Canada-U.S. softwood lumber agreement

diversification of markets for Canadian lumber in South Korea and Mexico and exploring new markets in Asia within the TPP.

While greater diversification is always good, **Russell Taylor**, CEO of **International Wood Markets Group**, said the reality is that the U.S. has always been Canada's biggest customer and always will be because no other major lumber-producing country can sell lumber to the U.S. as cheaply or easily as Canada can.

"Market diversification is important, but it's a bit of a backup plan to a weaker U.S. market," he said. "Our mills are designed to produce lumber for the U.S. market. We've designed our technology to produce two-by-fours, and that's not the size that the rest of the world wants."

During the housing market crash in the U.S., China provided a lifeline to B.C. producers, who capitalized on a construction boom in China to sell cheap lumber for construction framing – demand that has since plateaued.

"The only reason we were competitive in China is because we had a lot of mountain-pine-beetle-killed wood that nobody else would take and China would. They use it a few times and throw it away. And that's what you're calling market diversification."

In other words, like it or not, B.C.'s forestry industry will always be dependent on the U.S., so there will always be trade disputes.

Whereas most of the timber harvested in the U.S. is from private land, most of the logs harvested in Canada come from Crown land. American producers argue that the Crown tenure system is a form of subsidy that warrants protectionist measures.

When the North American Free Trade Agreement (NAFTA) was signed with the U.S. and Mexico, Canada insisted on excluding softwood lumber, which is why it has had to be dealt with in a separate agreement.

As the Canada West Foundation report points out, Western Canada accounts for 74% of Canada's exports of softwood lumber to the U.S., so B.C. has always been the biggest target for countervailing duties. But as B.C.'s timber supply shrinks over the long term, it is expected that B.C. producers will no longer be able to produce lumber as cheaply as they have in the past, which might mitigate the call for countervailing duties.

B.C.'s shrinking timber supply has sent its three largest forestry companies on a buying spree in the U.S.

West Fraser Timber Co. Ltd. (TSX:WTF), **Interfor Corp.** (TSX:IFP) and **Canfor Corp.** (TSX:CFP) now own 35 sawmills in the U.S., according to *Branching Out*. That's more than they own in Canada, and it provides a hedge against countervailing duties, because the lumber their American mills produce would not be subject to duties. But an even greater threat to B.C.'s forestry sector might be the removal of restrictions on raw log exports under the TPP, not the lack of a new softwood lumber agreement.

The TPP talks have been highly secretive. However, in July, documents leaked to the *Canadian Press* indicated Japan is lobbying to have the current restriction on raw log exports removed.

B.C. mills have the first right of refusal before logs harvested on the B.C. coast – mostly from private forest land owned by **TimberWest** and **Island Timberlands** – can be exported.

If Japan succeeds in having those restrictions removed, and if China were also granted access to an unrestricted log market, Taylor said, "we would see the coastal sawmilling industry almost disappear." ■

Wall of cheap Canadian wood to surge south when deal expires

FOREST VIEW

PETER WOODBRIDGE

Christmas will arrive early for American buyers of Canadian softwood lumber.

The nine-year-old Canada-U.S. Softwood Lumber Agreement expires shortly. Hamstrung by a 12-month standstill agreement, the U.S. cannot invoke any surprise emergency trade measures in the interim.

A wall of wood, gift-wrapped in devalued Canadian mill wrap, inevitably will surge south.

Lumber is accumulating at sawmills, transit yards and rail points inside Canada. Shipped today, B.C.'s backlog would incur a 15% tariff entering the United States.

That tariff disappears on Canadian sawmillers' Mardi Gras day – potentially a yearlong extended Fat Tuesday celebration starting on October 13.

Canadian sawmillers know that the supply surge to the U.S. will further depress today's already rock-bottom lumber prices. China and other offshore buyers will benefit, but they are a sideshow at present.

Once again, Canada's oil-linked currency has come to the rescue of Canadian sawmills. At around US$0.75, the sharply devalued loonie is shoring up Canadian production and jobs.

All of this sticks in the craw of the **U.S. Coalition for Fair Lumber Imports**.

It's a much smaller group these days, of course. Canadian-based firms now own a significant proportion of U.S. sawmilling capacity. Although weakened, the coalition is far from lifeless. Rumour has it that politicians and policy-makers in Washington did not have an easy summer at their cottages. Coalition members lobbied aggressively to avoid a renewal being signed – without its terms being changed in favour of the U.S.

Unfortunately for them, there's nothing in the trade rule book that says a competitive advantage, based on exchange rate differentials, is unfair trade and therefore potentially subject to countervailing duties.

Since U.S. protectionism of its softwood lumber industry began to gain traction in the 1990s, Canadian provinces have cleaned up their approaches to pricing public timber sales. In the early days, American trade lawyers were able to identify practices that might have been construed by some as subsidies.

The most powerful arbitrators, including the North American Free Trade Agreement, the **World Trade Organization** and the **London Court of International Arbitration**, mostly found in favour of Canada – with some important exceptions.

During the legal process, the provinces went to great pains to remain onside and avoid visits to the penalty box. Coalition members intend to appeal.

Few in the industry (this columnist included) anticipated the recent surge of supply, and softening demand, behind today's low lumber prices. Prices for bellwether grades of spruce-pine-fir two-by-fours at mills in B.C. currently languish around US$240 per thousand board feet. That's dangerously close to production costs for the most efficient mills, and well under water for others – even when the mills receive $320 per thousand.

In the U.S. as well, many sawmills – including Canadian-owned mills such as supply-discipline leader **Interfor** – are curtailing operations until conditions improve.

Chances are, analysts say, lumber market instability will not be resolved any time soon. Recent plummeting prices for lumber company stocks confirm it.

Markets in China are not expected to help rescue demand in the immediate future. North American builders are entering their seasonal consumption downturns. Other export markets generally are lacklustre.

Medium-term prospects look much better. But that's not likely before spring 2016 at the earliest.

In the meantime, two events mark the calendar.

"Fat Tuesday" might bring immediate happiness for some, as Canadian sawmills ship excess inventories and enjoy the corresponding cash flows. Their "duty-free stores" will do a roaring trade.

But the ogre of U.S. protectionism hovers over the Canadian party. Lobbyists and policy-makers' meetings in Washington restart in earnest this month. After more than 100 years of wrangling over softwood lumber imports, American protectionism is unlikely to go away quietly. ■

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