

# Lumber and Timber Prices Projected to Rise with Tariffs on Canadian Lumber

By Rajan Parajuli, Craig Johnston, and Bob Abt

Following the expiration of the 2006 Softwood Lumber Agreement (SLA 2006) in October 2015, the softwood lumber trade dispute between the US and Canada has once again become a contentious topic. Despite several rounds of negotiations, the two countries failed to come up with a new trade agreement within a one-year “standstill” period, and Canadian lumber shipments to the US increased by 16% during this period. Central to the issue are the alleged subsidies provided to Canadian lumber producers and the subsequent injury to the US lumber industry, for which the US South is a primary lumber producing region.

The latest chapter of the trade dispute between the two otherwise friendly neighbors began in November 2017 with the imposition of countervailing duties (CVD) and anti-dumping (AD) tariffs on Canadian softwood lumber shipped to the US. The combined average rate of the duties is 20.83%; CVD and AD rates applied to products from individual lumber companies ranges from 9.38% for J.D. Irving to 23.56% for West Fraser. The issue is far from over: Canada has petitioned the World Trade Organization to rule that the US has broken international trade rules.

In this article, we estimate the potential impact of such lumber duties on the softwood lumber market in both countries, and then investigate the consequences on regional timber markets in the US South.

First, we simulated the potential market impacts of the average 20.83% tariff on Canadian lumber entering the US. We employed a 20-region global softwood lumber trade model that is conceptually similar to that developed by Johnston and van Kooten (2017), but differs in its policy focus. The model was updated to replicate the global softwood lumber market as of 2014, the most recent period of undistorted free trade between Canada and the US, allowing for the evaluation of undistorted market responses (The prevailing Random Lengths lumber composite price in 2014 exceeded the price trigger to enable export charges under SLA 2006. See Johnston and van Kooten (2017) for more details.). The model takes advantage of mixed complementary programming to allow for flexible policy analysis. Positive mathematical programming enables precise calibration of bilateral trade flows among all regions, which include five Canadian and three US regions. Details on the trade model, calibration and projection methods, and data sources can be obtained from Johnston and Parajuli (2017).

Simulation results suggest that a 20.83% tariff will curtail Canadian lumber shipments to the US by nearly 4 million cubic meters (m<sup>3</sup>), and will encourage the US domestic lumber industry to produce an additional 2 million m<sup>3</sup>, of which nearly 62% will come from Southern mills (Table 1). Lumber prices in the U.S. South are projected to rise by \$3.96/m<sup>3</sup>.

Next, we turned to the Subregional Timber Supply (SRTS) model to investigate the impacts of lumber tariffs on timber markets in the U.S. South. SRTS is an economic model of timber supply based on US Forest Service FIA data, which combines timber market prices and harvest feedbacks with forest resource dynamics (Abt et al. 2009). The model is primarily used to examine the potential impact of broad policy and sustainability questions impacting demand and supply assumptions on market and resource futures, specifically in 13 Southern states and their sub-regions. Because the SRTS covers only 13 southern states, our projection is limited to that region. Abt et al. (2009) described the SRTS structure, its modeling approach, model inputs, and projection scenarios in detail.

Using the global model estimate of a potential 3.3% lumber production increase in the US South, demand in SRTS was increased in 2018 relative to a baseline recession recovery scenario. For this projection, a supply function with assumed price elasticity of 0.5 and a supply-inventory elasticity of 1.0 was assumed. Other modeling details including assumptions are available from authors upon request.

Projection results from the SRTS model suggest that, due to the lumber tariffs, timber prices in the US South are expected to increase by about 7.3% over the next five years (Figure 1). Without tariffs, the prices are projected to drift downward, but with additional demand triggered by the tariffs, the prices are expected to be up 6.6% in 2018. Similarly, the tariffs could

raise annual sawtimber harvests in the region by 3.2% from 2018 to 2022. We note that the effect on sawtimber inventory is negligible, indicating that the price effect continues to grow even after the tariff consumption effect stabilizes after 2021.

Understanding the potential impacts of lumber tariffs will help policymakers and market participants navigate the evolving policy environment and plan for the future. Our findings show that, consistent with economic theory, the recently imposed CVD and AD policies are expected to positively affect both lumber and timber producers in the US South.

While this is good news for domestic lumber producers and US South timber markets, it is highly likely that a new deal will eventually be reached that might put an end to such high rates of CVD and AD tariffs. At the same time, it appears as though consumers of softwood lumber in the US are adversely affected by higher prices, and therefore, may reduce their consumption—however, the effect of such a reduction is expected to be small.

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## References

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|                      |              | Change in:        |             | Consumption     |              | Production       |              |
|----------------------|--------------|-------------------|-------------|-----------------|--------------|------------------|--------------|
|                      |              | Price             |             | m <sup>3</sup>  |              | m <sup>3</sup>   |              |
|                      |              | \$/m <sup>3</sup> |             |                 |              |                  |              |
| <b>Canada</b>        |              |                   |             |                 |              |                  |              |
|                      | BC Coast     | -4.80             | -2.5%       | 2,198           | 0.4%         | -192,604         | -5.1%        |
|                      | BC Interior  | -2.41             | -1.3%       | 4,164           | 0.2%         | -795,295         | -2.9%        |
|                      | Alberta      | -3.89             | -2.5%       | 8,981           | 0.4%         | -369,791         | -4.7%        |
|                      | Atlantic     | -6.45             | -3.8%       | 8,045           | 0.6%         | -201,134         | -7.2%        |
|                      | Rest of Can. | -4.42             | -2.7%       | 58,206          | 0.4%         | -785,157         | -4.7%        |
| <b>US</b>            |              |                   |             |                 |              |                  |              |
|                      | <b>South</b> | <b>3.96</b>       | <b>2.1%</b> | <b>-135,372</b> | <b>-0.4%</b> | <b>1,239,636</b> | <b>3.3%</b>  |
|                      | North        | 5.81              | 3.2%        | -215,411        | -0.5%        | 195,616          | 0.5%         |
|                      | West         | 4.20              | 2.5%        | -99,834         | -0.4%        | 594,715          | 1.6%         |
| <b>Rest of World</b> |              |                   |             |                 |              |                  |              |
|                      | <b>Total</b> | <b>-0.02</b>      | <b>0.0%</b> | <b>-2,872</b>   | <b>0.0%</b>  | <b>-57,883</b>   | <b>0.0%</b>  |
|                      |              |                   |             | <b>-371,896</b> | <b>-0.1%</b> | <b>-371,896</b>  | <b>-0.1%</b> |

Table 1. Estimated changes in prices, consumption, and production from 20.83% CVD and AD on Canadian lumber exports to the US.

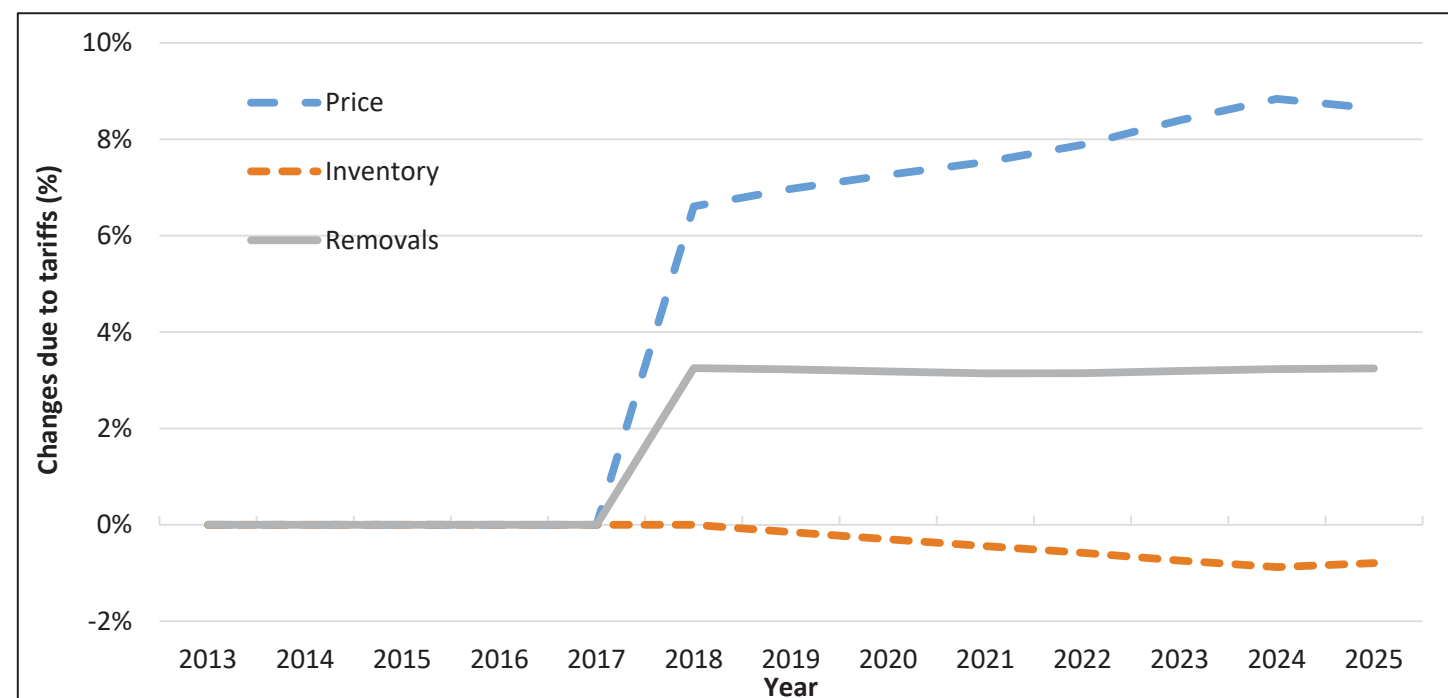


Figure 1. Estimated impacts of lumber tariffs on annual softwood sawtimber inventory, removals, and prices in the US South