PULP AND PAPER MODERNIZATION STUDY

VOLUME 1

NATIONAL REPORT

Program Evaluation Branch | **Direction de l'évaluation des programmes**

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PULP AND PAPER MODERNIZATION STUDY

VOLUME 1

NATIONAL REPORT

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TABLE OF CONTENTS

ABSTRACT

Study of the Pulp and Paper Industry Modernization Program

Background

Senior management directed in January 1983 that a study be conducted on the Pulp and Paper Industry Modernization Program, to provide some insight on how the subsidiary agreements of this program have operated and some conclusions that would serve in the future design of similar programs. The study centres on twenty pulp and paper companies in Ontario, Quebec and New Brunswick and focusses on four main issues: 1) Program alternatives; 2) The negotiation process; 3) Public fund leverage of private investment; and 4) Canadian content.

Major conclusions

1. The subsidiary agreement was a reasonably successful means of delivering the program and an adequate mechanism for joint federal/provincial targetting of assistance.
2. The levels of assistance were adequate initially, but were made less effective by the economic downturn.
3. Companies specified tax incentives as the preferable form of assistance to the industry.
4. Company/government negotiations were satisfactory.
5. Protracted federal/provicial negotiations in Quebec caused delayed investment.
6. Companies viewed the treatment they received as equitable despite differences between provinces.
7. The program advanced private sector investments and resulted in significantly higher levels of investment.
8. The Canadian content experience might have been better with closer monitoring. The program has brought benefits to some equipment manufacturers in Canada.

Major Recommendations

1. A pulp and paper sector strategy should be prepared to provide guidance in the development and application of future programs.
2. In future cases where there is a major interest by both federal and provincial governments such as a jointly administered program involving large projects and where joint targetting of funds are prime factors, consideration should be given to using the subsidiary agreement as an assistance mechanism.
3. More study is needed to determine the most effective instruments to encourage private sector investment.
4. In future programs, multi-year company plans should be mandatory for determining what level of assistance is provided.
5. The need for project assistance to equipment manufacturers to install unproven equipment should be examined, as well as IRDP's ability to meet such a need.
6. To facilitate program delivery, the information requirements from applicants must be clearly defined.
7. Consultations must occur with labour representatives, where labour adjustment is a factor.
8. Canadian content requirements in future programs should be clearly outlined and carefully monitored.
9. Systematic efforts should be made to alert Canadian equipment manufacturers to opportunities arising from government programs.
10. The use of target investment leverage ratios should be consistent in future programs.
11. National criteria should be applied consistently in multi/provincial programs.

PULP AND PAPER MODERNIZATION STUDY

EXECUTIVE SUMMARY

1.0 INTRODUCTION

In January 1983, the departmental Senior Management Committee approved the conduct of a study of the national Pulp and Paper Modernization Program which would provide additional insight into the operation of the program and alternatives for program design beyond the March 1984 expiration of the program.

Due to the relative immaturity of the program, this interim study focussed on the basic program evaluation issues of improvement and delivery/efficiency leaving impacts and objectives achievement to be evaluated at a later date. The specific study issues included:

- program alternatives, discussed under Program Design (section 2);
- negotiation processes, addressed under Program Delivery (section 3);
- leverage of private investment, the topic of section 4; and
- Canadian content of investments, discussed in section 5.

The study's findings are derived from consideration of activities undertaken through the subsidiary agreements signed in the provinces of Ontario, Quebec and New Brunswick which account for 83% of the federal program funding. Approximately 80 persons were interviewed, representing applicant companies, provincial and federal government officials, labour representatives and machinery manufacturers. In addition, project files were reviewed for 20 companies, which was over 50% of the assisted companies. The study team included representatives from the Department (H Q and regions) and each of the provincial governments.

Volume I of this report presents the major findings and recommendations on a national basis. Three additional volumes provide more detail on the study of the subsidiary agreement in each province. The study's major findings are summarized in this executive summary as they pertain to program design, program delivery, investment leverage, Canadian content, and lastly, policy implications. Recommendations are presented in bold type.

2.0 PROGRAM DESIGN

The study considered how the fundamental design of the program was received by governments and industry. The topics addressed included the subsidiary agreement mechanism, types of funding instruments, the level and type of assistance, and eligibility provisions.

The subsidiary agreement was considered by most involved and in particular by government officials as a preferred mechanism for the joint (federal/provincial) targetting of assistance in a national program directed at meeting different needs/interests in the various regions. This mechanism also enabled joint partnership with provinces having jurisdiction over wood resources in a national program aimed at a major industrial sector.

In future programs where federal/provincial jurisdiction, major projects and the potential for joint targetting of funds are prime factors, the subsidiary agreement should be considered as an assistance mechanism.

When questionned on the types of funding instruments desired for future assistance, companies indicated that tax incentives would be the preferable form of assistance to the industry while government officials favoured incentive grants. The government rationale for favouring grants over tax incentives centred on the company's ability to utilize grants more readily than tax incentives during periods of low profitability. Determination of the most suitable instrument would involve assessment of the government's objectives for the sector and projections of future company profitability.

The use of tax incentives and other types of assistance as future funding instruments should be investigated as an incentive measure to encourage modernization as an ongoing process over the medium to longer term.

On a more micro level, the study considered elements of the program design which impacted on the assistance delivered and the means of delivery such as the eligibility provisions, the requirement for five year plans, project levels of assistance and disbursement of funds.

The eligilibity provisions for the program were considered adequate. However there were variations among the provinces as to the appropriate balance between the criterion for commercial viability and incrementality.

For future programs, national criteria should be applied consistently in multi-provincial programs.

The requirement for company five year investment plans, which are an important instrument for delineating corporate investment intentions, was an essential ingredient in the Department's program planning process. Significant changes in these plans had, and will continue to have major implications for the overall cash management of the program.

In future capital assistance programs multi-year company investment plans should be mandatory for determining levels of assistance. Flexibility in future program use of such plans should be maintained so that changes in company or economic conditions may be dealt with appropriately.

The project level of assistance was seen as adequate by the respondents at the time the program was implemented. Had the downturn in the economy not taken place the basic level of assistance would have remained appropriate. Looking to the future, the IRDP maximum levels of assistance for modernization and expansion projects could accommodate this greater need since they are at least equal to or greater than those maxima provided under the modernization program.

In terms of the type of disbursement of funds provided under the program, opinions varied among companies as well as government officials as to whether up front/lump sum payments were more appropriate than progress payments. In Ontario, a blending of up front/lump sum payments (Provincial) with progress payments (Federal) was perceived to have been a major factor in advancing company investments.

In future joint programs consideration should be given to the types of payments to be used: up front/lump sum, progress payments, or a blending of the two.

3.0 PROGRAM DELIVERY

A number of issues have been identified with respect to program delivery such as the pace of negotiations, interprovincial treatment of companies and the involvement of labour in the modernization program.

The pace of negotiations varied among the three provinces. Negotiations were seen to proceed at a good pace in Ontario but at a somewhat slower pace in New Brunswick due to an apparent lack of understanding by the companies as to the type of information to be submitted. In Quebec, the prolonged and extensive negotiations between the federal and provincial governments as well as the large number of applications contributed to a longer program delivery period. Also Quebec respondents felt that for future joint programs if a similar orientation towards development was held by federal and provincial negotiators the process in arriving at agreements in principle would be facilitated.

For future programs, guidelines as to the specific information expected in applications must be promulgated and efforts taken to ensure that these are understood by the applicants to facilitate program delivery.

With respect to interprovincial treatment, there were differences among the regional segments relating to the percentage and type of assistance provided as well as the approach to the negotiation process. The general perception, however, was that the program was delivered in a coordinated and equitable manner. Contribution levels received by companies varied between 14% and 20% dependent upon the nature of the projects. In addition, the flow of funds differed among provinces in that Ontario companies received the provincial share in an up-front/lump sum payment.

The negotiation process differed substantially in the Quebec portion of the program in that the main negotiations took place between the federal and provicial governments with virtually no federal government to company negotiations. This is contrasted in the Ontario and New Brunswick portions of the program where negotiations with companies involved both levels of government. A valuable element of the negotiations in Ontario was the utilisation of a target investment leverage ratio by the government negotiators.

Labour felt that there were inadequate measures for labour involvement under the program and assistance for labour adjustment particularly in the areas of the promotion of earlier retirement and in the attrition process.

In a successor program to the pulp and paper modernization program, consideration must be given to more labour involvement and the appropriateness of complementary labour adjustment programs.

4.0 INVESTMENT LEVERAGE

Influencing the modernization investment pattern of the pulp and paper industry was a primary rationale for the program. In this regard the study has shown that the program has had a significant impact in moving ahead the investment plans of the companies and, in some instances, it has enhanced the scope or quality of the modernizations undertaken.

Total planned investments for modernization by the companies participating in the program over the 5 year period are significant, i.e., $1.3 billion (1978 dollars) in Ontario, $3.2 billion (mixed dollars) in Quebec and $ .4 billion (1978 dollars) in New Brunswick. Some of this planned investment was not eligible for cost sharing under the program, notably 53% in Quebec, 36% in New Brunswick and 12% in Ontario. Actual expenditures for the Ontario portion of the program as at December 31/82 are over $919 million (1978 dollars), with committed federal incentives of $59.4 million. In New Brunswick, actual eligible expenditures as at March 31/83 are over $186 million (1978 dollars) and federal incentives of over $20 million have been made. In Quebec, actual eligible investments (based on an August 15, 1983 report) totalled $420 million with federal incentives of $50 million being made.

In implementing the program, management committees for the subsidiary agreements appeared to place differing emphasis on their effort to increase levels of investment by the companies. In one province, a target investment leverage ratio was used, whereas, in another, the emphasis was on selecting projects promising long term commercial viability.

Future programs should consider the use of a target investment leverage ratio as a guideline. The use of these ratios should be consistent in future programs.

5.0 CANADIAN CONTENT

In order to generate spin-off benefits under the program, each subsidiary agreement contained provisions to ensure that the investment projects included a maximum of machinery and equipment made in Canada.

The study has revealed the Canadian content provisions of the program and the manner in which they were outlined were adequate. However, efforts on the part of government officials to increase Canadian content levels were not as systematic and concerted as they might have been. Despite this, the actual levels of Canadian content to be achieved under the program are estimated to average 85% overall on Canadian materials, professional services, and machinery and equipment.

Regarding the monitoring of Canadian content levels, many sources of data exist in each province; however, no formal system has been established to assemble the available data into a regular summary report for management purposes. Thus one must rely on estimates of actual achievements in this area.

Indications are that significant benefits have accrued to the Canadian machinery manufacturers in terms of substantially increased levels of activity. These benefits may have been slightly increased had more time been available to the equipment manufacturers to prepare for the increased demand, had better information on opportunities been provided under the program, and had more government assistance been available in bringing buyers and suppliers together. Machinery manufacturers felt that assistance for first installation projects would be very significant in the development of their sector.

Future programs should clearly define Canadian content requirements; systematic efforts should be made to alert equipment manufacturers to opportunities arising from government programs and a formal monitoring mechanism should be introduced. In addition, it is recommended that consideration be given to the need for first installation assistance and the ability of IRDP to meet such a need.

6.0 POLICY IMPLICATIONS

As the current subsidiary agreements are coming to an end and several needs still exist in the industry, a renewed policy development activity is required. Investments during the program have been substantial and are felt to have had a positive effect in making the sector more competitive. However, there are still problems facing the industry and, without some government initiative, the required level of investment may not be sustained. As the environment of this industry has changed since the last national strategy for the development of the forest products industry adopted in 1979 was developed, a complete review is required of the industry's needs and priorities and consideration given to potential government and private sector responses.

A pulp and paper sector strategy should be prepared which will provide guidance in the development and application of future programs.

Once the current subsidiary agreements expire, a number of programming options are available for continued governmental assistance to the pulp and paper sector. These include utilization of IRDP, tax incentives (which are preferred by the companies), or further subsidiary agreements. These would have to be examined in conjunction with sector strategy development and the department's work with the Forest Industry Advisory Committee.

1.0 INTRODUCTION

1.1 Purpose and Scope of Study

The purpose of the study is to provide answers to a number of questions of interest to Departmental Management regarding the national Pulp and Paper Modernization Program and to provide additional insight and information to senior management concerning future program design. This interim review of the program may also serve as a basis for determining an approach to future evaluations of industry sector programs. The study does not attempt to estimate impacts and effects (benefits accruing to Canada or the regions) as a result of the implementation of the modernization program. As the specific program segments mature with respect to the completion of investment plans an opportunity will be provided to undertake a detailed evaluation of the impacts and effects stemming from this initiative.

The information provided is based upon the experience gained through the use of subsidiary agreements which were the prime instruments for delivering a national program directed to the pulp and paper sector in a number of regions having similar as well as differing industry needs.

The scope of the study was defined by the Steering Committee and covered four specific issues as follows:

1. Program alternatives - potential means of achieving program objectives. This isssue is addressed in section 4.0 - Program Design.
2. The negotiation process - between governments and companies seeking assistance under the program. This is discussed in section 5.0 - Program Delivery.
3. Leverage - the extent to which public sector assistance has levered private investment by selected firms. Section 6.0 deals with this issue.
4. Canadian Content - requirements for sourcing materials, services, machinery and equipment in Canada. This issue is the topic of Section 7.0.

The study has purposely been limited to three regions namely, Ontario, Quebec and New Brunswick. These provinces represent the three largest in terms of program funding levels of the five subsidary agreements on pulp and paper modernization and account for nearly 90% of all public funds involved and 83% of the total federal share of the program. The majority of pulp and paper companies assisted under the program are located in the three provinces selected for study.

1.2 Structure of the Report

The report of the Pulp and Paper Modernization Program consists of a National Report Volume 1 (this volume) and three additional volumes related to each of the provincial segments in the study, namely, Volume 2 Ontario, Volume 3 Quebec and Volume 4 New Brunswick.

The National Report details findings and recommendations based upon the three studies undertaken in the three provincial segments and is divided into five major sections. Section 2.0, Study Background, briefly details the Pulp and Paper Modernization Program and DREE subsidiary agreement programming. Section 3.0 provides an overview of the study design.

Sections 4.0 - 7.0 cover each of the four issue areas of national significance and provide findings, conclusions and recommendations drawn from the results of analysis and data collection contained in each of the three provincial reports. Section 8.0, Policy Implications, highlights the issues which will require management attention in the near future concerning sector needs and the follow-on to the existing Subsidiary Agreements.

2.0 BACKGROUND

The purpose of this section is to describe the evolution of the pulp and paper modernization program and the nature of the industry at the time of the program's inception.

2.1 Pulp and Paper Modernization Program

The Department of Regional Economic Expansion was formally approached by the Province of Quēbec in 1978 to support a program to modernize their pulp and paper industry through a DREE sub-agreement. Initially, the Quēbec proposal identified a joint federal-provincial program to offer incentive assistance in the form of grants up to 25% of approved capital costs. The proposal was presented in the Discussion Paper: The Quēbec Proposal in a National Context (DREE-1-79DP) and discussed from a national perspective.

Early in 1979, Cabinet adopted a national strategy for the development of the forest products industry. As part of the national development strategy, incentive funds were to be provided to encourage investment in modernization and cost reduction in the pulp and paper industry. The funds so provided were to be expended under cost shared DREE subsidiary agreements with the Provinces.

On February 1, 1979 Mr. Andras, President of the Board of Economic Development Ministers presented the pulp and paper modernization program as a national development policy for assistance to the forest products industry. The pulp and paper modernization program as announced provided for federal contributions of $235 million toward federal/provincial cost shared agreements. The initial allocation of federal funds as announced February 1, 1979 was as follows:

Quēbec	$90 million (later amended to $135 million)
Ontario	$46 million (later amended to $60 million)
Atlantic Provinces	$60 million
Western Provinces	$39 million

On May 15, 1979 subsidiary development agreements between DREE and the provinces of Ontario and Quēbec were signed. The Minister of Regional Economic Expansion also indicated to other provinces that similar federal programming might be extended to those provinces where such development opportunities existed.

On July 31, 1980 the Minister for Regional Economic Expansion announced "an improved forest industry assistance program" which increased the funding to $276 million and redirected the program to projects in Newfoundland, Nova Scotia, New Brunswick, Quebec and Ontario. The Minister also announced at that time a commitment to work with the forest industry and the Governments of British Columbia, Alberta, Saskatchewan and Manitoba towards the development of programs tailored to the forestry needs of those provinces. The rationale for redirecting the program to projects in the east was that "Compared to eastern mills, pulp and paper mills in the west are relatively more modern and have turned in stronger performances in the world market. As a result, assistance provided under the terms of the modernization program is less appropriate there."*

Under the improved forest industry assistance program as announced in July 1980, subsequent subsidiary development agreements were negotiated with Provinces in the Atlantic Region. The implementation of the program to modernize the pulp and paper industry did not preclude the possibility that federal financial support could be provided to projects outside the framework of the program but within separate subsidiary development agreements for special cases.

Allocation of federal funds under the amended pulp and paper modernization program as announced July 31, 1980 were as follows:

Quebec	$135 million
Ontario	$ 60 million
Atlantic Provinces	$ 81 million
Total	$276 million

2.2 Subagreement Funding Levels

To date subsidiary development agreements have been negotiated between Canada and the Provinces of Newfoundland, New Brunswick, Nova Scotia, Québec, and Ontario under the program for the modernization of the pulp and paper industry. A summary of funding levels and Federal/ Provincial cost share ratios follows:

* News Release July 31/80.

Subagreement	NFLD.	N.B.	N.S.	QUE.	ONT.
Time Frame	June/81 to Mar./85	Aug./80 to Mar./84	May/81 to Mar./84	May/79 to Mar./84	May/79 to Mar./84
Financial Arrangements					
Total $ (millions) (Fed. and Prov.)	33.0	42.25	21.25	240.0	180.0
Cost Share % (Fed:Prov)	90:10	80:20	80:20	56:44	33:66

2.3 Industry Environment

The program as announced February 1, 1979 was designed to provide a basis for developing a dialogue on an integrated action plan which would provide support of the development of the Canadian forest products industry. Based upon an industry sector profile prepared by the Department of Industry Trade and Commerce and included as an annex in the Report of the Consultative Task Force on the Canadian Forest Products Industry (June 1978) 13 per cent of Canada's value added is attributed to the forest industries with the pulp and paper industry accounting for nearly half of the total manufacturing shipments and over $4 billion in export earnings. An estimate of employment in the pulp and paper industry was 86,995 (for 1976).

In spite of the growth record of the forest industry and in particular the pulp and paper industry's significantly increased earnings in 1978 (largely due to exchange rate differentials and an unprecedented increase in demand), Canadian firms faced increasing difficulties in competing in the marketplace and in attracting new investment capital.

The areas of difficulty experienced by the firms included:

- the average return on invested capital in the pulp and paper industry for the period 1965-1978 at 8.3% was considerably lower that for similar firms in the U.S. (11.1%) and for Canadian manufacturing generally (11.2%).

- the Canadian industry is characterized by a high degree of cyclical variation in return on invested capital (due in large part to the role Canadian firms play as swing suppliers to foreign markets) i.e. supplying to meet cyclical excess demand.

- the Canadian pulp and paper industry's share of several key export markets was being eroded by competition abroad.

- high input costs, low productivity, a growing scarcity in Canada and high expense for wood as well as lack of expenditures for necessary pollution abatement.

These factors, coupled with the downturn in the economy, were to place the industry in a very uncertain situation in the early 80's. Markets became soft with reductions in demand and falling prices, while costs continued to rise. Thus, in 1983, Canadian pulp and paper companies were facing a difficult environnment with diminished earnings.

3.0 STUDY DESIGN

The approach taken in the study relied heavily upon the comments, opinions and perceptions of officials in the private and public sectors who are or had been closely associated with the modernization program. The two major thrusts of the methodology involved interviewing these officials and undertaking a review of relevant files in government offices. The information obtained from interviews and file searches formed the basis for subsequent analysis. Representatives of the Department (H.Q. and regions) and of each provincial government participated in various study tasks, including the file searches, the interviews, the analysis, and the review of the various drafts of the report. Further information concerning the major activities involved in developing the study design and conducting the analysis will be found in the provincial reports.

3.1 Selection of Sample

Pulp and paper companies which were clients of the program and operated in at least one of the study regions represented the population from which companies were chosen for inclusion in the target group.

Given the rather small number of pulp and paper companies in the total population for each provincial segment, a sample size of approximately 50% or more of total program clients was used. In Ontario this represented 6 companies comprising fourteen mills, in Quebec ten companies comprising 29 mills and in New Brunswick four companies. Further information on the criteria used to select companies can be found in the provincial reports.

3.2 File Review

The file reviews undertaken in the three study segments of the program encompassed twenty companies and 47 mills. Data was obtained from Headquarters, ITC/DREE regional offices in Montreal, Toronto and Moncton as well as provincial government offices in Quebec City, Toronto and Fredericton.

3.3 Interviews

Interviews were held with officials from pulp and paper companies (40), the federal government (10), the provincial governments (14), machinery/equipment suppliers (10), and unions (5).

4.0 PROGRAM DESIGN

The purpose of this section is to consider aspects of the pulp and paper program which through inherent design contributed or detracted from achievement of the program's objectives. The section commences with an analysis of the project level of assistance and is followed by consideration of the types of assistance and disbursement of funds, the utilisation of five year plans, eligibility provisions, and lastly, the subagreement as a mechanism.

4.1 Level of Assistance - Projects

This section considers the project level of assistance available under the respective regional portions of the pulp and paper modernization program and those levels subsequently delivered to companies in the program. Project assistance levels for segments of eligible projects under the IRDP modernization/expansion element are also provided for comparison.

For the Ontario and Quebec portions of the program up to 25% of eligible costs were available as an incentive while for New Brunswick up to 20% of eligible costs were available. These amounts reflected the initial anticipated requirements for project level assistance in the respective regions.

The project level of assistance was seen as adequate by the companies at the time the program was implemented. Incentive levels granted in Ontario averaged 15% of eligible expenditures; in Quebec some initial proposals were awarded 25% on eligible expenditures, however, the bulk of projects were at the 20% level. In New Brunswick, the incentive level granted on eligible expenditures averaged 14%.

In the cases of New Brunswick and Ontario, the level of assistance actually awarded to different projects was the subject of negotiation with each company. However this was not the case in Quebec where a fixed level of assistance (25% then 20%) was awarded to all projects deemed eligible. The Quebec report has recommended an examination of the advantages and inconveniences of fixed and variable level grants.

Given the subsequent downturn in the economy, the prolonged recession, and high interest rates, project level assistance might not now be adequate particularly for the Quebec portion of the program where company investment has lagged behind planned expenditures primarily due to adverse economic conditions.

IRDP, for comparison purposes, will have maximum contribution levels of eligibility for machinery/ equipment and buildings which range from 25% to 50% depending upon the region and the respective Tier designation.

In conclusion, there were no serious problems identified with the project level of assistance and had the downturn in the economy not taken place, the basic level of project assistance would have been adequate. Upon first reivew, the IRDP may be better able to accommodate unforseen economic circumstances as maximum levels of assistance for modernization and expansion projects are at least equal to or greater than those maxima provided under the pulp and paper modernization program.

4.2 Type of Assistance and Disbursement of Funds

This section considers two specific aspects of the assistance provided, firstly, the instrument by which funds were made available to the program clients, and secondly, the type of payments (progress payments vs lump sum/up front payments) which were utilized. The perceptions of the different groups with respect to the funding instrument and means of disbursing funds are also presented.

4.2.1 Project Funding Instrument

The majority of companies interviewed identified tax incentives and/or changes in tax regulations as being the preferred instrument of assistance, assuming that companies would be in a financial position to utilize a tax incentive at some point.

With respect to the type of assistance actually offered, half of the companies in Ontario perceived the grant as not being their preferred instrument for funding purposes. Quebec companies also indicated that equity participation by governments and guaranteed loans were other types of preferred assistance.

Federal and provincial officials indicated a strong preference for grants as an appropriate funding instrument and viewed tax incentives as neither appropriate nor effective in causing investment to take place in the time frame required. The rationale given for favouring grants over tax incentives appears to centre on the companies' ability to utilize a grant during the time of low profits whereas with a tax incentive there may be a direct relationship between the size of incentive and profits earned.

In conclusion, federal/provincial officials favoured the grant as the most appropriate funding instrument while companies strongly preferred a tax incentive and/or changes in regulations as the most appropriate form of assistance. Evidence strongly supporting either position was not sufficient to absolutely favour one approach over the other.

Recommendation

The use of tax incentives and other types of assistance as future funding instruments should be investigated as an incentive measure to encourage modernization as an ongoing process over the medium to longer term.

4.2.2 Disbursement of Funds

In terms of the up-front/lump sum payment versus progress payments for disbursing funds, opinions varied among companies was well as federal/provincial officials in the three regional segments of the modernization program.

In Ontario, the majority of companies indicated a preference for the lump sum/up-front payments which were made by the province and these companies also would have liked to have seen the federal payments made up-front. Companies in New Brunswick were evenly split on their preference for lump sum/ up-front payments as opposed to progress payments. Companies favouring lump-sum/up front payments in both Ontario and New Brunswick felt that this form of payment would have a positive influence on their borrowing positions. In Quebec, companies generally favoured lump sum/up front payments but recognized the potential for reduced control. A blending of up front monies with the remainder of the grant in progress payments might be an approach to consider. The different forms of payment should be studied further to determine which is the most advantageous with respect to the sector.

Federal and provincial officials in Ontario viewed disbursement of program funds somewhat differently than their counterparts in New Brunswick and Quebec. In Ontario, federal officials saw a blend of up-front monies (provincial funding) with progress payments being made by the federal partner as an appropriate means of disbursement. New Brunswick federal officials tended to favour progress payments as the form for disbursing program funds as did federal officials in Quebec because of the project/financial control afforded by this type of disbursement.

Provincial officials in Quebec felt that lump sum/up-front payments would influence the level of investment by improving the companies borrowing positions, however, they saw the negative feature of this type of disbursement as reduced financial control.

In conclusion, the up-front/lump sum payment in Ontario was viewed as an important factor in bringing investments ahead. This was not the general case for the Quebec or New Brunswick segments of the program where only progress payments were used. Although companies cited up front payments as enhancing their borrowing positions there was no evidence to indicate that grants delivered via progress payments would not also have had the same effect on a company's borrowing positon. There may be a case for further investigation of the blending of up front/lump sum payments with progress payments to determine the adequacy of such an approach.

Recommendation

In future federal/provincial programs, consideration should be given to the types of payments to be used : up front/lump sum, progress payments, or a blending of the two.

4.3 Five Year Plans and Implications for Program Funding Levels

Five year plans of corporate investment were submitted by the applicants and formed the basis for reviewing their investment proposals.

Companies saw the request for five year plans as being reasonable and relevant. In some cases the requirement was consistent with the manner in which they planned and in other cases it added a discipline to the companies' planning process. In Quebec, some respondents saw the requirement as improving their overall process of planning.

Increases in investment levels from those presented in the plans may result in a need to adjust program funding levels. Since the program is capped both nationally and regionally, significant changes in the five year plans could have major implications for sourcing additional funding requirements and hence on the overall cash management of the program.

Initially program funding levels were seen as appropriate for the three regional program segments. However, the total program funding levels in the Ontario and Quebec portions of the program were subsequently increased to $180 million and $240 million respectively to accommodate proposals from the companies for additional and/or larger projects.

Both Ontario and New Brunswick have recently indicated a further requirement for increases in program funding levels of approximately $2.7 and $9.2 million respectively to accommodate additional new projects under the program. Under the Quebec portion of the modernization program, revised letters of offer (Mar/83) have been sent to the companies. Company responses to these letters indicate that the remaining level of incentives, approximately $29.2 million, (based on an August 15, 1983 report) may not be sufficient if the companies decide to go ahead with the investments as envisaged in these revised plans.

As was indicated by the majority of companies in Ontario and Quebec, there is a requirement to give more recognition to the fact that plans may change over a five year period due to shifts in markets, economic conditions, interest rates and inflation. It was suggested that these types of changes be accommodated through more flexibility in the five year plans.

Generally companies in Ontario have not requested postponements/deferrals in investment plans nor have postponements/cancellations been an issue to date in New Brunswick. Federal and provincial officials in Quebec have seen some postponement of investments to future years of the program as evidenced by revisions to the five year plans. As of March 31, 1983, companies under the Quebec portion of the program had expended 34% of total planned investment.

In summary, five year plans are a very important instrument for delineating corporate investment intentions and setting the tone for the investment activity which follows. Flexibility should exist in the five year plan process to allow for the accommodation of changing circumstances which impact on the timing or scope of projects.

Recommendations

In future capital assistance programs multi-year company investment plans should be mandatory for determining levels of assistance.

Flexibility should be maintained in future programs with respect to multi-year plans such that changes in conditions may be dealt with appropriately.

4.4 Eligibility Provisions

Eligibility provisions in the program are generally directed to types of projects and related capital costs in the areas of modernization, pollution abatement, and energy as well as to the types of activities within these three areas.

In terms of project selection criteria, the majority of companies indicated that the eligibility criteria were appropriate. Federal officials in New Brunswick saw the eligibility provisions as adequate while in Ontario federal officials viewed the criteria as non burdensome. Provincial officials generally perceived the eligibility provisions to be appropriate.

Some differences in criteria existed in the three regional segments of the program. For example, identification of prior commitment, compliance with statutory requirements for pollution and project commencement without government assistance differed between subsidiary agreements.

One specific criterion appearing in all three subagreements was the requirement that the project with assistance result in a commercially viable operation over the long-term without the need for additional government assistance. However, this criterion may also be in conflict with the criterion dealing with projects not going ahead without government assistance which is mentioned specifically in the Ontario and Quebec subagreements.

The exclusion of maintenance projects under the Ontario segment of the program was seen to be a "grey area" and very judgemental due to a lack of specific guidelines for maintenance projects (capital projects vs. maintenance and repair projects).

Some companies in Ontario and New Brunswick identified transportation/freight and exceptional start-up costs such as lost production due to training as being areas of additional assistance which would have been of benefit to them in improving cost competitiveness. Companies in Quebec felt that additional assistance for forestry development, research and development and a reduction of stumpage fees would be beneficial.

In conclusion, the cost eligibility criteria for the program would appear to have been appropriate. There may be, however, a need to define an appropriate balance between the basic criterion of commercial viability and that dealing with a project not likely commencing without government assistance. The suggestions to broaden the costs covered by the program were not widely supported.

Recommendation

For future programs national criteria should be applied consistently in multi/provincial programs.

4.5. The Subsidiary Agreement as an Assistance Mechanism

The purpose of this section is to address the adequacy of the subsidiary agreement as a means for delivering the Pulp and Paper program. By so doing it will be possible to determine the ways in which the subagreement might be used as a mechanism in future programs or ways in which it should be changed.

In assessing the adequacy of the subagreement it is important to note that it was used for a program where the provincial government has primary jurisdiction (for forestry resources) and where there were different needs and interests in the various provinces.

Companies in both Ontario and New Brunswick generally saw the subagreement as an adequate vehicle for the provision of assistance. In addition, the Quebec report has concluded that, despite potential dangers and difficulties, the subagreement is a good mechanism for a bilateral, sectoral approach to assistance in a field that comes under provincial jurisdiction.

The strengths of the subagreement as seen by government officials included the sectoral approach to assistance which enabled both governments to jointly target on specific areas in need of assistance in that particular industry sector. As well it provided a mechanism for cooperation between governments and ensured a coordinated approach to the assistance.

The joint delivery aspect, however, led to some of the weaknesses that were identified for the subagreement. Since it does involve another partner in the delivery of assistance to firms, there is a potential for protracted intergovernmental negotiations with respect to the level and type of assistance or other program details. In the case of the Quebec portion of the program, negotiations between the governments were somewhat prolonged because of questions as to the level of assistance, incrementality and the eligibility criteria in the program. Since a subsidiary agreement is a joint mechanism, it raises quesions as to who will have the dominant role in delivery. For the present program the respective provincial governments had the responsibility for delivery.

In the case of the Pulp and Paper program there were some problems in obtaining timely access to information particularly with respect to the questions raised in the study. In Quebec for example, information on production costs and energy costs was deemed confidential by the Province and not released to the study team. In Ontario, a summary status report is not yet available which would provide an update on a number of aspects of the Ontario portion of the program.

In the regions the subsidiary agreement mechanism provided an adequate means of joint partnership in a program addressed to the pulp and paper sector which is subject to provincial jurisdiction in such areas as

Recommendations

The subsidiary agreement should be considered as a delivery mechanism in future programs where federal/provincial jurisdiction, large projects and the potential for joint targetting of funds are major factors.

For future jointly delivered programs, means should be put in place to ensure that federal and provincial officials have equal access to the information on the program's delivery and impacts.

5.0 PROGRAM DELIVERY

The purpose of this section is to consider the differences in delivery approaches among the regions with a view to highlighting those which might be best emulated in future programs. Delivery is considered from the viewpoint of negotiation pace, the interprovincial treatment of companies and the involvement of labour.

5.1 Negotiation Pace

The speed of the program delivery varied among the three provinces. On average the time to process company proposals from time of application to approval took 8 months in Ontario, 10 months in New Brunswick and 12.5 months in Quebec. The reasons for the longer time in Quebec were extensive negotiations between the federal and provincial governments and the large volume of applications. In Quebec there were few subsequent discussions between the companies and the federal government. Government officials in the Quebec portion of the program felt that for future joint programs if a similar orientation towards development was held by federal and provincial negotiators, the process in arriving at agreements in principle would be facilitated. Over all the pace of the negotiations would seem to be of similar order of magnitude to those anticipated for major projects under IRDP.

The company and government perceptions of the pace of negotiations also varied across the three provinces studied. The companies in Ontario felt that the pace was reasonable and that any slowness was attributed to learning on both sides. Officials in Ontario felt that the good pace in negotiations was mainly due to management committee members having access to information on mill conditions, good working relationships between co-chairmen of the management committee and having decision makers "on the spot" with respect to achieving an agreement in principle early in the process.

On the other hand, in the case of New Brunswick, there was some suggestion that negotiations were prolonged due to insufficient guidelines concerning information requirements. Officials felt that this was simply due to a lack of understanding of the program by the companies rather than the lack of guidelines.

In conclusion the negotiations were seen to proceed at a good pace in Ontario with a somewhat more prolonged period required for New Brunswick because of a lack of clarity on the companies' part as to the type of information to be submitted.

Recommendation

Future programs must promulgate clear guidelines as to what information is expected in the applications and ensure that these are understood by the potential applicants to facilitate program delivery.

5.2 Interprovincial Treatment

The pulp and paper program is delivered provincially through subsidiary agreements between the federal and provincial governments. As such, this gives it a uniqueness for each of the provinces involved with a national overtone and focus. The purpose of this section is to determine the extent to which the program was treated and delivered consistently and uniformly in the provinces. Where differences do occur, the circumstances and reasons for those variations will be described. The interprovincial comparison of types of assistance in this section is based upon interviews with firms having mills in two or more provinces including four companies in Ontario, two companies in New Brunswick, and five companies in Quebec.

It is important to note at the outset that the perceptions of the persons interviewed indicated in general that there were no major problems in the delivery of the program. Officials of government and the companies felt that it was being delivered in a coordinated way. The study did identify specific differences for each of the provinces involved which will be addressed in the following sub sections.

5.2.1 Design Features and Implementation

The objective of this section is to examine the manner in which the program's original design features were implemented. This includes the differences in assistance, both of level and type, as well as the extent to which the negotiation process varied in the actual program implementation.

(a) Level of Assistance

The percentage of assistance given companies by government varied among the different provinces from approximately fourteen percent to twenty percent of the eligible costs. This range in incentives was due to a difference in projects, objectives, the size of the mills and the fact that the incentive levels were negotiated in Ontario and New Brunswick, but fixed in Quebec. Notwithstanding these differences in percentage of assistance, the companies indicated that they felt treated equitably.

(b) Type of Assistance

The type of assistance varied with Ontario companies receiving an "up front" partial payment followed by progress payments whereas companies in Quebec and New Brunswick simply received progress payments. The "up front" payments in Ontario are credited with bringing certain projects forward in time. While the companies clearly preferred the up front payments they did not feel that the existence of only progress payments in New Brunswick and Quebec created problems with respect to the program's delivery.

5.2.2. Negotiation Process

The purpose of the negotiations was to obtain agreement between the government and the companies with respect to the type of projects to be assisted, the scope of the projects and their timing. Negotiations with the companies did take place in all provinces although the type of negotiations varied among the provinces.

In the case of Quebec, respondents indicated that no federal government/company negotiations took place, simply a presentation of five year plans that served as the basis for determining, through some discussion, the amount of assistance to be paid. The potential for negotiations with companies in Quebec was reduced by the use of a fixed level of assistance. The main negotiations in the Quebec portion of the program occurred between the governments (federal and provincial).

In the case of New Brunswick, half of the companies perceived better treatment in the negotiation process in New Brunswick than in another province. In the Ontario segment of the program the management committee initially identified a benchmark target leverage ratio (total planned incentive to total planned company investment) as 1:7 for purposes of negotiation with the firms. Final investment plans indicate a ratio of 1:7 (public/private) based upon total planned investment of $1.338 billion for the Ontario segment of the program. New Brunswick used a similar ratio, however planned target ratios were not used in Quebec.

In conclusion, using the Ontario process as an example, the negotiation process does offer the opportunity to increase the leverage of government funds thereby increasing value for money. This would seem to be further facilitated with the use of predetermined leverage ratios on the part of the government negotiators.

5.3 Labour

As part of the study team's approach to obtain comments and perspectives from individuals/groups associated with the modernization program, discussions were held with labour representatives in two of the provinces covered by the study. These representatives indicated that there were inadequate measures for labour adjustment under the program particularily for the promotion of earlier retirement and assistance in the attrition process. This finding is related to a recommendation Section C (part iii) of the Interim Report of the Forest Industries Advisory Committee which was released recently.

Recommendation

In a successor program to the pulp and paper modernization program consideration must be given to more labour involvement, and the appropriateness of complementary labour adjustment programs.

6.0 INVESTMENT LEVERAGE

The purpose of this section is to report on the effect which the government assistance had on the amounts and timing of company investments. Firstly, a description of the companies' investment over time is provided. Secondly the efforts on the part of the two governments (federal and provincial) to change the companies' investment plans are examined. Finally, the degree to which the government efforts, assistance or negotiation were able to achieve incremental investments by the company is assessed.

6.1 Investment Levels Achieved

Actual investments realized to date versus those that were planned on the original signing of the agreements differ considerably among the provinces. Quebec companies have expended $1.061 billion (mixed dollars) of a total planned investment of $3.157 billion mixed dollars (34%) as of March 31, 1983. On the other hand, Ontario has expended $919,215,000, (1978 dollars) of an initial total planned investment of $1,292,207,000 (71%) as of December 31, 1982. Finally, the four New Brunswick companies sampled, have expended $249,000,000 of a total planned investment of $432,855,000, (1978 dollars) (57%) as of March 31, 1983.

The percentage of ineligible expenditures also varied considerably among the three provinces. In Quebec the initial planned ineligible expenditures totalled $1.359 billion dollars (in mixed dollars) or 53% of the total planned investment. For the New Brunswick portion planned ineligible expenditures totalled $156,899,000 (1978 dollars) or 36.2% of the total planned investment. In Ontario total planned ineligible investments totalled $155,793,000 (1978 dollars) or 12% of total planned investment. The Quebec figure on ineligible projects is significantly higher than in the other two provinces primarily because of the high concentration of newprint mills in that province: newsprint machine acceleration projects were not eligible under the program.

6.2 Efforts to Increase Levels of Investment

The efforts in Quebec focused primarily on selecting projects with long term commercial viability rather than on increasing the level of investment per se. For example, government officials were able to persuade one company to forego plans to modernize two outdated machines and to install new equipment. The main discussions in Quebec took place between the federal and provincial governments with a subsequent selection of appropriate projects from the companies' five year plans.

In Ontario, federal and provincial officials perceived a concerted effort by the management committee to increase levels of investment and focus investment during the initial stages of the negotiation process with the companies. Evidence based on interviews indicates that, during the early stages of the plan formulation, two cases were cited where one company doubled the level of investment and another company tripled the level of investment due to the efforts of the management committee. In a few other cases in Ontario there were increases in investment levels.

In the case of New Brunswick, officials did not see any concerted effort to increase the level of investments initially proposed by the companies.

In Ontario, and New Brunswick to a lesser extent, the main focus was on improving the levels of investment by the companies whereas in Quebec the focus on the part of government was on selecting projects which would result in long term commercial viability.

With respect to increasing the scope of investment, companies did not see the program having as great an influence as it did on timing. Evidence from the file reviews in New Brunswick indicates companies did increase total investments by $124.8 million. In this case the increase in the final plan for investments over initial levels of investments may be attributed to improved engineering estimates and financial data rather than in negotiation per se. In Quebec the amounts of assistance were not considered large enough by the companies to significantly affect project investment.

Interviews have indicated that investment plans were moved forward as a result of the assistance provided. In some cases the quality and the quantity of the investments were increased.

Recommendation

Future programs should consider the use of target investment leverage ratios as a guideline. The use of these ratios should be consistent in future programs.

6.3 Incrementality

The majority of companies in Ontario and Quebec and half the New Brunswick companies indicated that the most significant influence of the program has been on the timing of their investments : the program was instrumental in bringing them forward. This was seen in Ontario as being a result of the up front/lump sum provincial payments which provided a demonstration of "good faith" on the governments' part to the companies.

7.0 CANADIAN CONTENT

While a secondary objective within the program, Canadian content was important as a means of providing opportunities to the pulp and paper supply industries. This section considers the Canadian content requirements in the program, the monitoring of content requirement achievement, and the effect of the program on Canadian machinery suppliers.

7.1 Canadian Content Requirements in the Program

The requirements for Canadian content in the purchase of machinery and equipment under the program are defined in each subsidiary agreement, specifically sections 11 (1) for Ontario, 28 for Quebec, and 2.9 (a) for New Brunswick. The Quebec agreement makes reference to "Canadian material as well as Canadian professional services", whereas the two other agreements refer, in addition, to "machinery and equipment".

Once the company's investment plan has been examined and the projects selected for assistance, a contract or letter of offer is signed with the company. This contract specifies in detail the terms of the assistance and the requirements on the part of the company. This includes, for Ontario and New Brunswick, a specific level of Canadian content based on the detailed analysis of the plan and discussions with the company. The Quebec contracts do not specify the level of Canadian content to be achieved by the company. However, the letter of offer to the company contains a strongly-worded papagraph referring to the importance attached by both governments to the maximization of Canadian content and the possibility of assistance being withheld if the level is not deemed adequate.

The study has revealed that the manner in which the Canadian content requirements of the program were defined and the Canadian content provisions were adequate. Most respondents felt that the wording used was satisfactory.

The majority of pulp and paper companies in Ontario and New Brunswick perceived that the Canadian content requirements were sufficiently defined in the contracts. With respect to the letters of offer with Quebec companies, Canadian content requirements were not quantified in their view, however companies indicated that they buy Canadian if price, technology, services and delivery are similar to those available elsewhere.

Federal and provincial officials in Ontario felt that the wording in the contract between the governments and the respective company was adequately defined (more so than in the subagreement proper). Under the New Brunswick portion of the program federal and provincial officials felt that it was feasible to define Canadian content and that having requirements so identified ensures consideration of Canadian content in project proposals. In Quebec, federal and provincial officials felt that, in any sectoral program where there is an impact on equipment suppliers, Canadian content requirements should be clearly specified at the outset with program participants.

Companies in New Brunswick and Ontario generally saw the percentage of Canadian content specified in their contracts (estimated to average 85%) as being reasonable. Quebec companies, similarly, did not object to the Canadian content requirements of the program. The imposition of a requirement for a higher level of Canadian content (90% - 95%) would be seen by companies in the three provinces as being unrealistically restrictive: the achievement of Canadian content levels with respect to machinery/equipment purchases depends to some extent upon the availability of "state of the art" technology in Canada and the capability of Canadian manufacturers to meet delivery requirements given that price and quality are competitive with those of offshore suppliers.

On the matter of efforts to increase the amounts of Canadian content in various eligible projects, attempts appear to have been made individually and on an ad hoc basis. Only a few companies in Ontario perceived any attempt by governments to increase the Canadian content levels through the negotiation process while companies in New Brunswick perceived no attempt being made on the part of governments. This may be due to the fact that, to a large extent, Canadian content levels were already considered adequate by government officials, thus reducing the number of companies being persuaded by government officials to increase Canadian content.

In Quebec, pulp and paper companies made no effort to pressure suppliers on the matter of Canadian content. Government officials, both federal and provincial, did ask pulp and paper companies to justify their purchases of foreign equipment. The Management Committee for the Canada-Quebec subsidiary agreement did set up a sub-committee on Canadian content; however, the recommendations that the sub-committee made to the Management Committee were not actioned.

It is interesting to note that cases were reported to the study team in Quebec where certain foreign manufacturers approached Canadian firms as sub-contractors, in an attempt to increase the level of Canadian content in the foreign firm's machinery. Likewise, some Canadian manufacturers approached foreign suppliers to convince them to consider Canadian content.

In conclusion, the experience of this program with regard to Canadian content appears, on the whole, to have been a positive one. Other programs of the Department, involving capital assistance, would likely benefit from a clear delineation, in program design and in program implementation, of Canadian content requirements, and a more concerted effort to alert Canadian equipment manufacturers to opportunities arising from government programs.

Recommendations

1. **Canadian content requirements should be clearly outlined in the design and implementation of departmental assistance programs.**

2. **Systematic efforts should be made to alert Canadian machinery and equipment suppliers to opportunities arising from government programs.**

7.2 Monitoring of Canadian Content Levels

The monitoring of Canadian content levels under the pulp and paper modernization agreements depends to a large extent on the cooperation of the pulp and paper companies with the governments. The subsidiary agreements and the contracts/letters of offer with companies specify that the parties will make available to each other, data and information that are required for program monitoring and management.

Sources for the capture of data on Canadian content levels, both planned and actual, vary in quality and number from province to province, but are nevertheless numerous: company investment plans; contracts with the companies; thirty day notices (of a company's intention to let a contract off-shore valued at more than $250,000); quarterly or semi-annual reports submitted in some provinces by the companies; company claims for progress payments; reports prepared by provincial analysts on individual projects; and the various post-project audits that are conducted. Thus a wealth of data and information exists on both planned and actual levels of Canadian content.

As program administration is handled by the provincial governments for each subsidiary agreement, primary responsibility for monitoring Canadian content levels rests with provincial officials; they in turn, provide the information to the federal partner. However, the study revealed that no formal system exists, at the federal level, to systematically assemble the available data into a regular summary report for program management. Any monitoring system that is developed should indicate Canadian content levels in categories which are useful to management.

Recommendation

If the Department designs Canadian content requirments into its programs, a more formalized approach to reporting actual results in this area should be adopted.

7.3 Effect of the Modernization Program on Canadian Machinery and Equipment Manufacturers/Suppliers

Canadian manufacturers and suppliers of pulp and paper machinery and equipment reaped benefits from the modernization program. Although there are instances of off-shore purchases of machinery and equipment, estimates by officials of the actual level of Canadian content in projects average about 85% (overall on items such as materials, professional services and machinery and equipment), which is quite substantial. Post project audits will confirm the accuracy of this estimate.

Those manufacturers/suppliers of pulp and paper machinery and equipment that were interviewed in Ontario and Quebec indicated that the modernization program has benefitted their industry by causing substantial orders to be placed that would not have gone ahead otherwise. Some machinery and equipment manufacturers also cited the program as a key factor in getting them through the recession. There were only a few instances cited where there were imports of similar items into Canada.

Pulp and paper companies want machinery that is technologically state-of-the-art and that is already in operation. Some of the machinery manufacturers interviewed stated that getting the first installation of machinery and equipment into a mill is a very difficult problem to overcome. Assistance in this area, it was felt, would serve as an incentive for manufacturers to develop more Canadian-made machinery. The study team has not determined the extent to which this is a real need or problem, nor, if it is significant, how well the provisions of the new IRDP would respond to it.

A report entitled "Pulp and Paper Mill Equipment" (prepared in 1982 by the Machinery Branch, Department of Industry Trade and Commerce) indicates that pulp and paper modernization initiatives have resulted in significant increases in the size of the domestic market, increases in the level of Canadian production and a major impact upon trade trends. Specifically the report states that "pulp and paper equipment production in Canada has increased between 1979 and 1981 at an average annual rate estimated at 40 percent reaching close to $400 million in 1981 with a greater proportion of this increased production - 76 percent in 1981 - being directed at the Canadian market. Coincidentally, exports declined from $118.1 million in 1979 to $94.8 million in 1981, an average annual decline of 10 percent".

Although substantial increases in imports took place during the same period (an annual increase of 62 percent) the share of the domestic market which was held by imports appears to have decreased by some 8 percent (45 percent in 1979 to 37 percent in 1981). The increased competition from imports in the Canadian market as a result of the modernization program initiatives gave rise to some anti-dumping investigation which indicated that dumping has come about but was not "materially injurious to Canadian production" (Pulp and Paper Mill Equipment - Report).

Notwithstanding the apparent benefit of a large increase in domestic shipments of pulp and paper machinery and equipment with an estimated 92% average annual growth for 1979-81 which corresponded in time to program implementation and, to a lesser extent, cyclical demand (for the period 1970-1979 domestic market expanded at an average rate of only 4 percent) respondents from the different groups (machinery/equipment suppliers, pulp and paper companies, federal/ provincial officials) felt that the potential for benefits could have been greater. Factors which have been identified as somewhat limiting the positive impacts of the program on equipment manufacturers and suppliers include:

- insufficient lead time to enable the establishment and matching of pulp and paper company requirements with Canadian machinery/equipment manufacturers ability to supply;
- lack of an adequate formal mechanism (or easy means) for directly alerting machinery and equipment suppliers to the opportunities under the modernization program;
- government seen as not taking an active enough role in bringing pulp and paper companies together with manufacturers of machinery and equipment. The major thrust of the Federal government was felt by some manufacturers to be in the export market area, with very little attempted regarding the promotion in the domestic market. Some suppliers claimed not to be fully aware of the modernization program nor of the specific companies which were associated with the program.

Recommendations

1. **The significance of the problem raised with respect to the first installation of Canadian-made machinery should be examined.**

2. **The provisions of the IRDP for assistance to "first installation" projects should be reviewed to ascertain their adequacy in meeting the needs of the Canadian machinery and equipment manufacturers.**

3. In the design of new programs for the Department, the three factors identified as influencing program benefits (lead time for suppliers to prepare for increased demand, information for suppliers on market opportunities resulting from a government program, and the involvement of government in bringing Canadian buyers and suppliers together) should be considered and taken into account according to their relative merits.

8.0 POLICY IMPLICATIONS

This section builds upon the conclusions of the previous sections in a manner which highlights the issues that should receive the attention of management in the near future. These issues include current sector needs and the question relating to the follow-on to the subsidiary agreement.

8.1 Program Achievement and Sector Needs

Although this study was not intended to address specific program results, it has nonetheless identified a general consensus that investment levels have increased quite substantially as a result of the program. With these substantially higher investment levels in cost-cutting modernizations, it is widely held that the industry has made significant progress toward greater competitiveness. While this study has gauged neither the full extent of achievement to date, nor what remains to be done, it is certain that the industry will have to maintain a significant level of investment in order to continue its progress toward international competitiveness.

One very real danger is that upon expiry of the subsidiary agreements, adequate levels of private investment will not be sustained to continue the gains that have been made to date, or to ensure that other problems facing the industry are addressed. Indications are that several areas, aside from modernization, need to be dealt with if the industry is to become more competitive.

The report of the Consultative Task Force on the Forest Products Industry (June 1978) identified four broad areas of concern as follows: cost disadvantages facing Canadian producers; the investment climate facing the industry at that time (the unattractiveness of Canada for major new forest industry investment); the difficulties of generating adequate capital to improve productivity and reduce costs, and forest resource management problems. The more recent report of the Forest Industry

Advisory Committee has identified factors such as increased competition in foreign markets, wide and frequent swings in currency exchange rates, world-wide technological developments in manufacturing and the market place, and wood supply constraints as challenges which are currently facing the forest products industry. Additionally, the respondents in this study identified areas requiring greater investment as R&D, management of forest resources and transportation.

In the newsprint sector, there are indications that investments may not be made due to the current over-capacity arising from soft markets. The cash flow for newsprint mills is not strong currently nor is the outlook expected to be favourable until 1986-1987 when excessive over-capacity is anticipated to be absorbed.

A strategy for the development of the pulp and paper industry was developed in 1978. Since that date, a number of events have occurred which significantly altered the environment in which the industry is operating. For example, the economy has taken a serious downturn, competition has increased in foreign markets, technological developments have appeared, and EEC tariff restrictions have been reduced for the EFTA, which may have a negative impact upon the Canadian share of European newsprint markets. In addition to these external factors, a number of modernization initiatives have been undertaken, in the context of the modernization program, which will affect the industry from within. Thus, it is not certain that the strategy developed in 1978 continues to be relevant.

It would therefore be appropriate to develop an updated sector strategy for the development of the industry. This is particularly important since the current program will terminate soon and since there is an investment momentum in the industry that should be sustained.

Any further measures for the pulp and paper sector are likely to affect the machinery and equipment sector. Such inter-sectoral relationships must be considered in developing a pulp and paper strategy so that the needs of machinery manufacturers, insofar as they relate to the pulp and paper sector, are addressed in a comprehensive and co-ordinated manner.

Recommendation

A pulp and paper sector strategy should be prepared which will provide guidance in the development and application of future programs and take into account the needs and views of the pulp and paper companies, the provincial governments, labour, and Canadian machinery manufacturers.

8.2 Post Subsidiary Agreement Options

There are a number of instruments which could be utilized in assisting the pulp and paper industry after expiry of the subagreement.

Three such instruments for consideration based upon the department's projected programming, industry desires and past experience are the IRDP, specific tax incentives/changes in regulations and the development of new subsidiary agreements. No matter which instrument of assistance is to be utilized in the future with respect to the pulp and paper industry the possibility of countervail action taking place against domestic producers should be an important consideration for the post modernization program period.

1. IRDP

IRDP has been designated as the first instrument for the provision of assistance to new initiatives in the pulp and paper sector apart from those projects presently underway or pending approval.

Essentially IRDP facilitates a regional/sectoral approach for targetting assistance to program clients and enables linking of assistance to the location (TIER GROUP) of a firm. However, there may be constraints in the utilization of IRDP with respect to the size of program funding required for solving major resource processing industry problems.

A second complicating factor is that companies operating in a resource based industry are often subject to provincial ownership/ jurisdiction of needed resources (e.g. wood supply). Under IRDP there may be a question as to how the appropriate degree of interface with provinces will be obtained given that IRDP delivery is more unilateral in nature than was delivery of assistance through the subsidiary agreement mechanism.

2. Tax Incentives

Company officials interviewed indicated a strong preference for tax incentives/changes in regulations as a preferred form of assistance. Further study may be required to investigate the implications of such assistance (federally and/or provincially) as an alternate to the present grants provided. Tax incentives may also be seen as a less conspicuous form of assistance with respect to the issue of countervail. While the tax incentive allows the companies greater discretion in their investments and involves less "red tape" than grants, much of the appeal of tax incentives is lost during the time of low profits when perhaps the assistance is needed the most.

3. Subsidiary Agreements

The subagreement mechanism provided a means of accommodating factors such as joint (federal/ provincial) funding, joint sectoral targetting of assistance to program clients as well as an opportunity for direct inputs from the participating provinces into a federal program. When these factors are important, and informal complementary programming to industry can't be implemented with provincial governments, there may be a need to formalize arrangements with the provinces via subsidiary agreement-oriented instruments. The new economic development agreements being forged with the provinces may be a starting point in this regard.