

EFFECT OF A DUTY ON SOFTWOOD LUMBER ON BRITISH COLUMBIA

British Columbia's Softwood Lumber Industry

Despite continued diversification in the provincial economy, the forest products industry continues to play a major role in the economic well-being of British Columbia. In 1999, forest industry gross domestic product (GDP), expressed in current dollars, totalled \$9.0 billion, representing 8.6% of total provincial GDP. In comparison, the construction industry contributed \$5.6 billion to GDP, and petroleum and natural gas accounted for \$1.3 billion during the same year. The breakdown by forest industry was:

- Logging..... 40%
- Wood Industries (about 80%
softwood lumber)..... 40%
- Pulp and Paper..... 20%

In addition, when indirect economic activity resulting from the spending of the industry and its employees is included, the forest industry accounted for about 15% of total provincial GDP.

Direct employment in the forest industry totalled 97,100 persons in 2000, representing 6% of total provincial employment. About one-third of this number was employed in forestry, logging and support services. Another 30,400 people are employed in sawmills. Others work in plywood mills, engineered wood products manufacturing and the pulp and paper industry. As with GDP, indirect economic activity increases the sector's importance. With indirect effects, the forest industry accounted for about 14% of total provincial employment.

Forest industry manufacturing shipments in 2000 totalled \$20.2 billion, representing just over 50% of the value of shipments by all manufacturing industries in British Columbia. Softwood lumber accounted for about \$8 billion in shipments in 2000.

Most forest products shipments are exported to international markets. Forest product exports in 2000 totalled \$16.2 billion, representing one half of the total value of goods exported by B.C. industries in 2000. Softwood lumber is British Columbia's largest export, accounting for about \$7 billion of exports. Of these, British Columbia's softwood lumber exports to the U.S. were worth nearly \$5 billion. About 85% of British Columbia's softwood lumber production was exported.

Provincial-level statistics sometimes understate the importance of the forest industry to regional economies in British Columbia. Outside the Lower Mainland and Capital Region, economic dependence on resource industries in general, and specifically the forest industry, increases noticeably. Of the 63 local areas outside of the Lower Mainland, 25 list forestry as the principal basic income source.

Effects of a Countervailing Duty

On August 9, the U.S. announced that it would charge a 19.3% duty (tariff) on the value of softwood lumber imports from Canada. This is a preliminary rate, subject to further investigation and verification by the U.S., as well as challenges from the Canadian federal and provincial governments. In other cases, including previous softwood lumber cases, the final rate has often been less than the preliminary rate.

In addition, on September 24, the U.S. is expected to announce its preliminary determination in the anti-dumping investigation. This could result in an additional anti-dumping duty, which would be added to the 19.3% countervailing duty rate.

The general impact of a duty is to reduce U.S. demand for Canadian softwood lumber. Some of the factors that influence the magnitude and distribution of the effects on B.C. producers and the economy in general, are discussed below.

Nature of demand and supply

Generally, the price impact of a tariff will be shared between the importer and exporter. How much the consumer price rises compared to the drop in the producer price depends on the nature of demand and supply in each region. In general, the more responsive U.S. consumers are to changes in the price of Canadian lumber, the more the price received by Canadian exporters will fall due to the tariff. However, if the U.S. is not able to increase its domestic supply of wood substantially, then the tariff will tend to lead to an increase in the prices paid by U.S. consumers, rather than to a fall in the price received by Canadian mills.

Market cycles

The North American lumber market is subject to wide price swings. Prices were below US\$200 per thousand board feet (mfbm) early in 2001, but have increased since then to about US\$300/mfbm for Spruce-Pine-Fir 2×4s in August of 2001. At current prices, a duty of 20% translates to about \$60/mfbm, and reduces Canadian sawmill returns to US\$240/mfbm. Some market observers state that the break-even point for B.C. interior sawmills is about US\$220/mfbm. However, there is wide variation in costs around this average. To the extent that marginal companies have higher break-even points, they might shut down due to a 20% tariff and \$300/mfbm price. In the longer run, the tariff will reduce the profitability of Canadian sawmills relative to U.S. mills and lead to proportionately less investment in the sector and a decrease in relative competitiveness.

Higher-valued products

Because the duty is applied to the value of the exports, producers of higher-valued products will be paying larger per unit duties. For example, red cedar 2×8s at US\$600/mfbm would face an additional burden of \$120/mfbm. Clear red cedar at \$1,200/mfbm would pay US\$240/mfbm in duties. Market observers state that these types of payments could not be sustained because of profit margins in the milling of cedar, leading some Canadian mills to shut down and reduce the overall supply of cedar. To the extent that cedar is less available in the U.S. and there are few substitutes, the duty would likely lead to higher prices in the U.S., lessening the effect on Canadian producer prices, but also encouraging consumers to switch to substitutes.

Remanufacturers who buy lumber and either cut it to produce higher grades or manufacture fingerjointed products will also be disproportionately affected because they produce a relatively high-valued product, at low per unit margins. Remanufacturers will be additionally affected because U.S. customs charges the duty on an “entered value” basis, rather than a “first mill” basis. A “first mill” duty would be assessed on the value of the lumber as it left the primary sawmill, which is lower than the value at the border.

Effects on producers

Regionally, there are some parts of British Columbia that are always on the margin of being economically viable for logging. Mills in these areas

will likely be the first to be affected by the duty. In addition, some companies have been running several sawmills at less than capacity for a number of years. The duty might then force these companies to shut their least efficient mills.

Effect of the Softwood Lumber Agreement (1996-2001)

The Softwood Lumber Agreement (SLA), by restricting U.S. imports of Canadian lumber to a fixed level and charging duties on imports above that level, affected the relationship between consumer and producer prices over the 1996-2001 period. In particular, the SLA, by restricting imports to the U.S., likely increased U.S. prices and reduced Canadian prices, similar to a tariff. Since the countervail duty is replacing the SLA, it will not have the same effect as a 19.3% tariff applied in a formerly free market. Prior to the SLA, there were other restrictions such as an export tax and countervailing duties so that there has not been free trade in softwood lumber between Canada and the U.S. since the early 1980s.

Conclusion

The countervail duty, as proposed, would have a serious impact on the B.C. forest sector as well as on American consumers who must pay more for B.C. products. British Columbia, along with the federal government is fighting this unfair tariff. Because the outcome of the process is still uncertain, it remains unclear what the ultimate impact on the province will be.