

## The Effect of a Tariff Elimination Policy on the Forest Sector: A Global Perspective

John Perez-Garcia. 2001

### Executive Summary

Current tariffs on wood products act as a barrier to trade. They restrict market access to more efficient producers. When a multilateral tariff elimination policy is simulated with a global trade model the results project greater trade activity in softwood lumber and plywood, and a greater market share for the US, Canada and European producers. Smaller but similar effects are found in the hardwood sector.

The scenario analysis also suggests the possibility that, in the short term, tariff elimination may not lead to increase global consumption. A tariff elimination policy may result in a strong demand effect in the North American market, and, as a result, may lead to higher prices. Supply tightness may come from either stronger than expected demand growth and restrictions on supply availability in North America. Demand rigidity in Asian economies for lumber and plywood lead to positive, but small consumption gains with tariff liberalization.

Initial changes in softwood lumber trade flows reach 20% from baseline dropping to 13% by 2010. The result suggests that tariffs in softwood lumber have restricted markets mostly for North American and European producers. Because the North American, particularly the US market, and Europe are also the major consumers of softwood lumber, a tariff elimination scenario results in greater international demand for their products raising domestic prices and lowering domestic consumption. This reduction in North American and European domestic consumption outweighs consumption gains in Japan, Australia and Mexico, regions where tariff elimination occurs.

The current economic outlook for Asia is likely having a strong influence on the above result. Baseline results suggest a strong demand in the US while Asian consumption has fallen. The current global market condition has raised product prices in the US and lowered prices in Asia, an effect expected from lowering tariffs, but due to different forces. With an expanding US domestic markets and little consumption growth in Asian, the tariff elimination policy places further upward price pressure on US consumers as US and other producers shift some production from domestic to international markets. A further strengthening of foreign demand through a tariff elimination scenario reinforces upward price pressures affecting consumers in the US. Hence, the simulation suggests a global consumption decline in the short term with a price rise in the North American and European markets. This result suggests low cost producers are constrained from meeting expanded demand from tariff liberalization in the short run.

A dominant North American market characterizes the global softwood plywood sector. The simulation results suggest that tariff elimination in the softwood plywood sector increases trade activity as well as global consumption and production. The US, a major consumer and producer of softwood plywood, acts as an exporter reducing its consumption and increasing output. As such the US dominates the response from a tariff elimination scenario in the model. Since many of the producing sectors outside the US have exogenous behavior for this sector, production changes in the model are limited. The limited production capacity outside North America for softwood plywood is likely to lessen the importance from these exogenous production constraints. Tariff effects on plywood trade are substantial percentage-wise; they reach 8% immediately and attain 14% by 2010.

Softwood plywood is viewed as a mature product in decline being replaced by alternative engineered materials. Production capacity expansion in these engineered materials outside the U.S. are more likely to

lessen the expanded production and consumption associated with the simulated tariff elimination policy in softwood plywood. Currently, fiberboard and reconstituted products are projected exogenously in CGTM.

Tariff elimination in the softwood lumber and plywood sectors has a direct impact on the sawlog and pulpwood sectors. There is little evidence of any substantial effect from a tariff elimination policy in the softwood sawlog sector and no recorded changes in the pulpwood sector due to tariff elimination. This is because tariffs currently exist in countries with limited market behavior, such as China, or with small trade flows such as Mexico. Hence, changes observed in the log sector are driven primarily by the softwood lumber tariff elimination. Softwood log trade is lower under the tariff elimination policy. Changes in trade activity in the softwood log sector reach 8% from baseline due to lumber and plywood tariff elimination.

Hardwood sector results are smaller than the softwood sector impacts. Assumptions regarding China's consumptive behavior have a strong influence on the results. Sensitivity analysis with higher Chinese consumption projects greater imports originating from nearby Asian countries. Otherwise, much of the increase in production would come from the US.

The above results suggests the major part of increased softwood harvests would involve Canadian forests which are mostly natural followed by secondary forests in the US and Europe. Depending on Chinese consumption changes, the major increase in hardwood harvests would originate from Southeast Asian producers under high Chinese consumption growth. Otherwise, the increase in hardwood consumption would flow from US forests.

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