

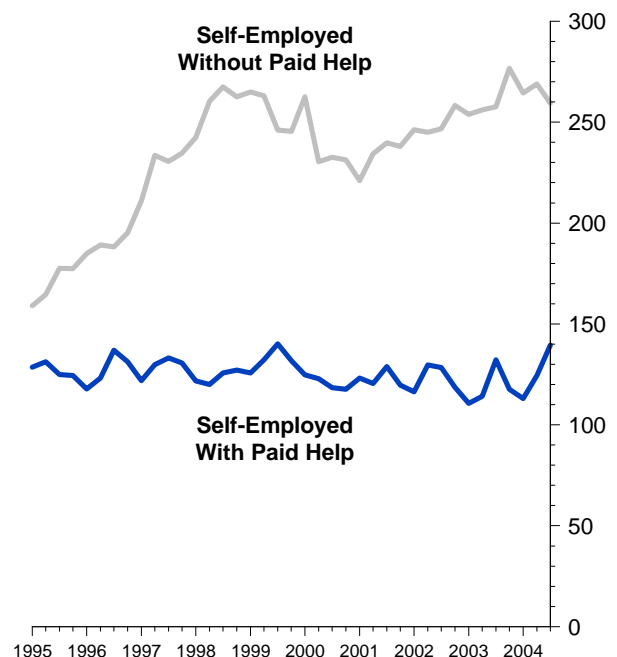
Small Business Quarterly ♦ 3rd Quarter 2004

- The number of self-employed in BC rose to its highest level in six years, growing 2.0% in the third quarter compared to the same quarter in 2003, to just over 400 thousand. Self-employed with paid help expanded 5.5%, while self-employed without paid help edged up 0.6%. This marked the fourteenth consecutive quarterly increase in self-employed without paid help.
- The number of small businesses in BC (excluding self-employed persons) edged up 0.7% in the second quarter compared to the same period in 2003.
- Year-over-year growth in small business employment was 2.7% in the second quarter, well above the 1.5% change in overall employment. Most of the increase was in businesses with 1 to 19 employees, where employment jumped 3.8%.
- There was a continuation in the strong growth in the number of new business incorporations in BC. In the third quarter, there were 7.3% more new incorporations compared to the same period in 2003.
- Both business and consumer bankruptcies experienced a year-over-year decline in the third quarter, the eighth consecutive quarter this has occurred. Business bankruptcies fell 13.1% and consumer bankruptcies dropped 16.0%.
- Urban housing starts in British Columbia continued to climb in the third quarter, rising 11.1% over the number recorded in the third quarter of 2003. Vancouver saw a 5.7% jump in housing starts. The demand for new housing is being driven, at least in

part, by low interest rates. The Prime Rate averaged 3.83% in the third quarter, although it has since climbed to 4.25%. Meanwhile, conventional five-year mortgage rates edged up slightly in the third quarter, but at an average of 6.38% over the quarter, were still relatively low.

- Total chartered bank business loans edged up 1.0% in the third quarter compared to the same period a year earlier. Loans under \$200,000, which are the most likely to be taken out by small businesses, experienced surprising growth of 15.3%, after recording declines in every quarter since the beginning of 1999 except for two—and in those quarters, growth was less than one per cent.

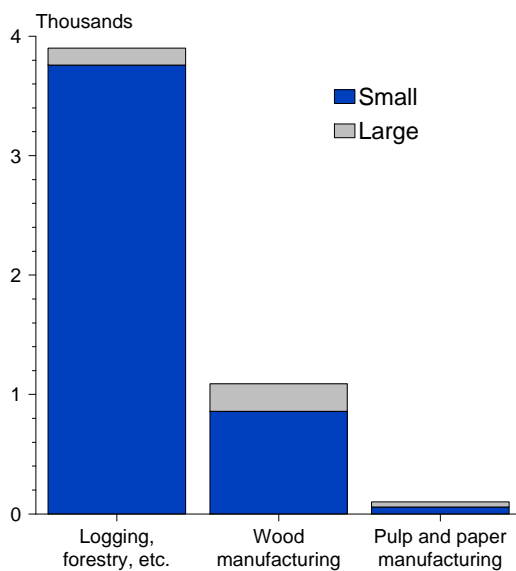
The number of self-employed without paid help in BC has been increasing since early in 2001



Lumber Dispute Big Issue for Small Business

Small businesses play a large role in BC's forest sector. By far the majority of forest sector firms operating in BC are establishments with fewer than 50 employees, which is the definition of a small business.¹ Logging and forestry operations (i.e., silviculture and support activities for forestry) in particular are dominated by smaller companies, but wood manufacturing facilities are more often small businesses as well.

The forest sector is dominated by small firms, particularly in logging and forest services



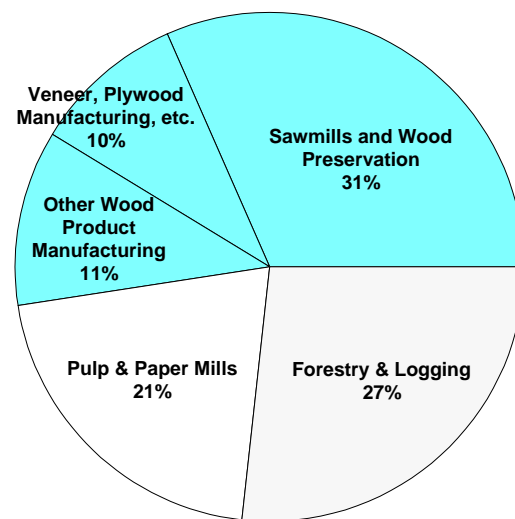
Although there are more small businesses in number in the forest sector, the larger facilities employ the majority of the workers, at least in the manufacturing operations. In logging, forestry and support enterprises, where small businesses comprise 96% of all firms, only 57% of the employees work in those businesses. Although there are no details readily available by size of business for forestry-specific manufacturing, the percentage of all manufacturing em-

¹ Business counts and employment numbers expressed in this report exclude self-employed individuals.

ployees working in small businesses is only 32%, despite the fact that small businesses make up 89% of all manufacturing establishments in the province. Enterprises producing wood, pulp and paper products comprise about 14% of all BC manufacturing firms, but employ 28% of manufacturing workers. This indicates that the majority of manufacturing employees in the forest sector in BC work for larger firms.

Of these forest sector workers, more than half (52%) are involved in making wood products. Forestry and logging operations employ 27% and pulp and paper mills employ 21% of forest sector workers.

The majority of employment in the forest sector is in wood manufacturing



Note: Employment is for both small and large businesses

With so many small businesses in BC involved in logging and wood manufacturing activities, the current dispute with the United States over softwood lumber is a major issue of concern for the small business sector in this province. In a poll of its members in June 2003, the Canadian Federation of Independent Business found that 33% of

BC's small businesses felt their business was significantly harmed by the lumber dispute and a further 37% were slightly harmed.²

The dispute stems from allegations on the part of American lumber manufacturers that Canadian wood production is subsidized. As a result of the complaint from the American lumber lobby, the US Department of Commerce investigated and came to the decision that there was a subsidy amounting to 18.79%. In addition, they felt that Canadian companies were dumping their product in the US at less than the cost of production and slapped lumber imports from Canada with an additional 8.43% anti-dumping duty. The combined duty of 27.22% has had a significant impact on BC's lumber business.

In an effort to remain profitable despite the imposition of the punishing duties, larger firms attempted to rationalize their operations by shutting down inefficient mills and ramping up production at other mills to gain efficiencies and benefit from economies of scale. While this was a successful strategy for some of the larger lumber companies in the province, it was not an option available to many small business operations with only one small mill and a limited amount of wood supply. Many of these smaller operations simply could not operate with a duty of that magnitude and were forced to shut their doors.

Canada has claimed from the beginning of the dispute that the allegations of subsidization and dumping are false and has brought the issue before several panels in both the World Trade Organization (WTO) and the North American

Free Trade Agreement (NAFTA). While the results of these appeals have been somewhat mixed, on the whole the decisions have supported Canada's position and rejected the contention that Canada's softwood lumber exports are harming the US industry.

Both the WTO and NAFTA have found that the US Department of Commerce has made errors in calculating both the countervailing and anti-dumping duties. More importantly, both tribunals also found that imports of Canadian lumber were not harming the American industry. This is a crucial decision for Canadian lumber producers, because under US and international law, if there is no injury to domestic industry, duties cannot be imposed. This means that the issues of whether or not Canadian lumber is subsidized or dumped are moot.

The United States has appealed each decision by both the WTO and NAFTA, but in each case, the findings were the same: Imports of Canadian lumber have not caused injury to the American industry. In the second remand of the injury question, the NAFTA panel used some harsh language to describe the actions of the US International Trade Commission (ITC—the body responsible for determining whether or not an American industry is injured by imports and therefore, that those imports should be subject to duties determined by the Department of Commerce), suggesting that to allow the process to continue with yet another remand would cause the process to “become a mockery and an exercise in futility.” The panel directed the ITC to find that Canadian lumber does not injure the US industry. The ITC reluctantly abided by the ruling, but reversed itself less than three months later in responding to a WTO finding, once again claiming that Cana-

² Mallett, Ted. Quarterly Business Barometer, 2003 No. 2, Canadian Federation of Independent Business (June 2003).

dian lumber poses a threat to American producers. The reversal coincided with the application for an extraordinary challenge of the NAFTA panel's decision. This challenge is the last avenue of appeal in the NAFTA process. If the United States loses this appeal, the process should end. The duties should be removed from Canadian lumber and the monies collected so far should be returned.

However, the US government has hinted that it has no intention of returning the duties, suggesting that it has no obligation to do so. West Fraser Timber Company is already in a battle to have a portion of its duties returned after the US Department of Commerce revised the company's anti-dumping duty to zero, but refused to refund duties already paid. This does not augur well for the return of the approximately \$US 3.7 billion in duties paid so far.³

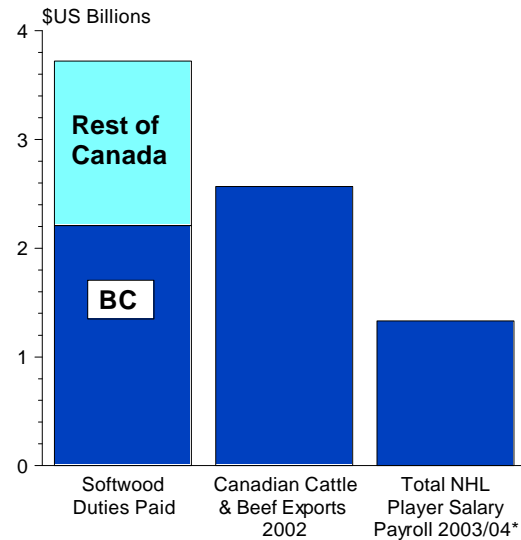
To put that figure into perspective, in 2002, prior to the discovery of a cow infected with BSE that prompted the closure of the US border to Canadian cattle and beef, the value of total Canadian exports of cattle and beef products amounted to just under \$US 2.6 billion. The softwood lumber duties deposited with US Customs are almost triple the total National Hockey League player salary payroll for the 2003/04 season.⁴

³ This is an estimate to the end of December based on value of exports shipped to the US. It uses the average dumping duty of 8.43% to determine the dumping portion, although some individual firms may have higher or lower duties.

⁴ The figure used for NHL player payroll excludes incentives and salaries of players playing in fewer than 30 games, so technically it is an understatement of the true player payroll; however, it is highly doubtful that including these

About \$2.2 billion of the duties collected so far have come from BC, which alone could cover the entire player payroll of the NHL and then some.

Softwood duties put in perspective



*Source for NHL payroll: USA Today (excludes incentives and salaries of players appearing in fewer than 30 games)

With this much money at stake, it is understandable that Canadian lumber companies are seeing red when they hear hints that the money won't be returned even if the duties are found to be illegal. The recent introduction of a bill by Montana Senator Max Baucus to distribute the funds to US companies using legislation that has already been deemed illegal by the WTO (commonly known as the Byrd Amendment) has sparked even more outrage. BC's Minister of Forests, Mike de Jong, suggested that the bill could start a trade war if it is passed, stating, "You can't steal \$4 billion from a country and not expect that there would be repercussions."⁵

costs would come anywhere close to doubling the \$US 1.3 billion amount, let alone tripling it.

⁵ As quoted in "Softwood dispute could prompt trade war: B.C. minister," CBC News Online (www.cbc.ca), Nov. 15, 2004.

The Canadian government has already prepared a list of commodities subject to possible retaliation if the Byrd Amendment is not repealed. The WTO has authorized Canada and seven other WTO members (Brazil, Chile, the European Union, India, Japan, Mexico and South Korea) to retaliate up to 72% of the annual level of duties collected and paid out to US companies. For Canada, this amount is relatively small (approximately \$17 million worth of duties have been disbursed to American producers between 2001 and 2003)⁶; however, if the softwood lumber duties are distributed, that value will soar. While it is unlikely that Baucus' bill will ever be passed and odds are that the Byrd amendment will go the way of the Dodo, it is quite possible that Canada will have to go to the courts once again to get the lumber duties returned.

It was thought that after an administrative review of the duties, the US Department of Commerce would halve the 27.2% duty rate on shipments to the US. However, in a move that has further infuriated the Canadian industry, they made a much smaller revision. In a preliminary decision back in June, the Commerce Department proposed reducing the combined duties to 13.2%, but the final duty, as announced on December 14, has come in at 21.21%. Although anti-dumping duties were cut in half to 4.03%, the countervailing portion was revised to 17.18%, down only slightly from 18.79%.

In order to come up with the higher countervailing duty, the US Department

⁶ "Notice seeking comments on possible trade retaliation against the United States in Response to that country's failure to repeal the *Continued Dumping and Subsidy Offset Act*," Canada Gazette Part I, Extra Vol. 138, No. 19, Nov. 23, 2004, p. 2.

of Commerce applied a different method to calculate duties for BC using a cross-border pricing model that both NAFTA and the WTO have already ruled is illegal.⁷

The application of yet another methodology to arrive at a number not significantly lower than the existing duty had Minister de Jong suggesting, "It increasingly looks as if they come up with a number and then employ a methodology to try and get to that number."⁸ John Allan, the president of the BC Lumber Trade Council, echoed the forest minister's frustration, stating, "The whole Commerce methodology and process is a bankrupt one. It is designed, as I've said in the past, to grind you into dust. I'm mad as hell."⁹

While it is thought that this move is meant to push the Canadian side back to the negotiating table, those in the Canadian industry, including Allan, have suggested that the opposite is more likely to occur. "I think cutting a deal is just the wrong thing to do right now, given these rates, in the sense that the Americans have basically stuck it to us," he said.¹⁰ Talk like that suggests that the Canadian contingent is more resolved than ever to proceed via the litigation route, rather than seeking a negotiated settlement.

⁷ The BC-specific countervailing rate is 22.69%; however, this does not mean that BC companies will pay higher duties. Rather, the BC rate is used to calculate the average Canadian rate (17.18%), which is then applied to all Canadian lumber exports to the US.

⁸ As quoted in: Luke, Paul, "U.S. delivers softwood shock," *The Province*, Dec. 15, 2004, p. A35.

⁹ Ibid.

¹⁰ As quoted in: Morton, Peter and Greenwood, John, "U.S. lumber move 'shocking,'" *Victoria Times-Colonist*, Dec. 15, 2004, p. D1.

Whatever happens, this long-running dispute has already had a dramatic impact on the structure of BC's forest sector and when the sawdust finally settles it is likely that small businesses will play a different role in forest-based industries compared to the period before this round of the dispute began. They will probably be less involved in sawmilling operations and more oriented toward niche markets and specialized products.

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