

PERSPECTIVE

Lumber

Another episode in a long battle

Canadian and U.S. producers have been at loggerheads on lumber for a long time. The United States imposed the first tariff barrier in 1789. Between the end of the 18th century and the end of the 20th, there were sporadic trade confrontations over lumber. Since the 1980s, however, the conflict is recurrent and remains a constant irritant in Canadian-American trade relations. Where is the Quebec industry at right now? Here is a brief picture of the situation.

The parties

The Canada–U.S. softwood lumber agreement which had been in force since October 2006 (SLA 2006) expired in 2015. The parties have not managed to agree since then.

Canada's roundwood market differs from the U.S. market. In Canada, most exploitable forest belongs to the provinces (under Canada's Constitution); in the United States, it is privately owned. More than 90% of Canadian lumber comes from Crown land, whereas the figure is closer to 30% in the United States.

U.S. producers do not want to extend the terms of the 2006 accord, and do not want the next agreement to have the same bases. Their main grievances involve how the royalties on timber rights for Crown forests are established, and how much they are in Canada. For their part, Canadian sawmillers end up with an axe hanging over their heads: without an agreement, the Americans will impose import tariffs on Canadian lumber like they did in during the last bargaining period. Americans who think that Canada is competing unfairly consider such tariffs "anti-dumping and countervailing" penalties.

If such penalties were imposed, we would see a repetition of what happened in the early 2000s. The tariffs were initially set at about 32% in 2001, and were then lowered to around 22% as of 2002. They were in force until an agreement was reached in 2006.

If it is imposed again, this "punitive" provision will hurt Canadian producers, and handicap their capacity to invest and develop. It could come into effect as early as the spring of 2017.

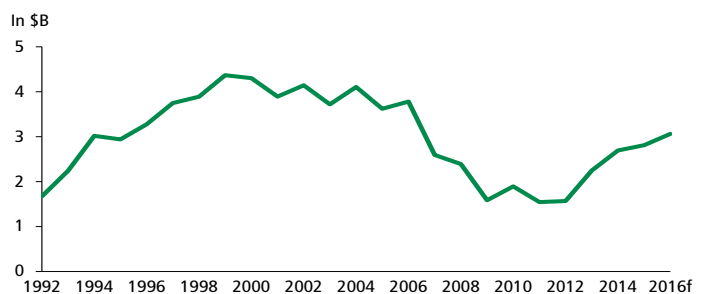
During the previous dispute, US\$5.5B was provided to cover the tariffs imposed by the United States. In the settlement for the 2006–2015 agreement, the United States was warded US\$1B.

The importance of the wood industry in Quebec

Year in and year out, the lumber industry alone accounts for 0.2% to 0.3% of Quebec's GDP, while the wood products industry (lumber, veneer, assembled wood, prefabricated homes, etc.) accounts for nearly 1%. However, in about 200 Quebec municipalities, the forestry industry (work in forests and plants) is the only economic activity once retailing is excluded.

The value of wood product sales (lumber, veneer, assembled wood, prefabricated homes, etc.) amounted to \$7.1B in Quebec in 2015. This represents 5.0% of the total value of Quebec manufacturer sales that year (it was 7.0% in 2004). As for sawmill sales, according to the estimates for 2016, they alone total approximately \$3.0B (graph 1).

GRAPH 1
Quebec: Sawmill sales* have strengthened since 2012



f: forecasts; * Sawmills except shingle and shake mills.
Sources: Statistics Canada and Desjardins, Economic Studies

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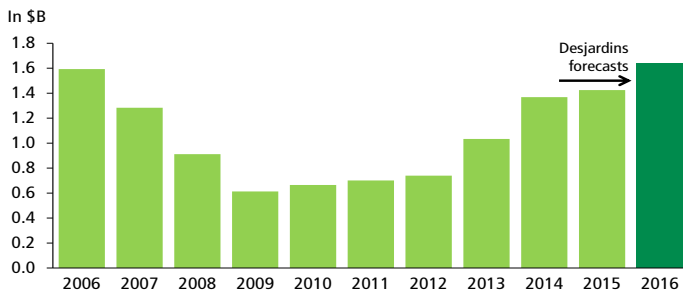
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NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

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According to Statistics Canada, international exports by Quebec sawmills could amount to about \$1.6B for 2016 (graph 2). Note that 90% to 95% of Quebec producers' international lumber exports have gone to the United States in recent years, which makes the strategic importance of the U.S. market clear very quickly.

GRAPH 2
Quebec: International exports go almost entirely to the United States



Sources: Statistics Canada, Institut de la statistique du Québec and Desjardins, Economic Studies

The 2000s: A variety of challenges

Quebec's lumber industry has gone through a lot in the last 15 years. Three factors can be pinpointed, although they are not the only ones:

- ▶ The Canadian dollar's rapid ascent starting at the end of 2002.
- ▶ The growling of the U.S. lumber coalition, which imposed sanctions on Canadian producers.
- ▶ The collapse of the U.S. housing market in the middle of the last decade.

The Ministère des Forêts, de la Faune et des Parcs du Québec has kept an inventory of the jobs lost in forestry since April 2005. In the wood sector alone, 8,585 workers were laid off in primary, secondary and tertiary manufacturing¹ between April 2005 and the middle of November 2016, and 186 plants shut down during this period.

Strength in unity

In the United States, the cohesiveness among the powers is obvious: the producers are concentrated in the Southern and Western states. Canadian wood accounts for approximately 30% of annual consumption in the United States, so this is a major issue.

¹ Primary: shakes, lumber, panels, wood pellets, etc. Secondary and tertiary: trusses and engineered panels, flooring strips, milled wood, frames and mouldings, wood polymer composite, etc.

On the Canadian side, the provinces don't work together. Each province has its own way of administering the royalties charged to producers. For its part, Quebec has had an auction system in place since April 2013 for a portion of the wood harvested here.² In fact, each province puts forward its own arguments and has its own agenda.

It is currently a buyers' market, given the dynamics and size of the U.S. market. There is a lot of demand, particularly outside Canada's borders.

Lastly, we might think that U.S. customers such as the major big box building supply dealers would support the Canadian cause, given local producers' advantageous prices. We quickly realize, however, that wood only accounts for a small share of these merchants' sales, and does not justify creating a common front to support Canadian lumber. For its part, the National Association of Home Builders (NAHB), a federation with more than 140,000 members in the United States, one third of whom are homebuilders and renovators, is very positive about free trade. The NAHB worked on scenarios for taxes on Canadian lumber that show that Canada is not the only party hurt when such taxes are levied. However, the federation's conclusions did not manage to influence the U.S. coalition's intentions.

Beyond the lumber dispute

The Quebec wood industry has to tackle many other problems:

- ▶ In primary manufacturing, the products are similar throughout the continent: it is very difficult to stand out. The battle is therefore waged on price, and plants elsewhere in Canada and the United States can deliver quality products in quantity for less than Quebec plants.
- ▶ In Quebec, due to the weather conditions and the location of the supply (further and further north), the wood is small. For example, it takes nine trees to yield 1 m³ of wood whereas it takes three trees in British Columbia.
- ▶ Wood has been less available in recent years. The logging potential has been reduced from what it was in the early 2000s, and an auction system has been instituted for 25% of the wood harvested.
- ▶ According to industry representatives, logging rights, royalties and the fees associated with fighting forest fires are also constraints, and add to Quebec plants' uncompetitive production costs.

² Ministère des Forêts, de la Faune et des Parcs: "The implementation of an open market by the creation of the Bureau de mise en marché des bois (BMMB) is a cornerstone in the reform of the Quebec forestry regime. The BMMB uses the prices obtained at auction to establish the value of the royalties that forestry companies must pay for each cubic metre of wood harvested under their supply guarantee. This approach makes it possible to collect a fair value for every tree harvested from public lands, which belong to all Quebecers."

- ▶ Note also that the industry's investment in high-performance equipment is not up to par. Quebec corporations are smaller than corporations elsewhere in Canada.
- ▶ The Quebec industry also knows that the effort has to focus on innovation and developing innovative products that can provide solutions on construction sites and elsewhere. The industry must become less dependent on the residential market, and target other sectors. Wood is now being used in applications as varied as the transportation, food and clothing industries, but more outlets for wood fibre must be found.

What comes next

The existing protectionist climate in the United States is being exacerbated by the arrival of a new president whose intentions in the area of free trade lean more toward restricting trade. For the moment, U.S. producers have filed their complaint on what they deem to be unfair competition from Canadian producers. It is U.S. institutions like the United States International Trade Commission that will rule on whether or not there has been an injury, and it is the Department of Commerce that will set the antidumping and countervailing duties that will be imposed.

For now, the weak Canadian dollar remains good for Canadian producers. But the situation is uncomfortable given the potential sanctions and many challenges facing the industry.

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