

Competition Policy Review Panel

FPAC Submission

January 2008

Executive Summary

The Canadian forest products industry is a significant wealth generator across the Canadian economy. Its importance to Canadians, now and tomorrow, is substantial and its competitive position, and the underlying factors at play, is worthy of serious consideration.

The industry is in the midst of a perfect storm of unprecedented challenges which are placing tremendous pressure on firms, employees, and communities. In addition to structural and cyclical market challenges, the industry is struggling to adapt to an appreciated and volatile Canadian dollar.

While these challenges represent a dark cloud in the short term, the industry will emerge to be a strong and competitive global player. But the path to renewal must be chosen – by companies, by governments, by workers and by communities – it will not happen on its own. The Forest Products Association of Canada set up in July 2006 a CEO-led Task Force on Competitiveness which reported in May 2007, setting out the key elements of a path to industry renewal. This submission reflects the analysis and conclusions undertaken by this industry Task Force.

FPAC is pleased with the establishment of the Competition Policy Review Panel and its interest in broad public policy issues related to the competitiveness of the Canadian economy. In the case of the forest products industry, a key element of future competitiveness depends on the ability of the industry to consolidate its operations in order to reduce costs, remove excess capacity and create a platform for future capital investment. In the past, both federal and provincial policies have prevented the necessary industry consolidation. At the federal level, the implementation of Competition Policy has failed to recognize that the Canadian forest products industry operates within highly competitive and integrated global markets, and has put unnecessary and counterproductive limits on key mergers. Provincial policies have attempted to keep individual facilities open in specific communities by tying access to resources to specific facilities. In both cases, these policies have slowed the pace of adaptation, have prevented the emergence of strong global Canadian companies, and have contributed significantly to the difficulties that currently face the industry.

It is our view that the mergers policy and implementation is a critical element of Canada's competitiveness and that both policy and implementation must take into account the fact that Canada is a small, open, export dependent economy. The Canadian economy is fundamentally unlike the United States or the EU, both of which have large internal markets, and our policy framework must take this into consideration. At the same time, Canada is open to the world, and benefits from competitive well functioning markets. The implementation of mergers policy over the past decade in the forest products industry has included a number of cases where mergers were subject to divestiture conditions, and where transactions were intensely scrutinized despite the presence of highly competitive global and regional markets. **Based on this experience, FPAC recommends a number of changes to both the policy development and implementation of mergers policy in Canada.**

- Build Bureau Expertise – post-mortem studies of past Bureau decisions have indicated that the Bureau has fallen short in its ability to expertly review mergers in the forest products industry, creating a barrier to much needed further restructuring of the industry.

- Make Efficiencies A Recognized Element of Merger Review – the consideration of efficiencies as part of the Bureau’s review has been at the discretion of the Commissioner. In view of the broader economic interests of Canada as a small, open export-dependent economy, the consideration of efficiencies as a relevant and positive factor of mergers should be enshrined in legislation.
- Reform the Tribunal Process to Make it an Effective Option for Merger Proponents – the Bureau is effectively able to lever merger proponents into consent agreements because the proponents have no realistic options to otherwise complete a transaction. Given the length and cost of Tribunal cases, the Tribunal, as its rules and processes are currently structured and applied, cannot play an effective challenge to the Bureau.
- Make Mergers Policy Development Independent of Implementation –While the Bureau is an obvious source of expertise in competition policy matters and can contribute to policy development there is an inherent conflict with the Bureau developing policy and enforcing it. The former should be the responsibility of Industry Canada, much like Finance develops tax policy while the Canada Revenue Agency administers the act.

The forest products industry and the manufacturing industry as a whole have been severely challenged by the strength of the Canadian dollar. With a dollar hovering at parity, and the underlying conditions which have propelled it there unlikely to shift in the near term, it is essential that governments to act more aggressively to improve hosting conditions to support the competitiveness of the manufacturing sector. **While there are a number of specific actions that both federal and provincial governments could take in this regard, perhaps the most important would be to set ambitious targets and to benchmark Canada against the best in the world.** In a global economy that is as competitive as the one that we live in today, it is not sufficient to be middle of the pack. **Canada should aim to have the best hosting conditions among the OECD in terms of tax structure, R&D incentives, transportation costs, internal trade and other areas.** In this context, within the mandate of the Panel, governments should be very cautious on placing policy restrictions on capital flows, inward or outward, to avoid unintended consequences on the competitiveness and productivity of Canadian industries.

Industry Overview

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. In fact, a recent Statistics Canada report indicates that Canada's timber resources represent some \$240 billion in wealth for the country. 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. 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 1,600 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.

As the forest products industry has been a cornerstone of the Canadian economy going back 200 years, it can also be going forward. Canada has abundant natural resources – forests, water, energy – upon which the industry is founded. The industry is committed to working in a manner that is environmentally responsible, socially desirable and economically viable. In essence, these pillars of sustainability are a collective mindset which can lead Canada's forest products industry to be what Canadians want the industry to be: good stewards of the environment, good employers, good neighbours, and a generator of wealth for all.

The Competitiveness Challenge

The Canadian forest products industry is in the midst of a severely challenging period. These challenges are the result of a number of forces that have coincided to create a "perfect storm" of economic conditions. The rapid rise in the Canadian dollar, the mountain pine beetle infestation, the collapse of the U.S. housing market, the drop in demand for core products such as newsprint, and the emergence of strong global competitors have created unprecedented competitive pressure.

Two of the challenges listed above were largely unforeseen. First, the height and speed with which the Canadian dollar appreciated is unprecedented and occurred without any clear consensus of predictions from economists and analysts. Without the ability to adapt with the appreciated dollar has exacerbated all other challenges. Second, the plague-like proportions of the mountain pine beetle in the BC Interior will kill a forest area larger than the size of New Brunswick and affect timber volumes roughly three times Canada's total annual allowable harvest. The infestation is now in Alberta and working its way east across Canada. While the broader forest mix east of BC will buffer the impact in the rest of Canada, the beetle infestation will have an impact on the industry and its communities for decades to come. In BC, once the salvageable timber is harvested, some communities will be devastated as mills close due to no economic timber supplies.

Some of the current challenges are related to the specific market conditions in key product markets. In the case of solid wood products, the dramatic events in the U.S. housing market, exacerbated by the sub-prime mortgage crisis, have created a cyclical downturn that is unprecedented in the industry. In paper markets, Canada is an important North American producer of newsprint, which has seen a steady and accelerating decline in demand during this decade due to declining newspaper readership and competition from electronic media. While demand growth in other grades of paper remains steady, it is for debate whether similar trends will be seen over time. Globally, the pulp market has been a bright spot for Canadian producers, as strong demand from China has buoyed pulp markets and sustained margins.

It is the responsibility of industry to anticipate and react to the challenges shaping the specific product markets in which it operates. However, there are many aspects of industry competitiveness that are strongly influenced by governments, both federal and provincial. It is the industry's view that while the industry has been acting forcefully to address these challenges, governments by and large have been slow to react.

A Forest Products Industry Competitiveness Task Force, comprised of industry CEOs and senior industry analysts, was formed in 2006 in response to widely held and growing concerns about the Canadian industry's current situation and future prospects. Its mandate was to assess the hosting conditions faced by Canada's forest products industry with particular emphasis on identifying options for the sector to accelerate the rate of capital investment and pace of innovation in the Canadian forest products industry. Its report, released in May 2007, provides valuable information and perspectives on the challenges facing the industry and potential actions to accelerate the pace of renewal.

There are four major challenges that must be addressed for the industry to emerge from this difficult period positioned well for long term competitiveness: cost-competitiveness, investment and asset quality, industry structure, and future orientation.

Cost competitiveness

The Canadian forest products industry exports between 60 and 80 percent of its production depending on the product. The industry is one of Canada's largest exporters. It exports primarily to the U.S., but is among the largest Canadian exporters to Europe, China, South Korea, India and Japan. Over the past 15

years, the global market for forest products has become increasingly global. New production in the Southern Hemisphere with low-cost plantation style trees, massive capacity expansion in the production of paper and paperboard in China, and the continued global strength of large integrated European forest products companies have increased the pressure on Canada's traditional markets. For example, while Canada continues to be the preeminent supplier of forest products to the U.S. market, the Canadian share of U.S. foreign products imports fell from 69% to 57% between 2000 and 2006, as China, Germany, Brazil and others increased their market share in this lucrative market.

With intensifying global competition, Canada must continue to improve its overall cost competitiveness in order to retain and build markets for its products. This requires sustained attention to all of the key cost elements, including wood fibre costs, personnel costs and productivity, energy and transportation.

Of particular mention in this regard is the negative impact of the extreme volatility of the Canadian dollar over the past five years. The forest products industry is the most exposed of any Canadian manufacturing industry to the rapid rise in the value of the Canadian dollar. With a dollar that has risen by some 60% over a five year period, the speed of adaptation required of Canadian industry has been immense. In the pulp and paper sector, the rapid rise in the dollar has put in jeopardy many Canadian manufacturing facilities as North American production is rationalized, despite the equal or superior productivity performance of the Canadian facilities. Since 2002, 32,000 jobs have been lost in Canada's forest sector. In the first 9 months of 2007 alone, Canadian mills have announced 54 instances of capacity closure, resulting in the loss of over 6,500 jobs. The impact of the dollar is exacerbated by the border risk that has characterized the post 9-11 world, the history of softwood lumber and the disregard of the U.S. government for the provisions of NAFTA, which have combined to further weaken the competitive position of Canadian firms within the critical North American market.

Investment and Asset Quality

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.

Significant capital investments during the past decade in the B.C. Interior lumber industry have positioned this segment of the industry as among the most competitive in the world. However, in the pulp and paper sector, capital investment has lagged, and the quality of assets as a result is below that of key competitors.

Addressing the challenge of capital investment will require action on a number of fronts, to address cost competitiveness and to restructure and consolidate the industry. Canada's capital markets are not sufficient to attract the capital demanded by all Canadian industries. Certainly, the Canadian forest products industry sources its capital from financial markets both in Canada and abroad. Capital is fickle

and any restrictions or risk associated with investing in Canada only serves to raise the cost of capital or even shorten the supply of capital to Canadian firms.

Industry Structure

The Canadian forest products industry is quite fragmented compared to global competitors. 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. While two recent mergers have created Canadian firms that are in the top 20, there is a need for continued consolidation. Size alone is not a reliable predictor of performance and there are many examples of small successful firms in the industry. However, size does confer 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.

The fragmentation of the Canadian industry has been strongly influenced by both provincial and federal policies. Provincial governments have dictated industry structure through their forest management regimes, through practices such as appurtenancy which tie access to wood fibre to specific manufacturing facilities determined by the province. The federal government, for its part, has applied the Competition Act in a way that has slowed down the pace of mergers and acquisitions in the industry. The policy-induced fragmentation of the Canadian industry has several unintended and unfavourable 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.

In Canada, the pressure towards renewal through consolidation and rationalization will continue in the coming years. There are many instances of smaller firms prospering in the forest products industry. However, the artificial constraints imposed by both levels of government to growth and consolidation has been highly detrimental to the long-term competitiveness of the industry overall. It is no accident that three of the top ten forest companies in the world are from Finland, a country with one-fifth of Canada's forest resources which decided as a policy matter to allow consolidation of its forest products industry in the 1980s and 1990s.

Stronger 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. There are a number of emerging breakthrough technologies in the sector that hold the potential to offer significant commercial opportunities over time. 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.

The Industry Response

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 Forest Products Industry Competitiveness Task Force indicates that there will be ample North American and global demand to support a renewed Canadian forest products industry.

In response to the current challenges the industry has set out a path to renewal involving three key elements:

Getting Costs Right

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.

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.

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. While this is inextricably linked to the challenge of capital renewal, employee remuneration, legacy personnel costs and work organization also play a role.

Energy: The industry has the objective of becoming a net source of renewable energy. 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 in energy efficiency.

Transportation: There is neither effective rail competition nor effective shipper remedies to encourage a more pro-competitive outcome and avoid excessive costs to shippers. 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. From a public policy perspective, a lack of meaningful rail competition is an impairment of Canada's hosting conditions and weakness of the federal government's performance of instilling competition itself in the regulated, monopolistic sector. The federal government can reduce excessive rail costs by improving the remedies for rail freight shippers under the Canada Transportation Act.

Getting Industry Structure Right

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.

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 merger policies.

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; and 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.

The Policy Response

At the heart of the mandate of the Competition Policy Review Panel is the issue of what governments can do to create the conditions that will enable industries such as the forest industry to compete in global markets. The view of the forest products industry is that governments have an essential role in this regard and that the policy and regulatory stance of both federal and provincial governments will be a key ingredient in the success of the private sector.

In this regard, it is difficult to overemphasize the changed environment within which Canadian businesses are operating. The intensity of global competition has shifted and the speed of change is increasingly rapid. For example, China's forest products industry has grown consistently by double digits in recent years and now produces more than double the paper products of Canada and is the second largest forest products exporter into the United States. This is astounding growth. While the Canadian economy has had strong macroeconomic fundamentals, the rise of the dollar is severely challenging Canada's manufacturing base. These shifts in both long term and short term fundamentals point to the need for a more aggressive and forward-looking policy stance; a policy stance that aims to rapidly create world class hosting conditions for Canadian industry. The industry recommends that the Policy Competition Review Panel focus on two key areas: enabling world class Canadian companies to emerge and aggressive action to improve hosting conditions.

Enabling World-Class Canadian Companies to Emerge

In the forest products industry, scale is an increasingly critical success factor in lowering costs, improving productivity and creating companies that are economically sustainable over the long term. For example, Canada's largest kraft pulp mill, Alberta Pacific with capacity of 645,000 tonnes per year, is now dwarfed by the new mills being built around the world, such as the Veracel Celulose mill in Brazil at 900,000 tonnes per year or the Asia Pulp and Paper mill in China at 1,000,000 tonnes per year. The policy environment should recognize the benefits that accrue to Canada from successful Canadian companies that can compete with the best in the world. Too often, both federal and provincial policies have actively prevented strong Canadian companies from emerging. In this regard, FPAC recommends that the Panel consider four reforms to the current conduct of mergers policy in Canada.

Build Bureau Expertise

A key element of the future competitiveness depends on the ability of the industry to consolidate its operations in order to reduce costs, remove excess capacity and create a platform for future capital investment. Unfortunately, past merger reviews by the Competition Bureau have failed to recognize that the Canadian forest industry operates within highly competitive and integrated global markets, and have put unnecessary and counterproductive limits on key mergers. This approach sent a clear chill for several years such that firms shied away from potentially beneficial mergers for fear of adamant challenge by the Bureau. FPAC has commissioned port-mortem studies of mergers in the newsprint

sector and BC log market.¹ In the both cases the studies found conflicting results from what the Bureau had based its concerns upon - suggesting a change of approach.

In the most recent merger, between Abitibi-Consolidated and Bowater Incorporated, the Bureau again inappropriately defined the newsprint market as a region within Canada but did not challenge the merger. While FPAC is pleased with the outcome of the review, we remain concerned with the narrow definition of the relevant geographic market.

In respect of the BC mergers, it was the Bureau's first foray in the upstream log market and surprised many industry stakeholders. The surprise arose from the fact that log markets and the forest resource are generally of provincial jurisdiction, and a belief that no part of the supply chain should be immune from consolidation if that is what the market demands. Moreover, the industry remains concerned about the overlap and duplication of upstream log market reviews by the province, as mandated by its jurisdiction over forest resources, and the Bureau. The duplication puts additional burden on firms as they attempt to comply with two review processes. A less tangible or obvious impact of this duplication is that there is no clarity of which review rules in the case of contradictory conclusions by the two reviewing bodies. This uncertainty can create a chill and represent another barrier to the needed consolidation in the industry.

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.*

Make Efficiencies a Recognized Element of Merger Review

A primary driver of mergers in the forest products industry is economies of scale and to gain efficiencies. Thus, the treatment of efficiencies within the merger review process is of vital importance to the industry. Under the Competition Act, Section 96(1) provides an efficiency defence in the face of a merger that would otherwise result in a lessening of competition. Under the leadership of Commissioner von Finckenstein, the Bureau refused to consider efficiencies prior to the Tribunal stage and even sought legislative changes to further restrict the treatment of efficiencies. FPAC was pleased with his successor's pronouncements in September 2006 when Commissioner Scott acknowledged the positive role that efficiencies play in mergers, indicated that efficiencies will be considered without requiring recourse to the Tribunal, and encouraged merging parties to bring forward efficiencies evidence early in the review process. Commissioner Scott's statements were seen as a significant departure from previous policy and very well received by industry.

¹ Both studies are available from the FPAC office. The two studies are: *Canadian versus North American Forest Products Markets: Newsprint Study*, prepared by CRA International. December 2003; and *BC Forestry Mill Mergers: Testing for Monopsony*, prepared by CRA International. January 2007.

Given the importance of this issue, however, it is unfortunate that the manner in which efficiencies will be considered is subject to the discretion of the Commissioner. *In view of the broader economic interests of Canada as a small, open export-dependent economy, the consideration of efficiencies as a relevant and positive factor should be enshrined in legislation.* In addition, the Act could require the Commissioner to satisfy herself that the efficiencies do not offset any anti-competitive effects before she could bring an application to the Tribunal under the merger provisions of the Act. Furthermore, limiting consideration of the anti-competitive effects to those resulting from changes in output and excluding transfers between consumers and producers in the efficiencies trade-off analysis would simplify the analysis and make it more functional for parties to use the efficiencies exception.

Reform the Tribunal Process to Make it an Effective Option for Merger Proponents

The Panel should consider the process structure for competition policy enforcement. In the case of merger reviews, if the Bureau believes a proposed merger will substantially lessen or prevent competition, it can take its case to the Competition Tribunal. The Bureau may also ‘negotiate’ a consent agreement with the merger proponent as a compromise of meeting its concerns and avoiding an application before the Tribunal. But this ‘negotiation’ is not conducted on a level playing field, as the Bureau has little stake at risk going to the Tribunal. For example, the Bureau may start negotiations with a certain remedy that is greater than the minimum to address what it determines to be the anti-competitive aspects of a transaction. Through negotiations, parties may resolve some concerns and negotiate down to a smaller remedy. In the event of an impasse in negotiations, the Bureau states that its initial position is brought forward to the Tribunal not just the outstanding issues not resolved by negotiation. For merger proponents, this is an untenable situation – they can either face potentially lengthy and costly litigation before the Tribunal with an uncertain remedy outcome, or agree to what may amount to an unsubstantiated need for a structural remedy, most often a divestiture. As a result, the Bureau is effectively able to lever merger proponents into consent agreements because the proponents feel they have no realistic options to otherwise complete the transaction.

There is no challenge function to the Bureau to ensure it is fulfilling its role as set out by the intent and letter of the Competition Act. Given the length and cost of Tribunal cases, the Tribunal cannot play an effective challenge to the Bureau as the Tribunal rules and processes are currently structured and applied. *Examples of potential changes include; streamlining the Tribunal’s processes with effective time limits imposed; limiting the Tribunal’s consideration to a minimal remedy such that the outcome would be either the imposition of the minimal remedy or no remedy. Additionally, other reforms of the Tribunal process have been proposed by competition policy experts.*²

Make Mergers Policy Development Independent of Implementation

In Canada, competition policy is administered by the Competition Bureau, as an independent body separate from the department of Industry Canada. The Bureau also takes the lead on policy development related to mergers. For example, in 2003, the Bureau conducted consultations on the

² See, for example, A.N. Campbell, H.N. Janisch, and M.J. Trebilcock (1997) “Rethinking the Role of the Competition Tribunal” 76 *Canadian Bar Review* 297

potential legislative changes to the Competition Act. The Bureau has effectively become both the legislator and enforcer which creates an inherent conflict. There are several examples where policy development is held separate from enforcement – Finance Canada develops tax policy while the Canada Revenue Agency enforces compliance; Industry Canada is responsible for telecommunications policy while the Canadian Radio-Television and Telecommunications Commission implements the law; and, Transport Canada sets transportation policy while the Canadian Transportation Agency enforces it.

While the Bureau is an obvious source of expertise in competition policy matters and can contribute to policy development, it should not play both roles. The ultimate goal of Competition Policy should be to serve the economic interests of Canada, which necessarily involves a complex balancing and assessment of objectives and means for achieving them. The Bureau is not equipped to fulfill this task and the conflict between roles further prohibits such. *Therefore, mergers policy development should be undertaken by Industry Canada, with advice from the Bureau and in consultation with other stakeholders.*

Aggressive action to improve hosting conditions

Canada's record on hosting conditions is mixed. Relative to developing economies – which represent the industry's newest competitors – Canada has many advantages, such as a stable, predictable, rules-based business climate that investors often take for granted. This compares quite favourably to unsecure land resources, lower quality or less abundant natural resources, and generally, the less predictable business and political climate that can be found in a number of emerging competitor nations. However, relative to comparable developed countries, Canada's advantage is less clear. Among the disadvantages are higher effective tax rates on capital investment, tighter tenure policies, rising energy and fibre prices, and monopolistic rail transportation services. It should be noted that the unprecedented appreciation of the Canadian dollar has significantly worsened Canada's hosting conditions.

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. More effort is needed by Canadian governments to enhance the hosting conditions in Canada. Not all governments have equally contributed to the progress made thus far. Although many of relevant policy areas are outside of the Panel's jurisdiction, FPAC believes the Panel must be aware of the broader context. While there are a number of specific actions that both federal and provincial governments could take in this regard, perhaps the most important would be to set ambitious targets and to benchmark Canada against the best in the world. In a global economy that is as competitive as the one that we live in today, it is not sufficient to be middle of the pack. *Canada*

should aim to have the best hosting conditions among the OECD in terms of tax structure, R&D incentives, transportation costs, internal trade and other areas.

Conclusions

FPAC is pleased with the establishment of the Panel and its interest in broad policy issues related to competition. The context under which FPAC makes this submission is unprecedented and provides a prime example of how public policy can compound market challenges and seriously undermine the competitiveness of a Canadian industry.

Changing the course of an industry as large and diverse as Canada's forest products industry is a challenging task. The path to renewal must be chosen – by companies, by governments, by workers and by communities – it will not happen on its own. While there are a myriad of actions that will need to be taken – many outside the scope of the Panel's mandate – there is one common element for all stakeholders, which is to recognize that the new global marketplace is simply so competitive that all players must adjust quickly and decisively.

Within the mandate of the Panel, there are two key areas for action: first, to enable the creation of world-class Canadian companies by reforming mergers policy and its application; and second by setting and benchmarking progress against the world's leaders in creating competitive hosting conditions.

Summary of Recommendations

- *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.*
- *That the explicit consideration of efficiencies in the merger review process be included in the Competition Act by including it as a factor to be considered in the merger review and by requiring its consideration by the Commissioner as a precondition to filing an application under the merger provisions. In addition, the efficiency exception would be much more functional if in performing the trade-off analysis the anti-competitive effects are limited to those resulting from change in output and excluding transfers between consumers and producers.*
- *There should be a mechanism that will provide an effective, practical challenge to the Bureau, while respecting its independence. There is no effective challenge function to the Bureau to ensure it is fulfilling its role as set out by the intent and letter of the Competition Act. Given the length and cost of Tribunal cases, the Tribunal cannot play an effective challenge to the Bureau as the Tribunal rules and processes are currently structured and applied.*
- *That the policy development function for Competition Policy be the responsibility of Industry Canada, not the Competition Bureau. It is inappropriate for the Competition Bureau to be the enforcement body and also lead policy development. Policy development should be undertaken by Industry Canada - with advice from the Bureau and in consultation with stakeholders.*

- *That the federal government and provincial governments, in recognition of the unprecedented competitive environment that Canadian businesses are operating in, set ambitious benchmarks for improvements in business climate and take aggressive action to achieve them. Canada should strive to be the best in the OECD in terms of tax structure, R&D incentives, transportation costs, internal trade and other areas.*
- *That a very cautious approach be taken to placing policy restrictions on capital flows, inward or outward, to avoid unintended consequences. Canada's capital markets are not sufficient to attract the capital demanded by all Canadian industries, and access to capital is a critical success factor.*

Members of FPAC

AbitibiBowater Inc.
Alberta-Pacific Forest Industries Inc.
Canfor Corporation
Canfor Pulp Limited Partnership
Cariboo Pulp and Paper Company
Cascades Inc.
Catalyst Paper Corporation
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Howe Sound Pulp and Paper Limited Partnership
Kruger Inc.
Louisiana-Pacific Canada Ltd.
Mercer International
Mill & Timber Products Ltd.
Papier Masson
SFK Pulp
Stora Enso Port Hawkesbury Limited
Tembec Inc.
Tolko Industries Ltd.
UPM-Kymmene Miramichi, Inc.
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