

After the Windfall

Plotting a New Course for BC Beyond the Softwood Lumber Agreement



by Ben Parfitt

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CCPA
CANADIAN CENTRE
for POLICY ALTERNATIVES
BC Office



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By Ben Parfitt

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After the Windfall

Plotting a New Course for BC Beyond the Softwood Lumber Agreement

This paper examines events in the post-Softwood Lumber Agreement world, focusing on BC's five biggest forest companies. It finds that the agreement has generally weakened the position of the BC forest industry while strengthening the hand of US lumber producers.

IN OCTOBER 2006, the Canadian and US governments ended a prolonged trade dispute by signing the Softwood Lumber Agreement (SLA), a deal they said would bring greater certainty to the cross-border lumber trade. The dispute, which had dragged on for 54 months, revolved around US allegations that Canadian lumber producers were subsidized by provincial timber-pricing policies that effectively undervalued the trees the companies used to make their lumber.

Under the new deal, \$4 billion—80 per cent—of the duties collected by the US on Canadian lumber shipments were returned to Canada. The federal government then reimbursed individual Canadian forest companies based on the duties they had paid.

While the SLA ended the US duties, a new and controversial export tax was imposed. The tax, collected by the Canadian government, applied to lumber shipments to the US in the event that lumber prices fell below certain levels or exports exceeded certain volumes.

This paper examines events in the post-SLA world and focuses on British Columbia's five biggest forest companies. It finds that the agreement has generally weakened the position of the BC forest industry while strengthening the hand of US lumber producers.

First, the export tax has dragged down forest company fortunes. As of July 2008, BC companies had paid more than \$540 million in export taxes. The added taxes came at the worst possible time. With lumber prices plummeting due to a rapidly deteriorating US housing market, BC forest companies were awash in



red ink and saddled with bigger losses with the new tax. The result was numerous mill closures in BC.

Second, some BC companies opted to use a portion of their duty refunds to buy US forest companies—an outcome US trade officials undoubtedly foresaw. By imposing an export tax in Canada, the SLA created incentives for Canadian firms to invest in the US.

These two consequences of the SLA should compel the BC government to weigh all options including:

- Urging the federal government to scrap the SLA by providing the required six-month notice;
- Re-drawing provincial timber-pricing policies; and
- Working within the confines of the SLA to create more value-added manufacturing jobs in BC.

This paper recommends that BC start by pursuing the latter option. More value-added forest products—including wood trusses, beams, pallets, garage doors, and window and door frames—could be made in BC and are not subject to the SLA's punitive export tax provisions.

Making more higher-value forest products is not only a way around the tax provisions. It also strengthens the social and economic fabric of BC's rural, forestry-dependent communities, which would benefit from a manufacturing strategy that stresses generating more jobs from a smaller overall raw material supply.

Making more higher-value forest products is not only a way around the SLA's punitive tax provisions. It also strengthens the social and economic fabric of BC's rural, forestry-dependent communities.

Introduction

In April 2006, with a decision by the US Court of International Trade (CIT) pending, Canada's newly elected Conservative government did an about face and bowed to US pressure.



DURING THE MOST RECENT lumber dispute between Canada and the United States, Canadian forest companies paid approximately \$5 billion in countervailing and anti-dumping duties. The duties were imposed because the Coalition for Fair Lumber Imports, a powerful US lobby, convinced the American government that Canadian companies exporting lumber to the US enjoyed an unfair trade advantage. The Coalition alleged that provincial timber pricing policies in Canada undervalued the trees Canadian forest companies logged and hence were a form of subsidy.

Canada's forest industry and the provincial and federal governments responded by filing appeals before North American Free Trade Agreement (NAFTA) and World Trade Organization (WTO) panels as well as before US courts. By August 2003, less than two years after the dispute began, a NAFTA panel ruled that duties of 18 per cent were unreasonable and must be recalculated by the US Department of Commerce. Shortly after, a WTO panel found that provincial pricing policies, while potentially benefiting Canadian companies, were not subsidies and therefore the duties were unjustified.

In April 2006, with a decision by the US Court of International Trade (CIT) pending, Canada's newly elected Conservative government did an about face and bowed to US pressure. David Emerson, Canada's Minister of International Trade (earlier he headed British Columbia's largest forest company, Canfor Corporation), announced a tentative deal had been reached to end the dispute. Several months later, in October, a somewhat modified agreement came into effect.¹ In signing the deal Canada formally agreed to quash a legal fight that by then was unquestionably going its way. In the months between the deal being struck and its ratification, the CIT ruled that US softwood lumber producers suffered no "material injury" from Canadian softwood lumber imports. Then on October 13, just days after the agreement was ratified, the CIT ruled that

the duties illegally obtained by the US must be returned. But by then it was too late.

The hallmark of the agreement was the return to Canada of 80 per cent of the duties collected by the US during the longstanding dispute. Of equal significance were provisions in the agreement that shielded US lumber producers from open competition with their Canadian counterparts. This took two forms: quotas on US-bound lumber shipments or export taxes on those lumber shipments in the event that lumber prices fell.

Following ratification of the Softwood Lumber Agreement (SLA), the Canadian government reimbursed forest companies \$4.3 billion, with BC companies receiving about half of the refunds. How much, exactly, is unknown because the federal government will not disclose payments to individual companies (although many publicly traded companies did publish the figures in their quarterly and annual reports). The US kept \$1 billion of the collected duties, sending half to the Coalition for Fair Lumber Imports, the very lobby that had pushed for duties to be imposed on its Canadian competitors.²

The rebates provided BC companies with significant cash infusions and many forest industry workers and resource communities hoped the cash would be used to upgrade existing mills or build new ones. This did not happen for a variety of reasons, including:

- The SLA itself, which penalizes Canadian companies exporting lumber to the US;
- A rapid decline in US housing starts and the resultant collapse in lumber prices;
- BC's mountain pine beetle outbreak and its impacts on timber quality and quantity; and
- Changes to provincial forest policies in BC which dropped requirements that forest companies operate mills in exchange for access to publicly owned timber.

This paper examines what the five largest BC forest companies spent on or around the time the rebates were returned. The top five are chosen on the basis of the amount of public timber they have cutting rights to (Table 1 on page 10). Collectively, the five companies are estimated to have received \$1.67 billion in softwood duty rebates (Table 2 on page 11).

Ironically, three of the five BC companies made significant investments in US mills. A fourth made investments in mills producing forest products that were exempt from the SLA's provisions and therefore not subject to export taxes, but the mills in question were in Alberta. And the fifth continued on a course of closing mills and paying down company debt. Hence, BC mill towns and workers saw little tangible benefit from the returned duties.

The hallmark of the Softwood Lumber Agreement was the return to Canada of 80 per cent of the duties collected by the US during the longstanding dispute.

The experiences of the five companies examined in this report suggest that the Softwood Lumber Agreement has:

- Encouraged an increase in Canadian forest company investments in the United States;
- Led companies to rethink what they make and where because of the agreement's costly export tax provisions; and
- Exposed the province's vulnerability to over-reliance on one market.

Given the SLA's terms, Canadian forest companies will be in an extremely disadvantageous position when lumber prices are low because they will be forced to pay export taxes totalling 15 per cent of the value of the goods shipped. In the agreement's first 21 months alone, BC forest companies paid out just under \$540.5 million in softwood lumber export taxes, wiping out more than one quarter of what they received in rebates after the 54-month dispute ended.

Given the SLA's terms, Canadian forest companies will be in an extremely disadvantageous position when lumber prices are low because they will be forced to pay export taxes totalling 15 per cent of the value of the goods shipped.

The SLA also stipulates that changes to provincial policies, particularly timber-pricing policies, may trigger renewed action by the US lumber lobby. Conversely, changes to more "market-determined" timber pricing regimes may qualify individual provinces for exemption from the SLA's export measures.³ So there are both potential risks and benefits associated with changing BC's approach to timber pricing.

This paper concludes that the ongoing costs imposed on BC forest companies by the SLA require the provincial government to act. Broadly speaking, there are four options:

- **OPTION 1:** Stay the course.
- **OPTION 2:** Urge the federal government to exercise Canada's option to terminate the SLA by providing the required six-month written notice.
- **OPTION 3:** Redraw timber pricing and timber sales policies in BC as a precursor to announcing withdrawal from the SLA.
- **OPTION 4:** Creatively work within the confines of the SLA to encourage a more diversified provincial forest industry.

Each response carries potential risks and benefits, which are addressed later in this paper.

This report concludes that the status quo is unacceptable. It recommends that the province immediately pursue Option 4, while weighing the merits of Options 2 or 3. First, however, we examine why the softwood rebates failed to translate into new mill investments in BC.

The Softwood Rebates

Why No Investments in BC Mills?

THIS REPORT LOOKS AT some of the notable investments by the top five forest companies in BC at or around the time they received the return of 80 per cent of the anti-dumping and countervailing duties they had paid during the last softwood lumber dispute between Canada and the US.

A decline in lumber prices was already evident when the Softwood Lumber Agreement came into effect. Markets fell sharply thereafter. From a high of US\$450 (C\$598) per thousand board feet in August 2004, prices for SPF (spruce, pine, fir) plummeted. By early 2008 when the Canadian and US dollars were at par, the same lumber shipment sold for just US\$220.⁴

The precipitous drop in prices led to significant losses for BC forest companies. But worse, as stipulated under the SLA, once prices dipped below the US\$355 per thousand board feet threshold, Canadian lumber producers began paying the federal government taxes on US-bound shipments, taxes that totalled up to 15 per cent of the value of their exports depending on how far below the threshold prices fell. For US lumber producers the tax had advantages much like those under the previous duties. It increased costs for their major competitor, thus helping to ensure a greater share of the US lumber market for American producers. In the first 12 months the SLA was in effect, the six Canadian provinces covered by the agreement paid more than \$467 million in export taxes to the federal government, money that the federal government subsequently returned to the provinces.⁵ Just shy of 80 per cent of the export taxes collected—\$371 million—originated with BC forest companies. In the last quarter of 2007 and first two quarters of 2008, BC companies paid another \$169.5 million in export taxes, bringing their total for the first 21 months of the SLA to \$540.5 million.⁶

A decline in lumber prices was already evident when the Softwood Lumber Agreement came into effect.



Unquestionably, the drop in prices and the additional tax explains why there was not a slew of significant investments in new or upgraded mills in BC after the so-called “softwood windfall” was returned.

But it is not the only reason such investments failed to materialize. Another factor was the high debts that some BC forest companies carried. Yet another factor was the longstanding softwood lumber dispute itself. To resolve the dispute, the BC government enacted certain policy reforms to appease the powerful US lumber lobby.⁷ Among those reforms was the formal abandonment of longstanding requirements that BC forest companies own and operate certain mills in the province in exchange for access to timber on public forestlands. By dropping the requirement for appurtenant mills, it became easier for companies to close mills in the province. The result was that in the lead-up to, and on the after-side of, the SLA numerous mills in BC closed their doors.

When BC forest companies did make investments after receiving their sizeable Softwood Lumber Agreement rebates, they often chose to spend a portion of that money in the southeast United States.

The backdrop of a seemingly interminable on-again, off-again softwood lumber dispute also explains something else. When BC forest companies did make investments after receiving their sizeable Softwood Lumber Agreement rebates, they often chose to spend a portion of that money in the southeast United States. This outcome was one American trade negotiators undoubtedly foresaw and applauded because it meant more investment and economic spin-offs in the US. But the benefits ultimately cut two ways. By investing in the US South, Canadian companies gained a foothold in the biggest lumber-producing region in the world, a region with extremely low costs and no risks in terms of lumber output being subject to duties or export taxes. By investing in the US those same companies also gained another potential advantage: they made it more difficult for the US forest industry to launch another softwood lumber trade dispute with Canada (see the discussion of Option 2 later in this report).

Finally, two other factors explain why the much-anticipated surge in forest industry investments failed to occur with the return of the softwood duties. In BC’s interior, the mountain pine beetle had already prompted companies

Table 1: BC’s Top Five Forest Companies by Allocated Logging Rights on Public Land

Company	Allowable Annual Cut* (millions of cubic metres)	Percentage of Harvest
Canadian Forest Products (Canfor)	9.89	11.62%
Western Forest Products	7.06	8.30%
West Fraser Mills	5.67	6.67%
Tolko Industries	4.69	5.52%
International Forest Products	3.59	4.23%
TOTAL	31 million cubic metres	36.34%

Note: *The Allowable Annual Cut is the total volume of public timber that individual companies through various licence agreements with the province are legally entitled to log in a year. Actual logging rates vary depending on market conditions and other factors.

Source: BC Ministry of Forests. 2008. Apportionment System: Provincial Linkage AAC Report.



to substantially upgrade existing lumber mills or to build new ones. These investments had already staked the region to a 17.43 per cent share of the US housing market, the largest single out-of-country source at the time the SLA was signed.⁸

On BC's coast, meanwhile, a surge in the logging of private forestlands fuelled a boom in raw log exports. Once again, the backdrop of the SLA loomed large. While BC softwood lumber products were subject to export taxes under the new agreement, raw logs were not. Thus, the SLA provided an incentive to export raw logs because BC forest companies choosing to turn logs into lumber for sale to US customers paid a penalty to do so, but faced no penalty if they shipped raw logs to the same market.⁹ Since the SLA was signed, TimberWest, the region's largest private forestland owner and a significant log exporter, closed its last remaining sawmill in BC. With no remaining mills, the company essentially became a pure log marketer and exporter.¹⁰

With that said, what have BC's top five forest companies done with the softwood windfall? And what should the province consider doing in response to the trends noted in this report?

Table 2: Softwood Duty Refunds to BC's Top Five Forest Companies

Company	Softwood Duty Refund
Canadian Forest Products (Canfor)	\$717.7 million
Western Forest Products	\$110.3 million
West Fraser Mills	\$386.5 million
Tolko Industries*	\$340 million
International Forest Products	\$118.9 million
TOTAL	\$1.67 billion

Note: *Tolko Industries, a privately owned company, has not publicly disclosed its softwood rebate. The figure presented is the author's estimate based on the company's known allocation of publicly owned forest resources.

Sources: Fourth Quarter 2006 financial reports for Canadian Forest Products, Western Forest Products, West Fraser Mills and International Forest Products.

Heading South

In February 2007, BC's largest forest company, Canfor Corporation, released its 2006 earnings. With net income of nearly \$472 million, the profit picture seemed robust. But the earnings were far less rosy than the numbers suggested. Only with the one-time return of \$717.7 million (\$551.2 million after tax) in softwood lumber duties did the company turn a profit.

"Excluding the duty refund of \$717.7 million, an operating loss of \$61.6 million was recorded in the fourth quarter," the company reported.¹¹

Ironically, Canfor's lumber business had been the hardest hit. Only a few years earlier, the company had invested \$26.4 million to upgrade its Houston sawmill, making it the largest sawmill in the world.¹² In 2005, Canfor invested a further \$104 million to build another massive mill in Vanderhoof.¹³ No sooner was this done than the aforementioned US housing collapse began. Once again, excluding the duty refund, Canfor's lumber division recorded an operating loss for the fourth quarter of 2006 of \$72.5 million.¹⁴

Mounting losses at its BC sawmills, continued declines in timber quality due to the ongoing mountain pine beetle attack, and the prospect of paying export taxes on US-bound lumber shipments when prices were slumping, may explain why the year it received a net \$551.2 million in softwood duty rebates, Canfor elected to invest in new forestry operations in the southern US.

In January 2006, Canfor spent \$205 million (US) to purchase three sawmills, two wood-treatment plants, a value-added mill and a European lumber importing business, all located in North and South Carolina. At the time, the Canadian company explained the move as the beginning of an "opportunistic" expansion into the southeast US.¹⁵

As a leading lumber producer, Canfor liked what it saw in the US south. The region accounted for nearly 60 per cent of the nation's timber due to a significant increase in the area of planted pine, mostly on private lands. Its output of industrial wood fibre was exploding.¹⁶

Canfor was not the only BC forest company to invest in the US that year. In August 2006, West Fraser said that while it had "serious reservations" about the terms of the proposed SLA, it was nonetheless prepared to support the agreement.¹⁷ Three months later, the company bought 13 sawmills in North and South Carolina, Georgia, Florida, Alabama, Arkansas and Texas for \$325 million (US) from International Paper. Along with two other mills that the company bought earlier in Arkansas and Louisiana, West Fraser had increased its North American lumber production by 50 per cent to 2.2 billion board feet annually.¹⁸

According to company Chairman, President and CEO, Hank Ketcham, the purchase secured a footing in a market where the supply of wood fibre was increasing, whereas in BC, due to the mountain pine beetle and the elevated logging in response to it, supply was shrinking.

"The southern region of the US is North America's fastest growing market for wood products, currently representing approximately 40% of all North American housing starts," Ketcham said in explaining the foray into the US. "The fibre supply is also excellent, with harvests of southern yellow pine projected to continue increasing."¹⁹

As with Canfor, West Fraser's US foray was best viewed in the context of a deteriorating situation in BC and the ongoing trade dispute. In the months immediately preceding the SLA, West Fraser paid a 9 per cent duty on US-bound softwood lumber shipments. With slumping, post-SLA lumber prices, it paid a 15 per cent export tax on similar lumber products.²⁰ Under the circumstances, Ketcham's "serious reservations" about the deal were easily understood.

International Forest Products, or Interfor, also made significant investments in the US after receiving its softwood rebates. The rebates of just under \$119 million (US) were reported in the company's 2006 financial report. The same report noted that the company sold three of its BC operations that year: the MacKenzie sawmill in Surrey; B.W. Creative Wood Industries, a value-added company specializing in the production of wooden rails; and Helifor, Interfor's helicopter logging division. The company netted \$42 million with the sales.²¹

Having divested itself of these BC holdings, Interfor spent more than \$90 million that same year upgrading three sawmills—two in Oregon and one in Washington. Meanwhile, at the Adams Lake mill in southern BC, a new wood-fired energy plant was installed to replace a much more expensive natural gas-fired system.²²

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The following year, 2007, Interfor closed yet another coastal BC mill at Queensboro. Meanwhile, new spending proceeded at its Port Angeles mill, and plans were unveiled to build a new mill at a cost of \$100 million in Adams Lake.²³

Interfor's 2007 annual report clearly indicates that the company's investments in mill upgrades, particularly those in the United States, were intended to reduce its exposure to softwood-dispute related items, and to vulnerabilities in currency exchange rates—always an issue for Canadian companies selling products into the US and valued in US dollars.

With 40 per cent of its production capacity in the US as a result of post-SLA investments, Interfor was far less negatively impacted by currency swings and much more of its production was exempt from the trade agreement's costly export taxes.

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Heading East

Tolko's Ultimately Satisfying Ride?

TOLKO INDUSTRIES, a privately owned company, has not disclosed what it received in returned duties. Refunds received by its main competitors, however, serve to provide an estimate of \$340 million.²⁴

In 2006, the year the SLA was signed, Tolko made numerous small (relatively speaking) investments at its BC sawmills, including \$2.8 million at Armstrong, \$8.1 million at Williams Lake, \$2.5 million at Lavington, and \$7.2 million at Soda Creek. Tolko said the investments would help it to lower costs and better weather the storm brought on by the US housing downturn and collapse in lumber prices. The investments were also made so that Tolko's mills were better able to cope with the increased number of logs (many of lower quality) resulting from the mountain pine beetle attack.²⁵

These investments, however, paled in comparison with those that Tolko made in Alberta. There the focus was on new mills producing panels and engineered wood products and on emerging opportunities to work with aspen, a traditionally underutilized tree species.

The biggest of those investments, announced in 2005 but largely funded after Tolko received its softwood refunds, was in a new Oriented Strand Board (OSB) and engineered wood products mill near Slave Lake.²⁶ In July 2006, Tolko announced that it would also invest \$435 million to build a new I-joist mill in Alberta (I-joists are structural products used in house construction and consist of a middle web or band of OSB, topped and bottomed by lumber, and is generally much stronger than a solid lumber joist).²⁷

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Poor timing aside (the foray into both OSB and I-joists came as forest product markets began to deteriorate, leading to construction delays and the closure of older, less efficient mills in Tolko's portfolio), both investment decisions made some sense. Wood panels as well as forest products such as I-joists are excluded products under the SLA, an issue that is addressed at the end of this report (*Moving Forward: Four Possible Responses to the SLA* on page 19).



Western Forest Products’ Softwood Windfall

Closing Mills, Paying Debts

ALONE AMONG THE TOP FIVE forest companies in BC, Western Forest Products (WFP) has no interior forestry holdings. As an exclusively coastal forest company, it also has more publicly owned timber under its long-term control than do its coastal competitors. Its pre-eminent position was achieved in November 2005 when the company purchased 3.6 million cubic metres per year of Crown logging rights and five coastal sawmills from Cascadia Forest Products (formerly Brascan, formerly Weyerhaeuser, formerly MacMillan Bloedel) for \$221 million.²⁸

To understand the impact of the sale, it is important to mention that it was precipitated by Brascan’s earlier purchase of all of MacMillan Bloedel’s assets, which included logging rights to public forestland as well as private forestlands. No sooner did Brascan (now Brookfield Asset Management) complete the purchase than it split the private and public holdings into two entities, turning the public holdings over to Cascadia, which in turn sold to WFP. The splitting of the old MacBlo assets into two was widely viewed by forest industry analysts as a precursor to a major restructuring of the coastal industry—a restructuring that would result in mill closures and the loss of hundreds of jobs.

This restructuring had, in fact, already begun with WFP announcing in August 2005 that it had closed its Silvertree mill in Vancouver and indefinitely ceased production at its Saltair mill at Ladysmith on Vancouver Island.²⁹ The two closures cost 276 workers their jobs. Shortly thereafter it was announced that the Island Pheonix mill, which had been idled since September 2005 and was part of the Cascadia purchase, would remain closed at a loss of another 170 jobs. Then, in November 2006, Western announced that, following an “internal evaluation” of its mill portfolio in the aftermath of its Cascadia purchase, it would

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close its New Westminster mill where another 284 workers were employed.³⁰ The company said that the overall impact on the number of mill employees would be offset, somewhat, by the restarting of operations at Saltair. However, in May 2008 the company announced that the Saltair mill was in a state of “indefinite shutdown.”³¹

In November 2006, WFP reported it had received US\$109.6 million (C\$110.3 million) in softwood duty refunds, 80 per cent of which were used to pay down debt. “We will retain the balance,” company president Reynold Hert said at the time, “for working capital purposes as permitted under our debt agreement while we review options that may enable us to pay down further debt while maintaining liquidity.”³²

The debt repayment continues, with a strong focus on the sale of mill lands and private forest holdings for real estate. With the proceeds of the \$48 million sale of its New Westminster mill lands, Western used \$40 million to pay down debt. The company estimated that the sale of other “non-core” assets—including a proposed and highly contentious sale of 2,500 hectares of forestland on southern Vancouver Island for an estimated \$78 million, could net anywhere from \$100 million to \$130 million. With the \$40 million pay down on debt following the New Westminster mill sale, Western’s debt stood at \$135 million.³³

None of Western’s mill closures, like the closures of other coastal mills in recent years, triggered significant criticism by the provincial government, which perhaps should come as no surprise. A cornerstone of forest policy in BC for years was that forest companies gained access to the trees on publicly owned forestlands only after building mills that processed the timber coming off of those lands. But the provincial government did away with those requirements to appease the US softwood lumber lobby. In the post-SLA world, “market forces” are meant to determine what happens by way of forest industry developments in BC, except the market is distorted with Canadian companies paying penalties in the form of export taxes when they ship their softwood lumber products into the US. Given that reality, it is no surprise that Canfor, West Fraser and Interfor all increased investments in milling operations south of the 49th parallel. It will be interesting to see if Western follows suit after closing numerous BC mills.

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Moving Forward

Four Possible Responses to the Softwood Lumber Agreement

IN THE POST-SLA WORLD, BC forest companies have paid more than \$540 million in softwood lumber export taxes. In the face of continued and generally weak lumber markets, it is conceivable that during the lifetime of the seven-year agreement, BC forest company export tax payments could equal what the same companies paid in countervailing and anti-dumping duties to the US during the four and a half years of the lumber dispute.

While the taxes paid under the SLA stay in Canada to provide public benefit, as David Emerson, former Canfor president and more recently Canada's Foreign Minister was fond of pointing out,³⁴ this is of no consequence to companies saddled with significant added costs under an agreement that ensures neither free nor fair trade in lumber products. The central question is what to do in response.

OPTION 1: STAY THE COURSE.

The first option is simply to stay the course. Do nothing, hope for a market turnaround and a return to industry profitability. This approach assumes that lumber prices will rebound. BC lumber producers in the interior of the province in particular will reap the rewards because they operate low-cost mills. The positive aspect of such an approach is that it doesn't rock the boat with our biggest trading partner. On the negative side, however, that trading partner has consistently signalled that whenever the highly vocal US Coalition for Fair Lumber Imports reasserts that Canadian lumber producers are subsidized, it

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will respond by imposing punitive duties on our exports. Furthermore, there is nothing to prevent the US from either exercising its right to retreat from the agreement—a potential precursor to a new round in the seemingly interminable softwood lumber wars—or, upon the agreement ending, initiate a new set of countervailing and anti-dumping duties. The only protection afforded under the agreement is that were the US to announce its withdrawal, there is a one-year “standstill” clause in the agreement that would prevent it from launching another countervailing duty or anti-dumping duty case against Canada.

OPTION 2: URGE THE FEDERAL GOVERNMENT TO EXERCISE CANADA’S OPTION TO TERMINATE THE SLA BY PROVIDING THE REQUIRED SIX-MONTH WRITTEN NOTICE.

The second option is for Canada to terminate the SLA, giving the US government the requisite six-month written notice. While such a move carries risks in that it courts renewed duties, it is worth considering that just before the SLA became law BC forest companies paid less in duties than they now pay in export taxes. For example, Canfor’s combined duty payments in the third quarter of 2006 were 10.05 per cent of the value of its US lumber shipments,³⁵ while Interfor reported in the second quarter of that year (no figure is published in Interfor’s third quarter report) that its duty payments totalled 10.8 per cent.³⁶ Comparisons between duties paid prior to the SLA and export taxes paid after the agreement was ratified are made difficult because details on the product mixes exported to the US by specific Canadian softwood lumber producers are not publicly available. However, given the sizeable dollar amounts already paid in export taxes since the SLA was signed, it may well be that Canadian companies end up paying as much in export taxes during the lifetime of the agreement as they paid in duties during the dispute itself.

The important difference being, however, that the export tax dollars are collected by the Canadian government and later returned to the provinces, whereas under the dispute billions of dollars paid in duties went directly to the US government.

Terminating the agreement would also put to the test whether it is even in the cards for there to be a renewed round of sanctions. Lois McNabb, of the BC Ministry of Forests’ Economics and Trade Branch, raised this possibility at a Western Forest Economists’ symposium in May 2007. In her presentation, McNabb noted that in order for the powerful US softwood lumber lobby to successfully bring a new countervailing duty case against Canada it will have to have “a certain percentage of [US] producers on board.”³⁷ She also noted how recent US investments by Canfor, West Fraser and Interfor have served to change the complexion of that industry. A decision by Canada to withdraw from the SLA would put to the test whether those investments work against US lumber producers being able to launch a new campaign to impose duties

on incoming Canadian softwood. In order to do so, at least one quarter of US producers (by volume of production) would have to be on board and at least half of US producers taking a position on the issue (those holding no position are not counted) would have to support it.

There is no shortage of irony here. In the eyes of many British Columbians, the US forays by Canfor, West Fraser, Interfor and others signify an impending abandonment of BC as a base for forestry operations. Yet those same investments may have hobbled the US lumber lobby, making it far more difficult for it to impose sanctions on softwood lumber imports in future years.

Finally, a Canadian declaration to terminate the agreement would do two things. First, if the past is a guide to the future, a resumption of actions before international trade tribunals and the US courts would be likely. The last time out, the legal fight was generally working in Canada's favour, albeit at considerable cost. Second, it would force bilateral trade issues onto the table at an opportune time, given the recent US election campaign and support from the Democrats, in particular, for a re-opening of discussion over the merits (or lack thereof) of free trade.

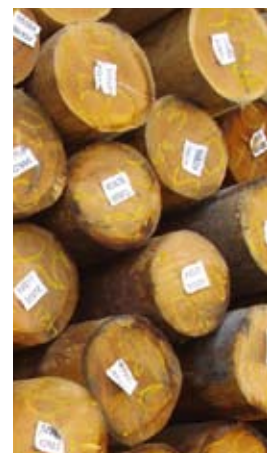
OPTION 3: REDRAW TIMBER PRICING AND TIMBER SALES POLICIES IN BC AS A PRECURSOR TO ANNOUNCING WITHDRAWAL FROM THE SLA.

This option carries considerable risks, but has potential upsides.

When the BC government last re-jigged its timber pricing policies and made other changes to forestry regulations in response to pressures from the US its efforts failed to achieve the desired result—full and free trade in lumber.³⁸ The major policy change was an expanded and allegedly more competitive timber auction program overseen by the government and known as BC Timber Sales. To expand the program, the province took logging privileges away from the major forest companies and, at taxpayers' expense, compensated the same companies \$200 million. A portion of the public timber was then reallocated to timber auctions. At the same time, the province curtailed timber auctions that were restricted to value-added companies only, on the basis that such sales were not fully open and could be construed as a form of subsidy. Despite these changes, BC lumber producers continue to pay punitive export taxes.

Consequently, re-opening talks with the US about what constitutes acceptable pricing policies in BC is a risky proposition. Furthermore, there is an over-arching issue to be considered: Sovereignty—BC's right to design pricing policies that it believes are in the best interests of the province. By framing changes to BC's timber pricing policies around a desire to meet US expectations, the province essentially signals two things: one, that the US is correct in asserting that provincial pricing policies are a form of subsidy, and two, that

One option is for Canada to terminate the SLA, giving the US government the requisite six-month written notice. While such a move carries risks in that it courts renewed duties, it is worth considering that just before the SLA became law BC forest companies paid less in duties than they now pay in export taxes.



outside interests—even at a time of allegedly “free” trade—should dictate how we value our publicly owned resources.

Nevertheless, anticipating that the US lumber lobby might renew calls for duties on BC lumber shipments—or that the US itself could exercise its option to withdraw from the SLA—it makes some sense for BC to anticipate such outcomes and to consider further changes to timber pricing and allocation.

But the context in which those changes are made should be squarely focused on the public good, not on designing policies that appease the US. Significantly, the thrust of the US argument does resonate with many people in BC who are involved in the forest industry. The heart of the issue is that many forest companies operating in the province are shielded from market forces. Too much of the raw material, the argument goes, is directly controlled by a handful of companies (see Table 1 on page 10) that have exclusive access to defined volumes of timber or areas of forestland. These companies do pay for the publicly owned timber they cut. But the government sets the fees and no one else can bid on that wood. This level of control, critics of the system contend, gives those companies a competitive advantage in the marketplace over rivals who may have little of their own secured timber and must purchase everything they need.

Significantly, from a public policy perspective in BC, this has led to numerous complaints from independent lumber manufacturers, lumber re-manufacturers, woodlot owners, First Nations and others that the market is skewed and that truly competitive timber sales are a myth. It also led the BC Forest Resources Commission in the early 1990s to recommend that the provincial government consider directing fully half of all the Crown timber logged in BC to auctions and using auction prices to determine what was paid on the remaining un-auctioned half.

The commission believed a more market-oriented approach was needed to drive competition, spur innovation and create a funding base for substantial increases in provincial reforestation efforts—all of which appear to be lacking right now in BC.

Given the large number of mill closures in coastal BC and a potentially sharp decline in traditional commodity lumber production in the interior due to the mountain pine beetle, a full, public review of timber allocation and pricing policies is warranted. What would happen if fully half of all public timber in BC’s forests was auctioned? Could auctions be designed to stimulate more lumber and value-added manufacturing in BC? Would more direct allocations of timber to First Nations and rural communities help foster more stability in the regions outside of BC’s major urban centres? Would restrictions on log exports stimulate more domestic manufacturing, and what would be the implications for international trade? These and other questions deserve a full public airing, followed by revisions to provincial pricing policies. But any changes to those policies should be in the interests of what is best for British Columbians. After

making such changes, the province could then decide whether it was better to stick with the SLA, or to exercise its rights to terminate the agreement and pursue a legal ruling that its pricing policies do not constitute a subsidy.

OPTION 4: CREATIVELY WORK WITHIN THE CONFINES OF THE SLA TO ENCOURAGE A HEALTHIER, MORE DIVERSIFIED PROVINCIAL FOREST INDUSTRY.

Under the SLA's "anti-circumvention" provisions, the Canadian government and provinces are prevented from redirecting export tax dollars to the companies that paid those taxes.³⁹ However, there are a number of actions that the BC government may take that would not be considered to circumvent the SLA's export measures.

Some of the more important of them are as follows:

- The province is free to "reduce wildfire risk," "protect watersheds," and "protect, restore or enhance forest ecosystems," which gives it broad powers to address the ongoing problems associated with the mountain pine beetle infestation by allocating timber supplies to various parties.
- The province retains the right under the SLA to make "payments or other compensation to First Nations to address or settle land claims." This particular provision is extremely broad and says nothing about how much timber by volume or forestland by area may be so allocated.
- The SLA excludes a wide range of wood products from its export restrictions including: wood trusses, I-joint beams, pallets, garage doors, edge-glued products, completed window and door frames, and wood panels such as OSB.
- The SLA also allows "independent lumber remanufacturers" who do not have secured supplies of their own timber to register for exempt status. Once registered, they pay tax only on the lumber input to create their products, not on the finished and much higher value of the product shipped into the US.
- The SLA says nothing about governments assisting the forest industry through marketing initiatives. Presumably, if those marketing initiatives were focused on higher-value products bound for the US market but exempt under the SLA there would be no issue. Nor would there likely be an issue if marketing efforts were directed at countries other than the US.

The thrust of the US argument does resonate with many people in BC who are involved in the forest industry. The heart of the issue is that many forest companies operating in the province are shielded from market forces.



Given these provisions in the SLA, the province should:

- Expeditiously proceed with long-term, area-based forest tenure awards to First Nations, as an interim step toward finalized treaty settlements. Larger areas of forestland would give First Nations the collateral they need to both attract investment capital and to strike productive business relationships with established players in the forest industry.
- Award new forest tenures at competitive market rates to companies making forest products that are excluded from the SLA. The timber could either come from a portion of the wood now in the BC Timber Sales program or, potentially, by taking back forest tenures over time from companies that have closed mills and shown no inclination to build new ones.
- Launch an ambitious marketing program that focuses on made-in-BC, value-added products both for sale in the US and in overseas markets.
- Assist independent lumber remanufacturers and secondary wood products manufacturers with tax credits and research and development dollars to increase the production of higher value products.

These actions and others could be taken within the terms of the SLA and with potentially enormous public benefit.

BC should launch an ambitious marketing program that focuses on made-in-BC, value-added products both for sale in the US and in overseas markets.



Conclusion

GIVEN THE ONGOING FINANCIAL PENALTIES BC forest companies face under the Softwood Lumber Agreement, staying the course is not a particularly tantalizing option.

As this paper demonstrates, in fact, the SLA has served to stimulate BC forest company investment in the US at the expense of the province's forest industry workers and rural resource communities. Exercising Canada's right to withdraw from the SLA, however, carries risks. For that reason, it makes sense to work creatively within the confines of the SLA to increase forest allocations to BC First Nations, which would have the added benefit of creating new partnerships between individual nations and forest companies, and to value-added manufacturers.

At the same time, the province should immediately explore what prospects there are to fundamentally rewrite provincial timber pricing policies so that the province is, for once and for all, free of any charges of subsidizing the provincial forest industry through its timber pricing policies.

If, at the end of the day, the changes required to appease the US softwood lumber lobby are deemed too onerous, Canada should exercise its right to terminate the SLA and pick up the legal battle where it left off in 2006.

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NOTES

- 1 Government of Canada and Government of the United States of America 2006b.
- 2 Ibid.
- 3 Ibid.
- 4 Woodbridge 2008.
- 5 Canada Revenue Agency 2008.
- 6 BC Ministry of Forests, Economics and Trade Branch 2008.
- 7 Province of British Columbia 2001.
- 8 Government of Canada and Government of the United States of America 2006b.
- 9 Parfitt 2006.
- 10 TimberWest 2008.
- 11 Canfor 2007.
- 12 Tice 2004.
- 13 Canfor 2005.
- 14 Canfor 2007.
- 15 Canfor 2006a.
- 16 Prestemon 2002. This analysis predicted a 50 per cent increase in output in the US South between 1995 and 2040.
- 17 West Fraser 2006a.
- 18 West Fraser 2006b.
- 19 Ibid.
- 20 West Fraser 2007.
- 21 Interfor 2007.
- 22 Ibid.
- 23 Interfor 2008.
- 24 West Fraser's softwood refunds of \$387 million are 54 per cent those of Canfor's, which received nearly \$718 million. West Fraser's allotment of publicly owned timber (see Table 1 on page 10) when compared to Canfor's is of a similar magnitude: 57 per cent. This suggests a fairly close correlation between the volume of timber controlled by interior forest companies and what they received by way of softwood duty refunds. Assuming that the same held true for Tolko, its refund would have been approximately \$340 million.
- 25 Tolko 2007a.
- 26 Tolko 2005.
- 27 Tolko 2006.
- 28 Western Forest Products 2005a.
- 29 Western Forest Products 2005b.
- 30 Western Forest Products 2006a.
- 31 Western Forest Products 2008.
- 32 Western Forest Products 2006b.
- 33 Hamilton 2008.
- 34 Canada Revenue Agency 2008.
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