

An Update on Japan's Proposed Safeguard Action Against Softwood Lumber Imports

Over the past forty years Japan has increasingly come to rely on imported timber to supply the raw material demand for the forest products industry. Today, over eighty percent of the wood processed by the forest products industry is imported. However, this figure varies considerably across specific industry sectors. For example, imports of softwood lumber account for just over thirty percent of total softwood lumber consumption. While rapidly increasing imports of softwood lumber, particularly from European countries, have caused concern within MAFF and some sectors of the sawmill industry, it is important to note that the total volume of softwood lumber imports has declined by more than ten percent over the period 1996-2000. And while it is true that imports of softwood lumber from Europe have increased substantially since 1993, this increase has been offset to a large extent by substantial declines in imports from Canada and the US.

The lack of competitiveness of Japan's wood producers and the continued growth in imported lumber and lumber products have led the Japanese government to review lumber import trends and their relation to the depressed wood products market. One possible result of the inquiry could be the implementation of a policy to safeguard the domestic industry from further growth in wood product imports. Any Safeguard Action under WTO guidelines would require the Japanese government to: (i) identify the affected industry (i.e., the forestry sector, the processing sector or value-added sector); (ii) identify the affected product and its relation to substitute import products; (iii) determine the unforeseen development that have led to a sharp increase in imports and resulted in injury to the affected industry; and (iv) determine how a Safeguard Action would improve the competitiveness of the affected industry over the 4 to 8 year period it is in effect.

Many of the reasons for the lack of competitiveness within the Japanese forestry and wood product sector have more to do with internal systemic issues than with softwood lumber imports.

Forestry Industry: Internal Systemic Issues

- ❖ Japan has an unusually high cost of forestry compared to other regions of the world.
- ❖ Poor profitability in forestry is due in part to geography (i.e., steep terrain) which increases the cost of timber harvest and extraction.
- ❖ The estimated IRR from a domestic sugi plantation has declined from 6.3% in 1965 to 4.1% in 1975 to 2.1% in 1985 to 0.9% in 1993.
- ❖ The exceedingly small size of private forests, most are around 5 hectares, makes it difficult for owners to raise capital and manage forests efficiently.
- ❖ The depopulation and aging of the forestry and wood products workforce seriously impacts productivity and efficiency within the forestry industry: 57% of forestry workers are over the age of 55 while less than 10% are under the age of 35.

Wood-processing Industry: Internal Systemic Issues

- ❖ Japan's harvesting and delivery costs to the mill are now nearly three times more than those costs in the US Pacific Northwest region and six times larger than those in Scandinavia and the southern hemisphere.
- ❖ High log prices, energy costs and labor costs combined with a low log processing efficiency results in Japan's sawmills being high cost producers of lumber relative to their competitors.
- ❖ Electrical rates for the sawmill sector in Japan are 3 to 4 times higher than other producers.
- ❖ The small size and scale of sawmills in Japan contribute to their lack of profitability. Production cost estimates for 1996 indicate that Japanese costs are approximately 156% higher than a sawmill in British Columbia, Canada. While labor, energy, and capital costs are less than 50% higher than BC, stumpage prices for sugi are 250% higher than hemlock.



❖ The performance based regulatory environment surrounding the housing industry (Housing Quality Assurance Act and the 10-Year Housing Warranty) is altering the product and species mix, displacing some domestic species. For example, demand for yellow cedar and treated lumber in ground sill (dodai) applications has also increased as a result of the 10-year Housing Warranty.

More importantly, over the past five years two significant factors have dramatically changed the competitive landscape of the softwood lumber industry in Japan. The first factor was the Kobe earthquake which provided the impetus for the passage of the Housing Quality Assurance Act. The second factor was the Asian economic crisis and the series of recessions that have affected the Japanese economy over the past four years. The combined effect of these regulatory and economic events has substantially changed the structure of the demand for softwood lumber. Specifically, these events have increased the price sensitivity of Japanese buyers, spurred a change in the preference for North American hemlock (and to some extent Japanese *sugi*) towards European whitewoods, and have prompted the change in the products demanded from both green lumber towards kiln dried lumber and from solid sawn lumber to glue laminated lumber.

The Japanese forest products sector, already marginally competitive in many market segments, has seen its competitiveness reduced further by recent regulatory and economic trends in Japan. High raw material costs, high processing costs, coupled with and the small size and production capability, low productivity, and out-dated processing technology of the typical Japanese sawmill severely restricts the ability of the industry to respond to this new competitive environment. In particular, the small size and production capacity of the typical sawmill restricts the ability of these firms to access capital and new processing technology that could help them increase their competitiveness. It is these and other systemic internal issues that are at the core of the competitiveness issue within the Japanese sawmill industry.

It is clear that the implementation of a Safeguard Action designed to provide the domestic sawmill industry with relief from competition from imported softwood lumber would not be likely to improve the competitiveness of the industry in the long-run. Most small and many medium-sized sawmills do not have a comparative advantage in the production of softwood lumber relative to lower cost producers in other countries given the internal systemic issues that exist within the industry. The net result of any Safeguard Action would be to impose high costs on Japanese consumers and home buyers while having only a marginal impact on the competitiveness of the sawmill industry.

Summary of the estimated impact of a 25% Safeguard tariff on softwood lumber imports.

	25% Safeguard Tariff
Lumber imports	-100%
Domestic lumber production	+20%
Log imports	+44%
Domestic log production	+7%
Japanese lumber prices	+16%
Japanese log prices	+7%
Gains to Japanese forest owners	+13% (US\$412 million)
Gains to Japanese sawmills	+212% (US\$2.2 billion)
Losses to Japanese consumers	-12% (US\$3 billion)