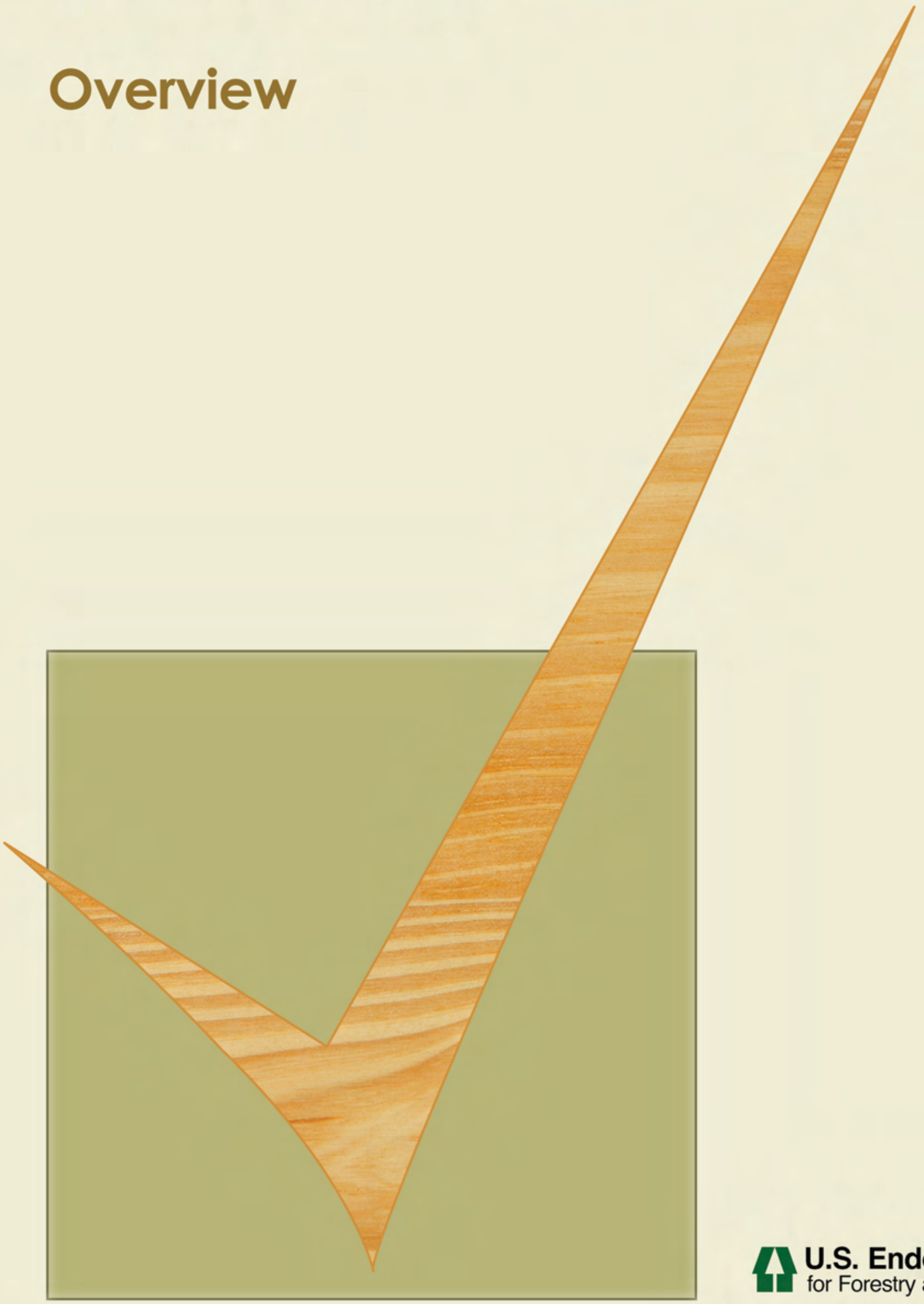
Commodity "Check-off"

The Potential for North American Softwood Lumber

Overview



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Generic product promotion offers opportunity for North America's softwood lumber industry

A feasibility study conducted by the U.S. Endowment for Forestry and Communities (the Endowment) finds that U.S. and Canadian softwood lumber producers could set up a fair and cost-efficient promotional program that would benefit the industry on both sides of the border. The authority to create a so-called check-off program comes from the U.S. 1996 Farm Bill. Canadian and U.S. industry would have a proportional say (based on market share) in governing the program and developing initiatives to grow the market, enhance the industry's reputation, and improve business conditions.

FINDINGS

The softwood lumber industry of North America is beset by competition from other construction materials, the collapse of the housing market, industry restructuring and globalization, and public policy challenges. Past voluntary efforts to promote forest products of any type have been sporadic, underfunded, and narrowly targeted, and campaigns have not lasted long enough to succeed. A better approach would involve most softwood lumber producers, on an equal basis, and have the marketing muscle to claw back losses in market share.

Check-off programs allow commodity producers to raise funds through self-imposed mandatory assessments overseen by the U.S. Department of Agriculture. The funds are used for generic product promotion—"Got Milk?" is an example—as well as research. Once a program is set up, government's role is limited to oversight and compliance.

A check-off program enjoys a broad funding base, lowering costs for all involved, and it is durable, since it can be terminated only through a referendum and cannot be stopped by a few disaffected producers. Thus a unified North American check-off could have the resources and staying power to achieve significant gains.

Here is an opportunity for industry to create a truly North American generic promotion program with cross-border equity in financing, process, and governance. This approach offers the best set of winning conditions that could help resolve trade tensions, grow the market, and improve business conditions.

RECOMMENDATION

The Endowment recommends that Canadian and U.S. producers pursue the idea, develop a shared vision, and achieve broad agreement on creating a unified softwood lumber check-off program. In the spirit of putting aside the disputes of recent years and focusing on what is best for the North American industry as a whole, the Endowment will facilitate a process to allow industry leaders to determine whether to pursue the idea.

THE FEASIBILITY STUDY

The full report, “Commodity ‘Check-off’: The Potential for North American Softwood Lumber,” examines the opportunities provided by check-off programs for generic promotion, summarizes the economic benefits from existing programs, presents research on implementation options, describes how a check-off program would be structured and implemented, and suggests how this tool might be used to improve business conditions for the forest products industry in North America. It also presents results of a survey of softwood lumber industry executives representing a majority of North American production, who generally expressed openness to considering a check-off program. The report was prepared by Phoenix Strategic Solutions, Inc., and is available in its entirety from the Endowment.

The summary on the pages that follow introduces the major issues surrounding a North American check-off program for softwood lumber.

THE U.S. ENDOWMENT FOR FORESTRY AND COMMUNITIES

The Endowment is a not-for-profit organization that works collaboratively with partners in the public and private sectors to advance working forests and forest-reliant communities and develop information useful to the broader community. It was established in September 2006 at the request of the governments of the United States and Canada in accordance with the terms of the Softwood Lumber Agreement.

Commodity "Check-off"

THE POTENTIAL FOR NORTH AMERICAN SOFTWOOD LUMBER

A summary of the major issues

Why a study on the feasibility of a "check-off" program for softwood lumber?

In the interest of growing domestic markets for sustainably produced forest products, the U.S. Endowment for Forestry and Communities (the Endowment) commissioned a study to examine the potential for a unified or coordinated government-sponsored "research and promotion" program for softwood lumber in the United States and Canada. Such programs can provide stable funding to support and expand markets, which in turn could benefit the broad range of forests, forest communities, and stakeholders in both countries.

The Endowment is one of the entities that emerged from the 2006 Softwood Lumber Agreement, which set aside funds for purposes related to improving conditions for forest landowners, forest-reliant communities, and sustainable forestry and for improving relationships between the Canadian and U.S. industries through collaborative projects to enhance business conditions.

The foresight of the North American industries and their respective governments to use some of the duties collected and held since 2002 to promote softwood lumber perhaps indicates that after decades of wearying conflict, industry may be ready to pursue cross-border collaboration to grow the market for everyone. The 2006 agreement does not expire until 2013, leaving ample time to try new approaches and create successful joint efforts.

Further, the globalization of the industry, heightened competition from abroad, and dramatically changing economic conditions suggest that the North American industry should invest in joint efforts to increase its overall market rather than sinking more money into costly trade cases.

Disputes delay the inevitable: competition is here to stay, and industry benefits most from a marketing strategy supported by all parties. Consequently, this study focuses on options for softwood lumber producers that are fair and cost-efficient and give industry on both sides of the border say in designing, implementing, and governing initiatives to grow the market, enhance the industry's reputation, and improve business conditions.

What's a check-off program?

Faced with declining markets and difficult operating environments, agricultural commodity producers have frequently asked their legislatures to levy small fees on their products and use the funds to improve business conditions through promotion, education, and other activities designed to stimulate market demand. These research and promotion programs—known as check-offs because farmers once checked the box to contribute—are well established as a way for producers to raise funds for generic product promotion. The U.S. Congress first allowed for the generic promotion of farm products in the 1930s. Today's programs require no special congressional authorization and are overseen by the U.S. Department of Agriculture (USDA).

Among the best known campaigns launched by these check-off programs are "Got Milk?," "Beef, It's What's for Dinner," and "Cotton, the Fabric of Our Lives." In addition to strengthening market position, check-off authority helps an industry address sustainability objectives, conduct research on public perceptions, and positively influence those perceptions. Funds may also be used to conduct research related to technical issues and product development, and to fund activities of industry's technical organizations like the American Wood Council and grading agencies.

Check-off programs are designed to strengthen the position of the industry in the marketplace and to maintain and expand domestic and foreign markets. Accordingly, program funds can be used to promote the industry's image, support research, provide consumer information, and conduct product promotion. They cannot be used for influencing any legislation or governmental action or policy, or for promoting individual company names.

How would it work?

A check-off program is fully funded by industry assessments, which are generally tied to each unit of the commodity. For example, the beef program assesses $1 per head; softwood lumber might be assessed per 1,000-board-foot unit or equivalent. Assessments are normally deducted at the time of sale.

The program can accumulate check-off reserve funds to permit a continuous, effective program of promotion and research in years when, because of market conditions, assessments may be reduced and program revenues fall. A program can also use revenue as matching funds for other government-funded programs, such as USDA's (FAS) Foreign Market Development programs, or to support other organizations for projects that are consistent with check-off statutory and regulatory authority.

Board members are nominated by industry and then appointed by the Secretary of Agriculture. USDA's Agricultural Marketing Service oversees the activities of the board and approves budgets and programs to ensure compliance with the legal provisions of the Farm Bill. The agency's administrative costs, typically $75,000 to $135,000 a year, are reimbursed by the check-off program.

How would this work for Canadian industry?

Authority exists to extend check-off programs to imported products and those who manufacture or process them. Since softwood lumber is an agricultural commodity that can participate in USDA's check-off programs, the volumes that Canadian and offshore producers ship to the U.S. market can participate. Several conditions apply:

- Assessment rates on imported products can be no higher than on domestic products.
- Promotional campaigns may not specify product origin (e.g., "Wood, the Natural Choice," is permitted, but "Canadian [or U.S.] Wood, the Natural Choice" is not).
- The program cannot include participation from some supplying countries but not others.
- All products must be treated equally, and in the same way as U.S. products, in accordance with the GATT principle of "National Treatment."
- The importing producers must have fairly allocated, representative seats on the governing board. For instance, if Canadian imports represent 35% of the U.S. market, then 35% of the board would be Canadian.

Determining who votes and who governs a check-off program is critical to its success. These issues would be resolved when the industry representatives work with USDA staff to develop a program. Clearly, an effective system for addressing assessments and assigning equitable voting rights to lumber producers in Canada (and any other exporting countries with significant market share) can be designed and would have a high likelihood of winning majority approval by production volume or even by number of companies. USDA's authority appears to provide the flexibility to design programs that work.

In reality, this could be a truly North American program for softwood lumber with cross-border equity in participation, financial contributions, process, and governance.

Who pays? Is participation mandatory?

In principle, all companies requesting or benefiting from a check-off program are said to be "covered" by the program. Unless otherwise exempted, these companies pay assessments to fund the program and participate in initial and subsequent referenda.

Free-riders—those who don't pay dues to a membership organization yet benefit from its activities—have long hampered industries' efforts at self-help, frustrated promotion and communication programs, and dampened member recruitment. Check-off assessments, in contrast, are mandatory: in theory, everyone in the industry pays (and everyone benefits).

Small producers often vote against check-offs because they don't see the direct benefits or they find the assessments burdensome. The 1996 Farm Bill, anticipating this, includes authority to establish exemptions for *de minimis* quantities.

Thus it is possible to define a check-off program's voting population by exempting the small producers that might object to participation. Since a check-off requires a simple majority vote to proceed, such an exemption significantly increases the chances for success. It also makes administration and compliance simpler and less costly. The benefits of the program would still accrue to the entire industry, even the exempt firms.

Issues and Concerns

In interviews, some Canadian and U.S. executives expressed reservations and offered suggestions and alternative ideas:

- Any check-off program could consolidate current promotion programs and thus lower costs and improve efficiency and effectiveness.
- A few thought that responsibility for a check-off should be shared equally with landowners.
- Some believe that Promotional efforts should target the trade—end-use decision makers and not the general public.
- Some companies conditioned their participation on how a program would work and be governed.
- Any check-off program should end the inequities in generic industry funding of programs and minimize the free-rider problem.
- From a promotional perspective, lumber cannot be separated from panels, and any program should include both.
- Canadian companies should contribute via the export tax, or the export tax could top off the fund, lowering the cost for all and strengthening the program.

These and other concerns could likely form the agenda for a high-level industry meeting to explore check-off further.

Do check-off programs make a difference?

The executives leading today's check-off programs find it difficult to isolate the impact of their programs from other market forces, ranging from global economic fluctuations to the weather. USDA requires that programs measure their effectiveness, however, and encourages check-off boards to commission econometric studies to separate the impacts of check-off activities from those of other factors. Although such studies can simulate market performance both with and without the promotion, they are data intensive, and therefore studies based on narrower quantitative assessments or qualitative approaches are often performed.

Studies of advertising for specific dairy, citrus, and several other products have generally found a strong positive relationship between the amount of money invested in generic advertising and sales of the product. At the high end, effectiveness evaluations report \$10 rates of return for each dollar spent; more usually, rates of return are in the \$4 to \$6 range. Such figures are representative for campaigns intended to increase sales directly; the effectiveness of a long-term effort promoting wood as a renewable and sustainable product, intended to prevent users from switching to competing products, would be more difficult to measure.

Check-off programs …

- have returned \$4 to \$10 for each dollar spent on promotion
- are operated and governed by industry members, for industry
- Outlast and outperform voluntary campaigns conducted by membership organizations
- Can involve Canadian suppliers as full partners who would benefit and participate equally
- Cannot be sunk or undermined by a minority of participants.

Could such a program help the softwood lumber industry?

The feasibility study deals with the success or failure of check-offs as sustainable programs; it does not examine the success or failure of their promotion, research, or communications campaigns. Overwhelmingly, programs have failed not because of poor communications programs but because of the failure to deal with problems in the conception, structure, and design of the check-off organization.

That said, opportunities for the forest products industry to improve its image and promote its products clearly exist. It can demonstrate sustainability and environmental stewardship, the resource is renewable, and its products sequester carbon. Such messages could be the stuff of a professional promotional campaign, provided that the promotion targets the market (rather than obviously targeting only policymakers, since lobbying is forbidden).

What opportunities for the industry might a check-off promotion support?

Competition from substitute materials—concrete, steel, and other nonrenewables—has consistently eroded softwood lumber's market share in a range of applications, from floors and windows to exterior walls, decking, siding, and roofing. This shift is primarily due to durability concerns and the desire for "maintenance-free" products. As lumber prices increase, builders may begin using more substitutes—something the steel industry works hard to encourage (via a hefty promotion campaign).

Two promising opportunities to claw back market share were identified by a 2005 Wood Products Council study. One is the nonresidential market, where recent changes to building codes have

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created new opportunities. The challenges are substantial and the payback period is long, however. Of more immediate interest are residential raised-wood systems. Once such systems are accepted by the building community, some of the market share lost to concrete could be recovered. A Forest Products Laboratory report concludes that much of the potential depends on consumer preference, but "through promotion, research efforts, and direct involvement of builders, architects, buyers, and others in the design, construction and use of softwood lumber in residential and non-residential building construction," softwood lumber could benefit.

Forest industry executives surveyed for this report were divided on what a future check-off program campaign should target—promotion aimed at improving business conditions and industry reputation, or promotion aimed specifically at increasing sales. Most, however, considered both to be important, necessary, and interrelated.

How is a check-off program set up?

Title V, Subtitle B, of the 1996 Farm Bill, called the Commodity Promotion, Research, and Information Act of 1996, gives USDA authority to establish national generic promotion and research programs for virtually any agricultural commodity, including "the products of forestry." A program is established by USDA at the request of an industry group that can show that it has a majority consensus, by numbers or by volume.

In essence, the process involves six stages, each requiring a successful outcome in order to proceed to the next, taking a total of 12 to 18 months:

1. An industry task force initiates discussions with USDA.
2. The task force prepares an application and makes a formal proposal to USDA, which determines whether there is an adequate basis for proceeding.
3. The proposal is published by USDA in the Federal Register, and USDA reviews any public comments.
4. USDA holds a referendum of all parties that would be assessed under the program.
5. USDA solicits nominations for the initial board of directors, appoints the board members in collaboration with industry, and calls the first organizational meeting.
6. The program begins: check-off activities are designed and implemented, fees are assessed, and the role of USDA shifts to compliance and oversight.

Fee Structure Scenarios

75¢ Annual revenue on 52 bbf in softwood lumber sales assessed at $.75 per mbf would generate $39 million, an amount sufficient for television commercials, major-newspaper advertisements, and spots in construction trade media.

$1 An assessment of $1 per mbf could produce $52 million—enough to conduct the same strong promotional campaign as above and fund research and a rainy-day reserve.

Why not build on existing promotion programs?

The statute and its regulations require that the check-off's governing board, staff, and budget be unaffiliated, although it can contract with existing associations to carry out appropriate activities. Policy advocacy of the kind that most existing organizations conduct is not allowed. Moreover, natural competition among associations would make it very difficult for any one organization to conduct a successful promotional campaign that truly promoted all North American softwood lumber.

Believing that forest products benefit from generic promotion, industry leaders have launched numerous communications programs for public outreach, education, and promotion. Although some programs have been effective, none have fully accomplished their original objectives, and gains have eroded or even disappeared once the campaigns ended. The four most significant campaigns—the current Abundant Forest Alliance and Wood Product Council market growth programs, the past Wood Promotion Network category marketing and positioning program, and the American Forest & Paper Association forest certification and reputation campaign—stand out for their size and objectives but have suffered from waning funding over time.

Lessons learned:

- Change requires long-term commitment. Changing public opinion is particularly costly; it requires sustained effort and continual reinforcement to prevent the erosion of gains. Support for new campaigns is initially high but erodes with both market cycles and industry consolidation and turnover. It usually takes three to five years to show substantive change, and longer to have an enduring impact; most efforts do not survive two or three years.
- Promotion must be proactive, not reactive. Industry generic promotions have been crisis driven, and the absence of a pool of funds to get out ahead of an issue or crisis has significantly reduced their effectiveness. Further, crisis-driven programs are simply that, and as soon as the crisis passes, funding stops. Industry tends to rework programs' goals, shifting focus and reducing expectations, often because of funding deficiencies, changing market conditions, or the emergence of a new crisis.
- Natural divisions hinder success. Structural and geographic divisions in the North American industry—big-small, foreign-domestic, East-West, public-private, paper-wood, funders–free-riders—have hampered efforts to maintain a critical mass of industry support.
- CEO support is critical for success. Ambitious programs require strong leadership to get off the ground, and without sustained CEO support, programs decline, retention suffers, and the number of free-riders grows.
- Voluntary industry promotion programs create resentments, dampening commitment. The many free-riders who withhold support from voluntary programs have frustrated fund-raising and discouraged those companies that, justifiably, do not wish to carry the burden for the entire industry.

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What are the advantages and disadvantages of check-off?

Check-off programs are perceived to provide certain benefits to their industries:

- generating significant funding for grow-the-market promotion;
- ensuring funding stability over time;
- addressing the free-rider problem;
- unifying the industry;
- improving the business operating environment;
- changing perceptions among target audiences by highlighting stewardship and sustainability;
- supporting a broad range of research beneficial to industry—on markets, product development, end-use application, safety, and sustainability; and
- supporting other industry organizations for grading, technology, promotion, sustainability, certification, and research.

Check-off programs can be controversial, however. To fund promotion, all producers are required to pay an assessment, generally tied to each unit they market and deducted from revenues at the time of sale. Some producers object strongly to what they consider a tax for activities they would not fund voluntarily, and others with private rights concerns have found the programs objectionable. The U.S. hardwood industry, which rejected a check-off in 1993–94, raised these concerns:

- paperwork and administrative costs;
- cumbersome governance structure;
- the creation of yet another industry group and bureaucracy requiring funding;
- the potential for conflict, should check-off assessments supplant dues to existing, voluntary industry associations; and
- government oversight of industry activities.

Why involve the government?

Producers prefer government-sponsored programs for two reasons. One is the "free-rider" problem: in a voluntary program, nonparticipating producers gain benefits without contributing promotion funds, whereas the government-sponsored, mandatory check-off ensures broad participation. The other is that voluntary efforts can be easily terminated by a small group of producers, whereas a government-sponsored check-off can be stopped only by referendum. Check-off programs have therefore proven to be much more representative and durable.

Because of the advantages of a government-sponsored program, across the agricultural setor, voluntary promotion accounts for only about 10 percent of all funding for generic efforts; the rest—90 percent of all promotion arrangements—operate under the aegis of federal or state laws, and nine of every 10 U.S. farmers now contribute to check-offs.

Although government involvement is minimal, some industries, having sought and established a check-off, nonetheless chafe under USDA oversight. And individual objections persist. A group of cattle ranchers, for example, challenged the constitutionality of check-off programs, arguing that the campaign promoting beef as a generic commodity hindered their own efforts to promote their beef as a superior product. Because they disagreed with the message, they said they should not be compelled to subsidize the campaign, and moreover, compelling them to subsidize speech with which they disagreed violated their First Amendment rights. The U.S. Supreme Court in 2005 ruled that because the Secretary of Agriculture has final say over promotional campaigns and USDA staff attend and participate in meetings where proposals are developed, the generic advertising was the government's own speech and therefore not subject to a First Amendment challenge.

Are there other possible approaches?

A check-off is not necessarily the only way to proceed. Another option for generic promotion would involve coordinating provincial and state check-off programs. Because the industry operates in so many states and provinces, however, achieving coordination and harmonization would be daunting.

Yet another option is parallel Canadian and U.S. national check-off programs, which may be appealing because of perceived governance and program advantages. A U.S. program could be easily established. But in Canada, given the lack of federal enabling legislation, the strength of provincial authority, and differences in provincial approaches, the process would likely be difficult and time consuming. The Canadian beef industry's check-off efforts may be path-breaking in this regard but have a distance to go.

Is a unified North American check-off program really feasible?

An interview-based survey of more than 30 North American softwood lumber industry CEOs or heads of business probed their level of interest in generic promotion to grow the market and improve business conditions, and explored whether check-off might be a viable means to that end. The executives represented more than 60% of North American production. With few exceptions, they saw value in generic softwood lumber promotion. A simple majority, representing about 51% of North American production, expressed interest in exploring check-off to achieve industry market goals (details on survey participants and results can be found in the full report).

Although traditional free-riders may decline to respond, consistent with their general reluctance to engage in collective initiatives, even if a significant number of companies not surveyed for the report voted no, a majority of North American production, by volume, appears ready to explore a check-off program.

Given the positive response, the Endowment believes it can confidently encourage further steps. As a next step, the Endowment is organizing a representative group of senior executives to consider a North American check-off program for softwood lumber, and to facilitate introductions of major players—industry representatives from both Canada and the United States—to USDA's Agricultural Marketing Service.

Since the Canadian share of the U.S. market is large, establishing a North American check-off must involve Canadian suppliers in the initial application discussions with USDA, and all affected Canadian and offshore volumes must be included in any referendum. The application must provide convincing evidence that a majority of the suppliers (both U.S. and non-U.S.) to the U.S. market agree with the goals and will support a check-off program when the referendum occurs. All suppliers would then be assessed identically on volumes sold to the U.S. market.

USDA staff have unofficially indicated that given the history of the softwood lumber dispute, the department will carefully scrutinize the level of support for any check-off program and seek assurances that opposition concerns are addressed.