

Forest Products Industry Competitiveness Task Force

Industry at a Crossroads: Choosing the Path to Renewal

May 2007



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Executive Summary

Technological innovation and globalization are transforming the traditional business practices and models of the global forest and paper industry at an accelerating rate. These changes, combined with a sharp appreciation in currency value and structural changes in key product markets, have created unprecedented competitive stresses for Canada's forest products industry.

The Forest Products Industry Competitiveness Task Force (Task Force) believes that the challenges facing the industry are structural in nature and that, if left unaddressed, they will lead to a trajectory of continued decline for the sector. However, the Task Force also strongly believes that decline is far from inevitable. Factors like global economic growth, emerging breakthrough technologies in the sector and increasing public concern with climate change and sustainability issues are creating unprecedented opportunities for Canada's forest sector in the international marketplace.

During the course of its work, the Task Force analyzed four scenarios which could offer a route to a more prosperous and sustainable future for Canada's forest products industry:

- 1) Global Softwood Competitor
- 2) North American Softwood Competitor
- 3) North American Multi-Product Competitor
- 4) Global Wood Products Competitor

The Task Force believes that each scenario is feasible and could offer a pathway on a regional or national basis to forest products industry renewal. Regardless of the pathway or pathways taken, the critical conditions to enable them are very similar. They are:

- 1) **Cost-competitiveness:** The Task Force believes that second quartile cost-competitiveness should be regarded as the minimum for sustained economic viability, but that first quartile cost-competitiveness is a more appropriate benchmark for enabling the sector to attract the new investment capital required for profound renewal. Although there are pockets of the Canadian industry that are very cost-competitive, only a minority of existing Canadian capacity meets the second—let alone first—quartile cost-competitiveness test. Major determinants of cost-competitiveness in the forest products industry include:
 - **Fibre Costs:** Delivered wood costs vary regionally. In the B.C. Interior and Alberta, wood costs are very competitive, largely as a result of a temporary increase in harvest volumes due to the mountain pine beetle infestation. By contrast, fibre costs on the B.C. Coast and across much of eastern Canada are high by international standards.
 - **Energy:** The forest products industry has a unique capacity to self-generate energy from renewable sources. Canada's pulp and paper sector already self-generates 60 percent of its energy needs from renewable sources and the forest sector as a whole has the potential to become a net source of green power within a decade and a half. However, some major segments of the industry, like the mechanical grades of pulp and paper, will remain significant consumers of purchased electricity and competitive power costs will be key to power their continued viability.
 - **Transformation Efficiency:** Despite pockets of excellence, the capital stock of the industry as a whole is older and less productive on average than that of leading global competitors.
 - **Personnel Costs:** Across each segment of the industry analyzed by the Task Force, Canada's personnel costs were the highest, or very near the highest, in the world. Additionally, labour productivity levels in most sectors of the industry are well below world-class levels, creating a productivity gap.



- **Transportation:** The forest products industry is the largest user of rail services in Canada. The cost associated with these services directly affects our ability to translate Canada's proximity to the world's largest and most lucrative market into competitive advantage. The monopoly power exercised by rail carriers over mills "captive" to a single rail line added \$280 million or 15 percent to the industry's total rail freight bill in 2006. While the ability of railways to extract monopoly rents from shippers substantially undermines the competitiveness of the Canadian forest products industry as a whole, this situation is particularly damaging to the cost-competitiveness of those production facilities operating in the most northerly and remote communities.

Increasing the share of Canadian production capacity in the first and second quartiles of cost-competitiveness will require some combination of lower input costs and greater investment in technology and scale.

- 2) **Investment:** The core challenge facing Canada's forest products industry is the requirement to attract the investment necessary to renew its capital stock. The Task Force concluded that the Canadian industry can attract the capital necessary to remain competitive in global markets for decades to come. However, this will require a willingness on the part of industry, policy-makers, labour and other stakeholders to embrace far-reaching changes. Despite substantial capital investments each year, the industry's capital stock has been shrinking as depreciation rates have exceeded capital expenditures for 10 consecutive years. While there are segments of the Canadian industry that have attained world-class levels of scale and productivity, billions more in annual capital investments are required to renew the industry's capital stock. Attracting new capital investment to the sector is ultimately the responsibility of the industry itself, but public policy also plays a critical role in shaping the sector's investment climate.
- 3) **Industry Structure:** The accelerating pace of change in global forest and paper markets increases the importance of a regulatory and public policy framework that allows the flexibility to adapt to the requirements of the global marketplace. By global standards, the Canadian forest products industry remains highly fragmented. Until early 2007, no Canadian-based company ranked among the 20 largest in the world. Larger firms in the industry enjoy many significant advantages, including a lower cost of capital, greater scale economies in production and marketing, and a superior ability to manage the risks associated with technological innovation and major capital projects. The industry needs to be able to quickly adapt its structure and operations in response to the accelerating pace of change in global forest and paper markets. As a result, the hidden and often unintended costs of policies which inhibit the ability of industry to adapt to a changing global environment continue to grow.
- 4) **Future Orientation:** Future success in the industry will require increased market sensitivity, continued leadership in sustainability, sustainable forest management and environmental performance, human resources excellence and a renewed focus on new geographic and end-use markets. The Task Force believes that a number of emerging breakthrough technologies in the sector hold the potential to offer significant commercial opportunities over time and that Canada should strive to be at the forefront in their development and early deployment to improve productivity, reduce costs and create new products and processes. Realizing these opportunities requires a strong innovation system which, in turn, depends on competitive strength in core businesses and a critical mass of globally competitive firms and production capacity in traditional product lines.



A Path to Renewal

Given the opportunities and challenges facing Canada's forest sector, the Task Force identified a path forward to enable its renewal. It involves three major elements:

- 1) **Getting Costs Right:** The four largest input costs for most products are fibre, personnel, energy and transportation. In all cases, both industry and government have a role to play in ensuring these costs are globally competitive:
 - **Fibre:** Provincial governments should reform tenure systems to make them more flexible and to optimize investment in sustainable forest management; of particular importance are eliminating appurtenancy where it continues to exist, and reforming other rules that have the effect of dictating industry structure and production decisions.
 - **Transportation:** The federal government can reduce excessive rail costs through legislation to expand running rights and strengthen final offer arbitration to create a more competitive rail system.
 - **Personnel:** Industry, in collaboration with labour, needs to identify means of increasing productivity in the sector so as to better match personnel costs with productivity levels.
 - **Energy:** The industry should commit to becoming a net source of renewable energy within a decade and a half. Public policy-makers can help to realize this objective through a market-oriented approach to environmental and renewable energy policy that encourages investment and innovation in renewable energy and technologies and energy efficiency.
- 2) **Getting Industry Structure Right:** Attracting billions of dollars in new capital investment to the sector is the only means by which further contraction in production capacity and a relative decline in asset quality may be avoided. Building the confidence of capital markets in the sector's future in order to enable capital renewal is ultimately the responsibility of the industry itself. However, the quality of hosting conditions created by Canada's public policy framework has an indisputable impact on the process. In this regard, governments can assist the renewal process through a more globally competitive tax and investment climate, as well as through a new approach to forest tenure and mergers policies. In particular, governments should:
 - Ensure tenure systems allow fibre to be allocated to its highest value use;
 - Apply mergers policy to the sector that recognizes the global nature of markets and competition;
 - Reduce the Marginal Effective Tax Rates (METR) on capital investment to below the OECD average within five years;
 - Eliminate capital taxes and the application of sales taxes to capital inputs at the provincial level;
 - Extend the announced two year accelerated capital cost allowance for new investments in manufacturing and processing equipment;
 - Make Scientific Research and Experimental Development (SR&ED) program credits refundable.



- 3) **Getting the Future Right:** Industry has a leadership role to play in enabling the renewal of Canada's forest sector through a focus on such priorities as continual improvement in sustainability and sustainable forest management performance, an increased customer focus, expanded market development efforts and a sustained commitment to the development and early deployment of breakthrough technologies. Actions that industry and governments can take to realize this objective include:
- Renewing and deepening partnerships to support the development and early deployment of the most promising bio-energy technologies;
 - Building on Canada's history of success in growing non-traditional geographic and end-use markets for wood products through public-private partnerships in support of market development;
 - Developing an environmental policy framework that is predictable, results-based and makes use of emissions pricing and economic instruments to enable the industry to move forward in further reducing its environmental and carbon footprint.

Conclusion

The Task Force is confident that revitalization of the Canadian forest products industry is possible and that Canada can—and should—be at the forefront in re-defining social, economic and sustainable success in the global forest and paper industry of the 21st century. However, the path to renewal must be chosen—by companies, by governments, by workers and by communities; it will not happen on its own. Renewal can be thought of as a multi-stage process involving a series of steps toward economically sustainable performance: restructuring, consolidation and reinvestment. While some segments of the industry are well advanced in this process, others have just begun.

The Task force recognizes that much of the needed change needs to be initiated by the industry itself, both at the firm level and collectively. However, capturing the unique opportunities that the new global marketplace offers will also require decisive action and far-sighted leadership on the part of policy-makers, labour and other stakeholders. Realizing the emerging opportunities in the global forest and paper industry offers a sustainable means of revitalizing one of Canada's most important industrial sectors and is of special importance to the self-sufficiency and economic well-being of hundreds of communities across rural Canada. The industry faces a very fundamental choice: continue on the current path or accept the reality of a changed global environment and strive for the opportunities that it offers.



I. INTRODUCTION

The Forest Products Industry Competitiveness Task Force (Task Force) was formed in response to widely held and growing concerns about the Canadian industry's current situation and future prospects. The full Task Force mandate and membership are listed in Annex I of this report.

The Task Force was formed by a group of leading industry executives, in partnership with senior federal policy-makers and recognized industry experts. The group's objective is to identify means of accelerating renewal and innovation in Canada's forest products industry and the key actions required by industry, government or other stakeholder groups to realize needed change.

The Task Force retained Poyry Forest Industry Consulting Oy, the pre-eminent global expert in the forest and paper industry, to offer strategic advice on the Canadian industry's competitive position and future prospects.

Informed by the results of the Poyry analysis, the Task Force concluded that technological innovation and globalization are transforming the traditional business models and trade patterns of the global forest and paper industry at an unprecedented rate. The industry's stakeholder community in Canada—including management, governments, Aboriginal peoples, labour and communities—face a fundamental choice about the future: either to accept the reality of a changed global environment and strive for the opportunities that it offers, or to choose to ignore this reality and face a future of diminishing possibilities.

- **While the Task Force believes that Canada possesses all of the elements necessary to compete for our share of the global forest and paper industry it also believes we are at risk of squandering this potential. Although there are many examples across Canada of industry, government or other stakeholders taking action to enable industry renewal, there are other instances where a resistance to needed change is undermining the longer-term viability of the sector.**
- **By embracing the opportunities that a changing global environment offers and making the difficult changes needed to realize them, the Task Force believes that Canada can be at the forefront in re-defining social, environmental and competitive excellence in the forest products industry of the 21st century.**

The status quo is not an option. The industry is under severe pressure and industry, government and other stakeholder groups must fundamentally re-think their approach to the sector. Status quo behavior simply will not translate into status quo outcomes but rather into relative and absolute declines in the industry's contribution to Canadian employment levels, trade balance, renewable energy production, payments to government and innovation effort, among other indicators of economic, social and environmental performance.

In large part, the difficulties being experienced by the industry reflect a need to accelerate the rate at which the sector is adapting to the new competitive reality. Many of the business practices, regulatory frameworks and the culture of stakeholder relations that govern operations in the industry today were developed decades ago when forest and paper markets were more regional and much less competitive. In the past, it may have been viable—even rational—for relations between industry, labour, governments and other stakeholder groups to focus largely on competing for the economic rents associated with our forest resource. With the intensification of competition in global forest and paper markets, deriving sustainable economic and social benefit from our forest resources depends increasingly on generating wealth through investment and the application of knowledge at each stage of the value chain rather than simply by appropriating resource rents. The changes taking place in the global forest and paper industry offer a unique window of opportunity for Canada to generate knowledge-based jobs and sustainable economic benefits from new products and markets.



II. WHY THE FOREST PRODUCTS INDUSTRY MATTERS TO CANADA

Throughout history, forest resources and forest products have been a cornerstone of the Canadian economy. The industry remains a critical part of the economy in each region of Canada and the country as a whole. Among industrial sectors, the forest products industry ranks ahead of both oil and gas and automotive manufacturing in terms of its contribution to GDP. The industry exports over \$38 billion in products a year and accounts for about 60 percent of Canada's merchandise trade surplus. While the vast majority of forest products are exported to traditional markets like the United States, Japan and Europe, the industry is also a leader in entering emerging markets. In 2006, forest products were Canada's leading export to India, China and South Korea.

The forest products industry directly employs over 300,000 Canadians and sustains over 500,000 more jobs through its activities. In addition to being one of Canada's leading industrial employers, the industry is by far the most geographically diffuse source of industrial activity in Canada's economy. **Although the industry makes an important contribution to employment and economic activity in Canada's largest cities, it is the forest sector's capacity to sustain high wage, high productivity jobs across vast stretches of the country's less populated regions that is perhaps its most unique characteristic.** There are over 300 communities across Canada in nine provinces stretching from the Atlantic coast to the Pacific that depend almost entirely on the forest products industry for their economic well-being.

Forest products is not only a large employer in Canada, it is also a well-paying one with wages well in excess of the national average. One recent study estimated that average wages and benefits across the sector are about \$70,000 per employee, and they can be significantly higher in certain segments of the industry.

The forest sector is an important source of employment and business opportunities for Aboriginal Canadians. There are over 1600 Aboriginal-owned businesses in Canada's forest sector, and the industry is a disproportionately large employer of the Aboriginal workforce across Canada. In recent years, dozens of new partnerships have been formed by Aboriginal communities and Canadian forest products companies, ranging from joint ventures to scholarship programs and training initiatives. Considerable scope exists to increase the quantity and depth of partnerships between forest products companies and Aboriginal groups in the years ahead.



III. THE CURRENT SITUATION: PROFOUND RESTRUCTURING

The forest products industry faces a series of challenges that are virtually unprecedented in its long history. **While the specifics vary considerably across regions and products, the situation of the industry overall is one of a sector in the midst of a profound restructuring.** It should be noted that the competitive stresses facing the industry as a result of a changing global marketplace are by no means unique to Canada. Factors like the rapid growth in plantation forestry in the southern hemisphere, as well as the integration of primary and secondary production capacity from non-traditional producing regions into global supply chains, have contributed to chronic overcapacity in segments of the sector and low average financial returns globally.

Despite the challenges facing the forest products industry as a whole, there are examples across Canada of facilities, companies and sectors that are global leaders in competitiveness. One such example is the softwood lumber sector in the British Columbia (B.C.) Interior which boasts a critical mass of production facilities that are world-class in terms of scale, productivity and cost-competitiveness. The competitive strength of the wood products sector in this region and across much of western Canada, combined with strong demand and prices, resulted in solid average returns through the first half of this decade, despite the softwood lumber dispute with the United States. High demand from an unprecedented boom in the U.S. residential construction market coupled with aggressive capital investment and a move to a more market-oriented forest policy framework all played a role in facilitating the competitive transformation of the softwood lumber sector in this region. **However, in a fast changing and increasingly competitive global marketplace, even global leaders must adapt and confront new challenges in order to thrive over time.** Take the case of the B.C. Interior's wood products sector which has seen a significant weakening in demand and prices for many of its products as a result of the sharp cyclical downturn in the U.S. housing market. Although the longer-term outlook for lumber demand is very positive, producers in the B.C. Interior will be constrained by the impacts of the mountain pine beetle on timber supply and quality in the medium to longer term. In addition, the economic fortunes of the lumber industry are dependent on a viable pulp and paper sector due to the importance of a market for wood residues to the industry's cost-competitiveness.

Outside of some pockets of global excellence, much of Canada's forest products industry is grappling with serious structural difficulties that are resulting in dislocations and capacity closure. While much of Canada's wood products sector benefited from strong demand and prices through the middle years of this decade, the sharp decline in prices for lumber, structural panels and other wood products that began in the first half of 2006 exposed important problems in the sector across much of eastern Canada and the B.C. Coast. By October of 2006, over 30 sawmills had either permanently or indefinitely closed a total of over 6.5 million cubic metres of capacity, more than offsetting the significant net growth in capacity in Canadian softwood lumber capacity that had taken place earlier in the decade. It is widely expected that continued cyclical weakness combined with ongoing restructuring will result in further capacity closures in the Canadian wood products sector, at least through 2007.

The pulp and paper sector has largely failed to benefit from the prolonged upswing in the business cycle and in corporate profitability through the early part of this decade. From 2000 to 2005, the pulp and paper sector failed to earn its cost of capital once, which is typically in the range of 8–13 percent. During this period, the pulp and paper sector suffered a total reduction in its production capacity of 12 percent with the reductions concentrated in the newsprint and softwood kraft pulp sectors.

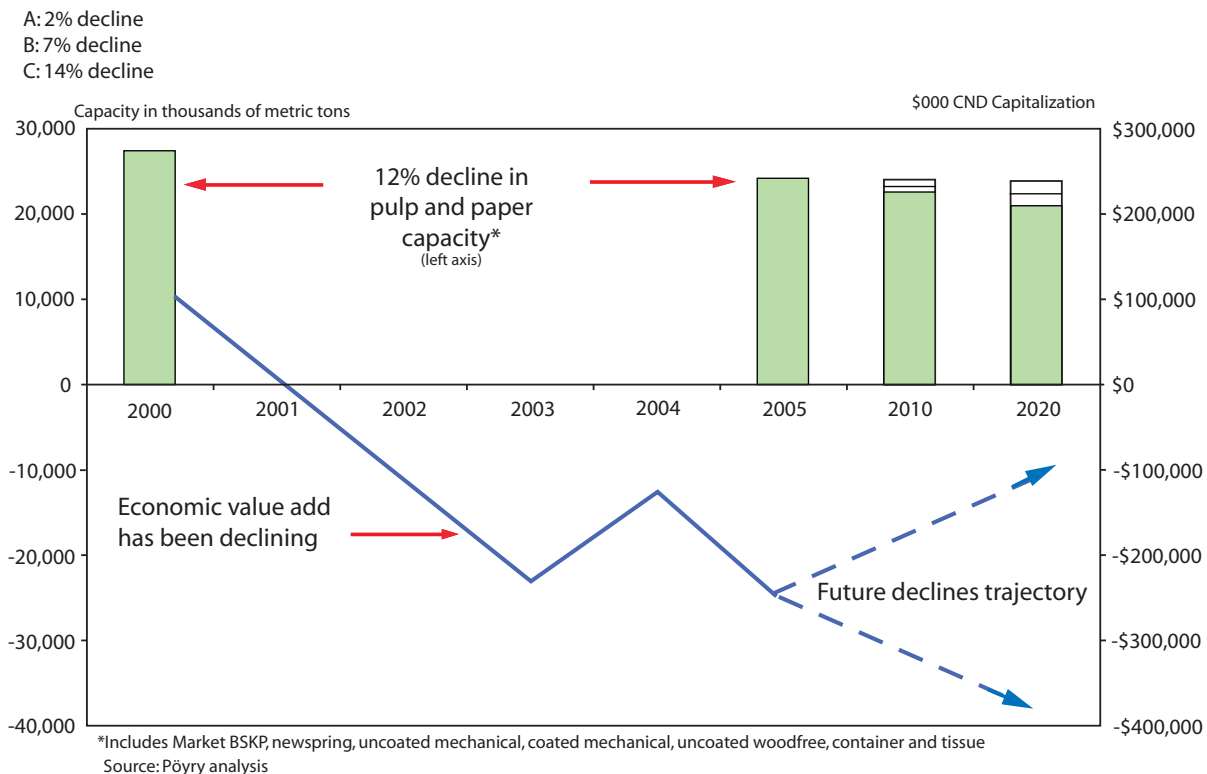
As an export-oriented industry, the Canadian forest products industry is particularly vulnerable to fluctuations in exchange rates, especially the Canada–U.S. dollar rate. Between 2002 and 2006, the average Canada-U.S. exchange rate increased from 63.6 cents to 88.1 cents, an increase of 38 percent. Given the export-driven nature of Canada's economy, a stronger Canadian dollar adversely impacts all exporting or trade-exposed Canadian industries. However, both the wood and pulp and paper sectors rank among the most vulnerable, in large part because the majority of their products are sold in U.S. dollars in the United States. Major input costs for Canadian forest products producers, by contrast, include electricity, labour and wood fibre, all of which are priced in Canadian dollars and do not adjust rapidly to exchange rate fluctuations. While Canadian manufacturers are sometimes thought to benefit from a stronger Canadian dollar through lower prices for machinery and equipment sold in U.S. dollars, this is generally not the case in the Canadian forest products industry where much of the imported machinery and equipment is priced in other currencies like the Euro. Between 2002 and 2006, the Canadian dollar appreciated by less than 5 percent against the Euro. By diminishing the cost-competitiveness of Canadian facilities, particularly in relation to their U.S. counterparts, the higher value of the Canadian dollar also has the effect of making capital investment at U.S. facilities relatively more attractive than in Canada.



3.1 The “Base Case” Outlook

Left unchecked, the structural factors which underlie the current situation will lead to a substantial further contraction of the industry. Figure 1 below illustrates the “destruction” of capital in Canada’s pulp and paper sector as a result of a sustained period of financial returns that are less than the sector’s cost of capital. Analysis conducted for the Task Force by Poyry Forest Industry Consulting estimates that a “business as usual” approach to the pulp and paper sector will result in a further net reduction in Canadian capacity of 2–14 percent by 2020, in addition to the 12 percent contraction experienced from 2000–2005.

FIGURE 1: Pulp and Paper Sector Base Case: Inadequate Returns on Capital Leading to a Further Contraction in Capacity and Job Losses



Given its unique geography, the structural and economic problems experienced by the forest products industry almost inevitably translate into distress for workers and communities whose livelihoods depend on the sector. There were 135 instances of permanent or indefinite capacity closures announced in the Canadian forest products industry in 2005–2006, resulting in the loss of over 16,000 direct jobs and tens of thousands more indirectly. Further net declines in production will likely have a disproportionate impact on employment as less efficient mills are shut and as productivity increases over time.



IV: CHOOSING A PATH

The Task Force strongly believes that a trajectory of decline for Canada's forest products industry is far from inevitable. Factors like global economic growth, emerging breakthrough technologies in the sector and increasing public concern with climate change and sustainability issues are creating unprecedented opportunities for Canada's forest sector in the international marketplace. If Canada's forest products industry and stakeholder community are willing to make the changes necessary to realize these opportunities, a renewed Canadian forest products industry can be a critical and sustainable element of Canada's economic and social fabric for decades to come.

4.1 Renewal Scenarios

The Task Force identified a number of potential scenarios for a successful Canadian industry over the next 5–15 years and the critical conditions necessary to realize them. Four different scenarios were analyzed and the Task Force believes that each could offer potential pathways to a more prosperous future.

- 1) Global Softwood Competitor:** This pathway involves competing in wood products, market pulp and mechanical printing papers in global markets. Key success factors would include competitive strength in softwood fibre and energy costs, as well as the ability to transfer manufacturing and market expertise into world class platforms in Canada and around the world. In many respects, this model resembles the renewal path that has been successfully followed by the Finnish forest products industry over the past two or three decades.
- 2) North American Softwood Competitor:** Although this scenario resembles #1 in terms of product mix, the focus in this case would be on competing in the North American, rather than the global, marketplace. Success would depend critically on the ability to leverage knowledge of and proximity to the U.S. market into competitive success at production facilities on both sides of the border.
- 3) North American Multi-Product Competitor:** As in scenario #2, the focus of this pathway would be on the North American market but with a broader product mix that would include packaging grades, freesheet paper and tissue products. Competitive success would depend in part on using local market knowledge to offer superior price and service to a North American customer base.
- 4) Global Wood Product Competitor:** This scenario involves a focus on serving global markets for lumber, panels and engineered wood products. Pulp and paper and bioenergy production would continue to remain an important part of the industry in this scenario in providing a market for wood residues from sawmills. Leveraging Canadian strengths in Canadian softwood resources, as well as wood products manufacturing, marketing and distribution, would be key to success under this scenario.

The product mix and markets for the Canadian forest products industry have always varied across regions and this will continue to be the case. **Regardless of which path or paths are most attractive on a regional or national basis, it is the view of the Task Force that the critical conditions to enable them are very similar.**



4.2 Building on Strengths

Despite the current challenges, Canada retains significant advantages within the global forest and paper industry.

These include world-class educational and research institutions serving the industry, as well as a highly skilled labour force with technical, marketing and management expertise that can confer competitive advantage in a time of rapid change. North America's unrivalled status as the largest and most lucrative market for most forest products can also be a significant advantage to Canadian producers in terms of market and customer knowledge, transportation costs and other factors. The size, diversity and unique qualities of Canada's fibre basket also create the potential for competitive advantage relative to industries built on faster growing, uniform plantation resources. Canada's long tradition as the world's largest exporter of forest products, as a world leader in sustainable forest management and as a leading producer of newsprint market pulp and lumber offer a platform for renewal and growth if the core competitiveness issues are understood and action is taken. **North American and global markets for forest products continue to grow and analysis undertaken by the Task Force indicates that there will be ample North American and global demand to support a renewed Canadian forest products industry.**

Recent low-cost entrants into global forest and paper markets typically enjoy tremendous advantages in terms of input costs which may appear to present a formidable, if not insurmountable, barrier to Canadian cost-competitiveness. **But, major overseas producers also face significant challenges and constraints, whether it be infrastructure limitations and investment climate issues in Russia, energy, water and fibre supply uncertainties in China or social or land-use conflicts in Latin America. In addition, many recent entrants into global markets face serious questions regarding sustainability performance, illegal logging and deforestation.**



V. CRITICAL CHALLENGES MUST BE ADDRESSED

While many factors influence the competitive position of the Canadian forest products industry and its constituent segments, **the core challenge facing the industry is an inability to generate an average return on capital employed equal to its cost of capital over the business cycle, and a resulting inability to attract sufficient investment capital to renew its capital stock.** This is particularly true in the capital-intensive pulp and paper segment of the industry where returns over the past decade have been weakest and capital requirements are the largest.

The Task Force identified a number of common conditions that are critical for all success scenarios for the Canadian industry—that is, conditions that are required for the industry to compete in the relevant product and geographic markets, earn its cost of capital and generate sufficient profitability in order to reinvest in renewal.

5.1 Overall Cost-Competitiveness

The Task Force believes that the most fundamental condition for sustained economic viability is second quartile cost-competitiveness. That is, Canadian production facilities must be able to better the cost position of over 50 percent of their rivals. However, the forest products industry is an extremely competitive business in which only a relatively small number of firms globally have consistently earned a rate of return in excess of their cost of capital in recent years. **Given this context, the Task Force believes that while second quartile cost competitive facilities may be regarded as economically viable, first quartile cost-competitiveness is a more appropriate benchmark for making the Canadian industry attractive to the new capital investment needed to fully realize the new opportunities that the global marketplace offers.**

As with virtually any other tradable good or service, the ability to compete with relevant international rivals on the basis of cost is key to long-term viability. Competitively priced input costs are critical not only to near-term economic viability in globalizing markets but also to attracting investment capital necessary to improve the industry’s asset quality. This is particularly the case in a mature industry where all products, including higher value products, compete primarily on the basis of cost. **Without improved cost-competitiveness, large segments of the industry risk being trapped in a cycle of low profitability, lack of access to capital and low reinvestment.**

FIGURE 2: The Majority of Canadian Pulp and Paper Capacity Fails to Meet the Second Quartile Test

Product	% of capacity in 1st Quartile	% of capacity in 2nd Quartile	% of capacity in 1st and 2nd Quartiles	Share of Canadian Production (****)
News-print (*)	7	27	34	25%
SC-B	8	23	31	2%
LWC	0	21	21	3%
(N)BSKP (**)	32	29	61	23%
UCFS	0	0	0	5%
Container-board (***)	0	8	8	14%
Total - as a % of capacity analyzed	16	18	34	100%
Total as a % of Canadian capacity	12	16	28	77%

Source: Pöyry analysis

(*) Std. newsprint assessed in comparison to North American producers

(**) Northern market softwood kraft pulp

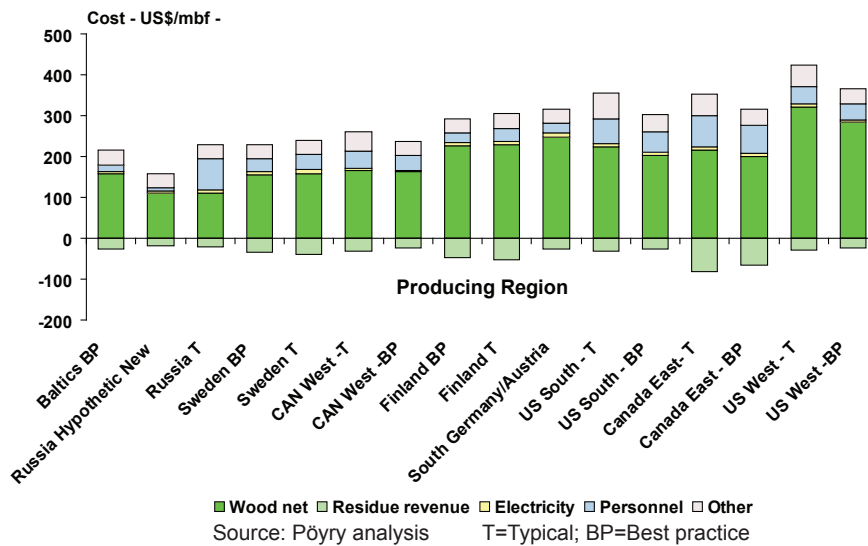
(***) Linerboard and corrugated medium

(****) Does not add to 100% because certain grades are selected



Figure 2 summarizes the share of capacity in many major segments of the pulp and paper sector that are first or second quartile in terms of cost-competitiveness relative to their major global competitors. **For most products, a wide majority of Canadian capacity fails to meet the second—let alone first—quartile test.** While some producers were able to attain first or second quartile cost-competitiveness in most of the product categories analyzed, they represent a minority of total capacity. Among the pulp and paper sub-sectors analyzed by the Task Force, only 34 percent of capacity are second quartile or better and just 16 percent met the first quartile test. This suggests that although Canadian pulp and paper producers are able to attain world-class levels of cost-competitiveness in a variety of market segments, it is also clear that some combination of productivity improvement and improved input cost-competitiveness is required for a majority of Canadian capacity even to reach the minimum level of performance to assure long-term viability.

FIGURE 3: Cost Comparison – Dimension Lumber



While Western Canadian Capacity is Very Competitive, Eastern Capacity is High Cost

The chart in Figure 3 illustrates average costs in lumber production across a number of major producing regions of the world. The competitive position of Canadian producers varies sharply across regions, with western Canadian production costs being the lowest of any North American region and among the lowest globally. By contrast, production costs in eastern Canada are among the highest in both North American and global terms as a result of higher wood and transformation costs.

Major input costs in the production of forest products include fibre, labour, energy and transportation. Figure 4 provides some examples of the relative share of each of these items to total production costs for several major segments of the industry.



FIGURE 4: Typical Production Costs for Selected Canadian Forest Products

Item	Bleached Softwood Kraft Pulp– Western Canada– Delivered to Chicago	Newsprint– Eastern Canada– delivered to U.S.	Softwood Lumber– B.C. Interior– Delivered to Chicago
Wood Fibre	36%	17%	52%
Labour	18%	18%	17%
Energy	11%	21%	4%
Transportation to Market	14%	23%	20%
Other	21%	21%	7%

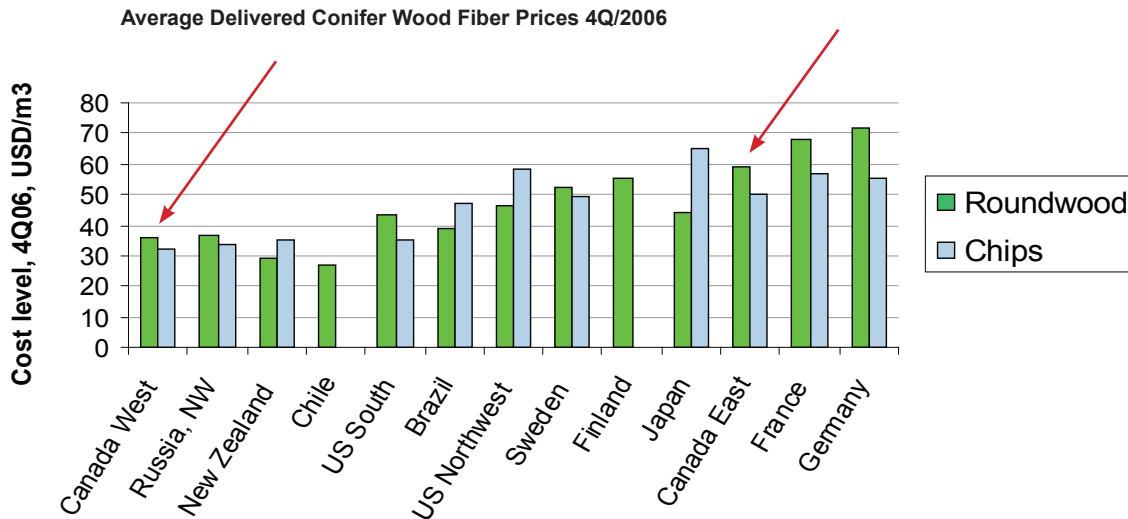
Sources: Poyry, RISI

5.1.1 Wood Fibre Costs

In most segments of the Canadian forest products industry, wood fibre is the single largest input cost and can account for over half of variable production costs for some products. For this reason, **the Task Force believes that second quartile delivered wood costs are a precondition to a globally competitive forest products industry.**

Fibre costs for Canadian forest products producers vary widely across products and regions. In the B.C. Interior and across much of western Canada, delivered wood costs in both the softwood lumber and pulp and paper sectors are very cost competitive. To a significant extent, this situation is the result of a temporary increase in harvest volumes as a result of the mountain pine beetle infestation. In eastern Canada, by contrast, high delivered costs for softwood are partially offset by high residual chip prices; eastern pulp and paper producers face some of the highest fibre costs of any producing region in the world.

FIGURE 5: Canadian Wood Costs Range From Among the Lowest to Among the Highest Relative to Global Competitors



Source: Wood Resources International, February 2007



5.1.2 Personnel Costs

High personnel costs are a significant contributor to the Canadian industry’s cost-competitiveness gap. **While Canadian personnel costs are the highest or very near the highest in the world, average productivity levels are substantially below world-class levels.** This is a significant contributor to Canada’s overall cost disadvantage. Figures 6 and 7 show the relationship between personnel costs and productivity across major producing regions around the world for the softwood kraft pulp and softwood lumber sectors, respectively.

In part, this gap is a reflection of the need for capital renewal in parts of the Canadian industry as newer, larger production facilities will tend to enjoy higher rates of labour productivity. However, as can be seen in Figure 6, Canadian productivity levels lag those of world leaders even at facilities of similar size. This suggests that factors like management, work practices and skills also contribute to the productivity gap.

FIGURE 6: Canada’s Personnel Cost Among the Highest but Productivity Often Lags

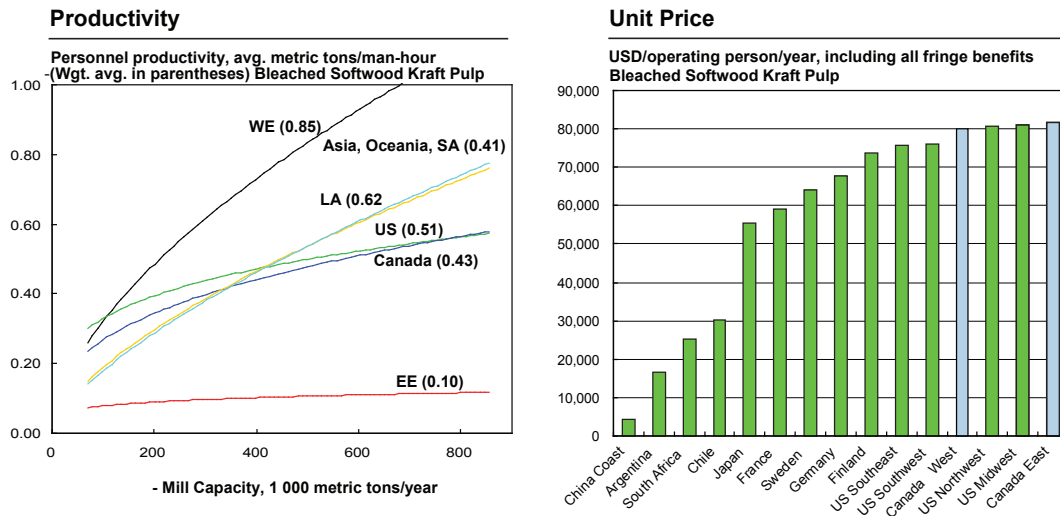
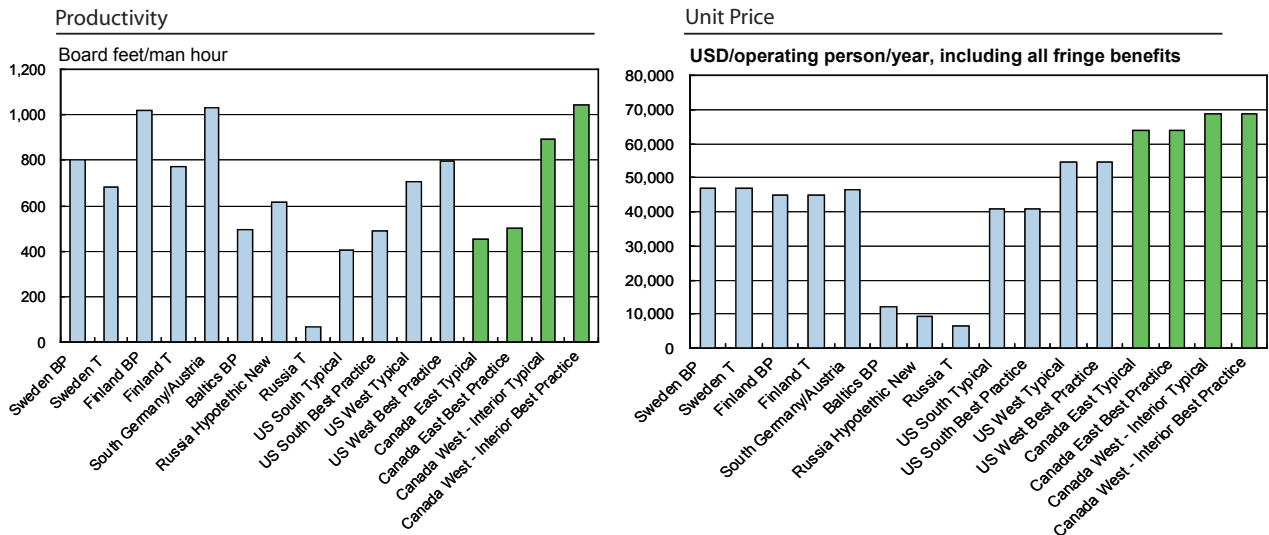


FIGURE 7: Personnel Cost – Softwood Lumber

Canadian Personnel Costs in the Lumber Sector are Among the Highest in the World. While Productivity Rates are Also High in Western Canada, This is Not the Case in Eastern Canada



Source: Pöry analysis



5.1.3 Energy

The pulp and paper sector is the largest industrial user of energy in Canada. Although this sector self-generates about 60 percent of energy needs from renewable sources, it is adversely impacted by a rise in fossil fuel prices or industrial power rates. **Through capital renewal and technological innovation, the Task Force believes that the forest products industry as a whole can substantially increase the quantity of energy it generates from renewable sources and become a net source of green power by 2020. However, even as the industry moves toward net energy self sufficiency major segments of the pulp and paper sector, like the newsprint industry, will continue to purchase significant quantities of electricity.** Industrial power rates vary widely across Canada, with B.C., Québec and Manitoba offering very competitive rates, while rates in Ontario and some other provinces are at the high end of the North American cost curve.

5.1.4 Transportation

Across all segments of Canada's forest products industry, transportation costs are a large share of the delivered cost of products. The forest products industry is the largest consumer of rail services in Canada and the second largest consumer of trucking services. Reliable, cost-effective rail service is critical to the competitiveness of these facilities, particularly for those whose distance from tidewater or major population centres limits the viability of other modes of transport. Most of the Canadian forest products industry is located in smaller and more remote communities where they are "captive shippers" served by a single rail line. Analysis commissioned by the Task Force provides further evidence that Canada's railways can use their market power to earn excess profits from the forest products industry with returns from captive shippers well above that required to attract the capital needed to invest in new infrastructure. **Overall, analysis commissioned by the Task Force estimates that, in 2006, excess freight charges by railways as a result of their monopoly power over the sector's captive shippers added \$280 million or 15 percent to the industry's total rail freight bill.**

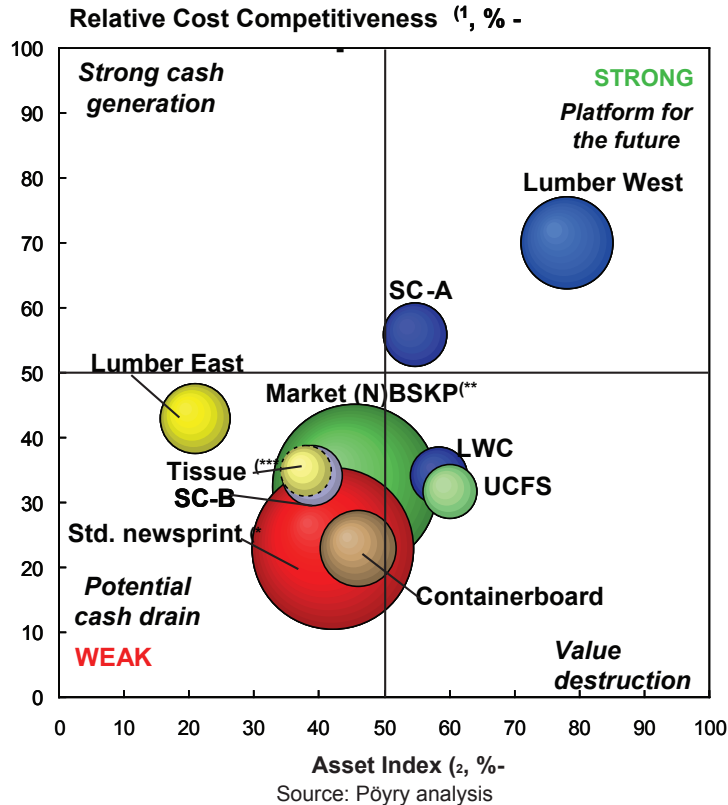
5.2 Investment and Asset Quality

Asset quality is an essential contributor to overall cost-competitiveness and labour productivity. With average returns below its cost of capital, new investment in the industry has been lower than depreciation for 10 years consecutively. For example, although Canada's forest products industry made \$3.5 billion in capital investments in 2006, depreciation of capital stock was \$4.5 billion. An exception to this trend has been the Interior region of B.C. where recent investments have lead to a strong asset quality position in softwood lumber and other wood products.

Figure 8 summarizes the average cost-competitiveness and asset quality of eastern and western softwood lumber producers as well as production capacity for several grades of pulp and paper. It demonstrates that average asset quality for many segments of the industry is well below that of competitors, resulting in lower cost-competitiveness.



FIGURE 8: Transformation Efficiency is Key to Cost-Competitiveness



With capital expenditures below depreciation levels, Canadian asset quality is declining each year. At the same time, significant quantities of world-class production capacity are entering global markets through capacity expansion, further depressing Canada’s relative standing in terms of asset quality and cost-competitiveness.

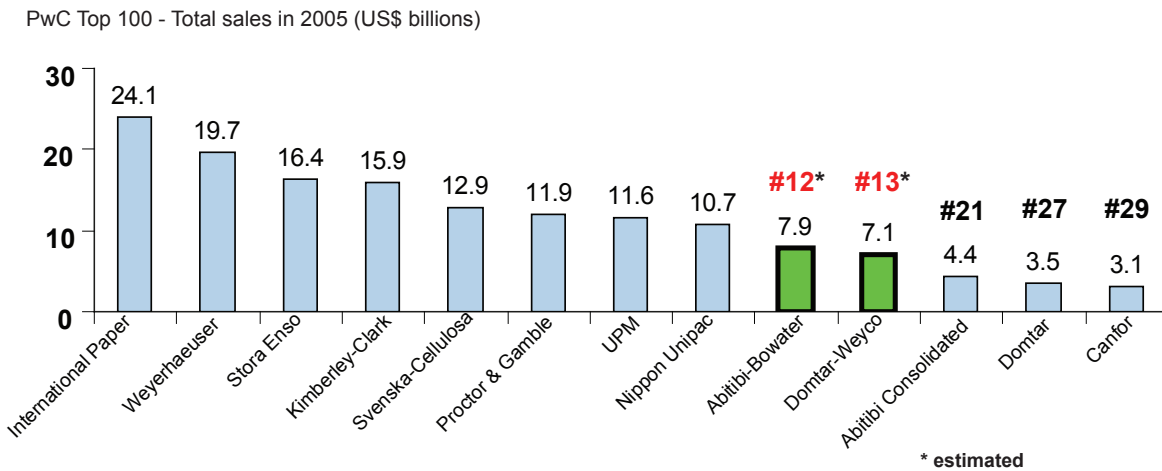
5.3 Industry Structure

The past decade has brought a tremendous amount of restructuring and consolidation within the global forest and paper industry. **One result of this process has been the emergence of a small number of large, often globally-oriented firms within the industry. In North America and globally, there has also been a significant rationalization of product mix within firms as many choose to focus on specific product areas and divest themselves of other types of industry-related assets.** Another pronounced trend within the North American sector over the past decade has been significant growth in the share of industry assets owned by privately held firms.

As with the global forest and paper industry, the Canadian industry has seen a significant amount of rationalization, specialization and merger and acquisition activity take place. One result of this process has been the emergence of Canadian-based firms that are world scale in specific product areas, including the world’s largest newsprint producer and three of North America’s four largest softwood lumber producers. However, **until very recently, no Canadian-based forest products company ranked among the 20 largest firms in the sector globally measured by revenues or enterprise value.** It should be noted that two mergers within the industry—one recently completed and another proposed—would create two Canadian-based forest products firms of a more global scale.



FIGURE 9: Mergers Policy has Played a Role in Impeding the Formation of Global Scale, Canadian-Based Firms



While size alone is not a reliable predictor of performance—there are many examples of small successful firms in the industry—it confers important advantages. Larger facilities can significantly reduce costs through economies of scale in production. Large firms have the capacity to invest in innovation both in products and markets, and benefit from economies of scale in distribution and from a lower cost of capital. Canada’s forest products industry faces a cost of capital that is among the highest in the industrialized world and it is likely that the small size of Canadian firms in relation to their global counterparts is a major contributing factor. Research has consistently found a clear correlation between a firm’s market capitalization and its cost of debt and, to a lesser extent, equity capital.

5.4 A Stronger Future Orientation

Competitive success in the forest product industry of the future will require not only competitive input costs and world-class assets but also a capacity for the industry and its stakeholder community to anticipate and adapt to a changing global environment. The Canadian forest sector of tomorrow requires an increased market sensitivity, a commitment to continued leadership in sustainable forest management and environmental performance, human resources excellence and a renewed focus on new geographic and end-use markets.

5.4.1 A More Innovative Industry Cluster

While Canada has a long history of global leadership in innovation in the forest sector, there is evidence to suggest that the industry is falling behind its leading competitors in research and development (R&D). Canada’s forest sector is in the midst of affecting far-reaching changes to its innovation system, including the creation of FPInnovations the largest forest sector research institute of its kind in the world created by the merger of smaller organizations. However, no Canadian-based companies have the large, in-house R&D capacity that many of their leading international competitors maintain. This in part reflects the relatively small size of Canadian-based firms as larger companies are better able to manage the risks and capture the benefits of product and process innovations.

In addition, the emergence of countries like Finland as leading global competitors and innovators in the global forest and paper industry has been attributed not just to the emergence of global-scale forest products companies within the country, but also to the competitive strength of its equipment supply sector and broader forest products industry cluster. By contrast, Canada’s traditional status as a major supplier of machinery and equipment to the global industry has eroded substantially, particularly in the case of the pulp and paper sector.



Aside from the obvious loss of knowledge-based jobs and economic activity, reliance on offshore producers for machinery and equipment largely precludes the potential to derive competitive advantage from technology as the Canadian industry becomes reliant on the same technologies available to all producers in the global industry. In the near term, this reinforces the importance of a world-class investment climate and second quartile cost-competitiveness as these offer the only means of competing for investment in the installation of world-class equipment at Canadian production facilities. Over the longer term, the Task Force believes that Canada should set as its objective the strengthening of its forest sector innovation cluster, including allied upstream and downstream industries. In the case of the machinery and equipment sector, the most obvious means of moving toward this objective is through increased capital expenditures in Canada and a renewed commitment to research and innovation within the Canadian forest products industry.

The Task Force believes that technological innovation in such areas as bioenergy, nanotechnology and biorefining, as well as in building products and systems, can offer significant opportunities over time and that Canada should strive to be at the forefront in their development and early deployment. The Task Force also believes that the countries that will derive the greatest benefit from these opportunities will be those with the strongest forest sector innovation systems and the globally competitive firms needed to underpin them. **In this regard, these and other knowledge-based opportunities for the forest products industry and bio-economy of the 21st century can be thought of as complements to—rather than substitutes for—competitive strength in traditional products and core businesses.**

5.4.2 A More Responsive Investment Climate and Policy Framework

Overall, the stable, predictable, rules-based business climate that investors take for granted in Canada is a significant source of competitive advantage relative to the environment facing producers in many emerging competitor nations. In recent years, there have been a number of public policy reforms undertaken at both the federal and provincial levels that are playing an important role in enabling renewal in Canada's forest products industry. These include major tenure reforms in some provinces, a more robust renewable energy policy, increased support for research and innovation, new market development initiatives and lower effective tax rates on capital investment. However, just as industry must learn to adapt more rapidly to the fundamental changes taking place in its global environment, so too must policy makers become more adept at understanding and responding to a changing global context.

The single most important role for governments in the industry renewal process is to avoid impeding new investment into the sector. For example, the most direct means through which governments influence private sector investment decisions is through taxation. Despite recent improvements at both the federal and provincial levels, effective rates of taxation on capital investment in Canada's forest products industry remain higher than those in many leading competitor nations. **Given the centrality of capital investment to adjusting to the unprecedented appreciation in the Canadian dollar and to the long-term future of the industry, uncompetitive tax rates on capital investment are profoundly counterproductive.** At both the federal and provincial levels, governments have acknowledged the problem and have taken some important near-term steps to improving Canada's tax competitiveness. However, more rapid and sustained action is required to alleviate the pressures created by the appreciation in the Canadian dollar and intensifying global competition.



VI: INDUSTRY AT A CROSSROADS: THE PATH TO RENEWAL

Given the opportunities and challenges facing Canada's forest products industry, the Task Force identified a path forward to enable its renewal. To get there from here, the Task Force has identified priority areas for action. These center on three major elements:

- Getting costs right
- Getting Industry Structure Right
- Getting the Future Right

6.1. Getting Costs Right

The analysis conducted by the Task Force has identified second quartile cost-competitiveness as a critical condition for the economic viability of the industry. The four largest elements of the cost structure for most products are fibre, personnel, energy and transportation. In all cases, industry—both at the firm level and collectively—has a leadership role to play in affecting change. Government and labour also have an important enabling role to play in improving cost-competitiveness and the industry's competitive position overall.

Match Labour Costs with Labour Productivity

High personnel costs overall were identified as the single largest competitiveness gap for Canada's forest products industry. There are a number of factors that underlie this observation, including ageing capital stock, high wages and benefits which have been made less competitive because of the appreciation of the Canadian dollar and underperforming work organization.

At the same time, there is increasing evidence of a shortage of skilled workers in certain occupations and regions, and the workforce is older than the workforce of the Canadian labour market as a whole. Tackling these issues will require a combination of enhanced productivity, lower costs and a long term human resources development strategy. While these issues are inextricably linked to the challenge of capital renewal, employee remuneration, legacy personnel costs and work organization also play a role.

- **It is recommended that the industry work with labour to improve productivity through better management and better work organization.**
- **It is also recommended that the industry assess the longer term human resources approach required to enable it to attract and develop the workforce it needs for the future and so that the next generation of Canadian workers considers the industry as a good place to work and establish a career. With many players, including governments (federal and provincial), educational institutions across the country, unions and companies, this will require a multi-faceted approach that draws on the expertise and resources of multiple stakeholders.**

Reform Transportation Policy to Permit Real Competition in the Rail Industry

In Canada and around the world, it is widely accepted that it is a basic responsibility of government to limit the market power of "natural monopolies" either by introducing competition to the market or by regulating the prices or profits of monopolists. However, for rural industries such as forest products, there is neither effective rail competition nor effective shipper remedies to encourage a more pro-competitive outcome. Research commissioned by the Task Force is providing further evidence that Canada's current rail transportation policy framework is failing to effectively carry out this function. From a public policy perspective, this failure not only reduces the competitiveness of much of Canada's forest products industry but hinders the development of all goods-producing industries in Canada's rural and remote regions.

- **It is recommended that the federal government take action to introduce effective pro-competitive remedies for rail freight shippers in the Canada Transportation Act. This would include an expansion of existing running rights provisions in federal legislation and a strengthened final offer arbitration process.**



Reduce Fibre Costs and Increase the Flexibility of Provincial Tenure Policies

For most, if not all, of the major products of Canada's forest products industry, fibre is the single largest input cost. It is largely controlled by provincial governments through their tenure policy and pricing systems. As resource owners, provinces have a shared interest in working with industry and other stakeholders to ensure that the tenure system works to sustainably generate the greatest value possible from forest resources for the benefit of host communities and the economy as a whole, and to ensure that forests are managed in a sustainable manner.

Fibre costs are also often profoundly shaped by regulations regarding the harvest and processing of the resource which, in many cases, have little to do with ensuring sustainable forest management. Not only can cumbersome and prescriptive rules regarding the harvesting and use of the resource increase fibre costs directly, they can also hinder investment and constrain the capacity of the industry to adapt its structure and operations to make optimal use of the available resource. They do not offer firms sufficient flexibility to adapt to the new competitive landscape facing the industry. The continued globalization of the industry, combined with steady increases in the minimum efficient scale of the world's most competitive production facilities, is further exacerbating this problem.

In addition, more efficient use of Canada's commercial forest lands could be made and yields improved if stronger incentives were created to optimize levels of investment in forest management. The large investments that will be necessary to reforest those lands impacted by the mountain pine beetle infestation may provide a unique window of opportunity to experiment with new models of public-private partnerships in this regard.

The critical importance of tenure policy to the economic, social and environmental sustainability of the forest sector was underscored when provincial-level task forces established to examine competitive issues in the forest products industry, including those in Ontario, British Columbia and Alberta, identified tenure reform as a key priority.

- **It is therefore recommended that provincial governments ensure that tenure policies do not stand in the way of the Canadian forest products industry adapting to rapidly changing market conditions, and do not impede restructuring and rationalization. This includes eliminating appurtenancy where it continues to exist, and reforming other rules that have the effect of dictating industry structure and production decisions. As well, policy should allow for transfers of licenses and access based on market conditions and for continued streamlining of the regulatory processes. Experimentation at the provincial or community level should be encouraged to find new models of tenure that allow for greater efficiency in fibre allocation and promote investment in forest management, while allowing for community involvement in forest management processes and continuing to contribute to the overall objective of sustainability.**

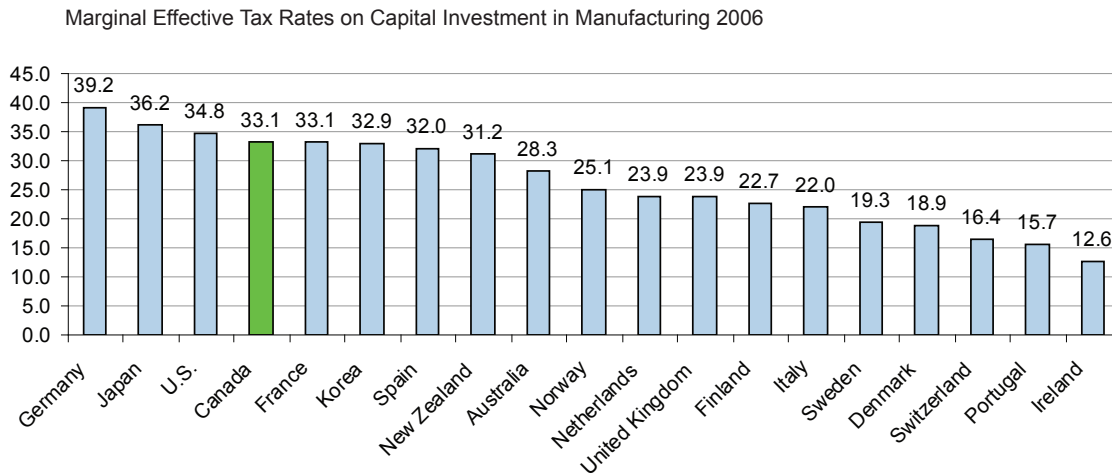
6.2 Getting Industry Structure Right

Aggressively Reduce Taxation of Capital Investment

While a substantial portion of Canada's existing production capacity meets the criterion of second quartile cost-competitiveness, ageing capital stock and declining asset quality represent a critical threat to the long-term capacity of the industry. **Ultimately, there are only two means through which the industry's overall cost-competitiveness and asset quality may be improved: further capacity closure or capital investment.** It is in the interests not only of industry but also of governments, labour, communities and other stakeholders that capital investment plays as large a role in industry renewal as possible.



FIGURE 10: Canada’s Taxes on Capital Investment are Very High



Source: CD Howe 2006

Although they have declined recently as a result of both federal and provincial policy changes, effective rates of taxation on capital investment in Canada’s forest products industry remain among the highest of any major producing country in the world. In addition to deterring capital investment, there is evidence to suggest that Canada’s uncompetitive tax regime acts as a drag on innovation activity and is important in explaining the relatively low R&D intensity of the Canadian economy. In the forest products industry, sustaining and enhancing research and innovation investments during periods of weak profitability is a significant challenge for many firms. **Hosting conditions for Canada’s forest products industry—and the manufacturing sector generally—could be greatly improved if federal and provincial governments would commit to reducing Canada’s marginal effective rate of taxation on capital investment to below the OECD (Organization for Economic Co-operation and Development) average within five years.**

Priority actions to achieve this goal include:

- The rapid elimination of provincial capital taxes in Saskatchewan, Manitoba, Ontario, Quebec, New Brunswick and Nova Scotia;
- Elimination of sales taxes on capital inputs by British Columbia, Manitoba and Ontario;
- Extension of the announced two-year accelerated capital cost allowance for new investments in manufacturing and processing equipment as well as information and communications technologies, at least until statutory tax rates are made more globally competitive;
- Making Scientific Research and Experimental Development (SR&ED) program tax credits refundable;



Administer Mergers Policy in a Way that Recognizes the Global Nature of Competition

In Canada, the pressure towards renewal through consolidation and rationalization will continue in the coming years. Although there are many instances of smaller firms prospering in the forest products industry, federal and provincial policy has effectively precluded Canadian-based firms from attaining the scale of their leading global competitors and has been highly detrimental to the long-term competitiveness of the Canadian forest products industry. In addition to provincial appurtenancy regulations, the application of the federal Competition Act to mergers in the industry has limited the capacity of market forces and firm strategy to bring about the type of consolidation in the sector that has taken place in many leading competitor countries. The policy-induced fragmentation of the Canadian industry has several unintended and unfavorable consequences for the Canadian forest sector. For example, fragmentation has had the effect of discouraging capital investment through a higher cost of capital and has reduced the ability of the industry to realize scale economies in production and marketing. It also acts as a deterrent to investment in the development and early deployment of leading edge technologies.

- **It is critical that when policy-makers choose to actively intervene in the marketplace to change the industry's structure they have a detailed and current understanding of both the costs and benefits of their actions. In this regard, it is recommended that the Competition Bureau increase its expertise in the forest products industry, avoid duplication with provincial governments on issues related to upstream markets (e.g., log/timber markets), and administer the Act in a way that is well informed by the globalization of markets in the forest products sector.**

6.3 Getting the Future Right

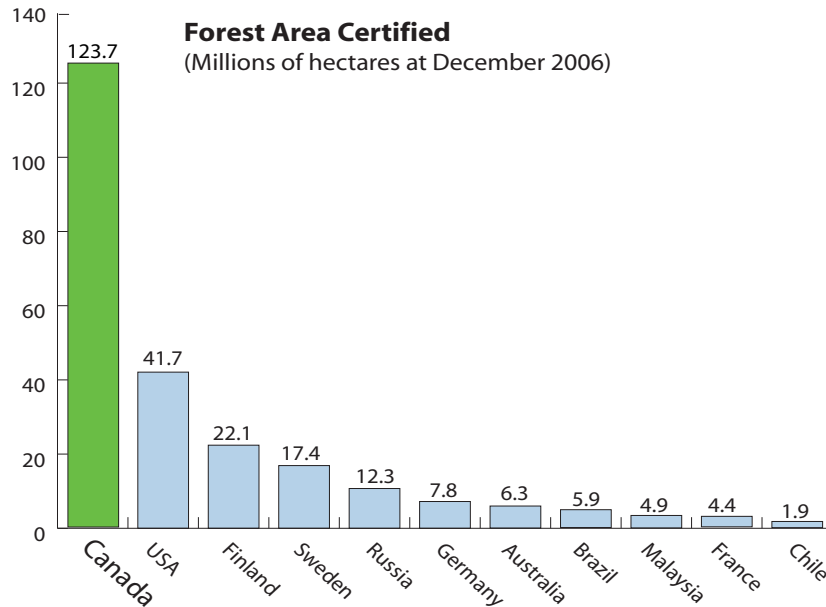
Sustain and Promote Canada's Global Leadership in Sustainable Forest Management

Maintaining and enhancing Canada's global leadership in sustainable forest management and environmental performance through a commitment to continuous improvement. While many competitor nations have serious problems with illegal logging and deforestation, Canada remains committed to world-class performance and continuous improvement in sustainable forest management. As illustrated in Figure 11, Canada is an unparalleled leader in third-party certification of sustainable forest management practices. As customer and consumer preoccupations with the environment continue to grow, there exists the potential to derive competitive advantage from sustainability performance in the future, both in relation to international rivals and producers of competing materials. For example, there is significant evidence to suggest that wood products used in many construction applications are considerably less energy and greenhouse gas emissions intensive on a lifecycle basis than substitute materials.

In the Canadian forest products industry, most producers are stewards of publicly owned forest resources. Maintaining public confidence and a "social license" to manage public lands requires that the Canadian industry remains at the global forefront in sustainable forest management and adopts new scientific knowledge and best practices into its operations. It also requires that forests be managed in a fashion that recognizes multiple uses of forests and non-timber values, including ecosystem integrity, ecological services, spiritual values and their role as biological carbon sinks.



FIGURE 11: SFM Certification – Canada is the World Leader



The Canadian forest products industry takes pride in the great strides it has made to reduce its environmental footprint throughout its value chain. The Canadian pulp and paper sector, for example, has been a leader among Canadian industries in addressing air quality and climate change. Since 1990, FPAC member pulp and paper facilities have reduced their greenhouse gas emissions by 44 percent while increasing production volumes. In addition to its record of achievement in reducing its environmental footprint, the forest products industry also takes pride in the constructive, collaborative approach it has adopted to addressing environmental issues with governments and other stakeholders. Looking to the future, emerging bioenergy technologies offer the opportunity for the forest products industry not only to further reduce emissions but also to produce biofuels and other fossil fuel substitutes that will help to reduce CO₂ emissions well beyond the industry’s own operations.

Innovate in Customers, Products and Markets

While cost-competitiveness remains critical to the industry’s future, low-cost competitors also make it increasingly important that Canadian firms differentiate their products by adding value for their customers. In some instances, this may be done through relatively simple changes—like improving consistency by ensuring a customer’s product is always manufactured by the same paper machine. In other cases, a strong customer focus could lead to the design and development of new products specially customized to meet the needs of an individual customer. In many other mature, goods-producing industries manufacturers have found that they can profitably add value for their customers through enhanced service provision. In the context of the forest products industry, these services could include such things as specialized delivery schedules, product tracking, long-term supply contracts, fibre traceability or product warranties.

Marketing and market development activities will also play a key role in both growing demand and differentiating Canadian forest products from available substitutes. In the wood products sector, there are numerous examples around the world of sustained campaigns of promotion, education and market access resulting in substantial or even dramatic increases in per capita consumption of wood products. As the share of wood in residential construction is increasingly challenged by alternative and substitute products, it will be essential to take advantage of the opportunity to increase the use of wood products in non-residential construction and other non-traditional end-uses. In this regard, the current downturn in demand and prices for wood products in North America may offer a window of opportunity. While residential construction activity has declined sharply, non-residential investment continues to grow and wood products have become substantially less expensive in relation to substitute materials.



Further into the future, across the forest products industry, a number of innovations and breakthrough technologies hold the promise of substantially or dramatically improving productivity and sustainability performance as well as enabling the development of new products. In the wood products sector, the development of new building products and systems could allow Canada to tap into fast-growing overseas markets and new hybrid building products will expand the possibilities for the use of wood fibre in a range of non-traditional applications. In the pulp and paper sector, nanotechnology is opening up exciting new product development possibilities, such as inexpensive bioactive papers that detect, repel or deactivate pathogens. In addition to new wood and paper products, the forest products industry of the future will rely to a much greater extent on a wide array of non-traditional products, both wood fibre-based and non-timber products. Innovation in forest management practices and governance also offers the potential to find more sustainable and cost-effective means of growing fibre, managing forests and delivering fibre to manufacturing facilities.

- **The industry needs to continue to work together and with governments to take advantage of the most promising opportunities in both emerging and traditional geographic markets. This includes developing global markets for Canadian wood products and building systems as a solution to global housing needs and expanding the use of wood in non-residential construction in North America.**

Canada has a history of successful partnership between industry and government in overseas market development activities in the wood products sector. Renewed partnerships are required to realize the most promising opportunities in non-traditional geographic and end-use markets in the 21st century.

Create Competitive Advantage at the Forefront of the Bio-Economy

Through technological innovation and new investment, Canada's forest products industry can, within a decade and a half, become a net source of green power. From a competitive standpoint, reductions in energy intensity combined with the production of green heat, power and even transportation fuel can strengthen the competitiveness of the forest products industry both by creating profitable new businesses and by improving cost-competitiveness in traditional product lines. In addition, renewed Canadian leadership in the development and early deployment of energy efficiency and bioenergy technologies can make a significant contribution to national and international efforts to improve air quality and reduce greenhouse gas emissions. Allowing the transformation of traditional pulp mills into "biorefineries" producing bioenergy, bio-chemicals, ethanol, biodiesel and other products may offer new opportunities to marginal facilities across the country. Over time, the concept of the biorefinery could create dozens or even hundreds of new niche markets for traditional pulp mills as well as some very large market opportunities.

Given the risks and costs associated with the development and early deployment of new technologies in the sector, those countries with large, financially viable private sector firms at the heart of their innovation chains are best placed to lead in realizing the opportunities offered by breakthrough technology. Reasserting Canadian leadership in the development and deployment of industry technologies will require more investment, sustained commitment and new partnerships between the industry, its research institutes, universities, allied industries and government.

Public policy can also play an important role in realizing these opportunities through the use of market-based, results-oriented policy instruments in the pursuit of climate change and air quality objectives. The forest products industry is proud of its record of leadership in reducing air and greenhouse gas emissions and of the progressive, proactive stance it has adopted in engaging with governments and other stakeholders around environmental issues. The Task Force believes that an efficient, market-oriented public policy framework is critical to enabling even further reductions in the future in a least cost manner and to encouraging the development and early deployment of environmental technologies.

- **The Canadian forest products industry should quantify its carbon footprint across its value chain in order to set targets for its continuous reduction and its ultimate elimination. A supportive policy framework can play an important role in enabling the industry to realize its potential to contribute to greenhouse gas mitigation, including the use of market-based instruments, investment in R&D and platform technology development, and a predictable, results-based approach to target setting.**



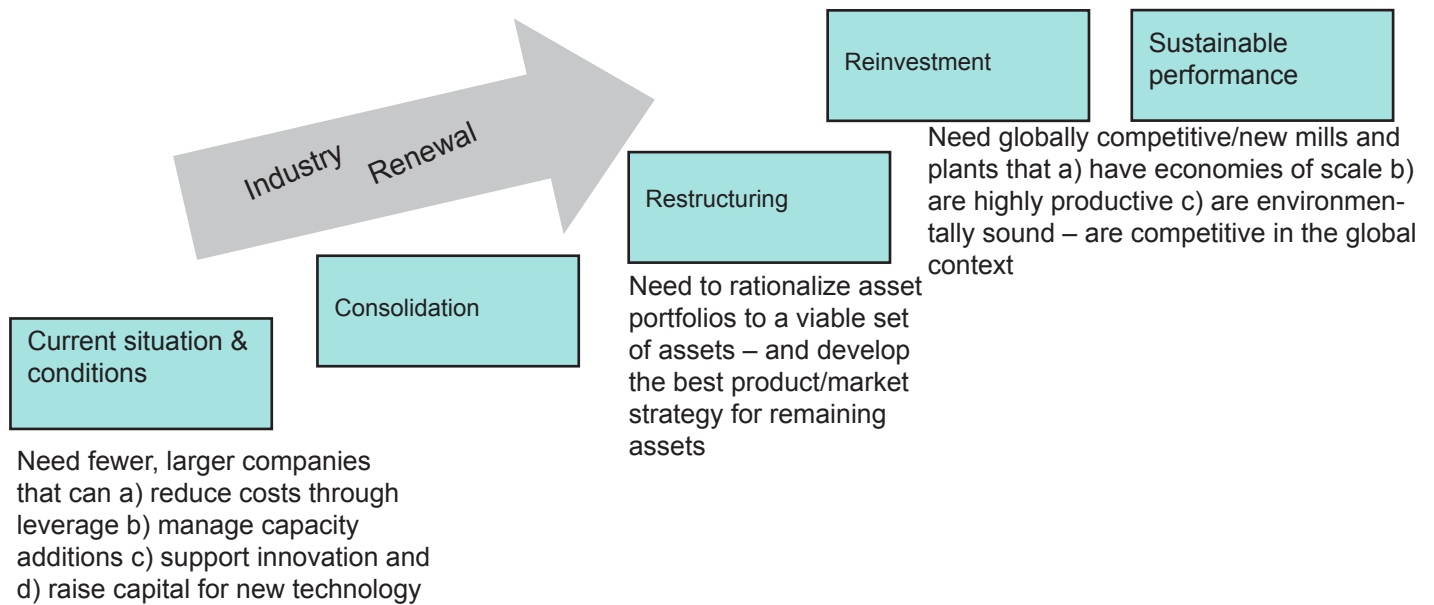
FIGURE 12: An Agenda for Transformation

Issue	From	To	Enabling Measures
Cost-Competitiveness	Pockets of globally competitive producers	An industry where Canada is second quartile or better across all major product lines	Improved asset quality and more competitive input costs
Fibre	A mixed national situation in terms of fibre cost	Delivered wood costs that are second quartile or better across regions	Reform tenure systems to make them more flexible; eliminate appurtenancy where applicable
Transportation	No effective relief from the market power of railways for “captive” shippers	Competitive price and service levels in rail transport	Expanded running rights and more accessible Final Offer Arbitration for shippers
Asset Quality	Capital investment below depreciation	Asset renewal and accelerated productivity growth across regions and product lines	Make Canadian effective tax rates on investment more globally competitive
Energy	Wide variation in electricity costs and steady growth in self-generation	A commitment to becoming a net green energy source	A market-based approach to environmental and renewable energy policy
Firm and Facility Size	A relatively fragmented industry with a few world-class facilities	The emergence of world-scale, Canadian-based firms and production facilities	Remove regulatory impediments to industry adapting its structure and operations to a changing global marketplace
Industry Cluster	Pockets of innovation excellence	A world-class innovation system with strong upstream and downstream linkages	A renewed commitment to excellence in research and innovation
Public Policy and Investment Climate	An uneven and often modest pace to policy reform	A national commitment to creating a world-class climate for capital investment and industry renewal	Strengthened dialogue and partnership between industry and policy-makers on sustainability, investment climate and market development issues



Conclusion

FIGURE 13: Steps to Sustainable Performance for All Renewal Scenarios



Changing the course of an industry as large and diverse as Canada’s forest products industry is a challenging task. Restructuring and renewal will take time and require the energy and commitment of industry leadership, unions, employees and governments. Renewal can be thought of as a multi-stage process involving a series of discrete steps toward economically sustainable performance: consolidation, restructuring and reinvestment.

While some segments of the industry, supported by a constructive public policy framework, are well advanced in this trajectory, others have only begun. **The path to renewal must be chosen—by companies, by governments, by workers and by communities; it will not happen on its own.**

“The global forest industry can play a significant role in combating climate change by optimizing the use of raw material, increasing efficiency, producing bioenergy and expanding into bio-refinery products while developing the competitiveness of the sector.” UN Food and Agriculture Organization

However, competitive success for the Canadian forest products industry in the years ahead will depend as much on cultural change as it will on undertaking specific actions or initiatives. Just a decade or two ago, the key markets which Canada’s industry served were less global and much less competitive than is the case today. While fundamental changes have taken place in recent years in the product markets in which the industry competes, many business practices, public policy structures and the culture of stakeholder relations within the sector have not fully adapted to the new reality. Perhaps more important than any single measure that might be adopted by any stakeholder group in support of sector renewal is a recognition by all that the new global marketplace is simply too competitive to support the rent-seeking behavior of the past.

The Task Force is confident that it is within the capacity of the Canadian industry and its stakeholder community to adapt and succeed in the global marketplace of the 21st century. Global demand for forest and paper products has been robust and will continue to increase over time. Although new, low-cost entrants into global market enjoy formidable advantages, Canada also has many key sources of core competitive advantage. This report attempts to outline a path toward renewal for Canada’s forest products industry. The Task Force believes that a renewed forest sector can offer substantial benefits not only to the industry itself but also to the environment, industry employees, host communities, Aboriginal people, resource owners and Canada as a whole.



Annex I

Forest Products Industry Competitiveness Task Force Mandate and Membership

Mandate

The purpose of the Task Force will be to assess the hosting conditions faced by Canada's forest products industry. Particular emphasis will be placed on identifying options for the sector to accelerate the rate of capital investment and pace of innovation in the Canadian forest products industry.

Membership

Task Force Chair

- Henry (Hank) Ketcham III, President & CEO, West Fraser Timber Company Ltd., Vancouver, BC
- Russ Horner, Past Chair, President & CEO, Catalyst Paper, Vancouver, BC

Members

- John Weaver, President & CEO Abitibi-Consolidated, Montreal, QC
- Brad Thorlakson, President, Tolko Marketing and Sales Ltd., Vernon, BC
- Pierre Monahan, Executive Vice President, Building Products, Bowater Canadian Forest Products Inc. Montreal QC
- Bernd Eikens, Senior Vice President North America, UPM-Kymmene North America, Westmount, IL USA
- Jim Lopez, President & CEO, Tembec Inc., Temiscaming, QC
- Jim Shepherd, President & CEO Canfor Corporation, Vancouver, BC
- Paul Richards, President & CEO, Canfor Pulp Limited Partnership, Vancouver, BC
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- Ian de la Roche, President & CEO, FPInnovations, Vancouver, BC
- Task Force Secretary: Avrim Lazar, President & CEO, FPAC, Ottawa, ON

Ex-Officio

- John Knubley, Associate Deputy Minister, Natural Resources Canada
- Richard Dicerni, Deputy Minister, Industry Canada

Contributors

Many others have participated in the work of this Task Force, including representatives from provincial industry associations, federal and provincial governments, research institutes, universities, and FPAC member companies. While the conclusions of the Task Force are the responsibilities of its members and secretariat, the contributions of many within the broader forest sector have been essential to the analysis and recommendations of the report as well as greatly appreciated.

Forest Products Industry Competitiveness Task Force

Industry at a Crossroads: Choosing the Path to Renewal
May 2007