

## **Sharing the Wealth: Stumpage Arrangements for Community Forest Agreements in British Columbia**

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**Introduction** – Since the inception of the community forest programme the question of stumpage payments has been a matter of some controversy – should stumpage be paid and, if so, how much; should the unique features of community forests be considered in the determination of stumpage; should stumpage be calculated as for other Crown tenures or should a different, more appropriate, approach be used.

In the brief period available to me this morning, I will briefly discuss some of these issues and, hopefully, stimulate some constructive discussion on this important topic.

### **What is Stumpage?**

Stumpage is the value of standing timber. Economists often refer to it as *economic rent* or the residual value of the resource after **all** the costs managing it, protecting it, and bringing it to market have been met.

To land owners producing timber, stumpage is the value of their final product. It is a major determinant of their cash flow and provides a return to their investments in managing timber crops. Without the promise of recouping a return in the form of stumpage, there is no financial incentive to invest in the establishment and management of timber crops.

### **Questions?**

Should stumpage be paid by holders of CFPA's and, ultimately, CFAs?

Can a case be made for CFA stumpages that are lower, for comparable timber, than those paid by holders of industrial forest tenures, for example TFLs FLs.?

If CFA holders provide a direct return to the Crown, how should it be determine

Let us address each of these questions in turn.

### **Should stumpages be paid by the holders of CFAs?**

I believe that the answer to this question is yes.

The provincial Crown retains title to the land within CFA s and represents interests of the people of BC in the land. It is reasonable therefore that the government, on behalf of the people, should **share** in the wealth generated by timber on the land in a consistent and **equitable** manner.

The key words here are **share** and **equitable**. How much stumpage should CFA holders pay and how should it be calculated and levied?

### **Can a case be made for CFA stumpage payments that are lower than economic rent or full market value of the timber resource?**

I believe such a case can be argued on two principle grounds.

First, one must consider the rationale underlying the establishment of community forests, their special nature and their purpose.

Second, agreement holders must be provided with equity in timber resources in order to encourage investments designed to enhance their market value and augment the benefits, both local and provincial, that they generate.

#### ***The Special Nature of Community Forest Agreements***

Community forests were established in response to several imperatives including:

- to help diversify a forest tenure system that had become concentrated in the hands of a relatively small number of industrial licensees;
- to empower rural people, living in forest communities, to develop and work towards forest management goals designed to contribute to their collective health, prosperity and survival over long term;
- to promote, at a grass roots level, the sustainable development of provincial forest resources;
- to promote innovative forest practices; and

- to allow environmentally sensitive areas of forest land, unsuitable for large scale industrial forest operations, to be brought into production and managed for the benefit of all British Columbians.

In December 1997 the CFAC set out to devise a tenure that would be long term, provide rights to a broad range of forest products and provide licensees with as much flexibility as possible in setting strategic and shorter term objectives and implementing management plans. When Dave Zirnheld, the Minister of Forests at the time, spoke to the CFAC at its inaugural meeting, he said that he envisaged a community forest tenure that would have many of the characteristics of fee-simple land short of alienating provincial title to the land itself. Clearly, the intent was to create a tenure that was in marked contrast to the existing industrial model.

What eventually emerged in legislation as the CFPAs fell far short of these lofty early principles. But, nevertheless, they are an innovation that *is* different to the more traditional industrial tenures and should be viewed in this light. Communities are more than just another category of Crown tenure holders.

The important differences between CFAs and other Crown tenures is recognized in the Government's Objectives for community forests that include:

- Provide long-term opportunities for achieving a range of community objectives including employment, forest related education and skills training and other social, environmental and economic benefits;
- *Enhance* the use of and benefits derived from the community forest agreement area.
- Encourage cooperation among stakeholders.

The special nature of community forests and the high expectations surrounding them are further reflected in the criteria set out in the *Requirements for Pilot Agreement Monitoring Reports.*, In addition to such categories as return to the province and economic self sufficiency, the monitoring procedures include:

- evidence that legal forest practices and environmental standards have been exceeded;
- achievements in applying innovative practices in such areas as forest operations, business management and public involvement;
- accomplishments in research and development;
- the extent to which management has achieved a balance across all forest resources

- success in enhancing regional economic diversity and stability; and
- the degree to which land not previously contributing to the well being of the local community has been brought into productive use.

Plainly, community forests are different to other forms of tenure. They are expected to be models of good sustainable forest practices and environmental management. They are intended to significantly enhance the welfare of local populations and their holders are expected to be risk-taking innovators who engage in research and development across a spectrum of activities for the common good.

CFA holders must be encouraged to meet these high standards and achieve goals that exceed those expected of other Crown licensees. They should also be rewarded for their accomplishments. The most practical, and indeed equitable, way of doing this is through the stumpage system. The provincial government should share the economic rent generated by CFAs with those who hold them. CFAs generate wealth in the form of timber but they also create many social benefits both local and provincial. A share of the stumpage or economic rent generated should be regarded as a return to the production of a broad range of social values

If the stumpage paid by holders of industrial tenures is less than the available economic rent or full value of the timber; income is being transferred from the people of British Columbia in order to enhance the profitability of a private enterprise – a subsidy to the private sector in fact. However, if the provincial government shares the stumpages generated by CFAs with the communities involved, these funds are not going to line the pockets of corporate shareholders but are being used by an important segment of British Columbia society to create important forest and social benefits. Such transfers of forest wealth are *not* subsidies but investments in the health and ecological integrity of our forests and in measures that enhance the quality of life of the province's rural citizens. It is also a means by which forest communities can share, albeit in modest way, in the provincial wealth generated by local resources.

### **Creating Equity in Timber Crops**

In order to provide licensees an incentive to invest in reforestation and/or more intensive silviculture they must hold equity in future timber crops. That is, they must be allowed to capture a portion of the economic rents, or timber values, resulting from their efforts.

Under current stumpage arrangements that are designed to capture all the economic rent for the Crown, any improvement in the value of the timber crop simply increases Crown stumpages – the license holder who makes the capital investment and takes the risk receives no return.

While the Crown, as landlord, is entitled to a share of the timber values generated, it is not entitled to those returns resulting from licensees' capital investments. While this argument can be made for all Crown forest tenures, it is particularly relevant to CFAs that

are in the business of producing timber for the market place and have, as one of their major purposes, the enhancement of timber values.

### **How should stumpage payments for CFAs be determined and levied?**

#### *Present Practices*

Since 1987, stumpages for long-term tenures in British Columbia have been calculated using the Comparative Value Timber Pricing system (CVTP).

Under the CVTP system, average or “base” stumpage prices, calculated to achieve a “target revenue” for the province, are set for the Coast and Interior. Whether stumpage for a particular cutting authority should be above or below the average is determined by means of an appraisal procedure that determines the net value of the timber concerned relative to the average value. Timber of above average value bears a stumpage price higher than the base price while timber of below average value is appraised at less than the base price. CFPA holders have complained that this procedure does not recognize the special features of community forests that impose extraordinary costs on their holders. If this is true then it puts community forests at a disadvantage compared to other forms of tenure and is clearly inequitable.

In March 2003, the government announced major changes to the provincial stumpage system. Under the new provisions, that became effective on the Coast on March 1, 2004, the province will introduce a market-based approach to stumpage determination. To accomplish this, 20 percent or more of the provincial allowable cut will eventually be sold to the highest bidder through competitive auctions. Approximately half this volume will be from allowable cut returned to the Crown by all tenure holders with AACs greater than 200,000 m<sup>3</sup>, and the balance will be supplied from the volume that is currently sold by B.C. Timber Sales to registered small businesses.

Under the market-based pricing system, bidders will compete, for timber sale licenses with terms of 4 years or less. Timber prices received at auction will be used to determine stumpage rates for that portion of the AAC that remains in long-term tenures including CFAs. Prices for non-competitive timber will be adjusted downwards to reflect the costs of satisfying tenure holders’ statutory and contractual obligations.

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### **Alternative Approaches to Stumpage Determination and Collection for Community Forest Agreements**

This is a complex issue that requires detailed analysis and is beyond the scope this presentation. However, let me throw out some ideas for consideration.

One solution is to simply stay with the market-based stumpage system. In the interests of equity, all the costs of satisfying the broad mandate of community forests must be fully accounted for in the downward adjustment of competitively determined market prices. If the government determines that community forest licensees should share in the economic rent generated by their timber producing activities, as I believe they should, then a special “community forest allowances” based upon a revenue sharing formula could be used to further reduce market determined stumpage values.

There could be a basic allowance for all community forests plus additional allowances that recognize an individual forest’s unique features and investments in enhanced timber management. Basic adjustments could be the subject of a predetermined revenue sharing formula while special adjustments could be negotiated and performance based.

Alternatively, innovative stumpage determination and collection arrangements could be introduced for CFAs. Central to any alternative scheme should be a rental charge per hectare based upon the natural productivity of the community forest’s operable area. Under such a scheme, the community would have certainty about future costs and the government would be assured of an annual income. The rental, that might be revised periodically to reflect market conditions, would be a percentage of the value that could be produced annually on a sustained basis assuming no improvements in productivity or timber values. Any investment designed to increase the values of timber crops would accrue to the community. Actual rental charges would be a matter of policy and would be written into the community forest agreement.

Under such an arrangement the government can be seen as renting the land to the community under a long term contractual agreement while the community has the flexibility to manage the land in order to produce a desirable flow of economic and social benefits. The capitalized value of the rents would be lower than the capitalized net revenue potential of the land ensuring the government shares in the costs of producing the many non-pecuniary benefits generated and that the community builds up equity in the timber crops produced.

A variation would be to replace community forest stumpage with a per hectare levy determined in a similar manner to property tax for managed Crown granted forestland. An “assessed” value for the community forest would be calculated as a combination of an annual rental based upon the natural productivity of the operable land base plus the market value of the timber harvested. The community forest’s contribution to the provincial government, in the form of an annual fee, would be a percentage of the assessed value (similar to the mil rate struck for Crown granted land). The annual fee would vary with the level of harvesting and would fall to the minimum per hectare charge when no harvesting occurs. Total fees would be set at a level that reflects the special nature of community forests and the government’s role in sharing the costs of meeting the community forest’s social agenda.

