
THE FUTURE OF SOFTWOOD LUMBER IMPORTS INTO THE U.S. MARKET

A presentation to the International Wood Products Association's
Annual Convention in San Juan, Puerto Rico, March 16, 2001

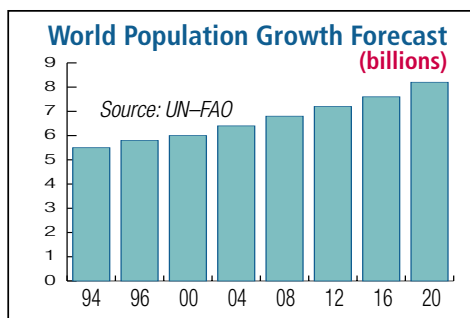
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The World's Demand for Wood

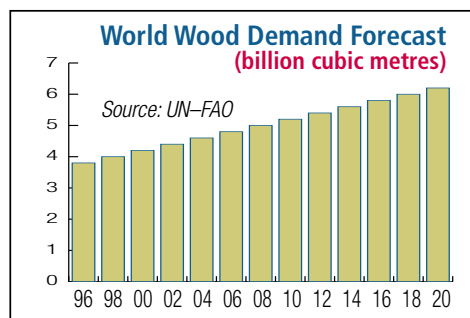
The North American market has been plagued with wood products oversupply in 2000. Lumber and panelboard production in both Canada and the U.S. reached historic levels in 1999 and these rates of output continued in the first half of 2000, plunging prices to their lowest levels since 1995. When will production and demand come back into better balance? The short-term outlook is not favourable! North American economic growth and wood products demand is forecast to ease further in 2001; U.S. housing starts are not expected to commence a new upcycle until 2002. In the medium- to long-term, however, if we look at wood products demand on a global basis, the outlook appears more hopeful.

World Demographics

The world's population is growing at the rate of more than 100 million per year; from the current level of just over six billion, worldwide population will surge to 8.2 billion by 2020 —



an additional 2.2 billion humans to be housed.



Although the greatest increase will occur in less developed countries with relatively low living standards, the pressure on the world's resources — particularly wood fibre — will be enormous. A few years from now, wood products' oversupply may be just a bad memory. Meanwhile, farsighted and aggressive marketing is needed to overcome the oversupply problem.

Wood Demand

According to UN-FAO studies, world roundwood demand used in lumber, panelboard and paper products is growing at an annual rate of 77 million cubic metres (15 billion bf, log scale), equivalent to the yearly harvest

of British Columbia. Despite the emergence of many non-wood substitutes, e.g., steel, aluminum and plastic, wood's unique properties continue to support its universal popularity. In fact, recent FAO studies indicate that per-capita consumption of wood is rising around the world.

Future World Markets

Where is the major world growth in demand for wood going to take place and on which countries or regions should North American exporters focus to alleviate the surplus now depressing the market?

- 1) The People's Republic of China, currently with a population of 1.2 billion set to expand to more than 1.4 billion by 2020, which will be chronically short of wood;
- 2) Other Asian countries, e.g., Korea, Taiwan and the Philippines, whose significant future wood needs will not be met by their limited resources;
- 3) India, whose current population of one billion is forecast to exceed China's by 2020; and
- 4) The countries of the Middle East, which have no forest resources of their own but vast petroleum wealth to pay for needed imports.

Canadian and U.S. producers should combine their efforts and resources to develop these markets, as the most positive means to combat oversupply.

U.S. Non-Canadian Softwood Lumber Imports

For decades, Canada has been the primary supplier of U.S. softwood lumber imports, providing virtually all of these products from foreign sources. In 1996, the Canada-U.S. Softwood Lumber Agreement was struck to limit the volume of these imports that could enter the U.S. duty-free. Little did the signators to the agreement realize that, rather than limiting softwood imports, the agreement would help to foster an exponential rise in imports from a relatively new source: offshore suppliers.

U.S. Offshore Softwood Lumber Imports (million bf)			
	1996	2000	Increase
Europe			
Austria	0.9	130.0	
Finland	4.2	25.0	
Germany	0.0	125.0	
Lithuania	0.7	40.0	
Sweden	2.5	65.0	
Total	8.3	385.0	2,156%
Latin America			
Brazil	102.1	325.0	
Chile	72.3	225.0	
Other	128.5	45.0	
Total	302.9	595.0	103%
Pacific			
New Zealand	61.7	148.0	
Other	3.0	25.0	
Total	64.7	165.0	154%
Grand Total	375.9	1,145.0	328%

Source: U.S. Commerce Department

In the past five years, U.S. softwood lumber imports from offshore sources, unfettered by tariffs or quotas, have soared, rising 328%, from 376 million bf in 1996 to 1,145 billion bf in 2000. These imports have now become a significant market factor and have the potential to rise considerably in the future. What's motivating these increases?

European Imports

As a group, the countries of the European Union are not only self-sufficient in softwood lumber, but have increasing volumes available for export. The major importing countries, particularly the United Kingdom, are developing their own domestic forests and have been reducing imports from other EU countries. In 1995, Sweden, Finland, Austria and Germany, sensing the need for more exports, retained the West Coast Lumber Inspection Bureau to instruct their producers about how to grade to ALS standards. European whitewood's quality is very suitable for use as either construction-grade dimension and studs, or appearance-grade boards. Currently, WCLIB has certified more than sixteen mills in these countries to grade-stamp their lumber ALS. In 2000, European imports totalled 385 million bf, still relatively small but enough to create a market impact in U.S. Northeast and Southeast markets.

Latin American Imports

Imports from this region are dominated by Chile and Brazil, although other countries, i.e., Argentina, Uruguay and Honduras, are becoming new sources. Mexico continues to be a small but important source. The region has become a major source of millwork products, either finished mouldings or blanks for remanufacture in the U.S. and a wide variety of value-added products. All of these countries have fast-growing pine forests (radiata, loblolly, ellioti) and their capacity to increase exports is almost unlimited.

Pacific

New Zealand has also become a major source of radiata pine mouldings and industrial millwork grades of lumber, competing fiercely with domestic U.S. ponderosa and sugar pine products. The country has some of the fastest-growing plantation forests in the world: its annual harvest is forecast to double from the current 18 million cubic metres to more than 40 million by 2020. Australia is also expanding its radiata pine forests and is set to become an exporter in the next few years.

European Softwood Invasion

Canada has been the primary source of U.S. imports of softwood lumber for decades. During the 1990s, New Zealand, Chile and Brazil have emerged as substantial suppliers to the U.S. of non-structural pine mouldings, shop and industrial grades of lumber, competing with domestic producers of ponderosa, sugar and white pine products. In the past two years, a new supplier has appeared: European whitewood exporters. Although still small in terms of market share, the emergence of European producers into an already oversupplied market is cause for concern for both Canadian and U.S. producers.

European Sales Initiative

The North American sales initiative by European producers has been well planned and in the works for more than five years. In 1995, producer associates in Sweden, Finland and Austria retained the West Coast Lumber Inspection Bureau to instruct their member mills on how to grade to ALS standards. Currently, about 16 mills in these countries have been certified by the WCLIB to grade-stamp their lumber ALS. To date, exports have been chiefly boards and studs shipped to U.S. Atlantic coast ports. Unlike Canadian imports, European lumber faces

Country	1999	2000F	Increase
Germany	7	120	161%
Austria	72	100	39%
Sweden	43	60	39%
Lithuania	13	49	277%
Finland	9	25	177%
Total	144	354	146%

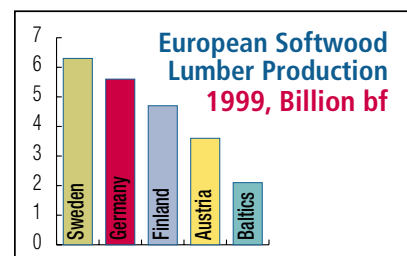
no tariff barriers or quota restrictions. Although volumes are still relatively small, in 2000 imports are forecast to exceed 300 million bf, up 146% from 1999.

U.S. importers report that European lumber has been well received by the trade. The product has gained a reputation for being

precision-sawn, free of wane, and of generally good appearance. Austrian studs have been particularly well received, sometimes commanding a small premium over domestic production.

European Productive Capacity

European softwood lumber production has been growing steadily in the past decade, particularly in the leading producing countries of Sweden and Finland. Moreover, the principal importing countries of the European Union — Germany, France and the U.K. — are becoming increasingly self-sufficient. Consequently, producers have turned aggressive in their quest for outlets for their products outside Europe.



Total softwood lumber production of the five principal exporting countries to the U.S. is just over 22 billion bf.

Sweden and Finland have the capacity to expand lumber production significantly, supported by extensive plantation forests. The Baltic States are increasing production, assisted by joint ventures with both European and U.S. partners. Austria, with its small domestic market, needs new markets in order to maintain production at viable levels.

Europe's Japanese Initiative

Can the Europeans really become a factor in the U.S. market? This same question was asked by dubious competitors six years ago when the Europeans entered the Japanese market, in the face of an established presence by Canadian and U.S. exporters. European exporters will ship a forecast 850 million bf to Japan in 2000, second only to Canadian exporters (chiefly from B.C.).

U.S. Softwood Lumber Supply

U.S. softwood lumber consumption in 2000 reached 53 billion board feet. The following is our estimate of the probable sources of supply.

U.S. Softwood Lumber Consumption • 2000 Forecast		
Source	Billion bf	% Share
Canada	18.1	34.2
U.S. South	16.0	30.2
U.S. West	15.7	29.6
Other U.S.	2.0	3.8
Offshore Imports	1.2	2.2
Total	53.0	100.0

This table shows how critical Canadian lumber supply is to the U.S., providing 34% of its requirements. Yet the relationship has been fraught with discord over the years. In 1996, the Canada-U.S. Softwood Lumber Agreement was reached, limiting duty-free imports to 14.7 billion bf.

Canada-U.S. Lumber History

With the expiry of the SLA on March 31, 2001, the longest-running trade dispute between Canada and the U.S. appears to be headed toward another bitter clash. Because of recent political changes in both countries, no meaningful discussions have taken place between the two parties. Government and industry officials on both sides of the border are resorting increasingly to acerbic rhetoric, and another long and costly countervailing duty case seems inevitable. If so, this will be the fifth such dispute between the two countries over a 20-year period without a permanent solution being achieved.

Natural Partners

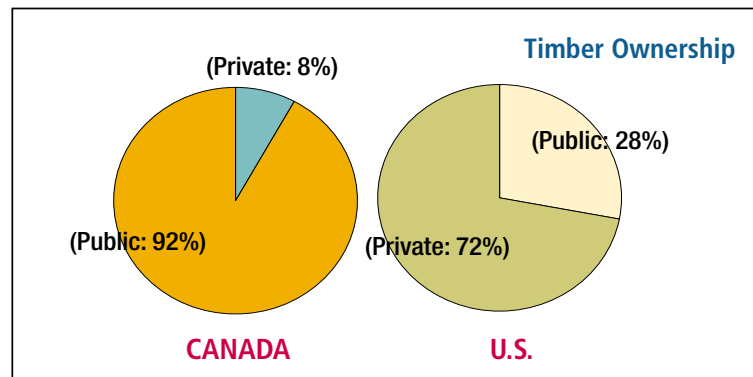
The distribution of timber resources and population in North America should have created a natural partnership in lumber supply: Canada, with its huge resource and small population, must export about two-thirds of its lumber production; the U.S., with ten times the population, must import about 35% of its lumber needs. With an obvious need for one another, why have the two countries not been able to achieve an accommodation? Past disputes have centred around these fundamental and seemingly irreconcilable issues:

- The differences in stumpage practices between the two countries;
- The U.S. Coalition's argument that free trade in lumber should also include free access by U.S. producers to Canadian timber; and
- A mechanism to control the market share Canadian lumber producers enjoy in the U.S. market.

What is the Issue?

The U.S. Coalition for Fair Lumber Imports claims that Canadian lumber is subsidized by low provincial stumpage rates, constituting unfair competition. At the root of this charge lies the fact that the two countries have different systems of timber ownership.

U.S. timber not consumed by its owners is sold on the open market at competitive prices; state or federal timber is sold at auction, usually to the highest bidder. Conversely, Canadian timber, owned mainly by provincial governments, is allocated to producers chiefly on a quota basis and stumpage is set



by various arbitrary formulas, which usually include a market factor. This latter system has been in place for decades; it would be politically and economically unacceptable for provincial governments to accede to the U.S. Coalition's demands that Canadian timber pricing be changed to open-market bidding and log export restrictions removed to allow foreign producers to bid on Canadian timber.

Are Canadian Producers Subsidized?

The U.S. Commerce Department has conducted numerous hearings over the past twenty years on this subject, but has never been able to prove conclusively that timber pricing policies in Canada constitute a subsidy. In fact, provincial government stumpage rates are not set to deliberately accord a subsidy to producers, but rather to extract as much revenue as possible from the lumber industry under its jurisdiction. Historically, the Canadian lumber industry has given its shareholders a relatively low rate of return on invested capital, indicating the absence of subsidy.

Exchange Rate Differential

Perhaps the biggest competitive advantage Canadian producers have over their U.S. counterparts is the low value of the Canadian dollar relative to the U.S. dollar. At the current exchange rate of around Cdn\$0.65 to the U.S. dollar, exchange revenue has been a big factor in maintaining Canadian lumber production this year during a period of depressed prices. But this is a function of international exchange rates and a fringe benefit over which Canadian producers have no control.

What Will Follow the SLA?

For the North American lumber industry, the biggest event in 2001 will undoubtedly be what happens after March 31, when the SLA expires. The following is an effort to answer some questions from our subscribers.

Will the Present Quota System Be Extended?

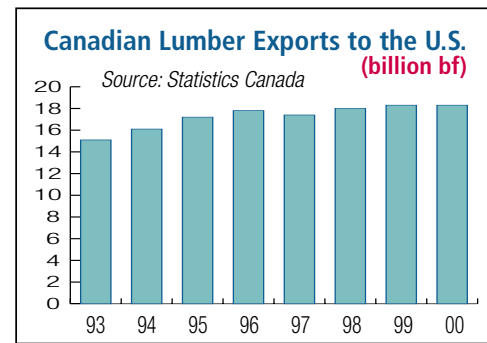
The answer to this question is one on which the Canadian industry seems unanimous: no! The quota system has proven to be inequitable, creating too many "haves and have-nots." Quotas based on historical shipments can be distorted. In addition, any system administered arbitrarily by government officials arouses suspicions of favouritism. Provinces or regions exempt from quotas, e.g., Saskatchewan, Manitoba and the Atlantic region, have been able to increase their market share in the U.S. at the expense of the participants in the SLA. Moreover, bitter disputes between the two countries have arisen over U.S. charges that some Canadian exporters have evaded the quota restrictions through various means.

Did the SLA Work?

The SLA was devised as a means to cap Canadian lumber exports to the U.S. and stabilize the market. Neither goals were achieved! In fact, Canadian exports rose from 17.2 billion bf in

1995 to more than 18.2 billion in 2000, with the exempted regions accounting for most of the increase.

During this period, imports of softwood lumber from Europe, Latin America and New Zealand, unhampered by tariffs or quotas, have steadily increased their market share, further destabilizing the market.



Can Canada Agree to the U.S. Coalition's Demands?

This is highly unlikely! The root of the dispute lies in the different timber ownership systems of the two countries. In Canada, 92% of the country's timberlands are owned by provincial governments; most of the timber is allocated to lumber companies on medium- to long-term tenures, providing security of cutting rights to the industry and a stable source of revenue for governments. Stumpage is set by the provincial governments using various formulae, including market prices for lumber. The U.S. Coalition charges this system is a subsidy since the stumpage established is not a true reflection of the timber's market value.

The Coalition's price for free trade is that Canadian timber pricing be changed to open-market auctions and U.S. producers be given the right to bid freely on Canadian timber. Log export restrictions would be abolished. In our view, this demand would be politically unacceptable to provincial governments and economically unworkable for the Canadian industry, keeping in mind that the current tenure system has been in place for decades.

What Happens Next?

The Canadian industry is divided over its strategy; political changes in both countries over the last few months have impeded government participation in the debate. Consequently, no meaningful negotiations have taken place between the combatants and time is running out. Meanwhile, chaotic market conditions caused by oversupply have given the U.S. Coalition a strong case to seek government protection through a countervailing duty charge. Although this course of action is not necessarily inevitable, it seems most likely at this time.

Canada-U.S. Trade War Looms

The annual Canadian Lumbermen's Association conference in Montreal in February brought together more than 800 delegates from both sides of the border. The expiry of the SLA on March 31 was the main topic of discussion. Conversations with speakers and delegates provided the following answers to key questions.

Will the SLA Be Extended?

No! The SLA will die on its expiry March 31. Neither country has any desire to see it extended.

Will There Be Free Trade in Lumber?

Yes! But only for a short period, if the U.S. Coalition for Fair Lumber Imports has its way.

What Follows?

It is highly unlikely that a new softwood agreement can be negotiated prior to the expiry of the SLA. The Coalition is preparing to launch a new countervailing duty (CVD) action on April 2, 2001.

What Are the Charges?

The Coalition's charges are well known, and state that Canadian lumber is subsidized by artificially low government stumpage rates and log export restrictions. It will seek import duties of 20%–30% on Canadian lumber imports to create what it terms a "level playing field." The Coalition will also file an anti-dumping charge simultaneously, charging that Canadian lumber is being sold below the costs of production.

Will the Coalition's Charges Stick?

The Coalition claims that more than one hundred U.S. mills have closed due to the current dismal lumber market. It charges that unfair Canadian competition is the chief reason for ten-year lows in prices and the recession in the lumber industry. The current unfavourable economic conditions strengthen the Coalition's case. Moreover, the Coalition has strong support in the U.S. Congress for its position.

What Will Canada's Defence Be?

The Canadian lumber industry will rebut the charges by stating that stumpage rates in Canada have risen considerably in recent years and are not a subsidy. The current weak market has been created by oversupply brought on by rising production in both the U.S. and Canada. The Canadian industry will also have major U.S. consumer groups supporting its case for the first time. Moreover, U.S. log export restrictions also apply on shipments from federal and state lands.

Will Offshore Imports Be Included?

No. Imports from Europe, South America and New Zealand, which surpassed one billion bf in 2000, will not be included in the new CVD case.

What's the Timetable?

The Coalition will aim for the following timetable, subject to U.S. Department of Commerce (DOC) rules and regulations:

- April 2 — new CVD action filed with the DOC;
- September 1 (or sooner) — interim CVD or anti-dumping duty on Canadian lumber applied, if subsidy proven to DOC; and
- December 31 (or earlier) — Final determination by DOC on subsidy issue. Before a duty becomes permanent, the U.S. International Trade Commission must confirm that the alleged subsidy has caused injury to the U.S. industry.

What's the Appeal Process?

If Canada loses, the country can appeal to the U.S. Court of International Trade or the World Trade Organization, claiming that any CVD violates NAFTA. However, such appeals would take months, if not years. Meanwhile, any CVD applied against Canadian imports would continue.