logging tax has been reduced to 10% effective January 1, 1978, and is now fully creditable against corporate tax.

CANADA

UNITED STATES

9. Inventory valuation

(a) FIFO basis of inventory valuation

May elect LIFO for inventory valuation.

(b) 3% inventory allowance is permitted as a deduction in calculating business income. This relates only to the tangible moveable property of the opening value of qualifying inventories.

10. Capital cost allowance

Accelerated rates applicable to certain production machinery.

No accelerated rates. Average rate approximates 15% - 20% reducing balance.

11. Provincial or state taxes

Provincial taxes for: Ontario 13%  
B.C. 15%  
N.B. 12%  
Quebec 12%

State tax rate on income in U.S. vary from no taxes in some states, up to 10.5% in Pennsylvania for example. Other state tax rate on income are as follows:  
Main 7%            Wisconsin 7.9%    S. Carolina 6%  
Oregon 7½%        Pennsylvania 10.5%    Georgia 6%  
The application and calculation of the state income tax rate varies among different states. States taxes are deductible from income subject to Federal tax.

There is a federal tax abatement equal to 10% of the portion of taxable income subject to provincial income tax, irrespective of the provincial rate.

12 Export incentives

None under the Income Tax Act

DISC (Deferral on 50% of export gross receipts which exceed 67% of average export gross receipt in base period)

TABLE I

CORPORATION INCOME TAX  
UNITED STATES AND CANADIAN FOREST PRODUCTS COMPANIES

Provision of Income Tax as Percentages of  
 Net Income Before Tax

	<u>7 United States Companies</u>	<u>6 Canadian Companies</u>
1970	32	47
1971	35	49
1972	37	47
1973	37	45
1974	39	45
1975	38	47
1976	34	50
1977	36	42
Total 1970 - 1977	36	46

Notes:

- (a) The 7 U.S. companies are: Boise Cascade Corp., Crown Zellerbach, Georgia-Pacific Corp., International Paper, Mead Corporation, St. Regis Paper Co. and Weyerhaeuser Co.
- (b) The 6 Canadian companies are: Abitibi Paper, British Columbia Forest, Consolidated-Bathurst, Crown Zellerbach Canada, Domtar and MacMillan Bloedel.
- (c) Net income before extraordinary items
- (d) Provision for income tax includes current plus deferred taxes.

Source: Calculations based on Annual Financial Report figures.

CORPORATION INCOME TAX - CANADIAN FOREST PRODUCTS COMPANIES  
(\$'000)

	1970	1971	1972	1973	1974	1975	1976	1977	1970 - 1977
<u>Abitibi Paper Co. (c)</u>									
(a) Net Income	5,032	4,123	6,749	18,797	35,904	14,885	11,364	37,908**	134,762
(b) Prov. for Income Tax	4,630	2,933	5,346	15,030	30,256	15,141	13,483	29,363	116,182
Total	9,662	7,056	12,095	33,827	66,160	30,026	24,847	67,271	250,944
Tax Percentage	48	42	44	44	46	50	54	44	46
<u>British Columbia Forest</u>									
Net Income	1,336	5,455	10,823	25,465	21,086	15,888	26,170	35,113	141,336
Prov. for Income Tax	956	5,550	10,440	22,750	21,080	15,900	25,960	27,559	130,195
Total	2,292	11,005	21,263	48,215	42,166	31,788	52,130	62,672	271,531
Tax Percentage	42	50	49	47	50	50	50	44	48
<u>Consolidated-Bathurst</u>									
Net Income	274	127	6,497	19,870	47,712	32,599	18,240	21,355	146,273
Prov. for Income Tax	3,545	1,392	4,674	14,220	34,463	20,338	9,227	10,038	92,960
Total	N/A	N/A	11,171	34,090	82,175	52,937	27,467	31,393	239,233
Tax Percentage			42	42	42	38	34	32	39
<u>Crown Zellerbach Canada</u>									
Net Income	6,500	8,800	11,940	28,118	20,235	13,300	21,100	24,693	134,686
Prov. for Income Tax	9,369	10,971	13,189	29,200	17,053	10,400	19,400	16,493	126,075
Total	15,869	19,771	25,129	57,318	37,288	23,700	40,500	41,186	260,761
Tax Percentage	59	55	52	51	46	44	48	40	48
<u>Domtar Inc.</u>									
Net Income	17,900	10,500	17,468	40,559	82,479	35,300	10,600	26,840	241,646
Prov. for Income Tax	9,300	9,000	13,575	26,652	64,462	23,900	7,900	13,720	168,509
Total	27,200	19,500	31,043	67,211	146,941	59,200	18,500	40,560	410,155
Tax Percentage	34	46	44	40	44	40	43	34	41
<u>MacMillan Bloedel Limited</u>									
Net Income	17,426	22,029	35,100 <sup>(z)</sup>	81,752 <sup>(z)</sup>	72,299	(18,943)	22,842	60,618	293,123
Prov. for Income Tax	18,834	20,138	32,453	66,607	60,454	(2,764)	36,074	54,141	285,937
Total	36,260	42,167	67,553	148,359	132,753	(21,707)	58,916	114,759	579,060
Tax Percentage	52	48	48	45	46	N/A	61	47	49
<u>TOTAL CANADIAN COMPANIES</u>									
Net Income	48,194	50,907	88,577	214,561	279,715	93,029	110,316	206,527	1,091,826
Prov. for Income Tax	43,089	48,592	79,677	174,459	227,768	82,915	112,044	151,314	919,858
Total	91,283*	99,499*	168,254	389,020	507,483	175,944	222,360	357,841	2,011,684
Tax Percentage	47	49	47	45	45	47	50	42	46

Notes: (a) Net income before extraordinary items.  
(b) Provision for income tax includes deferred plus current taxes.  
(c) Net income for Abitibi excludes mining operations.

\* Excludes Consolidated-Bathurst (1970 and 1971)

\*\* After minority shareholders' interest

† Provision for Consolidated-Bathurst for 1970 and 1971 is tax payments by subsidiaries; net income in on a corporate basis.

(z) Net income includes equity of party-owned companies.

N/A Not applicable

Source: Calculations based on Annual Financial Report figures.



TABLE III

CORPORATION INCOME TAX - UNITED STATES FOREST PRODUCTS COMPANIES  
(\$'000)

	1970	1971	1972	1973	1974	1975	1976	1977	1970 - 1977
<u>Boise Cascade Corp</u>									
(a) Net Income	23,318 <sup>/</sup>	(37,150)	24,390	90,250	103,640	63,890	97,330	115,610	518,428
(b) Prov. for Income Tax	6,797	13,036	37,290	73,190	71,730	35,180	54,750	80,810	359,747
Total	30,115	N/A	61,680	163,440	175,370	99,070	152,080	196,420	878,175
Tax Percentage	23		60	45	41	36	36	41	41
<u>Crown Zellerbach</u>									
Net Income	41,905	31,796	45,462	102,597	124,791	75,800	97,629	109,152	629,132
Prov. for Income Tax	24,000	21,500	26,394	54,648	64,153	52,461	50,088	53,344	346,588
Total	65,905	53,296	71,856	157,245	188,944	128,261	147,717	162,496	975,720
Tax Percentage	36	40	37	35	34	41	34	33	36
<u>Georgia-Pacific Corp.</u>									
Net Income	70,350	63,660	97,660	162,810	164,350	148,000	215,300	262,000	1,184,130
Prov. for Income Tax	29,500	34,400	72,000	112,500	100,000	83,500	141,000	191,000	763,900
Total	99,850	98,060	169,660	275,310	264,350	231,500	356,300	453,000	1,948,030
Tax Percentage	30	35	42	41	38	36	40	42	39
<u>International Paper</u>									
Net Income	82,477	68,389	102,736	159,800	262,600	218,000	254,000	233,700	1,381,702
Prov. for Income Tax	37,300	36,500	57,200	86,200	195,300	153,000	126,000	105,700	797,200
Total	119,777	104,889	159,936	246,000	457,900	371,000	380,000	339,400	2,178,902
Tax Percentage	31	35	36	35	43	41	33	31	37
<u>Mead Corporation</u>									
Net Income	19,900	23,308	26,048	49,461	81,969	52,778	88,796	98,000	440,260
Prov. for Income Tax	12,880	15,270	12,675	40,870	74,880	25,685	78,450	81,800	342,510
Total	32,780	38,578	38,723	90,331	156,849	78,463	167,246	179,800	782,770
Tax Percentage	39	40	33	45	48	33	47	45	44
<u>St. Regis Paper Co.</u>									
Net Income	36,610	16,766	41,320	72,579	112,965	106,920	107,533	106,786	601,479
Prov. for Income Tax	16,738	13,885	22,685	44,804	69,743	69,000	53,770	67,129	357,754
Total	53,348	30,651	64,005	117,383	182,708	175,920	161,303	173,915	959,233
Tax Percentage	31	45	35	38	38	39	33	39	37
<u>Weyerhaeuser Co.</u>									
Net Income	124,207	114,369	158,141	348,811	276,197	188,849	305,967	303,891	1,820,432
Prov. for Income Tax	56,350	52,615	64,900	162,500	142,700	110,600	106,800	131,000	827,465
Total	180,557	166,984	223,041	511,311	418,897	299,449	412,767	434,891	2,647,897
Tax Percentage	31	32	29	32	34	37	26	30	31
<u>TOTAL U.S. COMPANIES</u>									
Net Income	398,767	318,288	495,757	986,308	1,126,512	854,237	1,166,555	1,229,139	6,575,563
Prov. for Income Tax	183,565	174,170	293,144	574,712	718,506	529,426	610,858	710,783	3,795,164
Total	582,332	492,458**	788,901	1,561,020	1,845,018	1,383,663	1,777,413	1,939,922	10,370,727
Tax Percentage	32	35	37	37	39	38	34	36	36

Notes: (a) Net income before extraordinary items.  
(b) Provision for income tax include deferred plus current taxes.

\*\* Excludes Boise Cascade.

<sup>/</sup> Excludes \$10,632,000 income from discontinued operations.

N/A Not applicable

Source: Calculations based on Annual Financial Report figures.

TABLE IV

Financial Statistics  
Paper and Allied Industries and Forestry  
1970 - 1977  
(\$'000,000)

	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1970 to 1977</u>
(a) Earnings before Income Taxes	217	129	190	578	1187	592	515	628	4036
(b) Total Income Taxes	93	44	101	258	502	243	229	258	1728
(c) Net Earnings after Income Taxes	124	85	89	320	685	349	286	370	2308
(d) % of Total Income Taxes to Earnings (b/a x 100)	43%	34%	53%	45%	42%	41%	44%	41%	43%

Source: Statistics Canada, Industrial Corporations, Fourth Quarter 1977, Catalogue 61-003 Quarterly





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