

**TENURE AND PRICING
ISSUES AND DIRECTIONS**

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One in a series of “FOCUS ON OUR FORESTS” discussion papers

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NOTE: This paper is intended for discussion purposes only and does not reflect government policy.

Purpose of this Paper

This is one of a series of six background papers published in support of the Long Term Forest Policy Review being conducted by British Columbia's Jobs and Timber Advocate through the fall of 1999.

Other papers address:

- non-timber resource values;
- the merits of intensive land-use zonation;
- economic trends;
- small-scale forestry;
- enhancing value-added manufacturing; and
- community stability.

The Forest Policy Review has been initiated with the release of an initial discussion paper entitled *The Working Forest - Directions for the Future*. In outlining a vision for directional change, it states that "Government has a responsibility to bring together the many stakeholders who have a role in developing fair and effective policies". That responsibility will be reflected in workshops and meetings with stakeholders throughout the province during the fall of 1999, with an objective of crafting recommendations to Cabinet early in 2000.

This paper offers an overview of British Columbia's timber tenure system, its objectives, and its shortcomings. It summarizes the changing social environment, scans the conceptual approaches to tenure around the world, and poses numerous questions about the direction of tenure reform. It also briefly examines the merits of several ways in which the Province can secure tenure-related revenue. Finally it raises the notion of "quality for quantity" exchanges whereby a current tenure holder might voluntarily surrender some existing tenure rights in order to obtain a new, more beneficial tenure. As a result, government may gain flexibility to re-distribute opportunities on public land.

The following pages will address issues related to industrial security, the implementation of land-use zonation, regulatory and forest revenue mechanisms, and extracting more value from forest resources. This paper does not purport to address all significant aspects of the tenure and forest revenue system. In particular:

- It does not address the impact of First Nations treaty settlements. Rather it assumes that treaty settlement lands will be created throughout the province, and that provincial "tenure reform" will focus on the remainder of the landbase available for commercial forestry.
- Many people think of the tenure system as defining what forest practices are acceptable on the ground. For the purposes of this paper, however, that is not the case. Regulation of what happens on the land is founded in the province's forest practices code, which is applicable regardless of who holds the rights to public resources. Hence this discussion about the tenure system will not address forest practice issues, such as road-building standards, cut-block design, logging patterns, or silviculture. By extension, it will not deal directly with issues concerning protection of the province's ecosystems.
- This paper does not attempt to describe the existing forms of tenure in detail. Readers who wish to obtain detailed information are encouraged to contact the Ministry of Forests, Resource Tenures and Engineering Branch in Victoria.
- Finally, the scope of this paper extends only to timber-related tenures. Non-timber resource values are addressed in other papers in this series.

Background

Canada is nearly unique in the world in having a large forest industry based mostly on public land. Russia is the only other significant country in a similar situation. In other countries where commercial forestry is a significant part of the economy, the majority of commercial forest land is privately

owned. For example, roughly three-quarters of the forest land in Sweden and Finland, and over two-thirds of the forest land in the United States, is privately owned. In most other countries, there is a mix of large areas owned by industrial firms, and small areas owned by individuals and organizations who often are primarily focused on something other than the forest product business.

In contrast, only about four percent of British Columbia is private land. As a result, the forest products industry in this province relies almost entirely on access to public land and public timber. It is subject to very strong public influence on where and in what manner it can harvest timber, what it may do with the resulting logs, and what it has to pay for its rights on public land.

The private sector's right to use public timber is founded in a complex mix of several Provincial statutes, about two dozen attendant regulations, and various formal government Policies. Collectively those make up the tenure and forest revenue system, and constitute the interface between public and private interests.

At any one point in time, about two hundred timber-related licences and several thousand permits are in effect. Taken as a whole, the tenure and forest revenue system is the vehicle for defining:

- who has the rights to harvest Crown timber;
- what they may do with the timber;
- what they must pay for their rights; and
- what authority and obligations rest with tenure holders and with the Crown.

Tenure Commitments

The total area of the province is about 95 million hectares, of which about half is categorized as productive forest land. In turn, about half of the productive forest land is considered to be commercially useable and available to the forest industry.

There are two main types of administrative areas used by the BC Forest Service as the basis for regulating forest industry activities:

- 34 tree farm licence (TFL) areas, which cover about 8 million hectares¹; and
- 37 timber supply areas (TSAs), which cover about 82 million hectares.

Collectively these administrative areas are often referred to informally as management units. TFLs tend to be larger and more numerous on the Coast, whereas TSAs are the most common feature in the Interior. The Province's chief forester is the sole authority for determining how much timber may be harvested each year in each of the 71 management units. By law, that volume, which is known as the allowable annual cut (AAC), must be re-determined at least every five years.

Today, TFL areas account for about one-quarter of the total provincial AAC. In each TFL area, almost all of the AAC is reserved exclusively for the firm that holds the licence, with about five percent usually being available to the Province to sell to third parties. Each licence has a 25-year term, and by law the Province is obliged to offer to replace the licence every five years, indefinitely.²

¹ Some TFL-holders have voluntarily agreed to have their private land managed as part of their TFLs, as if it were Crown land. About one third of the TFLs in the province include a substantial area of private land, about one-third contain only a small area of private land, and the remaining one-third contain no private land at all.

² The law allows the Province to alter the contractual conditions in the proffered licence, but it must be for the same area. If the licensee accepts the new licence and any new obligations it may specify, a new 25-year term begins. If the licensee chooses instead to reject the offer, the existing licence simply runs its course for the remaining 20 years, and then expires. No one has ever rejected a TFL replacement offer.

The situation is very different in TSAs, which account for about three-quarters of the total provincial AAC. In each TSA, the Minister of Forests has the authority to decide how to dispose of the AAC determined by the chief forester. In each TSA, a number of licensees share the AAC, with the majority of the available volume having been committed years ago to replaceable forest licences. Almost all forest licences have terms of 15 years, and again by law, the Province is obliged to offer to replace most of them every five years, indefinitely.³ In total they account for slightly more than half of the Provincial AAC.

This leaves about one-quarter of the provincial AAC which has not been previously committed to long-term replaceable licences. About half of that remainder is dedicated to the Small Business Forest Enterprise Program (SBFEP), by which the Forest Service offers relatively short-term, non-replaceable sales to the highest bidder. Within the SBFEP, about two-thirds of the volume is sold to whoever offers the highest cash bonus bid. The remainder is sold to whoever offers the best combination of bonus bid and other benefits sought by the Province in each case.

Finally, the remaining one-eighth of the provincial AAC is used in support of woodlot licences, some pulpwood agreements, a few non-replaceable forest licences, and to facilitate one-time harvesting by mining interests, oil and gas companies, and the agricultural community.

Appendix I is a tabulated summary of the primary differences among private land and the seven most important forms of tenure on Crown land. More detailed information can be obtained from the Ministry of Forests, Resource Tenures and Engineering Branch, in Victoria.

Pricing

The Province obtains revenue from commercial forestry activities in several ways. Almost all direct revenue is obtained through the imposition of:

- annual rent charges on most licences;
- stumpage charges for timber that is cut;
- fees on logs exported from the province;
- charges for timber that is wasted; and
- various penalties.

Indirect revenue is obtained through corporate and personal income taxes, as well as a minor amount through the provincial “logging tax”.

In 1997/98, stumpage charges accounted for about \$1.8 billion, or 97 percent of total direct revenue. This means that a tenure-holder incurs almost no government charges until it actually cuts timber; there is very little cost incurred in holding the right to cut timber. This is in stark contrast to the situation with private land in BC or elsewhere, insofar as the owner of private land pays no one for the timber it cuts, but instead faces a significant cost in simply owning the land and timber in question. The cost of owning has two elements to it, namely an initial purchase price, and a continuing “opportunity cost” in choosing to retain ownership rather than sell the land and invest the proceeds in some other venture.⁴

Stumpage rates for timber sold competitively in the SBFEP are determined by the *Market Pricing System*. When a parcel of timber is to be offered for sale, the Ministry of Forests estimates what the

³ As with tree farm licences, the holder of a forest licence may choose to accept or reject a replacement offer. If it accepts the offer, a new licence is issued with a new 15-year term. If it rejects the offer, the existing licence runs its course for the remaining ten years, and then expires. In the past two decades, perhaps 700 forest licence replacement offers have been made, and only one was ever rejected.

⁴ A private land owner also carries the risk of catastrophic loss to forest resources, such as by wind or fire, whereas that risk is borne by the Province on public land.

total bid price has recently been for similar timber. The new parcel is offered to bidders at a fraction of that estimate (usually 70 percent) in order to allow bonus bids to set the actual selling price.

By definition, long-term tenures do not allow for competitive bidding except on a one-time basis when a new licence is offered. Instead, stumpage rates for timber cut under long-term tenures are calculated according to the *Comparative Value Pricing System*. This involves the Minister of Forests, on behalf of the Province, pre-setting an average stumpage rate for the Coast, and a separate average rate for the Interior. Based on the site-specific physical parameters of each parcel of timber, Ministry of Forests staff estimate the market value of forest products that can be generated from that parcel, and the cost that would typically be incurred in producing those products. For each parcel of timber, the difference between those two estimates is called its “value index”. If the value index of a given parcel happens to be equal to the average value index on the Coast or Interior as the case may be, the stumpage rate imposed is equal to the average rate pre-set by the Minister.⁵ To the extent a given parcel’s value index is higher or lower than the average, the stumpage rate for the parcel is accordingly higher or lower.

Changed Environment

The existing tenure and forest revenue system has its origins in contracts mostly created in the 1960's and earlier, and solidified when the *Forest Act* was completely rewritten in 1978. At that time, timber supplies seemed to be abundant and industrial access to them seemed secure. The primary objective of forest policy was to foster industrial expansion and economic development throughout the province. At the same time successive governments wanted licensees to shoulder the burden of forest management so that the direct cost to government was low. These objectives were achieved by giving corporations long-term, secure access to public timber, in return for which they accepted the costs of forest management, and made massive investments in world-class milling infrastructure.

In past decades, world markets readily absorbed British Columbia forest products. Shrinking employment in the woods and mills was not much of an issue, and society in general was not as environmentally conscious as it is today. Industrial profitability depended largely on maximizing the volume of logs processed each day, mostly in high-speed mills producing commodity lumber. First Nations land claims had a relatively low profile at best.

Social and industrial circumstances have changed dramatically since then:

- The public in British Columbia and elsewhere are increasingly advocating a conservation ethic to underlie commercial forestry;
- Our protected area system is being greatly expanded;
- The Province and Canada are crafting treaties with scores of First Nations;
- Rural communities are pressuring the Province to devolve control of public forests;
- The forest industry is beginning to rely on second-growth forests on the Coast;
- Some mills have become uneconomic, putting some rural communities at risk;
- There is a much stronger interest in maximizing the product value per cubic metre of harvest;
- Business interests in forestry, tourism, recreation, and fishing increasingly clash over the use of public resources;
- Protectionist pressures in the United States have become a significant factor in respect of the tenure and forest revenue system;

⁵ This short explanation is not strictly accurate in that (1) some of the timber in each parcel is often subject to a schedule of flat rates instead of the calculated rate, and (2) stumpage rate determinations take into account the effect of charging a nominal rate for some parcels even if the calculated rate should be less than zero. The details, however, are not important to this discussion.

- There is much more international competition in the sale of commodity products;
- Independent certification of forest practices is becoming important to the marketing of British Columbia's forest products;

These changes in the social environment are having serious impacts on the forest industry. The commercial forest land base is becoming smaller, and in some parts of the province, timber supply is forecast to shrink significantly over the next ten to twenty years. The milling capacity in the province exceeds the total timber supply, and the number of people employed in the forest industry, in total and per cubic metre of harvest, is declining. The cost of industrial timber supplies has risen dramatically, partly because of increased management obligations and partly because of increased stumpage rates. In some TSAs, the model of shared harvesting rights is breaking down.

Tenure System Objectives

The tenure system represents the interface between public and private interests. Given the fundamental dichotomy of those interests, at any point in time, timber tenure policies need to strike an optimum, stable balance among numerous competing objectives.

Experience suggests that the more important of those objectives are:

- 1) To ensure sound stewardship and sustainability of forest resources by:
 - ensuring that commercial forestry is based on a conservation ethic in parallel to management of the province's parks and wilderness areas; and
 - ensuring that all forest resources are well-managed by government agencies and the private sector
- 2) To support a dynamic, flexible, and competitive industry by:
 - encouraging international market competitiveness;
 - minimizing international trade problems;
 - providing adequate corporate security;
 - facilitating on-going industrial rationalization;
 - ensuring opportunities for new, innovative companies, both large and small;
 - ensuring opportunities for sustainable commercial utilization of non-timber resources;
 - allocating and pricing timber in a way that can accommodate market changes and reward efficiency;
- 3) To support stable forest-dependent communities by:
 - maximizing high quality forest employment;
 - ensuring adequate public involvement in land use decisions;
- 4) To ensure public control of forest management, and maintain the Crown's ability to change forest policies from time to time;
- 5) To minimize cost to government; and
- 6) To ensure satisfactory direct forest revenue.

Given the inherent contradictions among the objectives, no tenure system can fully satisfy all of them. Inevitably, trade-off's must be struck. Although the objectives are very constant over time, the relative priorities change, and from time to time it is necessary to assess whether the system needs updating to ensure that an optimum balance is indeed being achieved. The Province has decided that the time has come to make that assessment.

Conceptual Variants

A scan of jurisdictions around the world indicates that there are really only five basic approaches to timber tenures. As outlined in Appendix II, those basic approaches involve:

- Short-term timber sales;

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- Long-term licences or leases;
 - Outright sale of land and surface resources;
 - Harvesting by the State, with subsequent sale of logs; and
 - Co-operative land management.

The mix of benefits to the public and to the private sector is different with each of these approaches.

Issues

In British Columbia, nearly 80 percent of the current provincial AAC was committed years ago in the form of long-term licences held mostly by firms which own sawmills and pulpmills, and whose focus has historically been on extracting timber for use in those mills. This approach has given mill-owners security of supply, and in return they have shouldered forest management costs of many hundreds of million dollars per year. Because of the long-term commitments, the timber pricing system is mostly non-competitive in nature, leading to American assertions that lumber producers are subsidized by stumpage rates that are not market-driven.

Numerous issues have arisen in recent years, which are more-or-less pervasive in the tenure and forest revenue system, and which warrant informed public discussion. As detailed in Appendix III, the more important seem to arise in respect of:

- the shrinking timber supply and resulting impacts on employment and communities;
- the desire for corporate and community security despite changing land-use priorities and increasing demands from other commercial interests;
- the need to minimize costs to companies and government;
- the merits of current forest revenue policies; and
- changing views of acceptable forest practices.

Dealing with problems in these areas will entail trade-off's among the numerous competing objectives mentioned above. As enunciated in the discussion paper *The Working Forest - Directions for the Future*, the Province foresees a re-balancing among the objectives, based in large measure on public input in the coming months. Fundamental questions must be answered about how best to implement land-use zonation, promote greater employment through better forest management and value-added manufacturing, and improve market access.

Tenure Directions

In its discussion paper, the Province stated that governments must provide long-term certainty of tenure, which can only be achieved “if we decide conclusively which lands are for what purpose”, and only if “forest access for the many non-forestry commercial users, including B.C.’s burgeoning tourism sector, [is] clearly defined”. This implies more intensive industrial forestry, but on a smaller portion of the landbase, probably facilitated by a new form of industrial tenure and a more efficient, results-based method of regulating forest practices.

The discussion paper said that government and industry must work together “to create log markets which allow price signals to ensure the right log gets to the right mill”, and that there must be “a place for communities, First Nations, value-added producers and new entrants to the industry”. Creating this more diverse array of tenure-holders implies changing the mix of long-term and short-term tenures, as well as the attributes of some of those tenures.

Key Questions about Tenure

Many have argued that the Province’s ability to deal with emerging problems is hampered primarily because such a large share of the provincial AAC is committed in the form of long-term licences that are repeatedly replaceable without competition, and which are held by vertically integrated forest product companies. From a commercial perspective, the room for new entrants into the industry is quite limited, the log market is relatively small, and there is little room for community management. American criticism of the Province’s revenue policies has led to restrictions on the industry’s ability to sell lumber into the U.S. marketplace. Some domestic critics argue that the pre-set average stumpage rates in the *Comparative Value Pricing System* are too inflexible because they fail to automatically reflect rising industry costs.

In an ecological context, there are few if any meaningful incentives for corporations to manage forest land for anything but timber production. Practices aimed at ecological sustainability are typically rooted in regulation, with a government emphasis on enforcing compliance. Although various forums have concluded that there should be differing land-use priorities across the landscape, such zonation remains notional. It has not been put into practice through changes to application of the forest practices code. In addition, there has been no effort to harmonize the tenure system with land-use zonation.

In assessing whether fundamental changes are needed to the tenure and forest revenue system, many questions must be answered, some of which are as follows.

Forest Management

The Province has an abiding interest in maintaining healthy forests and recognizing the full range of forest values. The desire for biological sustainability underlies a growing conservation ethic as the base for defining acceptable forest practices. In assessing whether there might be better ways to ensure good forest management, these are some important questions:

- Has there been any significant change in the merits of having the private sector manage public forest land? Is there a need for broader application of area-based responsibilities? Can public and private interests be better harmonized?
- What is the best way to encourage corporations to manage forests for more than timber production? Is it by making each long-term tenure holder responsible for managing a defined area? Does it imply a need to enjoy exclusive rights to the resources on an area, or can rights be shared? Should corporations or individuals have the right to exploit resources other than timber, such as fauna or other flora, water, or recreational opportunities?

- Should the Province be concerned about corporate concentration? If so, should that concern be focused on manufacturing facilities, or tenure holdings, or both?
- How can the tenure system be best harmonized with the results of land-use planning initiatives? Should private sector forest management be concentrated on a smaller portion of the landscape? Should there be greater differentiation of forest practices across land-use zones? Should the system facilitate intensive commercial exploitation of some areas, with correspondingly less commercial use of other areas? To what extent is the public willing to approve of intensive timber management on part of the landbase?⁶
- Should the Province create new lease arrangements that would mimic the attributes of private land while maintaining public ownership of the land itself? If so, how could that be put into effect, given the legislated requirement to offer to replace each existing tree farm licence and most forest licences every five years, indefinitely?
- Should the Province sell in advance of harvesting, on a one-time basis, all of the timber on a given area? Should it go even further by selling in advance all of the timber yet to become merchantable on a given area over some specified period of time? Would this create a meaningful incentive for private sector investment on public land?
- Should a government agency, rather than a licensee, directly manage areas that are especially sensitive from an environmental perspective? If so, should that function be performed by a Crown corporation rather than a Ministry? Is the public willing to accept the high costs of direct management by a government agency?
- How can there be any rationalization of the tenure system without first settling First Nations treaties so that the available landbase is known?
- Is there a need to have one body responsible for management of timber supply areas? If so, how can that be achieved in light of the long-standing model of shared harvesting rights in those areas?
- Should the public care about independent certification of B.C. forest practices and hence of B.C. forest products? If so, does the tenure system need to change in order to facilitate corporations gaining independent certification?

Mix of Tenures

In its discussion paper, the Province identified a need for a globally competitive, dynamic and diverse forest industry which recognizes the needs of other commercial users of the land. It has said that “in the next century, our forests will be managed for many different reasons, many different values”, and that “... the public expects industry to respect other land users ...”. Translating this vision into fact implies answering the following questions.

- What is the optimum mix of long-term and short-term tenures? What should the attributes of each be? What forest resources should be captured by those tenures?
- Should the mix of tenure-holders be more diverse? If so, how can that be achieved without taking away rights already committed to existing tenure-holders?
- How can tenures for the timber-based industry be best harmonized with tenures for the commercial use of non-timber resources?

⁶ The merits of land-use zonation are examined in detail in a companion paper by George Hoberg, entitled *Getting More Benefits from BC Forest Lands: The Intensive Zoning Option*.

- If more timber should be sold competitively, how much is enough? To what extent should the Province forego stumpage bonus bids in order to direct timber to someone who commits to making higher valued products, or employing more people per cubic metre?
- Does the province need a bigger log market? If so, how big? Should long-term tenure holders be free to sell logs instead of process them? How beneficial would that be to processors who do not hold tenure rights?
- Should there be separate programs of competitive timber sales, with different bidding eligibility rules in each program?

Industrial Security and Social Stability

The Province's discussion paper stated that "in return for its right to operate on public lands, the public expects industry to respect many social goals – to protect the environment, respect other land users, work with First Nations, invest in technology, and provide jobs and community stability". The paper also states "if industry is to make the kind of long-term investments necessary to yield more and better quality timber, governments must provide long-term security of tenure". The following questions arise in respect of these statements.

- To what extent do manufacturers and investors, as distinct from land managers, need security of timber supply? Must security of log supply be founded in long-term tenures, or can it be found in a large log market supplied by forest land managers who have long-term security of tenure?
- If long-term tenures are desirable, how long should their term be? Should the term be tied to the time it takes to grow merchantable trees, or should it be tied to the time normally required to write down financial investments?
- If timber should generally flow to its highest and best use, what is that use? Is it the process that creates the most value per cubic metre? Is it the process that supports the highest numbers of jobs per cubic metre? If so, are wage rates important in such an assessment? Should the tenure system somehow favour local processing, or should it allow private sector economics to determine where processing is most efficient?
- Should a more attractive form of industrial tenure be developed? If so, what should its attributes be? Should it give a company greater freedom to do what it wishes with the timber it cuts?
- What is the best way to encourage independent remanufacturers? If tenure changes led to an increased log market at competitive prices, would that assist such firms?⁷
- Should the holders of long-term tenures be required to sell at arms length a proportion of the timber they harvest?
- Given shrinking timber supplies and increasing environmental concerns, has the concept of minimum cut requirements become outmoded? Does it still make sense to force licensees to risk losing their rights if they fail to harvest a minimum amount each year?
- Is it reasonable to require tenure-holders to maintain their workforce at current levels, or should they be allowed to rationalize their mix of labour and capital as are firms in other industries? Do existing "appurtenancy" rules actually protect jobs and community stability?

⁷ Related issues are examined in a companion paper by Peter Woodbridge & Associates Ltd., entitled 'Enhancing Value-Added-Manufacturing'.

- If there are compelling arguments for a higher proportion of short-term competitive sales, does that not imply less government control over what happens to harvested timber? Does it not imply less stability of employment and communities?
- Given that forest resources belong to all citizens of the province, should the government give local communities decision-making authority over the tenure system in their areas?

Pricing Directions

The timing and pattern of timber harvesting are strongly influenced by the nature of monetary charges imposed by the Province. From a tenure-holder's perspective, those charges can be sorted into fixed costs (e.g., annual rent charges) and variable costs (e.g., stumpage charges). The mix of those two types of cost is important to corporate decision-making. So too is the mix of "front-end" costs (e.g., both annual rent and stumpage charges) imposed before a company enjoys any forest product revenue, and "back-end" costs (e.g., income tax) imposed after company revenues are known.

The discussion paper which initiated the Long Term Forest Policy Review said that the public "expects government to share the benefits of the public forests fairly – among the public, communities, workers, non-timber users and the forest sector. And it must do so while encouraging a dynamic and profitable forest economy. Through revised forest policies and potential changes to the stumpage system, government must encourage industry to get the right tree to the right mill, provide secure access to international markets and ensure a fair return to the owners of our forests – the public". The discussion paper also said that the Province should develop a more market-responsive stumpage system.

Key Questions about Pricing

In light of those objectives, the Long Term Forest Policy Review is aimed in part at assessing whether changes need to be made in the nature and mix of charges imposed by the Province in order to encourage better forest management and better utilization of forest resources, and to improve the prospects for greater access to the U.S. lumber market. The following questions are important in this context:

- Does there need to be a fundamental change in revenue policies in order to create incentives for better forest management by the private sector and for better timber utilization?
- Is it best that almost all direct provincial revenue be based on stumpage charges, or should a higher proportion be based on annual rent in order to mimic the economic parameters of owning private land?
- Should the Province adopt a market-driven system for determining stumpage charges on long-term tenures? Should the Province adopt a "transaction-evidence" pricing system whereby prices offered for competitive short-term sales would be used in some way to determine non-competitive stumpage rates on long-term tenures?
- Should non-competitive stumpage rates be more sensitive to changes in the market values of forest products so that the Province absorbs a higher proportion of any change in market values?
- Should some of the Province's direct revenue be based on a "resource rent tax", whereby the Province and a licensee would share net profit from the licensee's log sales? Would this create meaningful incentives for companies to create more value from timber supplies, or would it make it easier for a company to be inefficient? Would the sharing occur only after some explicit provision had been made for licensee profit? Would a resource rent tax be a good basis for giving companies the right to secure revenue from forest resources other than timber?

- Should the Province relax its log export controls in order to assuage American criticism and thereby improve the prospects of achieving unfettered access to the U.S. lumber market?

Transition and “Quality for Quantity” Exchanges

If the Long Term Forest Policy Review were to conclude that the population of tenure-holders should be larger and/or more diverse, or that the log market needs to be significantly larger, that would imply reducing the share of tenure rights now held by existing long-term licensees.⁸ In light of the existing commitments, achieving either objective implies (1) the Province or the Legislature will have to abrogate commitments, with or without compensation, or (2) the Province and existing licensees will have to negotiate an exchange of existing tenures for some other tenure.

The following questions need to be addressed in this context:

- Does it make sense for the Province to offer current licensees a tenure that is more attractive to them, but for a smaller volume? Would such an exchange of “quality” (i.e., of tenure instrument) for “quantity” (i.e., of AAC) be a good way to make land and AAC available to new individuals and corporations, communities, parks and for treaty settlements?
- If this notion of “quality for quantity” exchanges has merit, what should be the attributes of a new form of industrial tenure? Should it:
 - involve stronger property rights, perhaps to resources other than timber?
 - involve relaxation of current constraints on the rate of harvest and the pattern of logging?
 - allow its holder to employ contractors as it wishes, or to direct logs to whatever facility it wishes?
 - entail a different pricing regime?
 - allow for log exports?
- To what extent could this kind of change, and indeed tenure rationalization more broadly, occur before First Nations treaties are settled?
- How could changes in the proportions and attributes of short-term and long-term tenures be achieved, given the existing commitments in existing licences? Should the Legislature impose changes to those licences, or should the Province rely entirely on the willingness of licensees to voluntarily change their tenure rights? Should the Province’s obligation to replace TFLs and most forest licences every five years be changed so that it can offer new forms of tenure instead of existing forms only?

Conclusion

The province’s tenure and forest revenue system is a very complex interface between public and private interests in forest management and timber utilization. It is the vehicle for achieving a wide-ranging mix of public and private benefits, among which priorities change and competing tensions abound.

The current system was mostly designed in an era when the primary social objective was one of economic development. That era has passed. The province now needs to design a more mature model of sustainable forest management, one that strikes an improved balance among numerous competing objectives. The Long Term Forest Policy Review is the first step in modernizing the tenure and forest revenue system.

⁸ In fact, this implication already exists with the prospect of significant areas of Provincial land being dedicated to treaty settlements.

Appendix I: COMPARISON AND CONTRAST OF FOREST TENURES IN B.C.

	Crown Grants	Tenures on Crown Land						
		Timber Licence	Timber Sale Licence (1)	Forest Licence	Tree Farm Licence	Woodlot Licence	Community Forest Agreement	Pulpwood Agreement
Ownership	Private ("fee simple")	Crown	Crown	Crown	Crown & Private	Crown & Private	Crown, private, Indian Reserve	Crown
Predecessor Tenure		Timber Licence Pulp Licence Timber Lease Timber Berth Pulp Lease	Timber Sale Licence	Timber Sale Harvesting Licence (Also Timber Sale Licence)	Tree Farm Licence (also Timber Sales, TSHLs, FLs)	Farm Woodlot Licence	None	Pulpwood Harvesting Area
Initiated By (Applies only to new licences)		N/A (i.e., because all TLs originated with one-time conversion of previous tenures)	Regional or District Manager	Minister	Minister	Regional or District Manager	Minister	Minister
Granted By		Regional Manager	Regional or District Manager, or Minister	Minister (Regional Manager signs)	Minister with Approval of Lieutenant Governor in Council	Regional or District Manager	Minister	Minister
Rights	Land & Timber	Harvest timber that was merchantable timber as of 1975	Usually to harvest a defined parcel of Crown land Sometimes to harvest an AAC	Specified volume per year in a specific Timber Supply Area	Occupation of specified area of Crown Land for the purpose of forest management	Occupation of specified area of Crown land for purpose of forest management <400 ha on Coast, <600 ha in Interior	Exclusive right to harvest timber on specified area	Harvest Crown timber if wood residue and logs not available from other sources
Advertising			Usually required	Required	Required / Public Hearing	Required	Required	Required / Public Hearing
Criteria for Acceptance			Some = highest bid Some = best proposal	Five criteria specified in <i>Forest Act</i>	Five criteria specified in <i>Forest Act</i>	Evaluation of eligible applicants	Seven criteria specified in <i>Forest Act</i>	Five criteria specified in <i>Forest Act</i>

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Appendix I: COMPARISON AND CONTRAST OF FOREST TENURES IN B.C. (cont'd.)

	<i>Tenures on Crown Land</i>							
	<i>Crown Grants</i>	<i>Timber Licence</i>	<i>Timber Sale Licence (1)</i>	<i>Forest Licence</i>	<i>Tree Farm Licence</i>	<i>Woodlot Licence</i>	<i>Community Forest Agreement</i>	<i>Pulpwood Agreement</i>
Term	Perpetuity	With that of TFL or, if outside, for a fixed term (variable)	Not exceeding 10 years	Not exceeding 20 years	25 years	Not exceeding 20 years	25 to 99 years	Not exceeding 25 years
Replacement		Reverts to TSA or TFL once free-growing status established	"Designated Applicant" may replace certain licence.	Most are replaceable on 5th anniversary	All existing TFLs are replaceable on 5 th or 10th anniversary. New TFL could be non-replaceable	All existing WLs are replaceable on 10th anniversary. New WL could be non-replaceable	Replaceable on 10th anniversary	Original PAs were replaceable on 10th anniversary. All PAs are now non-replaceable
Deposit			\$0.20/m ³ if AAC or graduated 10, 5, & 2% of value tendered	\$0.15/m ³ of AAC	\$0.10/m ³ of AAC	\$200		Variable
Management Plan		Required for TL in TFL Operating Plan for TL outside TFL	Generally not required	Required	Required	Required	Required	Required in some PAs prior to harvesting
Cutting Permits		Required	May or may not be required	Required	Required	Required	Required	Timber Sale Licences
Source of Crown Revenue	Property Tax	Stumpage and annual rent	Stumpage, bonus, and annual rent	Stumpage, bonus offer (if any), and annual rent	Stumpage and annual rent	Stumpage and lump sum bonus offer, if any	Stumpage and annual rent	Stumpage and lump sum bonus offer, if any
Cut Control (2)	None	Only if in TFL	Yes (3)	Yes	Yes	Yes	Negotiable	Option
Annual Rent	None	\$1.25/ha	\$0.10/m ³ of AAC or \$1.25/ha if area-based	\$0.25/m ³ of AAC	\$0.45/m ³ of AAC	\$0.25/m ³ of AAC	Negotiable	None
Property Tax	Yes	No	No	No	Yes, on private land only	Yes, on private land only	No	No

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Appendix I: COMPARISON AND CONTRAST OF FOREST TENURES IN B.C. (cont'd.)

	Crown Grants	Tenures on Crown Land						
		Timber Licence	Timber Sale Licence (1)	Forest Licence	Tree Farm Licence	Woodlot Licence	Community Forest Agreement	Pulpwood Agreement
Waste Assessment	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Contractor Clause	N/A	Partly	Partly	Yes	Yes	No	No	No
Maintain Production Facilities	N/A	No	Sometimes	If committed in original proposal	If committed in original proposal	Generally prohibited	No	Required
Annual Report	N/A	Yes, within TFLs	No	District Manager may require	Yes	Yes	Yes	Ministry may require
Reforestation	Required only if certain classification for property taxes	Required	Required (mix of Crown and licensee) (4)	Required of licensee	Required of licensee	Required of licensee	Required of agreement holder	Required of agreement holder
Reference in Forest Act or BC Assessment Act		<i>Forest Act</i> . Sections 27 through 32	<i>Forest Act</i> . Sections 20 through 23	<i>Forest Act</i> . Sections 13 through 19	<i>Forest Act</i> . Sections 33 through 39	<i>Forest Act</i> . Sections 44 through 46	<i>Forest Act</i> . Sections 43.1 through 43.5	<i>Forest Act</i> . Sections 40 through 44

(See footnotes on next page.)

Footnotes:

(1) The vast majority of TSLs are administered under the Small Business Forest Enterprise Program.

(2) Where cut control applies, it is usually +/- 50% each year, and +/- 10% over 5 years.
On woodlot licences, it is usually +/- 10% over 5 years.

Cut Control Penalties:

- * Over 110% in 5-year period: subject to penalty of double stumpage.
- * Overcuts reduce next period's cut for 5- year cut control only.
- * Undercuts can result in AAC reductions.
- * Note that cut control for replaceable licences is specified in Section 64 of the *Forest Act*.
- * Non-replaceable licences may specify cut control contractually, rather than by statute.

(3) Cut Control only applies to TSLs with AACs.

(4) Basic Silviculture is an obligation of the Licensee for replaceable TSLs where AAC > 10 000 m³. For other TSLs, this obligation rests with the Crown

Appendix II

Basic Approaches to Timber Tenures

A scan of jurisdictions around the world indicates that there are only five basic approaches to timber tenures:

i. Short-Term Timber Sales

Government can simply sell short-term timber sales to the highest bidder, as is common on public land in the United States. With this approach, government maximizes direct revenue, but incurs the cost of pre-harvest planning, basic road development, and long-term reforestation. Within a given jurisdiction, there can be more than one competitive program, with bidding restricted to different populations of competitors, such as small loggers, or small manufacturers.

With this approach, a government agency has relatively tight control of the location, timing and nature of harvesting. For example, it can choose to emphasize sales of poorer quality or remote timber, to favour partial cutting, and to generally design operations with a lighter “footprint” than the norm. A successful bidder typically has no management responsibilities other than to conduct the logging in an acceptable manner, and is typically allowed to do whatever it wishes with the timber that is cut. This approach supports an arms-length log market, which acts as a buffer between the logging and milling sectors, and facilitates logs flowing to their highest economic use.

ii. Long-term Licences or Leases

Government can enter into long-term contracts that stipulate the rights and obligations of both the government and the private party. In concept, a contract could involve the outright, one-time sale of all existing timber on a defined area. It may also involve the sale in advance of all timber that will become available through reforestation during the term of the licence or lease. A government may enter into such a contract with a purely private sector corporation, or with a junior-level government such as a municipality.

Long-term licences and leases are the most common form of tenure across Canada, including British Columbia. A long-term licence or lease affords security of access to the resource, and in return minimizes the government’s forest management costs. By definition, long-term tenures preclude competitive pricing of the timber in question, except perhaps for a one-time bonus offer when the tenure is first offered.

The longer the term of a tenure, the greater is the security afforded the tenure holder, and hence the greater is the incentive for high quality resource management. Conversely, the longer the term, the less opportunity will exist over time for anyone else to have access to the resources on the area in question.

iii. Outright Sale of Land and Surface Resources

Public land can be sold in large, industrial-scale parcels, or in small parcels for more personalized management. In an earlier era, this approach was common throughout the rest of the world, particularly in the United States and Europe. For example, 68 percent of the United States land base is privately owned. In Scandinavia, the figure ranges from 72 to 85 percent. In British Columbia, only 4 percent of the province is privately owned.

Although activities on private land are almost always subject to some degree of government regulation, an owner is almost always less constrained than would be the case under some form of tenure on similar public land. Outright ownership of land and resources confers the greatest amount of security, in perpetuity, and hence engenders maximum incentive for high-quality management of the land and its resources. It minimizes, however, the public's right and ability to derive public benefits from the land in question.

iv. Harvesting by the State

Instead of selling the right to harvest standing timber, government can do all of the work itself, and merely sell logs rather than trees to the highest bidder. The pre-harvest planning, access development, logging, and reforestation can be done by government employees or by specialist contractors. The government can intensively sort logs before they are sold, thus giving small users access to material that they otherwise may have difficulty acquiring. This approach forms a small part of British Columbia's Small Business Forest Enterprise Program.

v. Co-operative Management

In some countries it is common for land to be managed by a co-operative made up of individuals with no formal allegiance, or who represent organizations, local governments, and/or corporations that band together for the purpose of managing a defined area.

Appendix III

Key Tenure Issues

Timber Supply

- The tenure system was designed at a time when timber supplies were increasing, whereas supplies are now shrinking in many parts of the province. The system is not well-suited to administration of decreasing AACs, particularly in terms of discriminating among those who are willing to specialize in marginal timber, and those who concentrate on better quality timber.
- The forest industry in BC, especially in the Interior, will continue to rely mostly on old-growth timber for many decades to come. In contrast, most of British Columbia's international competitors increasingly rely upon plantation management which is relatively free of environmental constraints.
- The tree-growing capability of most of the province's landbase is generally lower than that of many other jurisdictions. This implies that natural biology will limit the extent to which anyone can create stronger incentives for private sector investment on public land.
- A significant portion of available, productive forest land is expected to be ceded in treaties with First Nations. This will trigger reductions in AACs of many management units, and therefore reductions in the amount of timber directly available to the industry

Corporate Security

- The public appear to be strongly opposed to privatizing any more land in the province. This seems to rule out copying the approach taken in virtually all other political jurisdictions. It seems to rule out giving forest product companies the same kind of security that their international competitors enjoy with their private land.
- Many people seem to oppose compensation to companies whose rights are taken away to make room for new parks or for treaty settlements. A government policy of this kind would certainly undermine a tenure-holder's willingness to invest in the province or commit to operational stability.
- There is continuing demand for re-distribution of some of the rights to public timber. This implies somehow reducing the commitments previously made to forest product companies, and which remain binding upon the Province.

Costs

- Industry profitability generally remains low despite relatively high lumber prices in the United States. Although this is due in large measure to continuing low pulp market prices, it nevertheless implies a need to reduce the cost of log supply to mills in the province.
- The public seem to demand that government spending be concentrated on health and education, not directed to forest land. The budget for the Ministry of Forests and the Ministry of Environment, Lands and Parks, continues to shrink each year. The public looks to the forest industry to shoulder the costs of forest development planning, road building, and reforestation. However, the private sector has little incentive, if any, to spend any more on public land than is required by law.

- The American lumber industry continues to have the ear of a protectionist federal government in the United States. As a result, lumber sales to the United States remain constrained by American interests. Some companies in British Columbia are able to sell most of their product into the United States, whereas others have little or no ability because they have little or no American lumber quota. This dichotomy implies a significant difference in profitability and therefore in ability to absorb the cost of forest management obligations and stumpage charges.

It appears that the United States will not back away from its trade restrictions until timber is sold in B.C. at unfettered competitive prices. This seems to imply taking back harvesting rights from existing licensees in order to support more competitive sales. It also seems to imply eliminating Provincial log export controls.

Community Stability

- Employment in the forest industry continues to shrink as AACs decline and as logging and milling equipment is continuously modernized. The public, however, demand employment stability and by extension, community stability.
- Because the existing capacity for primary timber processing already exceeds the supply of timber, the Province discourages any expansion of that capacity, and instead promotes the production of value-added products. At the same time, however, many value-added firms have great difficulty obtaining the raw material they need.
- Vertical integration remains the norm among forest product companies in the province. With little corporate separation of mills and woods, this results in relatively little volume moving through an open log market. Because most timber is processed by the company that holds the harvesting rights, workers and communities continue to look to the Province to set rules around processing and employment.
- Most timber belongs to the Province, and hence to all citizens in the province. However, dozens of communities want to control forest activities in their areas. This implies either (1) the Province giving communities control over the activities of existing tenure-holders, or else (2) somehow reducing existing tenure commitments so that there is room for communities to acquire their own tenures.

Forest Practices

- Most people agree that the province has passed through the timber exploitation phase, and now must manage its forests in a more mature way. However the tenure system offers little incentive for the private sector to do so, especially in the context of ecological sustainability.
- Despite land-use zonation being described in various collaborative plans, there is little, if any, discrimination of harvesting practices across zones. The tenure system has not changed to reflect the theory of zonation.
- Some forest product companies wish to gain certification of their forest practices and products by one or more non-governmental bodies. It is not at all clear that the tenure system will facilitate all licensees gaining certification if they wish.

Revenue Policies

- American criticism of BC's timber pricing policies seems to be unending. It originates with American lumber producers, and has a strong political element to it within the U.S. The criticism ignores the fundamental difference in land ownership patterns in Canada and the United States, and it is not at all clear that the Province can ever satisfy the American lumber lobby.

- Almost all of the Province's direct forest revenue is attributable to stumpage charges imposed when timber is cut. It costs a licensee very little to hold harvesting rights *per se*. This revenue regime sets up a very different set of operating incentives relative to those that exist on private land, where a much higher proportion of woods-related costs are fixed rather than variable.
- Ignoring bonus bids on some parcels of timber, the stumpage system essentially charges the same amount for a given parcel regardless of to whom it might be sold. Some people argue that the system instead should reflect the nature of each buyer so that the price charged depends on what the buyer does with the timber. They argue that this would promote greater diversity among manufacturers, and value-added manufacturing generally.
- Some people argue that direct revenue to the Province should be based at least in part on a "resource rent tax" (i.e., on a sharing of a licensee's gross profit attributable to log sales) rather than be based almost entirely on pre-set stumpage rates.