

SEPTEMBER 2015  
NAOMI CHRISTENSEN

# BRANCHING OUT

PREPARING FOR LIFE WITHOUT A  
SOFTWOOD LUMBER AGREEMENT



CENTRE FOR  
NATURAL  
RESOURCES  
POLICY



CENTRE FOR  
TRADE &  
INVESTMENT  
POLICY

CANADA WEST FOUNDATION



## CANADAWEST FOUNDATION

This report was prepared by Naomi Christensen for the Canada West Foundation's Centre for Natural Resources Policy and Centre for Trade & Investment Policy. The author extends thanks to John Allan, Dr. Roslyn Kunin, Paul Whittaker, Dan Wilkinson and Barbara Yaffe for providing comments on a draft of the report. Any errors or omissions remain the responsibility of the author. Finally, the author wishes to acknowledge the contributions of Trevor McLeod, Dylan Jones, Doug Firby, Catherine Harder and Sophie Lacerte of the Canada West Foundation.

The opinions expressed in this report are those of the author and are not necessarily those of the Canada West Foundation's Board of Directors, advisers or funders. Permission to use or reproduce this report is granted for personal or classroom use without fee and without formal request, provided that it is properly cited. Copies may not be made or distributed for profit or commercial advantage. Copies are available for download at no charge from the Canada West Foundation website at [www.cwf.ca](http://www.cwf.ca).

### Our 2015 Centre for Natural Resources Policy Patrons

The Arthur J.E. Child Foundation  
ATB Corporate Financial Services  
Enbridge Inc.  
Government of Alberta  
Government of Saskatchewan  
→ Crown Investments Corporation of Saskatchewan  
→ Saskatchewan Ministry of the Economy  
Imperial Oil Limited  
Max Bell Foundation  
N. Murray Edwards/Canadian Natural Resources Limited  
Ron Mannix/Coril Holdings Ltd.  
Tundra Oil and Gas Partnership

### Our 2015 Centre for Trade & Investment Policy Patrons

The Arthur J.E. Child Foundation  
CN  
Enbridge Inc.  
Government of Alberta  
Government of Saskatchewan  
→ Crown Investments Corporation of Saskatchewan  
→ Saskatchewan Ministry of the Economy  
Max Bell Foundation  
The Mosaic Company  
N.M. Edwards  
Port Metro Vancouver  
Richardson International

Patrons are listed as of September 2015. The Canada West Foundation has made every effort to ensure that all patrons who wish to be recognized are listed. If there is an error or omission, please contact us at 1.888.825.5293. (Patrons are donors who provide \$25,000 or more to the centre on an annual basis).



The Centre for Natural Resources Policy focuses on the economic importance of natural resources to Canada's prosperity and challenges the West to be a world leader in environmental performance and innovation.



The Centre for Trade & Investment Policy focuses on the economic importance of trade and investment to Canada's current and future prosperity and provides a powerful voice for western Canadian trade policy priorities.



© Canada West Foundation 2015  
ISBN 978-1-927488-68-3

Canada West Foundation is a registered Canadian charitable organization incorporated under federal charter.  
(#11882 8698 RR 0001)

The Canada West Foundation uses environmentally responsible paper and printing practices in the production of its publications.

**The Softwood Lumber Agreement (SLA)** between Canada and the United States will expire on Oct. 12, 2015. In an ideal world, Canada and the United States would have free trade in softwood lumber. However, as Canadians know, the softwood world has not been perfect for many years. Rather, it has been characterized by fierce trade disputes, protracted negotiations and, ultimately, softwood lumber agreements designed to bring temporary stability to the file.

Much has changed over the nine years that the latest SLA has been in place. Canadian timber supply is decreasing and poses less of a market threat to U.S. producers. Prices have been high enough that, until very recently, we were operating outside of the agreement (as though we had free trade). With more housing starts in the U.S., our southern neighbour needs to import our softwood lumber to meet demand. And, the focus of the U.S. Administration is on other trade issues, like negotiating multi-nation trade agreements. *(Continued)*

All of this means that the United States has little economic, market-share or political incentive to instigate trade action. Yet, Canadians who have been through drawn-out softwood battles with the U.S. are wary. After all, both history and President Barack Obama's refusal to approve the Keystone XL pipeline illustrate plainly that trade irritants can burn bright or flare up in a hurry. If, for example, the U.S. economy struggles or the value of the Canadian dollar continues to fall against the U.S. dollar, protectionist elements in the U.S. could reignite the desire to restrict entry of Canadian softwood lumber.

The Canadian government and industry both want another SLA to bring a measure of certainty to the industry. This is understandable. However, since it is highly unlikely that another SLA will be reached, it is time for Canada to adopt a new trade strategy for softwood lumber. It would be prudent for Canada to take a dual approach to protect its forest sector and insulate itself against the risk of future trade disputes with the United States. The prongs of this strategy should be:

---

## 01

### REFOCUS ON MARKET DIVERSIFICATION, BEYOND CHINA

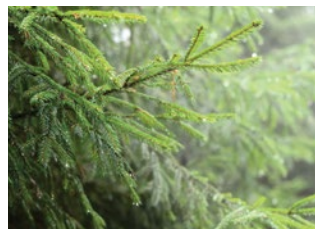
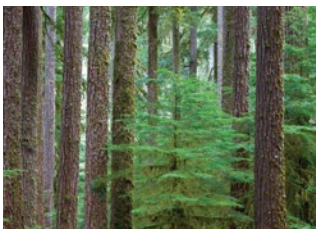
As growth in China slows and the U.S. recovers, Canada is susceptible to once again becoming overly reliant on one customer. Efforts to break into new markets are necessary to prevent this from occurring. Canada's competitors are already targeting countries like Vietnam, Thailand and Indonesia, where demand for imported softwood is on the rise; there is little knowledge about Canadian products in the region. Mexico is accessible to western Canada and relies on imports to meet domestic softwood demand. (See Figure 5 on page 16.)

---

## 02

### IMPROVE VALUE IN TRADE WITH THE U.S.

The U.S. has always been, and will continue to be, an important market for Canadian softwood lumber. There are actions Canada can take to improve the value of our trade with the U.S. and mitigate future trade disputes. These include actions within the U.S. market like seeking new value-added product markets and continuing to promote the Canadian brand, as well as bi-national cooperation such as advancing joint Canada-U.S. initiatives to grow the global softwood lumber market.





## SOFTWOOD LUMBER

Trees are classified as being either softwood or hardwood, although softwoods are not necessarily softer than hardwoods. Softwood comes from conifers, such as firs, pines, cedars and hemlock. While hardwood forests dominate global forest coverage, about

**80%** of timber harvested worldwide for commercial purposes is softwood.

Softwood lumber is most commonly used for wood-frame construction in residential building. It can also be used for interior and finishing purposes, like windows and doors. Softwood lumber is increasingly being used in non-residential construction. It is also used in pulp production, and for value-added products, including pressure-treated lumber, decking, wood pellets and horse bedding.

In 2014, the majority of Canada's softwood lumber production (**67%**) and exports (**74%**) came from western Canada.



The background of the entire image is a dense, repeating pattern of US dollar bills, specifically the \$100 bills, which are slightly tilted and overlapping. The color is a dark, muted green.

..... PART ONE .....

*The U.S. has*

**NO INCENTIVE**

*to sign another*

**AGREEMENT**



### THE SLA IS POPULAR IN CANADA BECAUSE IT HAS BROUGHT STABILITY AND PREDICTABILITY FOR

**CANADIAN EXPORTERS.** While Canada has recently been successful in obtaining new customers for softwood lumber, the U.S. remains, by far, our largest and most important customer. In 2014, 66 per cent of softwood lumber exports were shipped to the U.S.<sup>1</sup> *(For a breakdown of softwood lumber exports by western provinces, see Appendix A.)* Canada's softwood industry understandably desires another SLA to maintain stable access to its largest market.

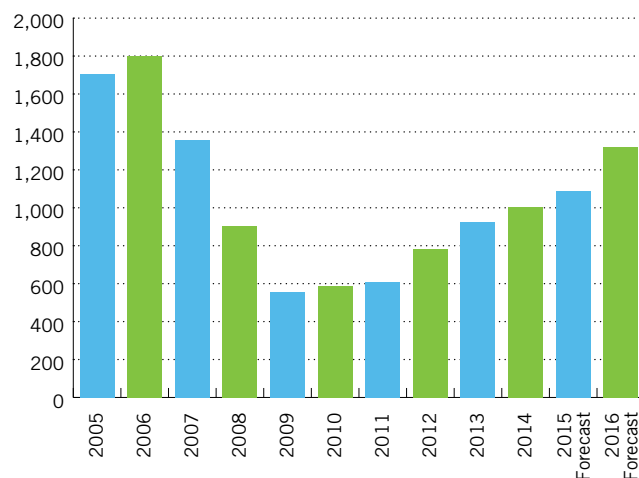
The U.S., however, has little incentive to sign another agreement. This is because many of the major factors affecting the Canada-U.S. softwood lumber trade relationship have changed during the SLA's existence. In particular, increasing U.S. housing starts and high softwood lumber prices negate the major benefits the U.S. receives under managed trade. Canada's decreasing timber supply prevents Canadian producers from capturing a larger piece of U.S. market share. As a result, the U.S. administration has paid little attention to the pending SLA expiry; it is focused on negotiating a number of multi-country trade agreements. Within the U.S., domestic softwood lumber producers oppose signing another SLA.

### Canada is helping the U.S. recover

U.S. softwood lumber demand exceeds domestic production, and nearly all the softwood lumber imported into the U.S. comes from Canada (96 per cent). While the U.S. has a long history of launching trade action to restrict the supply of Canadian softwood lumber into its market, imports of Canadian softwood lumber are helping its economic recovery.

After the 2008-09 global recession and U.S. housing crisis, housing starts in that country hit their lowest levels in 40 years. This year, for the first since the recession, starts will total more than one million. As the figure below indicates, starts are projected to keep increasing. Housing accounts for about 40 per cent of U.S. lumber demand; action on the part of the U.S. to restrict imports from Canada could be harmful to its recovery. This is because tariffs on imported goods decrease competition for domestic producers, usually resulting in a price increase. If U.S. consumers face higher prices, their consumption will decrease – slowing housing starts – or they will substitute to a different (cheaper) building material. However, it is also possible that the greater demand from the U.S. housing market for Canadian lumber may antagonize U.S. producers into pushing for trade restraints; U.S. producers believe “subsidized” Canadian lumber producers undercut their domestic industry.

**FIGURE 1: U.S. HOUSING STARTS<sup>2</sup>** (units in thousands)



Sources: U.S. Census Bureau, The Conference Board

## High prices lower U.S. bargaining power

The export measures in the SLA were negotiated when lumber prices were about \$70 lower per thousand board feet than they are today. As a result of high prices, these measures – which impose an export tax on Canadian lumber shipped to the U.S. – have been triggered only periodically during the past two years. From the perspective of U.S. interests, these terms, under current conditions, do not help the U.S. industry very much because prices are high enough that imports are not restricted via tariffs. Various industry forecasts<sup>3</sup> project lumber prices to remain high throughout 2015-2017. The International Wood Markets Group's latest five-year forecast predicts the combination of rising U.S. housing starts and falling Canadian timber supply will result in global lumber prices reaching record levels by 2017.

Current and projected prices are favourable for Canadian exporters who receive high prices for their product without the cost of export charges. The opposite is true for the U.S.; high prices weaken the U.S. argument that Canadian producers are selling softwood lumber into the U.S. market at prices below the cost of production (dumping).

If prices were to lower, it would then make more strategic sense for the U.S. to negotiate another, perhaps more aggressive, SLA. Under lower prices, U.S. dumping or countervailing action against Canada is likely to resurface. Either (or both) of these actions would give the U.S. bargaining chips with which to negotiate stiffer export charges/quotas for Canadian competitors. The challenge is that from the perspective of some U.S. interests, agreeing to another SLA at this point locks the U.S. into an agreement that is either too soft, or limits the U.S. ability to take more aggressive alternative action, should the need arise.

## SLA EXPORT MEASURES

Before there was an SLA, the U.S. levied import duties on softwood lumber from Canada – action rationalized as necessary to protect U.S. producers from “unfair” Canadian competition. The SLA stipulates that when the prevailing monthly price is at or under \$355 per thousand board feet, border measures of either an export charge or an export charge plus volume restraint be placed on Canadian softwood lumber exports to the U.S. (When the SLA was implemented, provinces had the choice of which export measure option they wanted to operate under.) No restraints are applied when the price is over \$355; prices are high enough that free trade is deemed to be sufficient. Between January 2013 and August 2015, prices have been above

US\$355 for 24 of 32 months. In effect, we have been operating outside the managed trade arrangement for nearly two years. While prices in summer (April-August 2015) were below the export charge threshold, they remain over \$300, as they have consistently been since June 2013.

The *Prevailing Monthly Price* is defined in the SLA as “the most recent four-week average of the weekly framing lumber composite (FLC) prices available 21 days before the beginning of the month to which the Prevailing Monthly Price shall be applied.” The FLC used is produced by Random Lengths, based on a weighted average of 15 structural softwood lumber prices outlined in the SLA.



## BASIS OF SOFTWOOD LUMBER DISPUTE

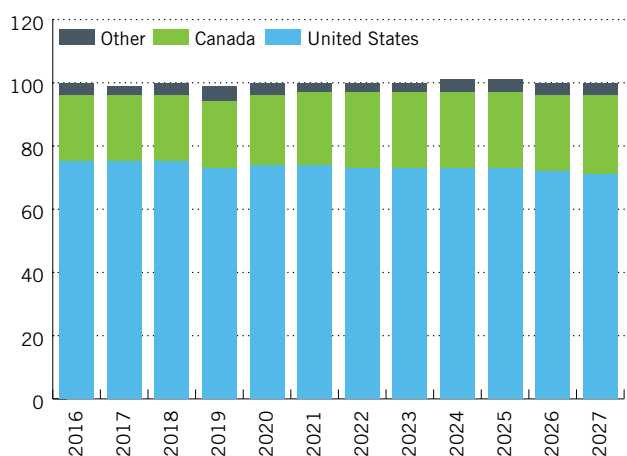
*The softwood lumber disputes boil down to differences between the two countries' forest industries. In the U.S., around 85 per cent of lumber supply is on private land, and rights to harvest on the small amount of publicly held land is determined via auction. U.S. producers take exception to the Canadian system, whereby provinces set a stumpage rate (a fee) that private companies pay the province to harvest timber on Crown land. Since the majority of Canadian timber is on public land (about 70 per cent), U.S. producers argue protectionist measures are needed to offset the "subsidized" Canadian lumber.<sup>5</sup>*

### Canada doesn't have the timber supply to threaten U.S. market share

The SLA caps Canadian softwood producers at a maximum of 34 per cent of the U.S. softwood lumber market. This was a response to U.S. producers' perpetual fear that "subsidized" Canadian softwood would take over market share to the detriment of domestic producers. When the agreement expires, and with it the market cap, Canada's declining timber supply will prevent it from capturing a larger share of the U.S. market.

Canada has historically occupied an average of 30 per cent of the U.S. market, with domestic producers holding close to the rest. Today, Canada holds about 27 per cent of the market and by 2027 this will drop to about 25 per cent. B.C.'s interior slid from occupying 17 per cent of the U.S. market share in 2007 to 13 per cent today. Since the implementation of the SLA, the U.S. share of its market has risen from 61 per cent to 71 per cent in 2014.

**FIGURE 2: U.S. SOFTWOOD LUMBER MARKET SHARE FORECAST 2016-2027 (%)**



Source: RISI Inc. North American Timber Forecast

As U.S. demand increases, Canada will not have the ability it has had in years past to increase its supply to meet U.S. demand. Speculation before the first SLA expired in 2001 was that Canadian softwood would flood the U.S. market without the restrictions imposed by the agreement. This time around, no such fears are being expressed.

### U.S. focus is on bigger deals

Federal officials have confirmed that Canada's position – that another SLA with the same terms should be signed – has been communicated to the U.S. federal government. Yet, the U.S. has shown little interest in discussing the topic. This is in sharp contrast to the negotiations for the two-year renewal of the agreement that began between the two countries in 2011, two years before the SLA's first expiration date in 2013.<sup>4</sup>

It is likely that the U.S. Trade Representative has limited capacity to deal with the SLA because the U.S. is intently focused on large trade deals like the Trans-Pacific Partnership (TPP) and Transatlantic Trade and Investment Partnership (T-TIP) with Europe, as well as ongoing trade disputes with China. There has been some discussion of log exports in the TPP negotiations, where Canada is a participant; it is possible that the U.S. plans to deal with softwood lumber trade through this larger trade deal.

### U.S. producers oppose another deal

The U.S. Lumber Coalition – the main lobby group of U.S. softwood lumber producers – has been very vocal about its opposition to a rollover of the terms in the SLA. U.S. producers want more stringent trade rules in place, although they have not formally indicated what measures they favour.



..... PART TWO .....

*Canada cannot*

**AFFORD**

*to be*

**COMPLACENT**



**CANADA'S SOFTWOOD LUMBER INDUSTRY IS LESS OF AN ECONOMIC THREAT TO U.S. PRODUCERS TODAY THAN WHEN THE SLA CAME INTO FORCE.** U.S demand is increasing and Canadian timber supply is decreasing, reducing Canada's ability to increase its share of the U.S. market. There is little economic reason for the U.S. to launch trade action against Canada. Yet the history of U.S. producers' ideological opposition to Canada's softwood lumber industry suggests that Canada cannot afford to ignore the potential for future action and must strive to mitigate against it.

### Canadian timber supply is decreasing

Canada's long-term timber supply is decreasing, mainly as a result of the mountain pine beetle infestation. B.C., which accounts for more than 50 per cent of total Canadian softwood lumber production, has been hardest hit by the beetle. The infestation spread to Alberta in 2006, mainly affecting forests in the province's northwest region. It is feared the infestation will spread eastward as far as Ontario, Quebec, and even parts of the Maritimes. This is possible because the beetle is now affecting the jack pine species, dominant in the boreal forest located in every province except New Brunswick and Nova Scotia. Originally, the infestation was limited to lodgepole pine, the dominant species in British Columbia and the Rocky Mountains.

**FIGURE 3: BRITISH COLUMBIA ANNUAL ALLOWABLE CUT**

PERIOD	AAC (million cubic metres)
1990s	72 (average)
2010	88
Forecast (to 2075)	65-70

Source: BC Ministry of Forest, Mines and Land

B.C.'s annual allowable cut (AAC) increased by 19 million cubic metres between 2000 and 2010 to allow for the salvaging of timber killed by the pine beetle. However, timber harvests – the actual amount of timber logged – averaged about 12 per cent below the AAC maximum because the recession and resulting market downturn reduced demand.<sup>8</sup>



## TIMBER SUPPLY

"Timber supply is the rate at which timber is made available for harvesting. It is a measure of the potential flow of logs out of the forest. Timber supply is not the same as the inventory, or amount, of timber in the forest."<sup>6</sup>

## ANNUAL ALLOWABLE CUT (AAC)

Annual allowable cuts (AACs) are determined by a provincial government. The AAC is the "rate of timber harvest permitted each year from a specified area of land." The AAC encompasses all Crown land and may include some private land.<sup>7</sup>



Timber supply forecasts vary by region in B.C. Supply in the central interior is expected to decrease the most, as it is the region that has been hardest hit by the pine beetle infestation. This is significant, considering more than 80 per cent of B.C.'s softwood lumber comes from the interior. By the end of this decade, timber harvests in B.C. are expected to total 20 per cent less than before the pine beetle infestation. Natural Resources Canada calculates that since the outbreak in the 1990s, the beetle has killed half of B.C.'s commercial lodgepole pine.<sup>9</sup> The province expects that by 2025 "once timber salvaging is no longer feasible, harvest levels are expected to decline to 50-60 million cubic metres per year."<sup>10</sup> In comparison, 70.9 million cubic metres were harvested in B.C. in 2013. While the pine beetle epidemic in B.C. is believed to have peaked in 2005, the effect of the infestation is long term. Fifty years from now, timber supply is expected to remain below the average of the 1990s and 2000s; the province projects that timber supply will reach 65-70 million cubic metres by 2075.

Declining timber supply is already having an effect. Since 2005, 24 mills in B.C. have closed; 21 remain closed. Twelve of these mills closed in the last five years. Industry analysis is that "some of these closures were the result of the U.S. housing market and global financial crisis downturn, but all were directly related to [mountain pine beetle] impact of reduced economic saw-log supplies occurring by the end of the current decade."<sup>11</sup>

In stark contrast, softwood lumber production in all regions of the U.S. has been rebounding in response to rising housing starts. The largest softwood producing region is the U.S. South, where timber supplies in privately owned southern yellow pine (SYP) plantations are rising. (SYP is one of

three main North American softwoods used in residential construction.) There is an estimated excess growth of about 30 billion board feet (bbf) of SYP: a year's worth of saw-timber.<sup>12</sup> This is the result of the decline in production following the burst in the U.S. housing bubble. Lumber production in the South is forecast to increase by 28 per cent to 20.3 bbf by 2019 – double the production of B.C.

Canadian companies are going to where there is growing timber supply and investing in U.S. sawmills. Canadian investment began in 2000, when Vancouver-based West Fraser bought two mills. Today, with 35 Canadian-owned mills in the southern and western U.S., "the combined sawmill count owned by West Fraser, Canfor and Interfor is now higher in the U.S. than it is in Canada, reflecting the tight availability of timber and limited lumber growth prospects in Western Canada."<sup>13</sup> Interfor's CEO Duncan Davies cited stability as the driver behind the 2014 purchase of four mills in the U.S. Mills in the U.S. are less exposed to currency fluctuations, timber shortages and potential trade disputes.<sup>14</sup> Canadian companies own about 4.5 per cent of the total number of sawmills in the U.S. – a small number, but double that of a decade ago.

A more integrated North American market means the top Canadian firms will be less affected by future U.S. trade suits against Canada because their U.S. operations will be exempt. The majority of Interfor's production is now based in the U.S. (68 per cent). Thirty-seven per cent of West Fraser's production is based in the U.S. and by 2016 Canfor expects 22 per cent of its sawmill capacity will be south of the border.

## WHY PRICE STIMULUS ISN'T AFFECTING CANADIAN PRODUCTION

In a normal commodity supply chain cycle, an increase in price stimulates an increase in production. This is not the case for Canadian softwood lumber. Between 2013 and 2014, softwood lumber production in B.C., the largest producing province, decreased. Production in Quebec remained relatively stable. Total Canadian production increased by only one per cent. Decreasing timber supply, coupled with mill closures (24 in B.C. in the past decade), means Canada does not have the physical capability to increase its softwood production by any significant amount. Firms are responding by investing in operations where timber supply is increasing – in the U.S. In 2017, overall Canadian production is expected to flatten because of tightening timber harvests (Wood Markets Monthly International Report Volume 19). Declining Canadian production is expected to impact global softwood supply by driving prices higher, protecting the Canadian industry from negative impacts of declining production.



Government policy in at least one province is also contributing to Canada's declining timber stock. In Quebec – the second largest softwood lumber producing province (21 per cent of total Canadian production in 2014) – the government's conservation policy has decreased the AAC on Crown land by 35 per cent since 2004.<sup>15</sup> This affects timber supply because the large majority (90 per cent) of timber harvesting in Quebec occurs on Crown land.

Timber age also affects timber supply. In B.C., harvesting has primarily occurred in old growth forests with high timber volumes. More than a decade ago, the government of B.C. began cautioning that as harvesting moves more into regenerated forests, trees will yield lower volumes per hectare because trees will be younger and second generation forests have a less valuable species mix. According to the government, "in most areas of the province, the level of harvesting will decline over time as the forest industry shifts from harvesting higher volume, old-growth forests, to harvesting younger forests of lower volume."<sup>16</sup>

### **Trade action remains a threat**

There is always a threat that U.S. protectionism will result in trade action against Canadian softwood lumber. As long as the two countries have different harvesting systems, there is a threat that U.S. companies will seek to punish Canadian producers.<sup>17</sup> (*For further details, see Appendix B.*) The depreciating Canadian dollar may motivate U.S. lumber producers to push for protectionist trade action to counter any competitive advantage of Canadian exporters. Sales of Canadian softwood lumber into the U.S. are conducted in U.S. dollars, meaning the lower the Canadian dollar, the higher the profits for Canadian exporters.

The SLA contains a clause stipulating that for one year following the agreement's expiry, neither country can launch litigation against the other. In other words, the earliest the U.S. could launch countervailing action against Canada is October 2016, what some refer to as the "real" expiry date of the SLA. If the U.S. proceeds with trade action when the clause expires, Canada would probably win. However, some financial repercussions could occur right away. If the U.S. imposes import duties on Canadian softwood, duties can be collected while North American Free Trade Agreement (NAFTA) and World Trade Organization (WTO) appeals are occurring. Even if the U.S. charges are unlikely to hold up under appeal, Canadian exporters can be affected for a very long time.

For example, between the expiration of the first SLA and the implementation of the current SLA (referred to as Lumber IV, between 2001 and 2006), the U.S. put countervailing and anti-dumping duties on imports of softwood lumber from Canada (27 per cent combined), collecting US\$5.3 billion. While the duties were later ruled to be illegal and the U.S. was ordered to pay Canada back,<sup>18</sup> during those five years, Canadian exporters faced significant financial penalties. In addition to financial costs to private firms, the duties also imposed a social cost on forestry-dependent communities which resulted in financial support from taxpayers. Industry Canada estimated that by 2004, 5,800 sawmill layoffs occurred as a direct result of the U.S. duties, with the largest increase in layoffs occurring in B.C. As a result, the federal government created a *Softwood Industry and Community Economic Adjustment Initiative*, spending \$336 million between 2002 and 2005 to help communities and workers hardest hit by the U.S. tariffs.<sup>19</sup>

Any litigation initiated in 2016 would take, at minimum, two years to resolve; appeals and arbitration can add years to the process. U.S. producers (representing more than 50 per cent of the country's softwood lumber production) would first need to file a countervailing and/or anti-dumping petition to the U.S. Department of Commerce. Following the filing of a petition, "[t]he Commerce Department carries out an investigation to determine whether dumping or subsidization is taking place; the International Trade Commission (ITC), an independent agency of the U.S. government, decides whether the domestic industry is being injured or threatened with injury by the imports in question. If both agencies make affirmative determinations, an AD [anti-dumping] or CVD [countervailing] order is entered."<sup>20</sup> According to the DOC, investigations typically take 12 to 18 months.

Canada can appeal any DOC finding to a panel under NAFTA and to the WTO. Chapter 19 of NAFTA contains a provision under which a country can request a binational panel as an alternative to a judicial review of a domestic court. A Chapter 19 Panel reviews the domestic anti-dumping or countervailing decision "to determine, based on the administrative record, whether the relevant administrative agency applied its national AD/CVD laws correctly."<sup>21</sup> The panel's decision is binding, and it can either uphold or remand the original decision. The latter involves sending the decision back to the domestic agency that made it with instructions to re-examine it based on the panel's findings. This occurred in 1993 when a panel ruled in Canada's favour, resulting in a reversal of the U.S. decision to impose import duties. Any country can challenge the revised decision of the domestic agency, sending it back to the binational panel.

According to the NAFTA Secretariat, the "ideal" timeline is for a panel to render its decision within 315 days after receiving a review request.<sup>22</sup> If a decision is remanded, the U.S. must address its original determination, and this second decision can be also be reviewed by a NAFTA panel. The WTO also has a dispute resolution process, which is supposed to take a maximum of 15 months, although timelines are flexible and can extend much longer. There are cases launched in 1995 that remain in the consultation stage today – a stage targeted to last 60 days.

The changed market conditions cited earlier weaken the U.S. arguments of countervailing and dumping against Canada's softwood lumber industry. They do not eliminate the threat that the U.S. will take action against Canada anyway, using – as always – the differences between the two countries' industries to seek trade limits. Canada must take action to mitigate this threat that goes beyond seeking another SLA, especially since the U.S. has no incentive to agree to one.



..... PART THREE .....

*Canada needs a dual*

# SOFTWOOD STRATEGY

**CANADA NEEDS STRATEGIES THAT WILL MAINTAIN A STRONG TRADING RELATIONSHIP WITH THE U.S.** – when managed trade is not in place to provide benefits to both sides – and refocus efforts on market diversification to make sure the economic recovery from the U.S. does not nullify progress made over the last decade to gain new customers for Canadian softwood lumber.

Canada should adopt the following strategies to mitigate future trade disputes with the U.S:

## 01

### REFOCUS ON MARKET DIVERSIFICATION, BEYOND CHINA

## 02

### IMPROVE VALUE IN TRADE WITH THE U.S.

### REFOCUS ON MARKET DIVERSIFICATION, BEYOND CHINA

Although it may seem counter-intuitive to renew focus on diversification when timber supply is constraining and the U.S. is rebounding, as much of a hedging strategy through policy as is possible should be undertaken for the reasons articulated in this paper.

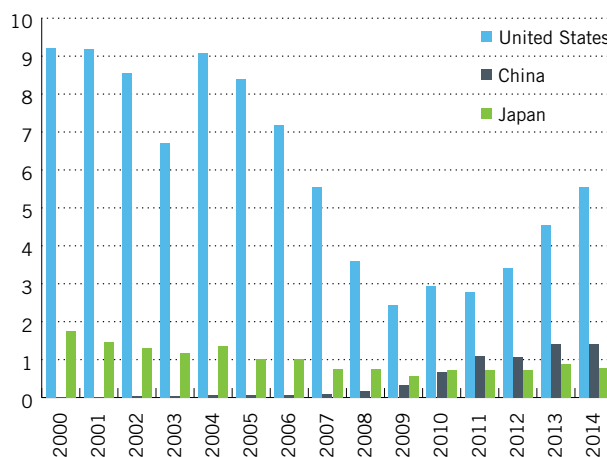
Canada cannot afford to revert back to near total reliance on the U.S. market. While the U.S. is a critical market, the more reliant we are on it, the more severely our industry is hurt when the U.S. takes trade action and imposes tariffs. Canada must work to increase exports to markets where demand for softwood lumber is high and increasing. Breaking into these markets in a significant way is time consuming. By renewing this focus now, Canada will be better prepared if the U.S. takes trade action down the road or if the U.S. economy (housing starts) decreases substantially. It will be more poised than ever before to pivot exports to other customers, rather than pay high export tariffs to the U.S.

Starting about a decade ago, the coinciding housing crisis in the U.S. and economic growth in China provided Canada with both the motivation and opportunity to diversify its customer base for softwood lumber. Canada was successful – exports of softwood lumber to China grew from a value of \$55 million in 2005 to \$1.4 billion in 2014. Before 2006, Canadian softwood lumber exports to China were less than one per cent of total national exports. Today, it hovers around 20 per cent of total exports.<sup>23</sup>

Now, the U.S. economic recovery is coinciding with a slowdown in growth in China; the start of 2015 brought about China's slowest GDP growth in six years. China's demand for wood products, which was growing annually at about 15 per cent between 2008 and 2013, is now expected to grow at five to eight per cent per year.<sup>24</sup>

Export data indicates that Canadian softwood lumber exports to the U.S. are rising at the expense of exports to China. Since 2011, exports to the U.S. have increased by 12.7 per cent, while exports to China have been stagnant.<sup>25</sup>

**FIGURE 4: CANADIAN SOFTWOOD LUMBER EXPORTS TO THE U.S., CHINA AND JAPAN (2000-2014) (billions C\$)**



Source: Industry Canada, Trade Data Online



**CANADA'S RELIANCE ON THE U.S. MARKET HAS DECLINED, BUT IT IS STILL OUR BEST CUSTOMER, AND ANOTHER TRADE DISPUTE WILL HURT OUR INDUSTRY.** While Canada should strive to excel in all markets, it must also be careful not to let the U.S. recovery negate the gains made over the last decade in new markets. Issues to pay particular attention to include losing market share in China to Russia, Canada's new trade agreement with South Korea, and opportunities in foreign markets beyond China, namely in Southeast Asia.

Figure 5 shows there are growth opportunities in markets where Canada is already established. Those include India and South Korea, as well as emerging markets where western Canada's trade opportunities for a variety of products are growing, such as the ASEAN<sup>26</sup> and Pacific Alliance<sup>27</sup> regions.

**FIGURE 5: MARKET DIVERSIFICATION OUTLOOK<sup>28</sup>**

COUNTRY / REGION	B.C. SHARE OF IMPORTS (%)	OUTLOOK
China	47	<ul style="list-style-type: none"> <li>→ Wood demand forecast of 6-8 per cent/year</li> <li>→ GDP growth lowest in 6 years</li> <li>→ Russia surpassed Canada as largest supplier of softwood lumber imports</li> </ul>
Japan	24	<ul style="list-style-type: none"> <li>→ Housing starts declining since 2014</li> <li>→ Wood Use Point Program incents use of Japanese wood products</li> <li>→ Japanese government encouraging the use of wood in non-residential construction</li> </ul>
India	17	<ul style="list-style-type: none"> <li>→ B.C. exports to India increasing since 2011</li> <li>→ Growing young middle class indicates future growth</li> <li>→ Demand likely to be for interior/finishing rather than framing</li> </ul>
South Korea	11	<ul style="list-style-type: none"> <li>→ B.C. maintained its share of exports to Korea despite new standards for wood products implemented in 2014</li> <li>→ CKFTA eliminates the 5% tariff on lumber by 2017</li> </ul>
European Union	3	<ul style="list-style-type: none"> <li>→ Mature housing sector</li> <li>→ Proposed Canada-Europe Comprehensive and Economic Trade Agreement will eliminate tariffs</li> </ul>
Pacific Alliance	N/A	<ul style="list-style-type: none"> <li>→ Opportunity to increase exports to Mexico</li> <li>→ The U.S. supplies about half of Mexican wood imports, and is increasing softwood lumber exports to Colombia and Peru</li> <li>→ Chile is a competitor; it is the tenth largest global exporter of softwood lumber, and fourth largest supplier to China</li> </ul>
ASEAN	N/A	<ul style="list-style-type: none"> <li>→ Canada has a majority share of the Philippines softwood lumber imports</li> <li>→ Opportunity to grow exports especially to Vietnam, Thailand and Indonesia</li> </ul>



**ASEAN Member States** are Indonesia, the Philippines, Thailand, Singapore, Vietnam, Malaysia, Myanmar, Cambodia, Laos & Brunei.

**The Pacific Alliance** is a Latin American trade bloc with four member states – Chile, Colombia, Mexico & Peru.

## China

In the first quarter of 2015, Russia surpassed Canada as China's largest softwood lumber supplier. Up to this point, B.C. was the leading supplier of softwood lumber products to China (since 2010). In 2014, B.C. sent one-quarter of its exports there. But while Canada's exports to China have stagnated, "from 2011 to 2013, Russia's market share in China rose to 38% from 36%, while Canada's fell to 40% from 46%."<sup>29</sup>

In 2014, the Chinese government declared a "war on pollution," and is increasing attention to "green building." China plans to build 200 "eco-cities" to minimize the environmental impacts of rapid urbanization. Natural Resources Canada is partnering with China to develop an eco-district project plan in the northeastern port city of Tianjin. Focus is being given to using wood frame construction "as a low-carbon and energy-efficient building material" as well as other green building practices.<sup>30</sup> As China transitions to more energy efficient ways of building, Canada should capitalize on the opportunity to export both knowledge and sustainable building materials, in a market it is already very active in.

## Japan

In Japan, housing starts began declining in 2014 when the government raised the consumption tax by several percentage points. In 2013-14, the government implemented a *Wood Use Points Program* (WUPP) aimed at financially incenting builders to use Japanese wood products in new home construction. Later exemptions were provided to U.S. products, including Douglas Fir, European whitewood, European Spruce, Swedish red pine and New Zealand radiata pine. However, no Canadian species were adopted as "local" wood.<sup>31</sup> While the WUPP was not renewed in 2015, the fact that the U.S. was able to gain exemptions while Canadian products remained shut out indicates Canada could be more adept at responding to protectionism in international markets outside of the United States.

A positive development for Canada is that the Japanese government is actively encouraging the use of wood as a construction material for non-residential buildings.

## India

India has a practice of building with wood, although it has traditionally used hardwood. As hardwood supplies tighten, demand for softwood as a building material increases. India's young population indicates continued growth for the country. Combined, these factors provide an opportunity for Canadian exporters to further increase their softwood lumber exports to India. In particular, B.C. softwood species are desirable in India, with several types receiving certification for entry within the last few years. Canada and the U.S. should consider a joint marketing campaign in India to extol the virtues of softwood lumber.

## South Korea

The Canada-Korea Free Trade Agreement (CKFTA), in force as of Jan. 1, 2015, could provide an opportunity for western Canadian provinces to increase exports to South Korea. The agreement will eliminate South Korea's five per cent tariff on softwood lumber imports from Canada by 2017, putting Canada on par with Chile, the U.S. and the European Union, which signed trade agreements with South Korea before Canada.

Tax reductions introduced in 2014 have increased activity in the housing market, which slumped in 2008. Korean building and energy codes have a target of net zero carbon emissions by 2025, presenting an opportunity for the use of wood construction including for low-rise buildings.<sup>32</sup> Canada's reputation as a sustainable lumber supplier should help capture market share.



## Pacific Alliance

### *Mexico*

Canada does not export very much softwood lumber to Mexico (less than one per cent in 2014), but Mexico presents an opportunity for Canadian softwood exporters.

The Mexican market is accessible to western Canada; the majority of Canada's softwood lumber exports to that country come from B.C. Although there is softwood lumber production in Mexico, it relies on imports to meet domestic demand for wood products. The U.S. supplies the majority of Mexico's wood imports, but U.S. millers and wholesalers have a tendency to focus less on exports when the U.S. market is doing well, as it currently is.<sup>33</sup> Chile and Peru also export softwood lumber to Mexico, and have an advantage over Canada in that, like Mexico, they are Spanish-speaking countries. The U.S. economic recovery could present an opportunity for Canadian softwood lumber exporters to become more competitive in Mexico. Breaking further into this market would likely require a collaborative effort on the part of Canadian companies, as has been undertaken in other markets.

Although the Mexican government is supportive of the use of wood in residential construction, the public views wood homes as a temporary form of housing, and less permanent than concrete or brick – the main building materials in Mexico.<sup>34</sup> Again, a marketing campaign to improve the perception of softwood as a home building material could prove useful.

### *Colombia & Peru*

U.S. softwood lumber producers have been making a concerted effort to increase exports to the Pacific Alliance countries of Colombia and Peru. Transportation costs make it difficult for western Canadian exporters to profitably access these markets. Canadian exports of Quebec softwood to Colombia dropped off in 2012; U.S. exports, while small, are steadily increasing. Chile supplies the majority of imports to Peru – more than 90 per cent – but the U.S. is second. It has increased its exports since 2011 and supplies more than five per cent. Canada contributes less than 0.5 per cent of Peru's imports.

## ASEAN

Canada exports about \$82.5 million worth of softwood lumber to the 10-country ASEAN region of Southeast Asia, and holds a majority market share in the Philippines.<sup>35</sup> The B.C. government's market development agency for forest products, Forestry Innovation Investment (FII), has identified Vietnam, Thailand and Indonesia as potential markets to grow Canadian softwood lumber exports. The sectors in which softwood is used in these countries are growing and projected to continue to do so, but Canada has some catching up to do; our competitors are already targeting these markets.

### *Vietnam*

Vietnam's demand for imported lumber is increasing, but Canada's softwood lumber exports to Vietnam have been declining since 2009. Canada has been losing market share to competitors, such as Chile and New Zealand, who are aggressively targeting the Vietnamese market.<sup>36</sup> Vietnam and Canada are both part of the Trans-Pacific Partnership trade negotiations, but so are Chile and New Zealand. Canada will need to actively promote Canadian softwood products and seek out new relationships to remain competitive in this market.

### Thailand

B.C. is the only province that exports softwood to Thailand. Exports are small, accounting for just 0.11 per cent of B.C.'s total softwood lumber exports in 2014. Thailand gets the majority of its softwood imports from New Zealand, the U.S., Brazil and Chile. Canadian exporters face general tariffs of 10 to 20 per cent; ASEAN countries, Australia, and New Zealand have an advantage over Canada in that they are exempt from tariffs.<sup>37</sup>

### Indonesia

Indonesia imports both softwood and hardwood from Canada; B.C. is the only province that exports softwood. Exports accounted for just 0.03 per cent of provincial softwood lumber exports in 2014. Import tariffs on wood products range from 0 to 10 per cent; ASEAN countries face no tariffs. The main inhibitor to growth in this market is that there is very little knowledge about Canadian wood products.

### Government market diversification programs

Much of the work that needs to be done to grow exports in newer markets involves being present – at trade fairs and through visits and events – and building relationships. This is work that industry must do, but there are ways government can support market diversification initiatives. These may include facilitating relationships, gathering market information that is lacking, financially supporting expansion efforts, and negotiating trade deals to lower trade barriers for Canadian exporters.

Both FII and Natural Resources Canada's *Expanding Market Opportunities (EMO) Program* focus on China, Japan, India and South Korea as priority markets for Canadian softwood lumber exports. With the slowdown in China and protectionist measures creeping into Japan (it is unclear what effect the TPP agreement will have on these measures), government-funded diversification initiatives should be reviewed.<sup>38</sup>

**FIGURE 6: SOFTWOOD USE IN SELECTED COUNTRIES**

COUNTRY	SOFTWOOD USE	OUTLOOK
MEXICO	<ul style="list-style-type: none"><li>→ Construction (<i>concrete forms and staging</i>)</li><li>→ Scaffolding</li><li>→ Packaging</li><li>→ Furniture</li></ul>	Exports from Canada to Mexico have increased minimally since 2012.
PHILIPPINES	<ul style="list-style-type: none"><li>→ Furniture</li><li>→ Joinery and carpentry</li><li>→ Construction</li><li>→ Packaging</li></ul>	Positive economic indicators in construction and furniture export sectors.
VIETNAM	<ul style="list-style-type: none"><li>→ Furniture</li><li>→ Packaging</li><li>→ Construction</li></ul>	Rapid growth in furniture industry with manufacturers moving from China, Hong Kong and Taiwan to take advantage of low labour costs.
THAILAND	<ul style="list-style-type: none"><li>→ Packaging</li><li>→ Construction</li><li>→ Furniture</li><li>→ Joinery and mouldings</li></ul>	Packaging industry projected to grow due to increasing foreign investment in tech industry.
INDONESIA	<ul style="list-style-type: none"><li>→ Furniture</li><li>→ Joinery and carpentry</li></ul>	Furniture industry projected to grow at 5 per cent/year.

Source: Forestry Innovation Investment, Canada Wood



For example, federal EMO funding expires next fiscal year (2015-16). Natural Resources Canada could conduct a market analysis to see which markets provide the best opportunities for Canadian wood products in 2016 and beyond. Since a new SLA with the U.S. is far from certain, a specific focus could be given to softwood lumber.

Whether the EMO program is renewed in 2016, or a new diversification program is put in place, it should be tailored towards expanding opportunities for Canadian softwood lumber in regions where Canada is not yet – but could become – a significant player, like ASEAN.

## IMPROVE VALUE IN TRADE WITH THE U.S.

### Seek new value-add products and markets within the U.S.

The U.S. has a large value-added wood products market, and Canadian producers hold a tiny share of it (one per cent in 2010).<sup>39</sup> Value-added products include windows, doors and frames. Another market with potential is wood products for resorts and luxury vacation homes. There may be opportunities for Canada to increase exports of these types of softwood products that do not compete with or threaten U.S. lumber producers.

### Promote the Canadian brand in the U.S.

The U.S. relies on Canadian softwood lumber to fill the gap in demand that is not satisfied by domestic producers. Despite this, the U.S. is extremely protectionist, often instigating trade action against the Canadian softwood lumber industry. One way to mitigate this threat could be to make Canadian softwood lumber more desirable in the U.S. market *because*

it is Canadian. This strategy is already underway, and should be continued. For example, the Canadian Wood Council<sup>40</sup> works with the U.S. Homebuilders Association to brand Canadian wood as affordable, durable, and sustainable.

The reputation of Canadian softwood lumber within the U.S. needs to be improved from “subsidized” lumber with an unfair competitive advantage over domestic lumber. Canada should increase proactive branding of Canadian softwood lumber in the U.S. market. There are actions the federal government can take, either on its own or by providing assistance to forestry associations, to brand Canadian softwood lumber as a desirable product in the U.S. One way to do this would be to build on the existing *Expanding Market Opportunities Program*.<sup>41</sup> Canadian softwood lumber could be branded on the sustainability of its production and use as a building material.

### Enhance the Expanding Market Opportunities Program

Under the North American component of the EMO, the federal government provides financial assistance to eligible recipients<sup>42</sup> to promote the use of wood for non-residential buildings (like schools, hospitals and malls). This is done through raising awareness of the benefits of wood as a construction material with the people who make decisions about what types of materials to build with, such as architects, builders, and government and building code officials. EMO also works with stakeholders to promote the environmental reputation of Canadian wood products, highlighting Canada's sustainable forest management practices.

Softwood lumber is considered to be the most “green” building material. Canada has done well in promoting things like our forest management practices and logging regulations to establish a global reputation as a provider of sustainable wood products. The federal government could utilize its connections with U.S. builders, architects and officials to proactively push this message in the United States. If builders and consumers in the U.S. associate Canadian softwood lumber with environmental stewardship, Canadian producers may be able to get a premium. Reduced imports from Canada might mean increased imports from other countries that do not have the forest management practices Canada has.

### **Utilize the Council of Forest Ministers**

The Canadian Council of Forest Ministers – the federal, provincial, and territorial ministers responsible for forestry – meet annually to discuss forestry issues and co-ordinate on common issues. At their most recent meeting (July 2015), the council unanimously reiterated support for a new SLA. Since the U.S. administration does not seem interested in participating in another SLA, the council should turn its attention to what it can do in the absence of an agreement. For example, it could become a forum through which the federal and provincial levels of government create a joint strategy for branding Canadian softwood lumber in the U.S. market. Involving the council in the creation of an in-market strategy would help ensure consistency of message, whether it be from the federal government or a province. In addition, the provinces, with input from their industry stakeholders, would be well-positioned to identify measures beyond branding that they or the federal government could act on to help maintain stable trade with the U.S.

### **Continue Canada-U.S. initiatives to grow the softwood lumber market.**

The SLA enhanced cooperation between Canada and the U.S. to increase non-traditional uses of softwood lumber and promote North American softwood lumber abroad.

The Bi-National Softwood Lumber Council, created by the SLA, funds projects that target growth in softwood demand for green building, non-residential, residential, and outdoor construction, both in North America and abroad. The council’s lifespan is not tied to the SLA, but rather to the lifespan of its fund; when the council was created, it received \$50 million as part of the settlement over the illegal duties collected by the U.S. between 2001 and 2006.

Canada should work with the U.S. to continue the council, as initiatives it has undertaken have benefited Canada’s industry. For example, the council initiated the Softwood Lumber Board (SLB), which is entirely industry-funded. It is located in the U.S., but its board is made up of companies from both the U.S. and Canada. Its mandate is to stimulate and increase softwood lumber consumption in the U.S. to combat aggressive marketing campaigns for other building materials, like concrete, steel and plastics. These products were gaining share of the construction industry at the expense of lumber. Increased softwood lumber consumption in the U.S. market helps Canadian producers, as the U.S. is still their largest export market.

It is in the interests of both the Canadian and U.S. industries to grow the market for their product together. Continuing this cooperative relationship may also help in mitigating further trade action from the U.S. against Canada.





## NEXT STEPS

The time to begin planning for life without a softwood lumber agreement was yesterday. It is not when the SLA expires in October without a renewed deal in place. Nor is it when the one-year moratorium on trade action expires in October 2016.

There are steps the federal government, provinces and industry can take to plan for a trading environment with the U.S. that does not involve managed softwood lumber trade:

---

### CONTINUE MARKET DIVERSIFICATION

---

- Take advantage of the opportunity provided by the Canada-Korea Free Trade Agreement to increase softwood exports to that country.
- Establish relationships with potential Trans-Pacific Partnership partners, like Vietnam, that import softwood lumber before our competitors, such as Chile, do.
- Develop a strategy to increase the market in, and exports to, Mexico.
- Develop a strategy to grow relationships and market share in ASEAN countries.
- Continue investment in innovative technologies, with an aim at increasing productivity to help offset Canada's declining timber supply and maintain international competitiveness.

---

### IMPROVE VALUE IN TRADE WITH THE U.S.

---

- Strengthen the brand of Canadian softwood lumber in the U.S. market by emphasizing Canada's sustainable forest management and products.
- Enhance the federal EMO program to utilize established relationships with decision-makers in the U.S. market to build the Canadian brand.
- Gather information about opportunities to increase value-added product exports.
- Continue bi-national cooperation to increase softwood lumber demand.



## APPENDIX A

### Provincial softwood lumber exports by western province

#### British Columbia

In 2014, softwood lumber accounted for 16 per cent of the total value of B.C.'s exported commodities.<sup>44</sup>

In 2014, just more than half (53 per cent) of B.C.'s total softwood lumber exports were destined for the U.S. market. Yet, of all the provinces, B.C. has the most diversified trading portfolio. As indicated in Figure 7, while B.C.'s exports to the U.S. have decreased since 2006, exports to markets in Asia have risen.

B.C. has been the leading supplier of softwood lumber products to China since 2010. After the U.S., China is B.C.'s second largest export destination, making up about 25 per cent of the province's exports in 2014.

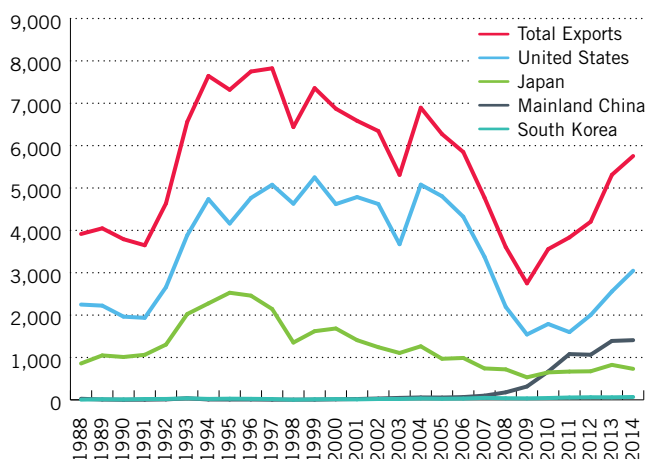
Japan, a country with a steady demand for wood, accounted for 13 per cent of B.C.'s softwood lumber exports in 2014. Europe is B.C.'s fourth largest softwood lumber customer at around three per cent of annual exports. South Korea – a country Canada implemented a free trade agreement with this year – rounds out the top five export destinations, at 1.1 per cent of provincial exports. B.C. exports similar amounts to the Philippines.

#### Alberta

In 2014, softwood lumber accounted for about half a per cent of the total value of Alberta's exported commodities.<sup>45</sup>

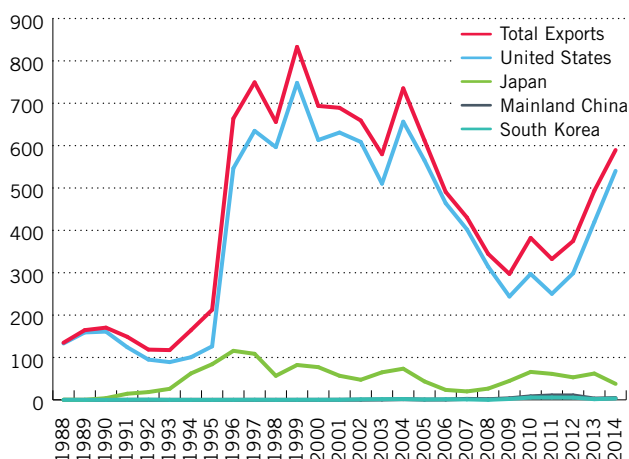
In 2014, Alberta accounted for about seven per cent of Canada's softwood lumber exports. As indicated in Figure 8, a large majority of Alberta's softwood lumber exports are destined for the U.S. In 2014, exports to the U.S. made up 91.7 per cent of the province's total softwood lumber exports. Alberta occupies eight per cent of U.S. market share. Japan, Alberta's second largest customer, accounted for 6.4 per cent of exports in 2014; Alberta has a 26 per cent market share. Alberta has a small presence in other Asian markets, sending an annual average of just more than two per cent of total exports to China and South Korea since 2006.<sup>46</sup> In 2014, Alberta held 11 per cent of Chinese market share, nine per cent of South Korean market share, and 10 per cent of Taiwanese market share.

**FIGURE 7: BRITISH COLUMBIA SOFTWOOD LUMBER EXPORTS BY DESTINATION** (millions C\$)



Source: BC Stats – Ministry of Technology, Innovation and Citizens' Services

**FIGURE 8: ALBERTA SOFTWOOD LUMBER EXPORTS BY DESTINATION** (millions C\$)



Source: Statistics Canada, Canadian International Merchandise Trade Database

**WESTERN CANADA'S FORESTRY SECTOR CONSTITUTES THE MAJORITY OF CANADA'S SOFTWOOD LUMBER EXPORTS.** THE WEST ACCOUNTED FOR MORE THAN **74 PER CENT** OF CANADA'S SOFTWOOD LUMBER EXPORTS IN 2014; MORE THAN 66 PER CENT WERE FROM BRITISH COLUMBIA. QUEBEC IS CANADA'S SECOND LARGEST SOFTWOOD LUMBER EXPORTER, ACCOUNTING FOR 12.6 PER CENT OF THE NATIONAL TOTAL IN 2014.<sup>43</sup>

## Saskatchewan

In 2014, softwood lumber accounted for about 0.1 per cent of the total value of Saskatchewan's exported commodities.<sup>47</sup>

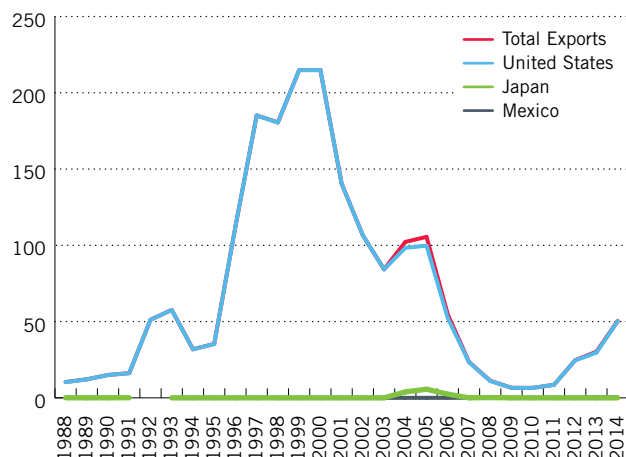
Saskatchewan contributes less than one per cent to Canada's total softwood lumber exports (0.6 per cent in 2014). As shown in Figure 9, Saskatchewan relies on the U.S. market the most of the western provinces. In 2014, 99.4 per cent of its softwood lumber exports were shipped to the U.S. Saskatchewan has intermittent exports to Mexico and Japan, but does not export any softwood lumber to mainland China or South Korea.

## Manitoba

In 2014, softwood lumber accounted for about 0.06 per cent of the total value of Manitoba's exported commodities.<sup>48</sup>

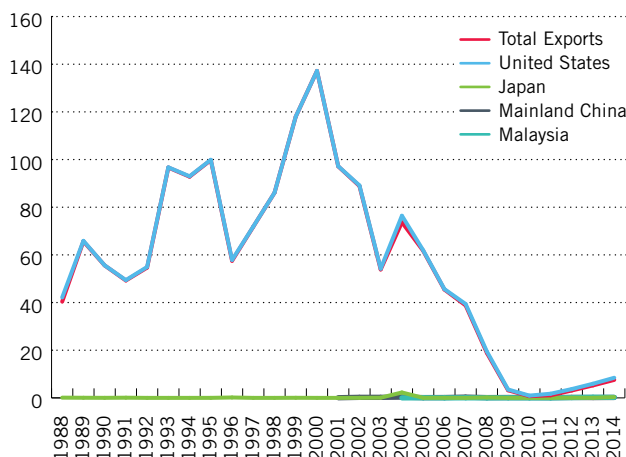
Manitoba is the smallest softwood lumber exporter of the western provinces, accounting for 0.1 per cent of Canada's softwood lumber exports in 2014. Manitoba is similar to Saskatchewan in that the majority of its softwood lumber exports are sold into the U.S. market (89.4 per cent in 2014). However, Manitoba's customer base is slightly more diversified than Saskatchewan's. In 2005, Manitoba began exporting softwood lumber to mainland China; China accounted for 4.5 per cent of provincial softwood lumber exports in 2013 and 2.4 per cent in 2014. In 2014, Japan and Malaysia accounted for more than six per cent of Manitoba's softwood exports.

**FIGURE 9: SASKATCHEWAN SOFTWOOD LUMBER EXPORTS BY DESTINATION** (millions C\$)



Source: Statistics Canada, Canadian International Merchandise Trade Database

**FIGURE 10: MANITOBA SOFTWOOD LUMBER EXPORTS BY DESTINATION** (millions C\$)



Source: Statistics Canada, Canadian International Merchandise Trade Database



## HISTORY *of the* CANADA-U.S. SOFTWOOD LUMBER DISPUTES

Canada and the U.S. have been trading lumber since the 1800s, and documented disputes date back just as long. For example, in the 1820s, “lumber interests were the principal U.S. motivation in the Maine-New Brunswick border dispute.”<sup>49</sup>

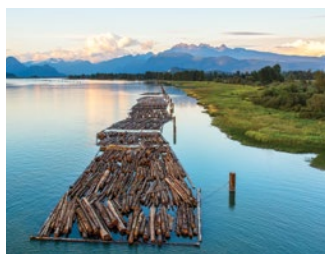


### 1930s

During the Great Depression, import duties were imposed on various goods including Canadian lumber. It increased from \$1 (per thousand board feet) in 1930 to \$4 in 1935.

#### 1937

In 1937, U.S. producers petitioned the U.S. government, claiming Canadian producers had an unfair advantage in terms of timber costs, wages and tax rates. The Department of Commerce (DOC) did not investigate.



IMPORT DUTIES WERE IMPOSED ON CANADIAN LUMBER DURING THE GREAT DEPRESSION. IT INCREASED FROM \$1 (PER THOUSAND BOARD FEET) IN 1930 TO

**\$4 *in* 1935.**

### 1960s

#### 1962

Prompted by Canada's growing market share, the U.S. Congress and a White House task force both looked into the issue of Canadian subsidies.

#### 1963

U.S. lumber producers petitioned the U.S. Tariff Commission; the commission did not impose any quotas or restrictions on Canadian imports.

### 1982-83

#### LUMBER I

U.S. producers formed a coalition and filed a countervailing petition with the DOC.

DOC investigated stumpage programs in British Columbia, Alberta, Ontario and Quebec.

DOC determined stumpage programs do not pass the specificity test used to determine whether a good is subsidized.

### 1986

#### LUMBER II

#### MAY

The U.S. Lumber Coalition filed a petition requesting a 27 per cent duty on Canadian softwood lumber imports. The DOC launched a second countervailing investigation.

#### OCTOBER

DOC determined Canadian stumpage programs are subsidized and imposed a 15 per cent countervailing duty on softwood lumber imports from Canada.

#### DECEMBER

Canada and the U.S. signed an MOU; Canada imposed a 15 per cent export charge on softwood lumber exports into the U.S. so revenue remained in Canada. Provinces could replace the export charge with their own policy changes, such as higher stumpage fees.

## 1991-94

### LUMBER III

#### 1991

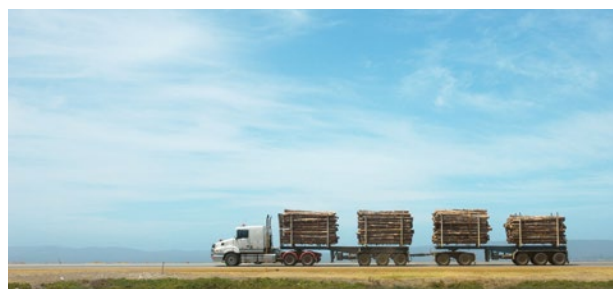
The DOC self-initiated a countervailing investigation after Canada terminated the MOU.

#### 1992

DOC imposed a countervailing duty of 6.51 per cent.

Canada now had a free trade agreement with the U.S.; a review panel remanded the U.S. determination. DOC affirmed its subsidy findings in its remand decision and increased the import duty to 11.54 per cent. Chapter 19 Panel reviewed the DOC remand determination and remanded it.

The U.S. government filed an Extraordinary Challenge to the Review Panel's decision. The Extraordinary Challenge Committee (ECC) of judges (two Canadians and one American) found no bias in the Review Panel's decision (the U.S. committee member gave a dissenting opinion).



## In 1996

A FIVE-YEAR SOFTWOOD LUMBER AGREEMENT WAS IMPLEMENTED BETWEEN CANADA & THE U.S.



## 1996

### SOFTWOOD LUMBER AGREEMENT

Between Lumber III and the SLA, Congress amended the U.S. countervailing law.

A five-year Softwood Lumber Agreement was implemented April 1996. Under the agreement, B.C., Alberta, Ontario and Quebec had a quota on the amount of softwood lumber that could be exported to the U.S. duty free; any exports above this amount were penalized.



## 2001-2006

### LUMBER IV

#### 2001

U.S. Lumber Coalition filed a countervailing petition and an anti-dumping petition following the SLA's expiration. The Maritime provinces were included in the AD petition.

The DOC decision was that provincial stumpage is a subsidy and Canadian softwood lumber was being dumped into the U.S. Canada appealed the decision to both a NAFTA Chapter 19 panel and the WTO.

#### 2003

NAFTA Panel upheld the anti-dumping duty but said the rate must be lowered. The DOC obliged.

#### 2002-2004

NAFTA Panel on the countervailing duty went back and forth several times with the U.S., each time resulting in the lowering of the duty.

#### 2004

NAFTA Panel ruled the U.S. is not injured by Canadian imports.

#### 2004

The U.S. requested an ECC; in 2005 it ruled the U.S. is not threatened or injured by imports from Canada.

#### 2005

a U.S. court ruled the U.S. cannot legally collect duties on lumber imports.

#### 2006

Canada and the U.S. signed the Softwood Lumber Agreement after five years of negotiations.

## 2007-2012

### INTERNATIONAL ARBITRATION

#### 2007

The U.S. initiated two disputes through the London Court of International Arbitration:

- That Canada failed to cap its export volumes or collect enough export tax.
- That Ontario and Quebec assisted their industries with programs that violate the SLA.

#### 2008

The LCIA ruled British Columbia and Alberta upheld the SLA, but Saskatchewan, Manitoba, Ontario and Quebec failed to implement quota allocations properly in the first six months of 2007.

#### 2009

LCIA ruled that Saskatchewan, Manitoba, Ontario and Quebec must have an additional export tax until \$68.26 million Cdn is collected (and given to the U.S.).

#### 2010

The U.S. sought a binding decision from the LCIA on whether timber pricing in the B.C. Interior violated the SLA.

#### 2012

The LCIA ruled British Columbia's timber pricing system does not violate the SLA.

**DOC:** Department of Commerce

**ECC:** Extraordinary Challenge Committee

**LCIA:** London Court of International Arbitration

**NAFTA:** North American Free Trade Agreement

**SLA:** Softwood Lumber Agreement

**WTO:** World Trade Organization



## ENDNOTES

- <sup>1</sup> For a breakdown of softwood lumber exports by western province, see Appendix A.
- <sup>2</sup> Not seasonally adjusted.
- <sup>3</sup> International Wood Markets Group Inc., RISI Inc.
- <sup>4</sup> The SLA was originally implemented for a period of seven years, and contained an option for a two year extension if both parties agreed to one, which they did in 2013. That two year extension ends this October, permanently ending the agreement.
- <sup>5</sup> Canadian Institute of Forestry, "The Canada-United States Softwood Lumber Dispute," [http://www.cif-ifc.org/wp-content/uploads/2014/05/Softwood\\_Lumber\\_Dispute.pdf](http://www.cif-ifc.org/wp-content/uploads/2014/05/Softwood_Lumber_Dispute.pdf), 2003, p.2.
- <sup>6</sup> British Columbia, "Timber Supply Analysis in British Columbia," [https://www.for.gov.bc.ca/hts/pubs/brochure/tsa\\_bro.htm](https://www.for.gov.bc.ca/hts/pubs/brochure/tsa_bro.htm).
- <sup>7</sup> British Columbia, [https://www.leg.bc.ca/cmt/39thparl/session-4/timber/documents/MTTS\\_Glossary\\_of\\_Terms\\_2012Jun.pdf](https://www.leg.bc.ca/cmt/39thparl/session-4/timber/documents/MTTS_Glossary_of_Terms_2012Jun.pdf).
- <sup>8</sup> BC Ministry of Forests, Mines and Lands, "The State of British Columbia's Forests, Third Edition," 2010, p. 135, 137.
- <sup>9</sup> Natural Resources Canada, "Mountain Pine Beetle," <https://www.nrcan.gc.ca/forests/insects-diseases/13381>.
- <sup>10</sup> BC Ministry of Forests, Mines and Lands, "The State of British Columbia's Forests, Third Edition," 2010, p. 135.
- <sup>11</sup> Russ Taylor, "B.C. Sawmills Closures "No Surprise,"" *Logging & Sawmilling Journal*, November 2013.
- <sup>12</sup> Paul Quinn and Hamir Patel, "Paper & Forest Products," RBC Capital Markets, May 2014.
- <sup>13</sup> Wood Markets, "Canada & U.S. "Top 20" Lumber Producers' Annual Ranking 2014," March 2015, <https://www.woodmarkets.com/canada-u-s-top-20-lumber-producers-annual-ranking/>.
- <sup>14</sup> Derrick Penner, "Interfor buys four mills, raising bet on U.S. lumber production to hedge against B.C. supply constraints," *Vancouver Sun*, December 22, 2014.
- <sup>15</sup> IHB, "Record-level for U.S. lumber prices predicted by 2017," [http://www.ihb.de/wood/news/North\\_America\\_softwood\\_lumber\\_prices\\_40075.html](http://www.ihb.de/wood/news/North_America_softwood_lumber_prices_40075.html).
- <sup>16</sup> British Columbia, "Timber Supply Analysis in British Columbia," [https://www.for.gov.bc.ca/hts/pubs/brochure/tsa\\_bro.htm](https://www.for.gov.bc.ca/hts/pubs/brochure/tsa_bro.htm).
- <sup>17</sup> Appendix B contains details of the disputes that have taken place since the 1930s, including the two disputes the U.S. launched – and lost – while the SLA has been in place.
- <sup>18</sup> The 2006 SLA negotiations resulted in an agreement between the two countries that the U.S. would pay Canada back in the amount of \$4.3 billion US\$. The remainder was split between the US Lumber Coalition and the Bi-National Softwood Lumber Council.
- <sup>19</sup> Industry Canada, "National Evaluation of the Softwood Industry and Community Economic Adjustment Initiative (SICEAI)," <https://www.ic.gc.ca/eic/site/ae-ve.nsf/eng/03049.html>, last modified 2010-10-04.
- <sup>20</sup> Patrick Macrory, "NAFTA Chapter 19: A Successful Experiment in International Trade Dispute Resolution," C.D. Howe Institute, No. 163, September 2002, p.5.
- <sup>21</sup> NAFTA Secretariat, "Overview of the Dispute Settlement Provisions," <https://www.nafta-sec-alena.org/Home/Dispute-Settlement/Overview-of-the-Dispute-Settlement-Provisions>, accessed June 29, 2015.
- <sup>22</sup> Ibid.
- <sup>23</sup> Industry Canada, *Trade Data Online*.
- <sup>24</sup> Russel Tayler, "The State of B.C.'s Wood Products Industry: 2015 Update," International Wood Markets Group Inc., p.21. [http://www.apecb.ca/resources/Russ\\_Taylor\\_2015-05-19.pdf](http://www.apecb.ca/resources/Russ_Taylor_2015-05-19.pdf).
- <sup>25</sup> Industry Canada, *Trade Data Online*.
- <sup>26</sup> ASEAN Member States are Indonesia, the Philippines, Thailand, Singapore, Vietnam, Malaysia, Myanmar, Cambodia, Laos and Brunei.
- <sup>27</sup> The Pacific Alliance is a Latin American trade bloc with four member states – Chile, Colombia, Mexico and Peru.
- <sup>28</sup> B.C. is used as a reference because it is Canada's largest exporter – by far – of softwood lumber.
- <sup>29</sup> Natural Resources Canada, "The competitiveness of Canadian softwood lumber in China," <http://cfs.nrcan.gc.ca/selective-cuttings/81>, 2014.
- <sup>30</sup> Natural Resource Canada, "Canada and China Announce Low-Carbon Eco-District Demonstration Project," 2014, <http://news.gc.ca/web/article-en.do?nid=880819>.
- <sup>31</sup> FPIInnovations, "British Columbia Forest Products Trend Analysis in Export Markets 2013," August 2014, p.19.
- <sup>32</sup> Canada Wood, "Asian Markets Policy Driver and Innovation in Wood Building," [http://www.cofi.org/wp-content/uploads/2015/01/06\\_1\\_Newman-AsianMarkets\\_2014.pdf](http://www.cofi.org/wp-content/uploads/2015/01/06_1_Newman-AsianMarkets_2014.pdf).
- <sup>33</sup> Softwood Export Council, <http://www.softwood.org/mexico.php>.
- <sup>34</sup> Jeff Serveau, "Market Opportunity in Mexico for Canadian Wood Products," Canada Wood, 2008.
- <sup>35</sup> Forestry Innovation Investment Ltd., "Other Markets – ASEAN Region," <http://www.bcfii.ca/bc-forest-sector/key-markets/other-markets/>, accessed July 2015.
- <sup>36</sup> Indufor, "South East Asia Strategic Review – Appendix 1 – Vietnam," Forestry Innovation Investment, 2015.
- <sup>37</sup> Indufor, "South East Asia Strategic Review – Appendix 3 – Thailand," Forestry Innovation Investment, 2015.
- <sup>38</sup> Indufor, "South East Asia Strategic Review – Appendix 4 – Indonesia," Forestry Innovation Investment, 2015.
- <sup>39</sup> MSC Marketing Solutions Consulting Ltd., "Estimating Market Potential in Forest Product Export Markets," Forestry Innovation Investment, 2012.
- <sup>40</sup> The association representing manufacturers of Canadian wood products used in construction.
- <sup>41</sup> In 2012 the federal government integrated its various forest sector initiatives into one program, EMO.
- <sup>42</sup> Not-for-profit forest products associations, manufactured housing associations, provinces, provincial Crown corporations, and not-for-profit organizations engaged in forest product research.
- <sup>43</sup> Industry Canada, *Trade Data Online*.
- <sup>44</sup> BC Stats.
- <sup>45</sup> Ibid.
- <sup>46</sup> Industry Canada, *Trade Data Online*.
- <sup>47</sup> BC Stats.
- <sup>48</sup> Ibid.
- <sup>49</sup> Michel Charron, *Lumber I to IV: History of the Canada-U.S. Softwood Lumber Dispute*, Parliament of Canada, 2005, <http://www.parl.gc.ca/Content/LOP/ResearchPublications/tips/tip134-e.htm>.

## REFERENCES

- BC Stats. "Softwood Lumber Exports." *Exports and Imports – Data*. Minister of Technology, Innovation and Citizens' Services. <http://www.bcstats.gov.bc.ca/StatisticsBySubject/ExportsImports/Data.aspx>
- British Columbia. "Glossary of Terms." *Mid-Term Timber Supply*. Ministry of Forests. [https://www.leg.bc.ca/cmt/39thparl/session4/timber/documents/MTTS\\_Glossary\\_of\\_Terms\\_2012Jun.pdf](https://www.leg.bc.ca/cmt/39thparl/session4/timber/documents/MTTS_Glossary_of_Terms_2012Jun.pdf)
- British Columbia. 2010. "Timber Harvest" *The State of British Columbia's Forests Third Edition*. Ministry of Forests. [https://www.for.gov.bc.ca/hfp/sof/2010/SOF\\_2010\\_Web.pdf](https://www.for.gov.bc.ca/hfp/sof/2010/SOF_2010_Web.pdf)
- British Columbia. 2002. *Timber Supply Analysis in British Columbia*. Ministry of Forests. [https://www.for.gov.bc.ca/hts/pubs/brochure/tsa\\_bro.htm](https://www.for.gov.bc.ca/hts/pubs/brochure/tsa_bro.htm)
- British Columbia. 2014. *2013 Economic State of the B.C. Forest Sector*. Ministry of Forest, Lands and Natural Resource Operations. <https://www.for.gov.bc.ca/ftp/het/external/publish/web/economic-state/Economic-State-of-BC-Forest-Sector-2013.pdf>
- Canada Wood. *Asian Markets Policy Driver and Innovation in Wood Building*. [http://www.cofi.org/wp-content/uploads/2015/01/06\\_1\\_Newman-AsianMarkets\\_2014.pdf](http://www.cofi.org/wp-content/uploads/2015/01/06_1_Newman-AsianMarkets_2014.pdf)
- Canadian Institute of Forestry. 2003. *The Canada-United States Softwood Lumber Dispute*. [http://www.cif-ifc.org/wp-content/uploads/2014/05/Softwood\\_Lumber\\_Dispute.pdf](http://www.cif-ifc.org/wp-content/uploads/2014/05/Softwood_Lumber_Dispute.pdf)
- Charron, Michel. 2005. *Lumber I to IV: History of the Canada-U.S. Softwood Lumber Dispute*. Parliament of Canada. <http://www.parl.gc.ca/Content/LOP/ResearchPublications/tips/tip134-e.htm>
- Forestry Innovation Investment Ltd. *Other Markets – ASEAN Region*. <http://www.bcfii.ca/bc-forest-sector/key-markets/other-markets/>
- FPIInnovations. 2014. *British Columbia Forest Products Trend Analysis in Export Markets 2013*.
- Indufor. 2015. *South East Asia Strategic Review – Appendix 1 – Vietnam*. Forestry Innovation Investment.
- Indufor. 2015. *South East Asia Strategic Review – Appendix 3 – Thailand*. Forestry Innovation Investment.
- Indufor. 2015. *South East Asia Strategic Review – Appendix 4 – Indonesia*. Forestry Innovation Investment.
- Industry Canada. 2010. *National Evaluation of the Softwood Industry and Community Economic Adjustment Initiative (SICEAI)*. <https://www.ic.gc.ca/eic/site/ae-ve.nsf/eng/03049.html>
- Industry Canada. *Trade Data Online*.
- Interfor. 2015. *Company Overview*. <http://www.interfor.com/sites/default/files/docs/reports/Company-Overview-May-2015.pdf>
- International Wood Markets Group Inc. 2015. *Canada & U.S. "Top 20" Lumber Producers' Annual Ranking: 2014*. <https://www.woodmarkets.com/wp-content/uploads/2015/03/15-03-26-Press-Release-Top-20-US-Canada-Lbr-Producers-RT2.pdf>
- International Wood Markets Group Inc. 2015. *Record-level for U.S. lumber prices predicted by 2017*. The Timber Network. [http://www.ihb.de/wood/news/North\\_America\\_softwood\\_lumber\\_prices\\_40075.html](http://www.ihb.de/wood/news/North_America_softwood_lumber_prices_40075.html)
- Macrory, Patrick. 2002. *NAFTA Chapter 19: A Successful Experiment in International Trade Dispute Resolution*. C.D. Howe Institute. [https://www.cdhowe.org/sites/default/files/attachments/research\\_papers/mixed/commentary\\_168.pdf](https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/commentary_168.pdf)
- MSC Marketing Solutions Consulting Ltd. 2012. *Estimating Market Potential in Forest Product Export Markets*. Forestry Innovation Investment.
- NAFTA Secretariat. "Overview of the Dispute Settlement Provisions." *Dispute Settlement*. <https://www.nafta-sec-alena.org/Home/Dispute-Settlement/Overview-of-the-Dispute-Settlement-Provisions>
- Natural Resource Canada. 2014. *Canada and China Announce Low-Carbon Eco-District Demonstration Project*. <http://news.gc.ca/web/article-en.do?nid=880819>
- Natural Resources Canada. 2014. *The competitiveness of Canadian softwood lumber in China*. <http://cfs.nrcan.gc.ca/selective-cuttings/81>
- Natural Resources Canada. 2015. "Mountain pine beetle." *Forest Topics*. <https://www.nrcan.gc.ca/forests/fire-insects-disturbances/top-insects/13381>
- Penner, Derrick. 2014. *Interfor busy fours mills, raising bet on U.S. lumber production to hedge against B.C. supply constraints*. Vancouver Sun. <http://www.vancouversun.com/business/Interfor+buys+four+mills+raising+lumber+production+hedge+against+supply+constraints/10674483/story.html>
- RISI Inc. 2012. *North American Timber Forecast – Excerpt, November 2012*. [http://www.risiinfo.com/Marketing/forecasts/Excerpts/na\\_timber\\_long.pdf](http://www.risiinfo.com/Marketing/forecasts/Excerpts/na_timber_long.pdf)
- RISI Inc. *World Timber Price Quarterly – February 2015*. [http://www.risiinfo.com/Marketing/Commentaries/world\\_timber.pdf](http://www.risiinfo.com/Marketing/Commentaries/world_timber.pdf)
- Statistics Canada. *Canadian International Merchandise Trade Database*. Minister of Industry.
- Serveau, Jeff. 2008. *Market Opportunity in Mexico for Canadian Wood Products*. Canada Wood.
- Softwood Export Council. <http://www.softwood.org/mexico.php>
- Taylor, Russ. 2013. *B.C. Sawmills Closures "No Surprise"*. Logging & Sawmilling Journal. <http://forestnet.com/LSJissues/nov2013/B.C.%20sawmill%20closures%20%E2%80%9CNo%20surprise%E2%80%9D.pdf>
- Taylor, Russ. 2015. *The State of B.C.'s Wood Products Industry: 2015 Update*. International Wood Markets Group Inc. [http://www.apecbc.ca/resources/Russ\\_Taylor\\_2015-05-19.pdf](http://www.apecbc.ca/resources/Russ_Taylor_2015-05-19.pdf)
- The Conference Board. 2015. *The U.S. Economic Forecast*. <https://www.conference-board.org/data/usforecast.cfm>
- Quinn, Paul and Hamir Patel. 2014. *Paper & Forest Products*. RBC Capital Markets. [https://www.rbcinsight.com/CM/Share/ResearchViewer/?SS\\_6DC17B89705492961C56F62DCBC5A1E7](https://www.rbcinsight.com/CM/Share/ResearchViewer/?SS_6DC17B89705492961C56F62DCBC5A1E7)
- U.S. Census Bureau. *New Residential Construction*.
- West Fraser Timber Co. Ltd. 2015. *Annual Information Form*. [http://www.westfraser.com/sites/default/files/2015%20Annual%20Information%20Form\\_0.pdf](http://www.westfraser.com/sites/default/files/2015%20Annual%20Information%20Form_0.pdf)



**THE CENTRE FOR NATURAL RESOURCES POLICY**  
CHAMPIONS THE RESPONSIBLE DEVELOPMENT  
OF WESTERN CANADIAN RESOURCES  
TO SAFEGUARD CANADA'S PROSPERITY.

**THE CENTRE FOR TRADE & INVESTMENT POLICY**  
CHAMPIONS THE PROFITABILITY OF OUR EXPORT ECONOMY  
BY SEEKING WAYS TO ENSURE ACCESS TO MARKETS  
AND SECURING FOREIGN CAPITAL  
WHILE PROTECTING CANADIAN INTERESTS.



900-105 12<sup>th</sup> Avenue SE  
Calgary AB T2G 1A1  
[cwf.ca](http://cwf.ca)