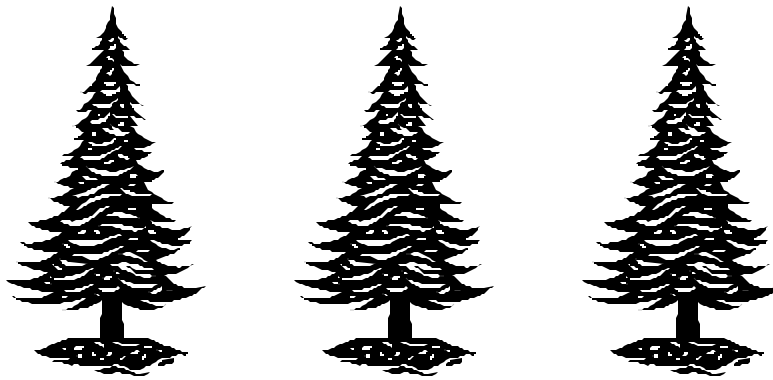


**STOPPING THE GIVEAWAY
OF
CANADA'S FORESTS**



**ESTABLISHING TRUE FREE TRADE IN
SOFTWOOD LUMBER**

Greg Mastel

October 2000

A Publication of the Global Economic Policy Project
New America Foundation

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EXECUTIVE SUMMARY

Canadian provincial governments have a long-standing policy of subsidizing their lumber mills, to the detriment of the U.S. lumber industry, U.S. landowners and the environment. Recently, a coalition of Canadian lumber companies, some lumber consumers, and others have aimed to change the longstanding U.S. policy of combating those subsidies. Under the veil of protecting consumers, this group aims to terminate the current U.S.-Canada agreement, which contains the damage from Canada's forestry regime, and ensure that no action is taken to offset the subsidies. With the U.S.-Canada Softwood Lumber Agreement (SLA) due to expire in March of 2001, a spirited debate on Canadian lumber subsidies and the measures taken to counter them is likely in the coming months.

Although it has garnered limited attention in the United States, this dispute is nearly two decades old. In 1986, to counter subsidies, the United States imposed a 15 percent duty on Canadian softwood lumber imports. Subsequently, the U.S. and Canadian governments reached a series of agreements designed to offset these subsidies. The most recent of these is the 1996 SLA.

At the heart of this dispute are different means of charging for the use of forest resources. In the United States, timberlands are held by private landowners and state and federal governments. The right to cut timber from public and private land is sold at auction or through other competitive means. Though there are some restrictions on log exports from public lands in the Pacific Northwest, the United States is the world's leading exporter of logs and unprocessed timber.

In Canada, the vast bulk of timberlands are owned by Canadian provincial and federal governments. The prices for the right to cut timber from this land - known as stumpage fees - are set administratively. These Canadian stumpage rates are set very low - only one-third to one-fourth of the market value of the rights - in order to subsidize the Canadian lumber industry. To further boost production, Canadian companies are obligated by their government licenses to cut trees even when prices are low. The Canadian industry

also benefits from a ban on virtually all log exports, which concentrates the impact of the stumpage subsidy in Canada and keeps log prices artificially low.

Despite the claims of the Canadian industry, the Canadian stumpage subsidies and export ban are clearly actionable subsidies under U.S. law and international trade agreements. The U.S. Commerce Department has twice determined that these subsidies are illegal under U.S. law and the Congress has concurred. In 1991, a GATT/WTO panel ruled in favor of the United States after Canada challenged the U.S. case to offset the subsidies.

The dispute has also been heavily litigated under the 1989 U.S.-Canada Free Trade Agreement (FTA) - now subsumed under the North American Free Trade Agreement (NAFTA). Unfortunately, the binational nature of the FTA and the charged nature of the issue in Canada resulted in many problems of bias and conflict of interest regarding the Canadian jurists on these panels. In the final panel decision in this dispute, two Canadian judges outvoted the American judge on the panel. The American judge - distinguished retired D.C. Circuit Chief Judge Malcolm Wilkey - characterized the decision this way: “[The decision] may violate more principles of appellate review of agency action than any opinion by a reviewing body which I have ever read.”

In 1996, to avoid further litigation, Canada proposed and the United States agreed to the SLA. The SLA is a modest restraint on Canadian softwood lumber. The first 14.7 billion board feet of lumber entering the United States from British Columbia, Alberta, Ontario, and Quebec and all lumber originating in Canada’s Maritime provinces - where most timber is private - are imported without duty. Imports

The 1996 U.S.-Canada Softwood Lumber Agreement (SLA)

- First 14.7 billion board feet (BBF) of lumber from covered provinces enter free.
- On next .65 BBF, Canada levies an export fee of about \$50 per thousand board feet (MBF).
- Additional imports pay \$100 per MBF.
- Applies only to British Columbia, Alberta, Ontario and Quebec – all others can import freely.
- If prices rise significantly, additional volume of “free” imports permitted.
- Expires March 31, 2001.

above that level from the subsidizing provinces are subject to a duty to partly offset the subsidies.

Despite criticism from Canadian lumber companies and their allies, the SLA has been a success. With the SLA in place, the U.S. softwood lumber industry has been able to increase production 18.4 percent, with attendant increases in market share and employment.

Just as importantly, the SLA has worked to restrain (marginally) Canadian overlogging of virgin, old-growth forest, which causes incalculable damage without the oversight of environmental protections like those applied in the United States. Approximately 90 percent of the lumber cut in Canada comes from virgin old-growth forests. What is worse, Canada lacks many of the critical environmental protection laws that are the backbone of environmental protection in the United States, and many of the laws Canada does have are not consistently enforced. For this reason, environmentalists in the United States and Canada strongly support the SLA.

Critics also argue that raising the price of Canadian lumber by offsetting subsidies harms consumer interests. Using a convoluted economic model, critics claim that the SLA has a significant impact on new home prices, but they ignore the basics. In reality, the impact upon the average U.S. consumer is minimal, since more than 95 percent of lumber imports enter the United States duty free and more than 98 percent of U.S. consumption is not subject to any fees under the SLA. Further, lumber accounts for a very small share of the cost of a home, a smaller share now than prior to the SLA. This year, the price of lumber has declined sharply in the United States in response to record levels of imports and other market factors.

On a more basic level, it is important to understand that the subsidies have now led to exactly the opposite problem - Canadian timber is artificially priced too low, creating excessive lumber production in Canada, unemployment in the U.S. industry, harming the environment, and generally distorting the market. A countervailing duty or other means to offset subsidies merely moves the price toward the appropriate level - the price consumers would pay under free market conditions.

For two decades, the United States has sought to establish true free trade in lumber between the United States and Canada - this means trade unhindered by duties and subsidies. This should remain the goal of U.S. policy. Unfortunately, Canada still seems unwilling to eliminate its subsidies, which benefit a few Canadian companies at the expense of U.S. producers, while doing enormous damage to the irreplaceable resource of virgin old-growth Canadian forests. Nor are these practices in the long-term interest of U.S. consumers. Thus, the United States should continue to impose duties or other trade restrictions in order to prevent the Canadian subsidies from harming the U.S. lumber industry and the environment, as well as to keep pressure on Canada for meaningful reform of its timber subsidies. If the U.S. government keeps pressure on Canada to reform its lumber subsidies, it is possible to advance the interests of both U.S. workers and the environment. The U.S. industry, consumers and the environment can win if Canada's lumber subsidies are reduced or eliminated.

INTRODUCTION

Although it has attracted limited attention in the United States, the U.S.-Canada dispute over Canadian lumber subsidies has raged for more than two decades. The complex history of this dispute includes actions under U.S. trade laws, decisions from dispute settlement bodies convened under trade agreements, legislative action on both sides of the border, court decisions, and meetings between heads of state. In Canada, the dispute has been and continues to be a front-page issue that can have a substantial impact upon national elections.

The long-running dispute was temporarily resolved in 1996 by a Softwood Lumber Agreement (SLA) between the United States and Canada. The essence of the SLA was to require subsidized imports from four Canadian provinces over a specified level to pay a fee partially offsetting the Canadian lumber subsidy. Imports from the Maritime provinces, which have something closer to a free market system, are entirely exempted. Recently, a coalition of U.S. groups, such as the National Lumber and Building Materials Dealers Association, and foreign groups, including a number of Canadian timber companies, have banded together to form the American Consumers for Affordable Housing. With the help of a recent publication from the Cato Institute, this group has aimed to scrap the SLA when it expires in 2001 and end U.S. efforts to counter or offset Canadian subsidies.

This paper aims to explain the history of and policy rationale for the longstanding U.S. policy of opposing and countering Canadian subsidies. It also explains why that policy has had no significant adverse impact on U.S. consumers, but has promoted rational timber management, benefited competitive American producers, and limited environmentally dangerous timber cutting in Canada. The paper concludes that the United States should continue to seek aggressively to eliminate Canadian lumber subsidies.

HISTORY OF THE SOFTWOOD LUMBER DISPUTE

Two Timber Systems

The United States and Canada are among the world's leaders in the production of forest products. In the United States, production of softwood lumber is concentrated in the fast growing forests of the Pacific Northwest and private timber farms in southeastern states. In Canada, the lumber industry operates throughout Canada's northern forests, although it is concentrated in British Columbia and Quebec.

Many of the timber species harvested in Canada and the United States are the same, but the system of ownership of timberland and the pricing of the rights to cut trees are far different. In the United States, timberlands are owned by private landowners, state governments, and the federal government. Private landowners generally manage their property to ensure a sustainable timber supply with ongoing planting and harvests; like all property owners, they seek to maximize the return on and value of their property.

The management of state and federal timberlands has increasingly evolved to reflect the multiple interests at stake in these lands, including timber harvests, environmental preservation, and recreational use. The right to cut trees - known as stumpage rights - has long been sold to timber companies at auction to ensure that sale prices reflect the full market value of the stumpage rights.

“[Deputy premier Dan] Miller...said B.C.'s 'Soviet-style' forestry system needs a major overhaul, but conceded his government does not have a clear vision to lift the industry...”

The Vancouver Sun
April 10, 1999

The situation in Canada is quite different. The vast bulk of Canadian timberland is held by Canada's provincial governments. These lands are generally managed to promote the Canadian forest products industry. Stumpage

prices are set at a level to encourage timber cutting rather than to reflect the value of the timber. A noted Canadian commentator recently summarized the cumulative effect of these provincial stumpage programs: “[Canadian provincial governments] provide subsidies to the

industry that exceed the stumpage the forestry companies pay our governments for the trees. In effect, our governments are paying the companies to remove our old growth forests for us, convert them into two-by-fours, and send them south.”¹

To ensure that the preferential impact of these subsidies flows to Canadian lumber mills, the export of virtually all logs from Canada is also blocked by a ban on log exports. The export ban was seen as so essential to protecting and maintaining its timber subsidies that Canada insisted that the North American Free Trade Agreement exclude bilateral log exports.²

Canada is not the only country that restricts exports of logs. Largely in response to concerns about closed forest products markets in Japan, even the United States maintains some restrictions on log exports from state and federal lands in the Pacific Northwest; however, this amounts to less than a quarter of the timber harvest in that region. There are no restrictions on log exports from private lands, and the United States is the leading exporter of unprocessed timber in the world, including substantial shipments to Canada.

U.S. Countervailing Duty Actions

Subsidies, like those granted to the Canadian timber industry, have long been subject to action under both U.S. trade law and international trade agreements, including the U.S.-Canada Free Trade Agreement (now subsumed by the North American Free Trade Agreement - NAFTA) and the World Trade Organization (WTO). Since the granting of a subsidy is an internal act within the subsidizing country, it is impossible for a complaining country to have the subsidy directly eliminated. Thus, the primary remedy provided by U.S. law and international agreement is a countervailing or offsetting duty upon imports that benefit from the subsidy. Such duties not only offset the market distortions caused by the subsidies but also encourage elimination of the subsidies themselves.

¹ Lawrence Solomon, “Drilling Holes in Forestry Rhetoric: It’s Not Free Trade Our Lumber Companies Want, It’s Free Trees,” *The Financial Post*, April 4, 2000, p. C 19.

² Carol Bradley, “Does NAFTA Cover Raw Log Exports?” *Gannett News Service*, November 16, 1993 and Keith Bradley, “Resolve Softwood Dispute First, PM Told,” *The Vancouver Sun*, December 10, 1993, pp. E2.

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In the matter of Canadian lumber subsidies, by the early 1980s the share of Canadian lumber in the U.S. market had risen substantially. The U.S. forest products industry filed a formal complaint under U.S. countervailing duty law in 1982.³ Initially, the U.S. Commerce Department declined to consider Canadian stumpage practices a subsidy, despite volumes of evidence from both sides of the border to the contrary.⁴

In subsequent decisions on issues involving subsidies of natural resource inputs, the U.S. Court of International Trade ruled that several of the procedures that the U.S. Commerce Department relied upon in the first Canadian lumber case were inconsistent with U.S. law. In 1986, the U.S. lumber industry filed a new countervailing duty complaint against imports of softwood lumber. In light of the intervening court decisions, the Commerce Department changed its procedures for measuring lumber subsidies and imposed a 15 percent duty on softwood lumber imports from Canada to offset the impact of stumpage subsidies.

“For years, evidence has been mounting that the government is handing over our timber to a powerful handful of forest corporations at giveaway prices.”

Daily News
Prince Rupert, B.C.
December 3, 1993

In the face of that decision, the Canadian federal government sought a negotiated solution to the dispute as an alternative to the U.S. government collecting the duty. These negotiations shortly resulted in an agreement with two primary

features. First, procedures were put in place to encourage Canadian provinces to raise stumpage rates to reflect more closely their true market value. Second, until and unless the reforms were implemented, the Canadian federal government agreed to collect a tax of 15 percent in lieu of the U.S. countervailing duty. This agreement was popularly known as the Memorandum of Understanding (MOU).

³ The case (C-122-015) was initiated on November 3, 1982.

⁴ Gary Clyde Hufbauer and Joanna Shelton Erb, *Subsidies in International Trade* (Washington, DC: Institute for International Economics, 1984) pp. 96.

The MOU resolved the issue of Canadian softwood lumber subsidies until 1991, when the Canadian federal government unilaterally terminated the MOU. Two factors likely drove the Canadian decision. First, the issue of softwood lumber subsidies remained a political hot potato. The Canadian lumber industry attacked the MOU as meddling in Canadian internal affairs on stumpage rights and unduly restricting exports to the United States. This created considerable political pressure on the Canadian government to pull out of the MOU.

Second, in 1989 the U.S.-Canada Free Trade Agreement (FTA) took effect. The FTA did not directly conflict with the MOU; in fact, the FTA explicitly sanctioned the terms of the MOU. But the FTA did create a new procedure for resolving disputes in countervailing duty cases that Canadian officials apparently felt might allow Canada to improve its position with regard to U.S. actions against Canadian softwood lumber subsidies.

In response to the unilateral abrogation of the MOU, the U.S. government immediately imposed an interim duty on softwood lumber imports from Canada to offset the impact of the subsidy and initiated a new CVD case. In this case, the Commerce Department again found that Canadian softwood lumber imports were unfairly subsidized, but at somewhat different rates. It calculated stumpage subsidies at a lower rate - 2.9 percent. But, building upon recent decisions on other issues,⁵ the Commerce Department also found that the Canadian ban on log exports added a countervailable subsidy of 8.6 percent on Canadian lumber.⁶

Binational Panel Reviews

As noted, one of the reasons that Canada may have chosen to unilaterally abrogate the MOU is that the U.S.-Canada Free Trade Agreement changed the international trade landscape vis-à-vis the United States. Although it dictated no change in the MOU or U.S. anti-subsidy law, the FTA established a new system for settling disputes involving application of countervailing (CVD) duties and antidumping (AD) duties. Chapter 19 of the

⁵ For example, see "Leather from Argentina," 55 Fed. Reg. 40,212 (Oct. 2, 1990). (Investigation C-357-803).

⁶ The 8.6 percent figure was the final figure settled on by Commerce after a remand from a U.S.-Canada FTA panel.

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agreement established a binational panel dispute settlement system in which a panel of experts drawn from the United States and Canada would review disputes involving AD and CVD laws. The panels were reviewable by an Extraordinary Challenge panel (a sort of appeals court made up of retired judges), but were otherwise binding upon both parties.

The binding authority of the panels (later adopted and expanded to include Mexico in the NAFTA) was a major concession of sovereignty by the United States and Canada - one even beyond that embodied in the WTO. The grant is supposed to be limited by the narrow mandate of these panels, which is to ensure that each country applies its own laws properly without questioning the merits of those laws. Since ultimate oversight of this limitation, however, is with another panel - the Extraordinary Challenge panel - the potential for interference with each country's trade laws is significant.

This potential was unfortunately realized in the softwood lumber dispute. As noted, the softwood lumber issue is and remains a concern of national political significance in Canada. This has driven successive Canadian governments to exhaust all options in defense of softwood lumber subsidies. In responding to the new U.S. countervailing duty action in 1991, Canada challenged both the finding of subsidy - made by the U.S. Commerce Department - and the finding of material injury - made by the U.S. International Trade Commission (under U.S. law, both subsidization of imports and injury from those imports must be established before duties can be imposed).

Ultimately both of these panels remanded aspects of the decision back to the U.S. implementing agencies - the Commerce Department and the International Trade Commission. In each case, the agencies upheld their original decisions, with the U.S. Commerce Department increasing its estimate of Canadian subsidies based on an error in their original methodology. The subsidy panel soon emerged as the dominant issue and the injury panel seemed to delay its decision - after several remands to the ITC, in which the ITC upheld its original determination - pending the outcome of the subsidy decision.

The disagreement between the subsidy panel and the Commerce Department was marked and a number of related issues emerged. For example, two of the Canadian panelists

had clear conflicts of interest that would have kept them from serving as a jurist in a U.S. court. Further, the panel was deeply split along national lines, with U.S. panelists voting to uphold the Commerce Department as having properly applied the law and Canadian panelists voting to overturn the U.S. legal decision. Since there was a Canadian majority, this resulted in a decision to overturn the U.S. Commerce Department's subsidy finding.

The United States appealed the decision to an Extraordinary Challenge panel. This panel was made up of two retired Canadian judges and one retired U.S. judge. Once again, the panel split

“No objective observer disputes that the B.C. government charges the major multinational companies well below the U.S. market price for ‘standing green’...Nor does anyone contest that the ban on log exports also significantly reduces the price the B.C. manufacturer must pay, since the only competition is with other local manufacturers.”

Business in Vancouver
August 17, 1993

along national lines, with Canadian judges supporting the position of the Canadian government and the U.S. judge supporting the U.S. position. The U.S. judge - former D.C. Circuit Chief Judge Malcolm Wilkey - is a distinguished American jurist who also acted as chairman of the panel. In his dissent, he blistered the decision of his Canadian colleagues and noted that the original panel decision “may violate more principles of appellate review of agency action than any opinion by a reviewing body which I have ever read.”⁷

The Softwood Lumber Agreement of 1996

By the mid-1990s, more than a decade of bilateral negotiations and litigation had not eliminated the Canadian lumber subsidies. Some Canadian provinces had adopted reforms in the way that stumpage prices were calculated, but the rates were still set administratively, rather than through a market-based mechanism such as an auction, and remained set at a fraction of their value. The ban on unprocessed timber exports also remained.

⁷ Decision of the Extraordinary Challenge Committee of the U.S.-Canada Free Trade Agreement, *Certain Softwood Lumber Products from Canada*, No. ECC-94-1904-01USA, August 3, 1994, pp. 37.

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After its defeat in the binational panel process and clarification of U.S. law by the Congress, the U.S. industry was preparing to file a new countervailing duty action. The Canadian industry was uncertain of its ability to succeed in another round of litigation; there was no guarantee that the newly instituted NAFTA panels would view the subsidy issue in the same way as the U.S.-Canada FTA panels had in 1991, given Congress' action. This uncertainty convinced the Canadian industry to urge its government to strike a bilateral agreement to head off litigation.

The result was the Softwood Lumber Agreement of 1996. In essence, this agreement allowed companies in the four primary lumber exporting provinces - British Columbia, Quebec, Alberta, and Ontario - to export lumber to the United States duty free up to an agreed upon level of 14.7 billion board feet, historically a high level. Above that level, Canadian companies would pay an escalating fee to offset the value of the subsidies.

The U.S. – Canada Softwood Lumber Agreement

Agreement Period: April 1, 1996 to March 31, 2001

Canadian Provinces Covered by the Agreement: British Columbia, Alberta, Ontario and Quebec

Untaxed Export Levels: The four provinces covered by the Agreement can export a total of 14.7 billion board feet of softwood lumber annually to the United States without paying a duty. Other provinces were wholly unrestrained.

Duties on Exports – Tier 1: Once the duty-free limit of 14.7 billion board feet has been met, the next 650 million board feet of softwood lumber exported from Canada to the United States will have a duty of \$50 per thousand board feet placed upon it.

Duties on Exports – Tier 2: After the 650 million board feet limit has been met, all additional exports from Canada to the United States will have a duty of \$100 per thousand board feet placed upon them

Administering Authorities: It is the responsibility of the Canadian government to allocate duty-free exports and exports at the \$50 per thousand board feet level to the producers in the four affected provinces and to collect the duties imposed on softwood lumber exports.

Trigger Price Pressure Valve: If the price of softwood lumber in the United States rises above a prescribed level (\$405 per thousand board feet delivered in the first two years of the agreement, \$410 per thousand board feet in every year thereafter), an additional 92 million board feet a quarter will be allowed to enter the United States duty-free.

Market Penetration: Under the SLA, Canada controls about 34.5 percent of the U.S. market.

The current agreement is set to run until March 31, 2001. Neither the United States nor Canada has made clear their intent after the agreement expires. Since the underlying

Canadian lumber subsidies have not been eliminated, the U.S. industry could and likely would file a case if the current agreement is allowed to expire without an end to the subsidies or the imposition of some offset.

From the perspective of countering Canadian subsidies and restoring the market function, such a case could be preferable, since a duty tailored to precisely offset existing subsidies on all Canadian lumber imports would be more efficient than the administrative compromise embodied in the SLA. Of course, a new CVD case would cause delay and could set off a new round of litigation within the United States and quite possibly Canadian complaints to the NAFTA or the WTO. In sum, since Canadian provinces remain opposed to fully reforming the stumpage system and eliminating lumber subsidies, another chapter in the long running saga remains a distinct possibility in April 2001.

CANADIAN SUBSIDIES DISTORT THE NORTH AMERICAN LUMBER MARKET

Critics of the SLA and U.S. policy aimed at countering Canadian subsidies, such as a recent Cato Institute report on the topic⁸, often overlook the subsidies entirely and focus instead on the measures taken to offset them. There is no doubt that the best possible solution would be to eliminate all distortions in the marketplace, including subsidies, duties, and other measures. This position has, in fact, been specifically endorsed by the U.S. government and industry. Focusing exclusively on the duties, however, diverts attention from the key issue and the problem that necessitated U.S. action - Canadian subsidies.

There can be little serious debate that subsidies, like stumpage fees and the export ban, distort the market. As will be discussed below, there is some debate as to the ultimate

“Canada’s provincial governments...provide subsidies to the industry... In effect our governments are paying the companies to remove our old growth forests for us, convert them into two-by-fours, and send them south.”

Lawrence Solomon
“Drilling Holes in Forestry Rhetoric”
The National Post
April 4, 2000

impact of the subsidies, but it is elementary economics that subsidies tend to distort production, unnecessarily burden taxpayers, artificially inflate production

and generally result in an inefficient outcome. This is a point that the defenders of Canadian subsidies - who tend to call themselves advocates for free trade - blithely ignore.

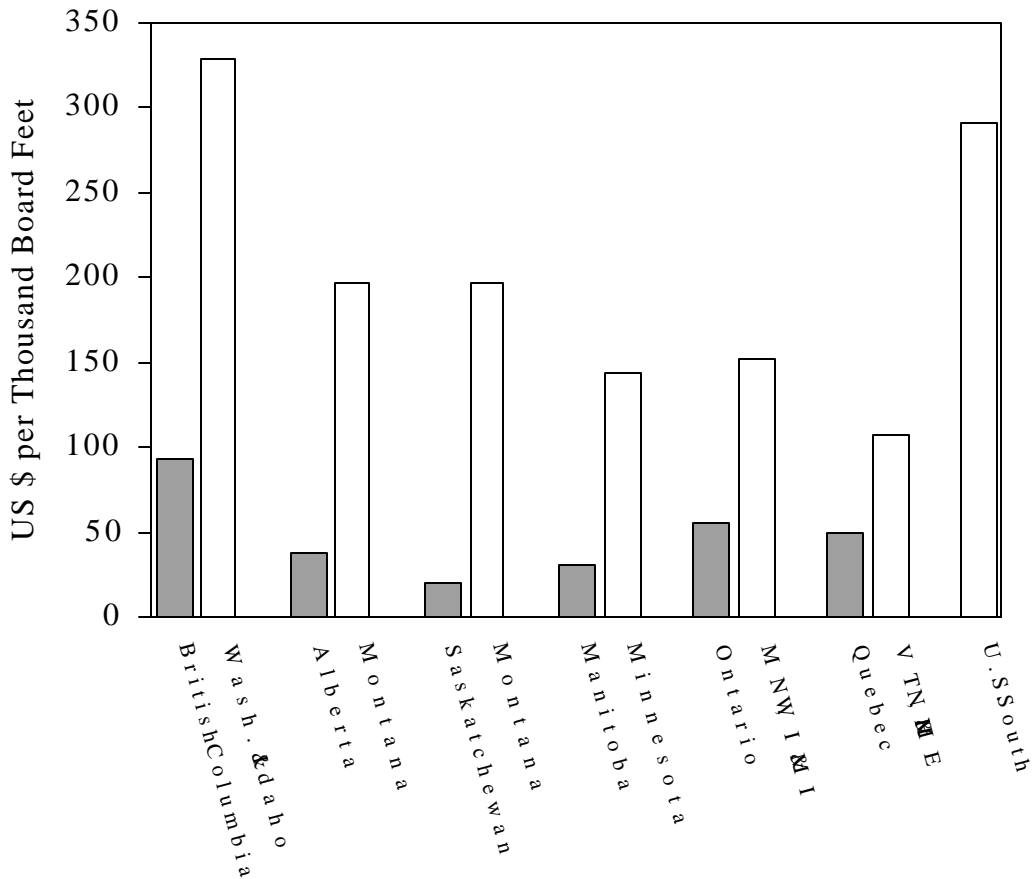
Canadian Lumber Subsidies

Nor is there any serious debate that Canadian provinces continue to heavily subsidize the lumber industry through artificially low stumpage rates, preferences for large companies through B.C.’s tenure system, minimum cut requirements (which have a particularly adverse impact upon the environment), and the log export ban. As Chart 1

⁸ Brink Lindsey, Mark A. Groombridge, and Prakash Loungani, *Nailing the Homeowner: The Economic Impact of Trade Protection of the Softwood Lumber Industry* (Washington, DC: CATO Institute, July 6, 2000).

indicates, the price charged for timber in Canada ranges from about 25 percent to 33 percent of the prices that timber in comparable timber stands fetches just across the border in the United States at auction. As the chart demonstrates, despite some reforms adopted in the last 15 years, the overall level of lumber subsidies in Canada is as high or higher than it was in 1986 or 1992.

Chart 1. Administered Canadian Provincial Softwood Stumpage Rates vs. U.S. Softwood Timber Prices Immediately Across the Border



Source: U.S. and Canadian Data⁹

⁹ The comparison employs the most recent data available from public sources. U.S. data are from the Timber Data Company (except U.S. South, which comes from Timber Mart-South). British Columbia data are from the British Columbia Coast Appraisal Manual and the British Columbia Interior Appraisal Manual. Alberta, Saskatchewan, Manitoba and Quebec data are from the National Forest Database of the Canadian Council for Forest Ministries. Data for Ontario are from a December 1999 letter from the Canadian Government to the U.S. Government.

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Canadian producers have argued that the comparison made in this chart is invalid because there are also variations in stumpage rates within the United States. They also argue that cross border comparisons are invalid.¹⁰ There are, of course, variations in the price for timber between different areas in the United States, but this is the result of different results from auctions and, thus, the result of buyers valuing different grades and species of timber and different harvest areas differently. It is manifestly not the result of government efforts to subsidize lumber production and, thus, is not comparable to administratively set Canadian prices, which confer subsidies on Canadian lumber producers.

Certainly, it is appropriate to compare similar grades of timber and similar stands in cross border comparisons to ensure an apples-to-apples comparison. But past comparisons between the same regions that adjust for species and quality and road building and silviculture expenses have demonstrated that these cross-border comparisons are appropriate.¹¹ In fact, the methodology for such cross border comparisons was originally created by Canadian forestry experts.¹²

The ongoing existence of these subsidies is confirmed by a wide range of independent analysts and observers, including the Natural Resources Defense Council,¹³ Elmsdale Lumber Co., Ltd.,¹⁴ the Castle-Crown Wilderness Coalition,¹⁵ the David Suzuki

¹⁰ British Columbia Lumber Trade Council, "Submission to the Trade Policy Staff Committee Regarding Softwood Lumber Practices in Canada and Softwood Lumber Trade Between the United States and Canada," April 13, 2000, p. 15. Available from the Office of the Secretary, United States Trade Representative.

¹¹ Commerce explicitly accepts such comparisons in its countervailing duty methodology. See "Countervailing Duties: Final Rule," 63 Fed Reg. 65,438-65,377 (Nov.25, 1998). Commerce will use world market price where "it is reasonable to conclude that actual transaction prices are significantly distorted as a result of the government's involvement in the market."

¹² David Haley, "A Regional Comparison of Stumpage Values in British Columbia and the United States Pacific Northwest," *Forestry Chronicle*, Vol. 56 No. 5, 1980, pp.225-230.

¹³ Natural Resources Defense Counsel, "Submission to the Trade Policy Staff Committee Regarding Softwood Lumber Practices in Canada and Softwood Lumber Trade Between the United States and Canada," April 13, 2000. Available from the Office of the Secretary, United States Trade Representative.

¹⁴ Elmsdale Lumber Company, "Submission to the Trade Policy Staff Committee Regarding Softwood Lumber Practices in Canada and Softwood Lumber Trade Between the United States and Canada," April 14, 2000. Available from the Office of the Secretary, United States Trade Representative.

¹⁵ Castle-Crown Wilderness Coalition, "Submission to the Trade Policy Staff Committee Regarding Softwood Lumber Practices in Canada and Softwood Lumber Trade Between the United States and Canada," April 14, 2000. Available from the Office of the Secretary, United States Trade Representative.

Foundation,¹⁶ the Raincoast Conservation Society,¹⁷ various groups of indigenous Canadian peoples,¹⁸ and many others.¹⁹

As a group of Canadian small businesses (which are largely excluded from the benefits of these subsidies by tenure programs that allocate benefits to major timber companies) noted in a letter to British Columbia's Minister of Forests: "We understand that the current system of tenure was implemented in order to lure the massive amounts of capital to build

"In Canada, provincial governments own most of the timber and there are numerous built-in incentives to maintain high production levels in falling export markets."

Ken Drushka
"Forest Industry Faces a Difficult Year"
The Vancouver Sun
March 22, 2000

pulp-, paper-, and sawmills... Whether or not this strategy is correct is open to debate. Clearly, however, it has served its purpose."²⁰

A number of other Canadian observers have commented similarly upon the provincial stumpage-tenure system. Lawrence Solomon, a previously cited Canadian editorialist, summarized the situation well when he wrote:

On paper, the U.S. loggers' plan [to introduce a market based system for timber sales to Canada] has some merits, particularly for Canada. Forest revenues would fill our government's coffers instead of depleting them, giving the fees to the true owner of the forests, the public-at-large. The economies of the forest provinces would benefit, especially that of British Columbia, the province with the country's biggest forest industry. By bleeding the productive parts of B.C.'s economy to finance its deforestation

¹⁶ David Suzuki Foundation, "Submission to the Trade Policy Staff Committee Regarding Softwood Lumber Practices in Canada and Softwood Lumber Trade Between the United States and Canada," April 12, 2000. Available from the Office of the Secretary, United States Trade Representative.

¹⁷ Letter to Ambassador Charlene Barshefsky from the Raincoast Conservation Society, "Canada – U.S. Softwood Lumber Trade and Environment Solution," April 14, 2000.

¹⁸ Interior Alliance, "An Overview of the Issues in British Columbia Pertaining to the Canada/U.S. Softwood Lumber Agreement," Submission to the USTR Trade Policy Staff Committee (Undated). Available from the Office of the Secretary, United States Trade Representative.

¹⁹ See also Kettle Range Conservation Group, "Submission to the Trade Policy Staff Committee Regarding Softwood Lumber Practices in Canada and Softwood Lumber Trade Between the United States and Canada," April 6, 2000 and the Society Promoting Environmental Conservation, "Submission to the Trade Policy Staff Committee Regarding Softwood Lumber Practices in Canada and Softwood Lumber Trade Between the United States and Canada," April 12, 2000. Available from the Office of the Secretary, United States Trade Representative.

²⁰ Letter from the Strathcona Small Business Loggers Association to the Honorable Andrew Petter, B.C. Minister of Forests, April 13, 1994.

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*program, B.C. governments have stunted the provincial economy, helping to make it Canada's worst economic performer over the last decade.*²¹

Another prominent Canadian editorialist agreed, estimating the value of the subsidies in the billions of dollars:

*By far the largest financial benefits the [B.C.] forest industry receives comes from foregone stumpage fees. . . Forestry consultant Michael Major, who worked in the industry for many years, has estimated this difference at \$6 billion annually. . . The present size of the subsidy creates an unlevel playing field and gives the forest industry an unfair advantage relative to other interests and sectors of the economy.*²²

In recent years, British Columbia has undertaken some reform of its stumpage system yet the prices are still ultimately set by bureaucrats and politicians, and remain far below a true market level. Again, perhaps Canadian commentators make the point most crisply. A British Columbia newspaper - *The Daily News* - put it simply: "Since the current B.C. forest tenure system does not include competitive bidding, timber prices remain low."²³ A Canadian author, Elizabeth May, taking note of the cross-border comparisons at the outset of this section noted: "Even the increased [B.C. stumpage] rates are estimated to be approximately half what forest companies would be paying for similar wood in the U.S."²⁴

Another B.C. newspaper, the *Alberni Valley Times*, concluded, "Jigging the stumpage only proves what the Americans have said all along: B.C. subsidizes its forest industry."²⁵ Further, in reporting on comments made by British Columbia's Forest Minister Andrew Petter in 1996, the paper made the following point:

*The move by the Forest Minister has confirmed what the Americans have been saying all along. The cost of timber to B.C. companies is politically driven, not market driven and the subsidy in a government-protected market may amount to unfair competition. The proof is in the cutting. B.C.'s companies have never paid world-level prices for timber.*²⁶

Although British Columbia is Canada's largest timber province, the problem of lumber subsidies is not confined to British Columbia. In fact, stumpage subsidies in

²¹ Solomon, *op. cit.*, pp. C19

²² Grant Copeland, *Acts of Balance* (British Columbia: New Society Publishers, 2000) pp. 137.

²³ Jim Cooperman, "Agency's Surplus Best Spent on Debt," *The Daily News*, September 17, 1996.

²⁴ Elizabeth May, *At the Cutting Edge* (Toronto: Key Porter Books, 1998) pp. 202.

²⁵ Rob Diotte, "Forest Code Changes Prove U.S. Countervail," *Alberni Valley Times*, April 3, 1998.

²⁶ Rob Diotte, "Petter Continues Adjusting Subsidy to Forest Industry," *Alberni Valley Times*, January 4, 1996.

Canada's second-largest timber producing province, Quebec, are at a similar level, as demonstrated in the chart at the beginning of this section. Like B.C., Quebec establishes stumpage rates through a complex administrative system, not competition. In recent years, Quebec has been unwilling even to implement the increases that its revised administrative regulations called for, because it feared these increases would undercut "the competitive position" of the Quebec lumber industry - essentially conceding that low stumpage rates are a competitive subsidy.²⁷

Quebec's stumpage subsidies have been high enough to draw the wrath of a B.C. Forest Minister:

[T]he [Quebec] government ... is subsidizing the forest industry with low stumpage rates... Quebec lumber is now turning up in U.S. markets as close to B.C. as Washington state, because its producers can afford to pay those [export tax] penalties thanks to bargain basement stumpage rates... They are subsidizing. They are not even making their costs... I know how the Americans feel.²⁸

Although some of the specific features of the administrative stumpage system vary, in Canada's other main timber producing provinces - Alberta, Ontario, Saskatchewan and Manitoba - the story is much the same. Again, the chart at the outset of this section demonstrates that stumpage rates for timber in these provinces are only a small fraction of stumpage rates in U.S. forests often only miles to the south.

The Export Ban

Although low stumpage rates are the principle vehicle through which Canadian provincial governments confer a subsidy upon the Canadian lumber industry, they are not the only mechanism. As noted in the previous section, tenure rights, non-enforcement of forestry regulations, and the export ban also confer a significant subsidy. The export ban deserves particular attention because it is integral to the operation of the Canadian subsidy system. Both Canada's timber producing provinces and the Canadian federal government maintain a ban or serious restrictions on exports of logs. Were it not for the ban, lumber mills outside Canada could import Canadian logs and capture much of the benefit of the

²⁷ Quebec Ministry of Natural Resources, *Press Release*, March 28, 2000.

²⁸ Canada News Wire, *Crees Meet with U.S. Trade Representatives on Quebec Forestry Devastation*, Press Release, March 1, 2000.

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Canadian stumpage subsidies. Since it is not likely that Canadian taxpayers would stand for seeing their tax dollars - in the form of stumpage revenue foregone - being used to subsidize lumber mills in the United States, Japan, or elsewhere in the world, the export ban is integral to maintaining the entire system of subsidies.

In economic terms, the export ban effectively concentrates the positive impact of preferential stumpage and other subsidies on local Canadian forest product companies. It keeps out-of-province companies from bidding on logs and thus depresses the price of these logs compared to open market prices. This is why the Commerce Department treated the export ban as a subsidy in the third CVD case on softwood lumber and other CVD cases involving export bans on other input products.²⁹ Again, Canadian sources acknowledge this impact. In an article on the topic, the *Vancouver Sun* explicitly noted, “[the log export ban] lowers the value of logs grown and harvested in B.C.”³⁰

Canadian Subsidies are Trade Distorting and Countervailable

Over the years, various analyses, most paid for by the Canadian industry, have disputed the position of the U.S. Commerce Department that Canadian timber subsidies were trade distorting and countervailable. One position taken by several sources is that the Commerce Department’s decision to change its approach to evaluating lumber subsidies between 1983 and 1986 is evidence that Commerce altered its results solely for political expediency.

Undeniably, virtually every political institution in democratic countries is subject to a degree of political pressure. It is important to consider at the outset that this phenomenon is not limited to points south of the Canadian border. It is difficult to imagine that any unbiased observer could conclude that there is greater potential for such political influence to distort outcomes in the United States rather than in Canada. As documented above, the

²⁹ Charles M. Gastle and Jean G. Castel, “Should the North American Free Trade Agreement Dispute Settlement Mechanism in Antidumping and Countervailing Duty Cases Be Reformed in Light of Softwood Lumber III?” *Law and Policy in International Business*, Vol. 26 No. 3, March 22, 1995, pp. 833.

³⁰ “Decline in Quality of Timber Limits Possibility for Value-added Solutions,” *The Vancouver Sun*, March 31, 1999, pp. D19.

influence of timber companies in continuing Canadian lumber subsidies, often in the face of harsh domestic criticism, is undeniable.

Countervailability

The assertion of bias on the part of U.S. officials ignores the body of expert opinion, legal decisions, and U.S. law that argue for and direct the current approach. In direct reference to Canadian lumber subsidies as well as other similar subsidies, two noted authorities on subsidy issues wrote in 1984 that:

... [W]hen a government furnishes transportable natural resources at bargain prices, either by selling its own rights or by imposing price controls on private owners, a potentially troublesome subsidy is conferred on the purchasing industry. The subsidy measurement received can be measured by reference to world prices. In our view, such cases should be addressed through the imposition of countervailing duties.³¹

After the 1983 Commerce decision, the U.S. Court of International Trade also found, in decisions on several unrelated cases, that natural resource subsidies were countervailable under U.S. law.³² The Congress and the Executive later expressly addressed this

“Jigging the stumpage only proves what the Americans have said all along: BC subsidizes its forest industry.”

Rob Diotte
Alberni Valley Times
April 3, 1998

issue and endorsed the approach of looking to international price comparisons to determine subsidies: “[I]f there are no useable market determined prices stemming from *actual* transactions, we will turn to world market prices that *would be available* to the purchaser.”³³ Finally, Canada challenged the 1991 U.S. countervailing duty case to the GATT as inconsistent with GATT requirements; a GATT dispute settlement panel rejected this claim and ruled in favor of the United States.³⁴ Despite the claims of Canadian critics, there is no doubt that Canadian stumpage subsidies are countervailable under U.S. law and the GATT/WTO.

³¹ Hufbauer and Shelton Erb, *op. cit.*, p. 99.

³² For example see *Cabot Corp. v. United States*, 620 F. Supp. 722 (C.I.T. 1985).

³³ “Countervailing Duties: Final Rule,” *op. cit.*

³⁴ General Agreement on Tariffs and Trade, *United States – Measures Affecting the Export of Softwood Lumber from Canada (II)*, BISD 40S/358.

Some Canadian sources make the further claim that log export restrictions are not countervailable subsidies under the WTO. Yet similar bans on exports aimed at depressing domestic prices have also been found to be subsidies in a number of domestic cases, without being challenged in the GATT/WTO.³⁵ In fact, the WTO specifically indicated that log export restrictions are an “an input subsidy to processors.” In reviewing Indonesia’s restrictions on log exports, a WTO report found (in language that also neatly describes the harmful effects of the Canadian system):

*Restricting exports of the primary resource encourages downstream processing by providing, in effect, an input subsidy to processors. By diverting export sales of the resource’s domestic price...Fostering production and exports of processed products indirectly, through export restrictions on raw material inputs, risks encouraging inefficient industries which could become permanently dependent on government support.*³⁶

Article 1 of the WTO Agreement on Subsidies and Countervailing Measures also holds that any action conferring a financial benefit, which the log export ban certainly does, can be considered a countervailable subsidy.³⁷ There are no GATT/WTO panel decisions to support the Canadian claim on this issue.

Trade Distortions

The Canadian forest products industry also retained two U.S. economists to complete an econometric analysis that suggested that the Canadian stumpage subsidies did not boost Canadian lumber production in particular years analyzed - 1984, 1985, and 1988.

This analysis is a case study of the limitations of applying economic analysis to policy problems of this nature. First, it should be understood that the study does not prove or claim to prove that the stumpage subsidies do not exist. Instead, the sole claim that the econometric comparisons seek to prove is that there is no clear evidence that the subsidies increased lumber production in specified years. As such, it has only very limited bearing on the appropriate timber trade policies for the United States and Canada.

³⁵ For example, see “Leather from Argentina,” *op.cit.*

³⁶ World Trade Organization, *Trade Policy Review: Indonesia* (1998) pp. 105.

³⁷ World Trade Organization, *Agreement on Subsidies and Countervailing Measures*, Article 1.1(b). A copy of the agreement can be found online at the WTO’s website, www.wto.org.

The most serious shortcomings of this analysis are that it ignores the underlying reason for these subsidies and the long-term impact they have upon the Canadian industry. As a Canadian group of small businesses noted in the previous section: "We understand that the current system of tenure was

"...[I]f forest licenses do not confer any below-market advantage for the license-holder, why are they bought and sold among forest companies for large sums of money? Why, indeed, should governments compensate license-holders for revoking timber rights when new parks, wildlife preserves and native reserves are created?"

Business Edge
Vancouver, B.C.
December 1994

implemented in order to lure the massive amounts of capital to build pulp-, paper-, and sawmills...[I]t has served its purpose."³⁸ Castle-Crown agreed with the B.C. small businessmen when it said, "...subsidies can be directly linked to a dramatic increase in exports of softwood lumber products."³⁹

In other words, the Canadian stumpage subsidies artificially encourage mill owners to invest the capital necessary to build and operate mills in Canada. Although its impact in particular years may be difficult to discern in the consultants' "static" analysis as a result of other factors impacting the marketplace, it is difficult to deny that the stumpage subsidies have been successful in establishing and encouraging the continued operation of lumber mills in British Columbia, Quebec, and elsewhere. In short, it may be difficult to prove that the stumpage subsidies boost production in a particular year, but it is also difficult to deny that many Canadian mills would not even exist were it not for the stumpage subsidies. If nothing else, the dogged refusal of Canadian mills and provincial governments to accept competitive timber pricing demonstrates that the subsidies continue to have an important impact. As will be discussed in greater depth in the next section, the boost given to the Canadian industry has had a number of adverse impacts upon the U.S. industry, the environment, and other interests.

³⁸ Letter from the Strathcona Small Business Loggers Association, *op. cit.*

³⁹ Castle Crown Wilderness Coalition, *op. cit.*

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Further, the analysis of the consultants for the Canadian industry is directly at odds with the independent analysis of a number of economists that specialize in timber economics. Many of these economists argue that stumpage rates do have a direct impact upon production and profitability.⁴⁰ It is important not to lose sight of the obvious nature of the claim made by these timber economists, and the counterintuitiveness of the claim that stumpage subsidies do not effect production. The basic point - accepted by economists and most others - is simply that input costs can impact profitability and production - a statement any businessman is likely to agree with.

Also demonstrating the ephemeral nature of econometric results, using more recent data for the years 1988, 1989 and 1990, the very same methodology employed by the consultants for the Canadian industry indicates that stumpage prices do have a significant impact upon the timber harvest in British Columbia.

Finally, it is important to note that the econometric analysis performed on behalf of the Canadian industry does not even consider the issue of the log export ban, which the U.S. Commerce Department found to actually generate a greater economic benefit for the Canadian industry than the stumpage subsidies.

The recent analysis by the Cato Institute repeated many of the same points made in the Canadian timber consultants' analysis. The Cato analysis also argued that the Canadian lumber industry was relatively unprofitable and that this argued against them being the recipients of subsidies.⁴¹ This argument makes little sense on its face. After all, the reason that governments normally extend subsidies is that they believe the industry is not profitable or not sufficiently profitable without subsidies. Subsidies attract sub-marginal producers to the industry, and permit unprofitable ones that would otherwise close to continue operating. Thus, it is not at all surprising that such an industry may not be highly profitable even with the benefit of the subsidy. The issue that should be addressed is the comparison of the

⁴⁰ For example, see Peter Pearse, *Introduction to Forestry Economics* (British Columbia: University of British Columbia Press, 1980) pp. 12 and Darius M. Adams, Clark S. Binkley, and Peter A. Cardellicchio, "Is the Level of National Forest Timber Harvest Sensitive to Price?" *Land Economics*, February 1992, pp. 74-84.

⁴¹ Lindsey, Groombridge and Loungani, *op. cit.*, pp. 8.

profitability of the industry with and without the subsidy. Cato does not make this comparison.

U.S. Subsidies

Although it has no direct legal relevance to the issue of addressing the trade injury caused by Canadian lumber subsidies, the Canadian timber industry and its defenders often attempt to inject the assertion that the U.S. industry is also subsidized into the debate. Normally, this claim seems to be raised merely as a distraction to divert attention from Canadian subsidies. Little attempt is made to bolster the claim; the hope seems to be that a few broad assertions will muddy the water sufficiently to confuse the casual observer.

The Cato analysis is a prime example of this strategy. It makes the claim that a number of federal subsidies notified to the WTO may constitute as much as \$600 million in benefits to industry annually, that various states extend tax breaks to timber companies, and that the U.S. maintains a log export ban of its own.

The matter of the U.S. log export ban has already been addressed. To review, the limitations on log exports in the United States apply to only a small portion of timber in western states and are designed to address a concern regarding Japanese restrictions on processed forest products. They do not apply to private lands from which most log exports are made. Finally, while Canada bans virtually all log exports, the United States is the world's largest exporter of logs and unprocessed timber - much of which goes to Canada. It strains credibility beyond any reasonable limit to compare the minor U.S. restrictions with Canada's sweeping ban.

The state tax benefits that Cato alludes to are so incompletely described that it is impossible to say much in rebuttal. They are not even assigned an estimated value for the purposes of comparison. Further, most of the described provisions appear to be efforts to extend generally available (and thus not countervailable or prohibited by the WTO) tax benefits, such as depreciation allowances or credits for past investment, to the timber industry on the same basis as other industries.

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Most of Cato's attention is focused on federal programs that have been notified to the GATT/WTO under the Subsidy Agreement.⁴² Some of the referenced benefits, such as exemptions from the fuel tax for helicopters used in logging, likely have no measurable impact on trade. As is the case with the state taxes, many of the tax provisions referenced merely extend a generally available tax policy, such as capital gains treatment, to the timber industry; it is difficult to imagine that another country would allege, let alone be able to make the case that these tax provisions resulted in "material injury" to their industry - the test applied in countervailing duty cases.

More than 80 percent of the total subsidy the United States notified the WTO of were programs designed to encourage the growing of trees to forestall erosion and promote other environmentally friendly purposes. It is difficult to credibly compare a U.S. program aimed at growing new trees with Canadian subsidies to cut them down.

Finally, even if the \$600 million figure is simply accepted, it is a small fraction of the value that Canadian observers have estimated for British Columbia's stumpage program - \$4

"We understand that the current system of tenure was implemented in order to lure the massive amounts of capital to build pulp-, paper- and sawmills...Clearly, however, it has served its purpose."

Strathcona Small Business Loggers Association
Letter to the B.C. Minister of Forests
April 13, 1994

billion. Other estimates run as high as \$7 billion annually.⁴³ Beyond that, the \$4 billion is only an estimate of the value of the

stumpage subsidy in one province. It does not consider stumpage subsidies in other provinces or the log export ban.

⁴² A strong argument can be made that the bureaucrats that chose to include these programs on their list included programs that, in fact, had no trade effect and should not have been notified. In any event, the scrupulousness of some bureaucrats in reporting U.S. subsidies certainly does not grant absolution for Canada's much larger stumpage subsidies and log export ban.

⁴³ Copeland, *op.cit.* In Canadian dollars, the estimates range between \$6 and \$10 billion.

CANADIAN SUBSIDIES ADVERSELY IMPACT U.S. INDUSTRY AND THE ENVIRONMENT

As any elementary economic textbook will attest, subsidies normally have a number of adverse impacts, including burdening taxpayers, causing inefficient resource allocation, and generally distorting commerce. In the case of the Canadian softwood lumber subsidies, all of these adverse impacts are generated. As a result, there is overinvestment in the lumber industry in Canada, which has a number of adverse impacts, including disadvantaging the competing market-oriented industry in the United States, disadvantaging competing interests in Canada, and causing overlogging of Canada's forest, with serious results for the environment.

Impact on U.S. Industry

Historically, the adverse impact of Canadian subsidies on U.S. industry has attracted the most attention in the United States. The impact of these subsidized imports on the U.S. market is massive, direct,

and undeniable. It is important to recognize that the United States, not Canada, is the market for most of the timber harvested in Canada. Approximately 80 percent of Canada's forest product exports

“The U.S. imports 80% of Canada's forest products. The presence of subsidized Canadian forest products in the U.S. marketplace drives down prices and adversely impacts U.S.-based producers and employment in this sector. The miniscule benefits to U.S. consumers of cheap Canadian wood are vastly outweighed by the environmental, social, and economic costs of Canadian subsidies.”

Environmental Non-Governmental
Organization (ENGO)
April 2000

go to the United States, which accounts for 66.7 percent of total Canadian production.⁴⁴ Canadian imports account for over one-third of the softwood lumber market in the United States, in spite of being shipped hundreds of miles more than competing U.S. products.

In light of these statistics, there is little serious debate that lumber imports from Canada have an adverse impact upon the U.S. industry. It is notable that the U.S.

⁴⁴ Data taken from StatsCanada.

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International Trade Commission - after reviewing the question of injury from Canadian imports four times from 1983 to 1991 - has consistently ruled that subsidized Canadian lumber imports injure the U.S. industry.⁴⁵

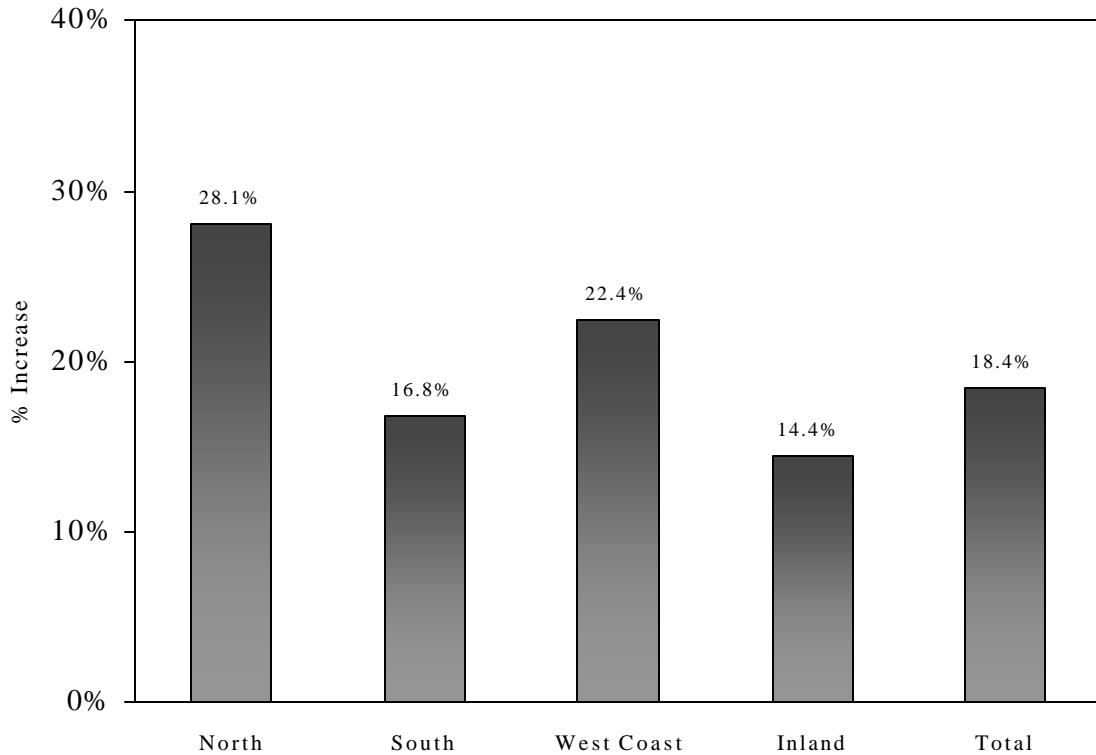
Estimating the exact size of the injury is a complicated question, but the results are undeniable. Prior to termination of the MOU, imports were at less than 28 percent of the market. In the period just before the current Softwood Lumber Agreement went into place, Canadian imports had captured 37.4 percent of the U.S. market. Since the agreement has been in place, the import share has ranged from 31.9 percent to 34.5 percent.⁴⁶

Since it competes directly with subsidized Canadian production, this decrease in Canadian market share has been mirrored by an increase in U.S. production. According to industry estimates, U.S. softwood lumber production has increased by an average of 18.4 percent with the agreement in place (See Chart 2). Similar patterns are evident from other U.S. efforts to restrain subsidized imports from Canada.

⁴⁵ For the most recent determination of injury, see U.S. International Trade Commission, *Certain Softwood Lumber from Canada*, USITC Investigation No. 701-TA-312, Publication No. 2530, July 13, 1992.

⁴⁶ Data is derived from the American Forest and Paper Association, *Statistical Roundup* (Washington, DC: AF&PA, 1999) and U.S. Department of the Census, IM145 & EM545 data.

**Chart 2. Increase in U.S. Lumber Production Under the SLA
(April 1995 – March 1996 vs. April 1999 – March 2000)**



Source: AF&PA

Impact Upon the Environment

One impact of Canadian lumber subsidies that has gotten insufficient attention is the devastating impact that they have upon the environment. There are vast differences between the way in which timber harvests are conducted in the United States as compared to Canada. More than 90 percent of the timber harvested in Canada is cut from old-growth forests in British Columbia, Quebec and elsewhere.⁴⁷ Efforts to expand timber production are focused largely upon areas that have not previously been logged. Further, Canadian companies have devoted fewer efforts to sustainable timber management than their U.S. counterparts and trees simply grow more slowly in colder Canada. As a result the rate of timber cut in Canada is estimated to be 25 percent above sustainable levels.⁴⁸ In short,

⁴⁷ Global Forest Watch Canada, *Canada's Forests at a Crossroads: An Assessment in the Year 2000* (Washington, DC: World Resources Institute, 2000) pp. 55.

⁴⁸ *Ibid.* For British Columbia, this number rises to over 40 percent.

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timber cutting in Canada is devastating irreplaceable, pristine ecosystems at a rate far faster than they can be replaced.

The U.S. lumber industry has also drawn its share of criticism from defenders of the environment, but decades of environmental consciousness-

“This forced allocation of forest lands to the [Canadian] logging industry gives them a greater supply and reduces cost to the forest industry to the detriment of other potential users... The result is environmental destruction of our old growth forests rather than using our forests in more environmental [sic] benign ways....”

Society Promoting Environmental Conservation
April 12, 2000

raising and federal and state environmental protections have had an effect. A small and declining percentage of the U.S. timber harvest is from old-growth forests. Indeed, many old-growth forests are protected on federal and state lands on which logging is prohibited. Most U.S. timber is harvested from private land and second and third growth harvest areas, which are far less environmentally sensitive than old growth forests. In fact, due to efforts to replant and recover forest land, the percentage of the total area of the United States covered by forest has increased in recent years.⁴⁹

Furthermore, all timber harvested in the United States is subject to various environmental laws, notably the Endangered Species Act, which sharply limits harvests in the U.S. Pacific Northwest to preserve Spotted Owl populations. Some Canadian government officials and timber company representatives have made extravagant claims about similar protections in Canada, but British Columbia’s oldest environmental group offered this pointed comparison:

One serious problem has been the unrestrained hyperbole from federal and provincial authorities in Canada regarding protecting biodiversity. I was surprised today to hear that our Federal minister says he has just introduced Species at Risk legislation that he claims is ‘the best in the world.’ With all due respect this claim is nonsense when we compare it to American legislation that really does have teeth and this was proven with the spotted owl decision. The proposed Canadian Act would not likely lead to a Spotted Owl type decision because the decision will be a political one by design,

⁴⁹ U.S. Department of Agriculture, *National Resources Inventory* (1997). Data available online at <http://www.nhq.nrcs.usda.gov/NRI/1997/>.

*not a scientific one. Resource politics are very strong in Canada. As a result, the Canadian Act does not provide the level of biodiversity protection that the American Act does. The proposed Canadian Act is further weakened due to constitutional divisions with the Provinces.*⁵⁰

It is for this reason that virtually every environmental protection group in the United States and Canada supports U.S. efforts to reduce Canadian timber subsidies through trade restrictions. Consider this sampling of environmentalist opinion, submitted in response to a U.S. government request for comments on the Softwood Lumber Agreement:

The Northwest Ecosystem Alliance, Defenders of Wildlife, Earthjustice Legal Defense Fund:

*Stumpage rates...are administratively set by provincial governments rather than through a competitive bidding process. Stumpage rates across Canada are well below the market average of similar species in the U.S....These lower prices provide an incentive to overcut Canada's forests.*⁵¹

The Castle-Crown Wilderness Coalition (an Alberta environmental group):

*...[T]here is ample evidence to indicate that the Alberta softwood lumber industry is the recipient of a range of economic subsidies and that those subsidies can be directly linked to a dramatic increase in exports of softwood lumber products from Alberta into the United States softwood lumber market....Despite clear warnings that Alberta's forests were being subjected to unsustainable levels of harvesting and all of the attendant environmental effects, the Government was steadfast in its almost ideological zeal to diversify the political economy by promoting one mega forestry project after another. In Alberta it is a well-known fact that Alberta's forests are in serious trouble – only the government and the softwood lumber industry itself refuse to acknowledge that reality.*⁵²

The David Suzuki Foundation:

*It is our position that any agreement between Canada and the US must recognize and respect how exports of under regulated and subsidized lumber products negatively impact the environment, economy, and communities and First Nations of British Columbia.*⁵³

The Raincoast Conservation Society:

*From an environmental perspective, a shift in harvest emphasis from the remaining original old growth forest to the replacement second growth forests will provide respite for critical old growth forest ecosystems and their full range of dependent species.*⁵⁴

⁵⁰ Letter from Paul Hundal, Director, Society for Promoting Environmental Conservation, Vancouver, B.C. to U.S. Trade Policy Staff Committee, April 12, 2000.

⁵¹ "Comments of Northwest Ecosystems Alliance, Earthjustice Legal Defense Fund and Defenders of Wildlife on the Canada/U.S. Softwood Lumber Agreement," Directed to the U.S. Trade Policy Staff Committee, April 14, 2000, pp. 1.

⁵² Castle-Crown Wilderness Coalition, *op. cit.*, pp. 20-21.

⁵³ David Suzuki Foundation, *op. cit.*, pp. 1.

⁵⁴ Letter from the Raincoast Conservation Society, *op. cit.*, pp. 1

The Society Promoting Environmental Conservation:

*You can help protect this natural treasure for all North Americans through your trade policy by not allowing these products [softwood lumber products] into your country. We wish to thank the American government and people for their contribution to biodiversity protection through their acceptance of the Spotted Owl decision. Your support through trade policy to induce Canada to meet these same objectives is needed now.*⁵⁵

The Kettle Range Conservation Group:

*Today these subsidies have to be addressed. It is, therefore, incumbent upon the U.S. government to negotiate with Canada an end to subsidies that cause ecological destruction, social inequities, and market distortion.*⁵⁶

Environmental Non-Governmental Organization (ENGO - coalition of several dozen environmental/biodiversity groups):

*... [L]ong term logging concessions are given to huge [Canadian] timber companies who pay well below market value for the trees they cut. These lower prices provide an incentive to overcut Canada's forests. For example, British Columbia, Canada's largest timber producing province, is cutting its forests 40 percent over sustainable levels. This 'overcut' of 9.8 billion board feet is equal to the total volume of lumber exported to the U.S. yearly from British Columbia alone under the Softwood Lumber Agreement... Ninety percent of the logging done in Canada is in virgin, old growth forests, nearly all by clear-cut methods. Unlike the U.S., where logging is governed by a strong regulatory framework, Canada lacks strong environmental laws. For example, Canada has no Endangered Species Act, stream protection is minimal and citizens and wildlife officials have little input into forest management. This situation is having significant adverse effects on U.S. efforts to protect our shared threatened and endangered species like bull trout grizzly bear woodland caribou, and salmon.*⁵⁷

The Natural Resources Defense Council:

*The U.S. re-negotiation of the U.S.-Canada Softwood Lumber Agreement (SLA) is one of the largest environmental issues facing the U.S. Administration. Approximately 90% of logging in Canada occurs in old-growth or primary forests, with 90% of this logging done by clearcut methods. As 80% of Canada's forest products are imported in to the U.S., it is the timber trade with the U.S. that is fueling the liquidation of Canada's old-growth or primary forests.*⁵⁸

⁵⁵ Society Promoting Environmental Conservation, *op. cit.*, pp. 4

⁵⁶ The Kettle Range Conservation Group, *op. cit.*, pp. 2

⁵⁷ ENGO, "Statement on the U.S.-Canada Softwood Lumber Agreement," April 12, 2000, pp. 1. Available from the Office of the Secretary, United States Trade Representative.

⁵⁸ Natural Resources Defense Council, *op. cit.*, (Executive Summary).

Rebutting Critics

For whatever reason, defenders of Canadian lumber subsidies have had comparatively little to say about the environmental impacts of these subsidies. Perhaps the most extensive effort to answer environmental critics was put forward by the Cato Institute, which advanced four closely related arguments.

First, Cato argues that there are better ways to promote environmental objectives than trade restrictions. The report goes on to call trade restrictions “absurdly

“The AAC [Allowable Annual Cut] and the timber industry’s bottom line are the primary drivers for provincial forest management. Forest management is not predicated on the need to protect ecosystems and the full range of forest values, nor is any consideration given to meet Canada’s international obligations to protect species. Conservation and the maintenance of ecosystem values, such as old-growth protection, endangered species, or fish habitat, exist only in the rhetoric of industry and government officials.”

The David Suzuki Foundation
April 12, 2000

roundabout and inefficient” means to address environmental concerns. It is not clear from this that the authors have carefully analyzed the situation. Environmental problems result from overharvesting of timber and the United States is the primary customer for Canadian timber. If the U.S. restricts its market to demand that the subsidies that result in overharvesting end, it is taking a direct - certainly the most direct available - step toward addressing the problem of overharvesting. It is hard to imagine a more effective step toward that end.

It would be better if the Canadian government took steps on its own to end the offensive practices - most notably subsidizing overlogging - but that is not an option available to U.S. policymakers and seems to be blocked by powerful political forces in Canada. Absent an end to the subsidies, the best option available to U.S. policymakers is restricting lumber imports to reduce directly markets for Canadian lumber and limit the adverse impact of the subsidies on other parties. These restrictions also provide Canada with a real incentive to reform its current lumber industry practices; this positive incentive

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would not exist if the restrictions were eliminated. Simply put, this is why there is near universal support for these restrictions in the environmental community.

Second, Cato argues that, “there is little reason to believe that terminating the SLA would have a significant impact on harvesting.”⁵⁹ This statement ignores the direct relationship traced above between the SLA and other measures to restrict subsidized Canadian imports and the reduced market share of subsidized Canadian products in the United States. In fact, the record demonstrates a direct relationship between the presence of U.S. restrictions and a decrease in subsidized lumber imports from Canada. This position would seem to be confirmed by the ongoing effort by the Canadian lumber industry to remove these restrictions in order to expand their exports.⁶⁰

To buttress this rather weak argument, the Cato authors also rely upon the study of the stumpage system by U.S. economists financed by the Canadian lumber industry. This analysis is rebutted above. Further, the claim is directly rebutted, as the statements quoted above demonstrate, by the numerous environmental groups directly involved with this issue.

Third, Cato cites a “number of private sector initiatives” being implemented to protect Canadian forests. No evidence that these initiatives will succeed is presented; in fact, even their description is cursory. Certainly, the fact that Canada’s timber harvest - 90 percent of which is being taken from old-growth forests - continues at unsustainable levels would provide a powerful demonstration that these private sector initiatives are not working. Nor have the Canadian provinces implemented a system of truly competitive sales, so inevitably the economic incentives to overharvest continue. At the very least, no reason is provided why trade restrictions on subsidized Canadian lumber in any way compromise or undermine these private sector efforts. Finally, the history of environmental regulation in the United States and around the world would seem to demonstrate conclusively that the problem cannot simply be left to the private sector.

⁵⁹ Lindsey, Groombridge and Loungani, *op. cit.*, pp. 10.

⁶⁰ See Discussion in Lawrence Solomon, “Drilling Holes in Forestry Rhetoric: It’s Not Free Trade Our Lumber Companies Want, Its Free Trees,” *The Financial Post*, April 4, 2000, p. C19.

The Cato argument closes with a quote from a U.S. company that imports lumber from Canada saying it would be “counterproductive” to limit trade with Canada because of Canada’s efforts to protect its forests.⁶¹ Again, the denunciations of Canadian government efforts by environmental groups on both sides of the border provide a powerful rebuttal.

Finally, the Cato analysis suggests that U.S. policymakers should look only at the U.S. environment. Again, U.S. policymakers continue to strive to improve forestry practices in the United States, with some considerable success, as is evidenced by the increase in forest cover in the United

“...Canadian timber is clearly produced in a manner that allows Canadian logging companies to externalize environmental costs and to therefore put a cheaper product on the market. The environmental costs are then either borne by ecosystem degradation, or by taxpayer-funded programs to repair the degradation.”

Natural Resources Defense Council
April 13, 2000

States. At the same time, the Canadian subsidies directly impact the U.S. environment by harming transboundary species and rivers and by impairing the economics of timber management in the United States. Further, Cato cannot pretend that the environment stops at the border. Restricting Canadian lumber imports is in exactly the same vein as previous limits on numerous products with negative environmental impacts, such as elephant tusks, whale teeth, jewelry made from sea turtle shells, bear livers, and so on. Again, this is why the environmental community on both sides of the border so aggressively calls for U.S. action to counter Canadian subsidies.

Cato’s analysis also includes the statement that “...trade restrictions artificially boost the cutting of U.S. forests.”⁶² Obviously, this is impossible to reconcile with the previous statement (made only four paragraphs earlier) that those restrictions have no effect on Canadian lumber harvest. Apparently, Cato has found a most unusual law of economics - one that applies only south of the Canadian border.⁶³

⁶¹ Lindsey, Groombridge and Loungani, *op. cit.*, pp. 10.

⁶² Lindsey, Groombridge and Loungani, *op. cit.*, pp. 10.

⁶³ It should be noted that this argument also concedes that Canadian subsidies do adversely impact the U.S. industry and that restrictions remedy that economic harm.

In view of the statements of defenders of the Canadian lumber subsidy, it is difficult to avoid the impression that they do not take the concerns of environmentalists very seriously in this instance. If so, that is a serious error on their part. As demonstrated above, Canadian lumber subsidies - chiefly low stumpage rates - pose a direct threat to virgin, old-growth forests in Canada. This is a precious, irreplaceable resource. It makes no sense to not only allow continued widespread destruction of this resource but, in fact, to subsidize it. As the market for most of this subsidized lumber, the United States has a unique obligation to act to encourage the Canadian government and the Canadian lumber industry to eliminate these subsidies.

Originally, the U.S. government and the U.S. lumber industry sought to counter and offset the impact of subsidized lumber imports from Canada for economic reasons. That rationale is still entirely valid and fully supported by U.S. trade law, sound trade principles, and the World Trade Organization. However, it is impossible to disentangle the adverse economic impacts of Canadian subsidies on the United States from the adverse environmental impacts; they both result from the same action - overlogging. But even if none of the economic and trade policy rationales for countering Canadian lumber subsidies existed, the adverse environmental impacts of Canadian lumber subsidies would provide sufficient reason for restrictions on Canadian lumber imports.

IMPACT OF SLA ON CONSUMERS

An increasingly popular tactic of opponents of trade sanctions - often regardless of the sanctions' purpose - is to argue that the impact of the restrictions on U.S. consumers outweighs the benefits. Since a simple static tariff analysis, which most of these consumer estimates are based upon, ignores almost all of the benefits of such a restriction - benefits to the environment, trade policy benefits, long-term benefits to the market, etc. - and ignores market limitations on consumer impacts, such as alternative supplies or replacement materials, the outcome almost inevitably is that the consumer impact outweighs the benefits. Thus, although the modeling exercise captures almost none of the relevant factors in the debate, opponents of trade limitations often parade it as "proof" of the correctness of their position.

In its report on the SLA, the Cato Institute also employs this popular tactic. Using its estimate, it argues that the SLA increases the price of lumber by \$50 to \$80 per thousand feet. The authors conclude that this, in turn, increases the price of the average new home by \$800 to \$1300 and prices 300,000 families out of the home market. In the same vein, Cato suggests that far more people are employed by lumber using industries than in the lumber industry and, thus, the benefits of the SLA outweigh the costs. This analysis is deeply flawed.

Prices Not Too High

The most fundamental error that the Cato Institute makes is assuming that Canadian lumber would be appropriately priced in the absence of the Agreement. In fact, because of the subsidies and artificially enhanced production, the price charged is below what the market would establish if allowed to operate. If allowed to operate without interference - in this case without the impact of Canadian subsidies - the market would establish a higher equilibrium price for lumber - close to that which would be established by the imposition of countervailing duties on subsidized imports (which the Commerce Department has calculated at 11-15 percent). In fact, the entire theory behind imposing countervailing duties

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to offset subsidies is to reestablish the normal equilibrium as it would exist without the subsidy.

“This [Canada’s forestry regime] has created a dynamic in which the rates of timber cutting in Canadian forests are exceedingly unsustainable. Canadian forest products have flooded the U.S. market, causing ecological destruction in Canada, and serious social impacts on forest dependent communities and market distortions in both countries.”

Great Lakes United
April 13, 2000

As explained above, the sub-optimal price resulting from the subsidy encourages overconsumption (in the form of overlogging), diverts resources from other sectors, and causes unemployment in the U.S. lumber industry. It is

important to understand that the same basic economic analysis that suggests that the cost of tariffs often outweigh the benefits would also suggest that the cost of subsidies often outweigh the benefits. Thus, Cato and others, who paint themselves as defenders of free trade, are actually defending protectionism in the form of Canadian lumber subsidies.

Strikingly, the Cato Institute itself concedes that subsidies are merely another form of protectionism in a number of other publications that criticize subsidies in other sectors. As one example, consider this recent comment from another Cato publication:

*Protection and subsidies alike deny Americans the freedom to spend and invest their resources as they choose. They diminish national wealth by diverting resources to less productive but politically favored sectors of the economy. Subsidies undermine support for an open economy by tainting the cause of free trade as just another favor for big business.*⁶⁴

In another paper, the same Cato authors involved in the Canadian lumber report made the following comment on subsidies:

*Domestic price supports and export subsidies cost taxpayers huge amounts of money while creating the market distortions that spur demand for import protection.*⁶⁵

⁶⁴ Daniel T. Griswold, *Free Trade, Free Markets: Rating the 105th Congress* (Washington, DC: CATO Institute, February, 1999) pp. 1.

⁶⁵ Brink Lindsey, Daniel T. Griswold, Mark A. Groombridge, and Aaron Lukas, *Seattle and Beyond, A WTO Agenda for the New Millennium* (Washington, DC: CATO Institute, November 4, 1999) pp. 11.

Once again, the Cato Institute appears to have identified an economic principle that, in its opinion, applies only south of the Canadian border.

SLA Impacts a Small Amount of Lumber

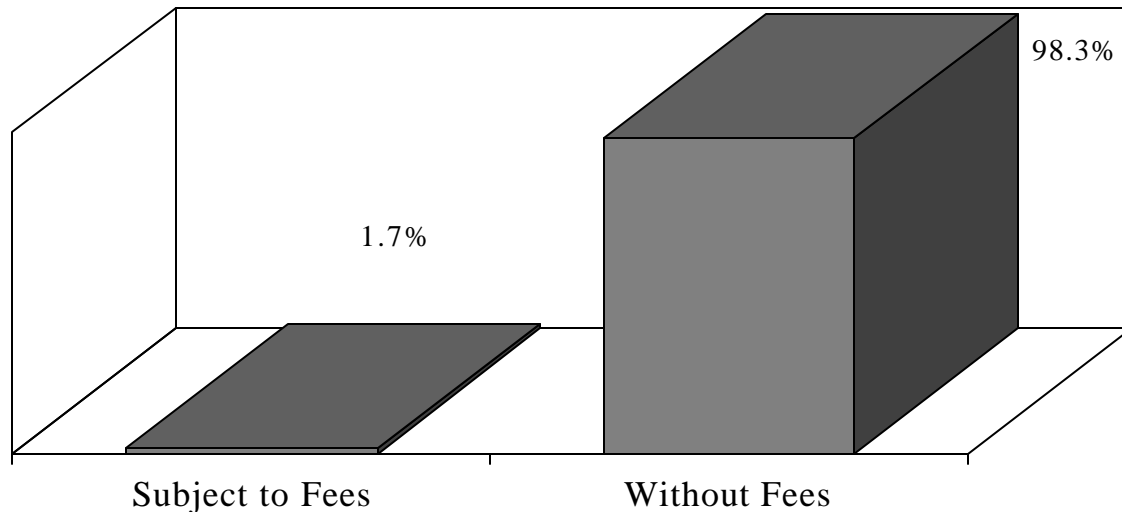
Cato also seems to assume that the cost of all lumber has increased by their estimate of \$50 to \$80 per thousand feet as a result of trade restrictions offsetting the subsidies. It is difficult to discern from the Cato publication how this estimate could be justified, since the supporting material needed to analyze their estimate was not provided. This makes it impossible to critically evaluate many of the claims made regarding the lumber market.

These analyses overlook the fact that only a very small portion of the lumber sold in the U.S. market actually pays any fee under the SLA. Under the SLA, the first 14.7 billion board feet of lumber imported from Canada pays no fee. The next 650 million board feet pays about \$50 per thousand feet; above that level the fee rises to \$100 per thousand board feet. Plus, all lumber from the Maritime and Prairie provinces is exempt from the fees. It is entirely possible, depending upon market conditions, that no Canadian lumber will be subject to fees in a given year. In reality, only 1.7 percent of U.S. consumption was subject to any fee at all.

It is simply impossible for such a small volume of lumber subject to fees to raise the price of all the lumber sold in the U.S. market by \$50 to \$80 per thousand feet. In the remaining 98.3 percent of the market, competition between lumber sellers would prevent prices from similarly rising (see Chart 3). In fact, while one cannot clearly discern Cato's method of analysis, its results closely parallel several other estimates that assumed the \$100 fee on 1.7 percent of imports increased prices exactly the same as a \$100 fee on all imports.⁶⁶

⁶⁶ Cato's estimate uses many of the same assumptions as the National Association of Home Builders (NAHB) does in its comments to the Trade Policy Staff Committee, achieving similar results.

Chart 3. Lumber Consumed in the United States Subject to Export Fees Under the SLA



Source: AF&PA, U.S. Customs, U.S. Census ('98 Data)

Other Reasons for Price Increase

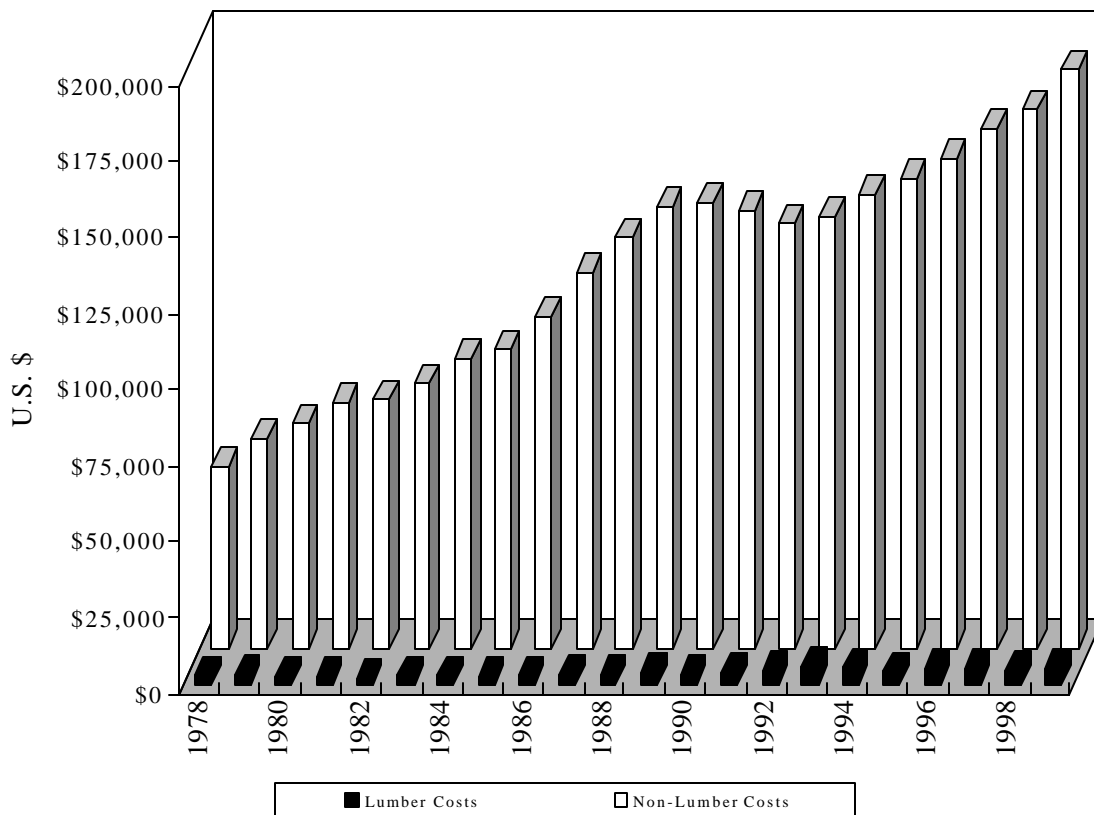
The Cato Institute also apparently assumes that restrictions on lumber imports are the only “unexplained” factor responsible for lumber price increases since the United States began taking measures to counter Canadian subsidies. Yet, the National Association of Home Builders itself claims that environmental restrictions in the Pacific Northwest have been the primary cause of lumber price increases in the 1990’s.⁶⁷ As any independent observer would concede, a number of factors have impacted the lumber market.

⁶⁷ See the National Association of Home Builders website at <http://www.nahb.org/facts/forecast/lumcost.html>. It states that, “The increases [in the price of lumber] have been caused primarily by environmental restrictions on timber harvesting in the forests of the Pacific Northwest.” (Site accessed September 21, 2000).

Impact on Housing Overstated

The claim that the SLA raises the price of the average new home by \$800 to \$1300 and prices 300,000 families out of the home market is particularly lacking in credibility. Lumber is actually a small part of the cost of a new single-family home - something less than 3 percent - and lumber prices have actually risen more slowly than other inputs needed for home construction (Chart 4). In fact, lumber prices are beginning to decline and in real terms, are at historically low levels. During 2000 alone, lumber prices have dropped from \$385 per thousand board feet in January to \$279 per thousand board feet in September, while home prices have continued to climb.⁶⁸ In light of this decline, it is difficult to argue that the SLA has harmed homebuyers.

Chart 4. Lumber vs. Non-Lumber Costs of a New Home 1978-1999



Source: U.S. Census, *Forest Products Journal* (Nov./Dec. 1994), Wood Products Council & *Random Lengths*

⁶⁸ Data derived from the U.S. Census Bureau and *Random Lengths* (www.randomlengths.com).

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Similarly, the methodology employed to extrapolate an estimate of 300,000 homebuyers impacted is also not provided. Given that the increase in housing costs, even if the Cato estimate is accepted, would be small if amortized over a 30 year mortgage - only a dollar or two a month - it is difficult to imagine such a large impact on housing purchases. An interest rate change of less than 1/8 of a percentage point would have a much greater impact on the housing market, far eclipsing the Cato estimate.

Finally, while it is true that more people are involved in construction overall than in lumber production, it is absurd to compare that miniscule impact to the devastation being caused by the subsidies to producers, workers and the environment.

More Reasonable Estimates

More credible and more reasonable estimates of the likely impact of restrictions on Canadian softwood lumber have been made. Employing the U.S. International Trade Commission's COMPAS model to estimate the impact of the SLA indicates that the Agreement reduces Canada's market share from 37-40 percent to the 34.5 percent actually observed and generates an estimate of the impact of the price of a new single-family home ranging from less than \$100 to about \$200.⁶⁹

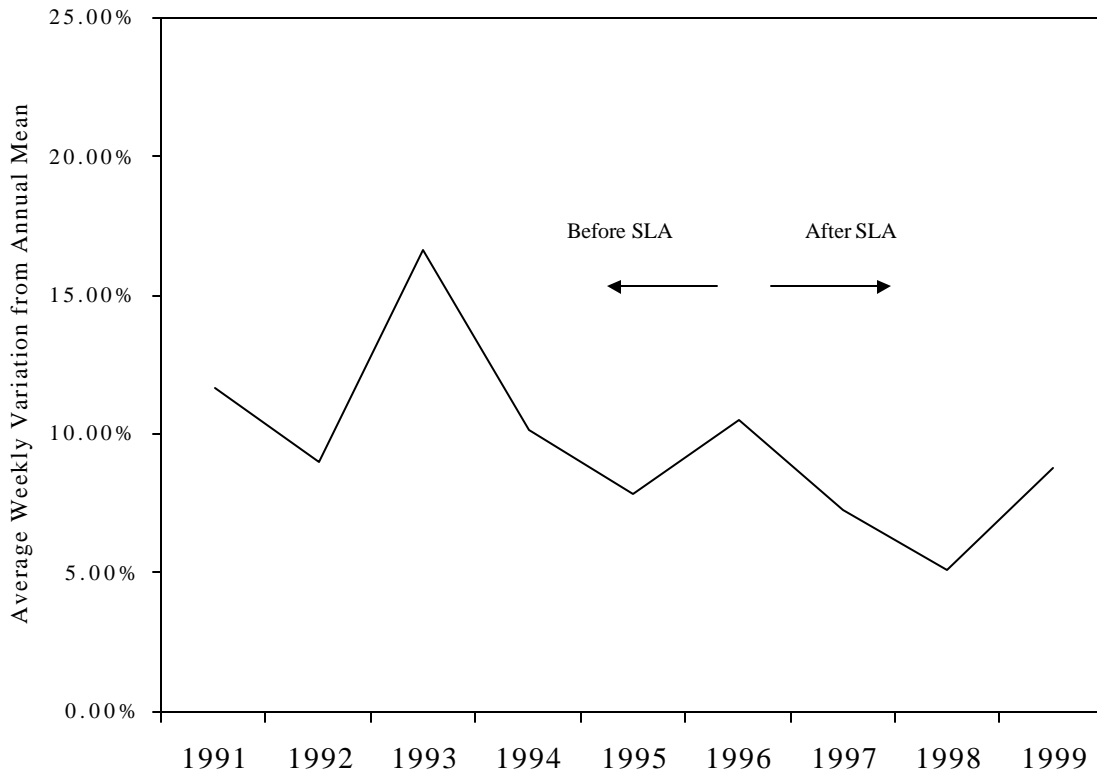
Volatility in Market

Cato also makes the claim that trade restrictions have created "volatility" in the lumber market. No documentation of any kind was provided to support this claim or to demonstrate its impact. In addition, unbiased observers of the lumber market note that volatility has actually decreased in recent years (See Chart 5).⁷⁰ Finally, it is again logical to assume that other measures that have had a broader impact on lumber supply, such as the Spotted Owl decision, would likely have a larger impact upon volatility.

⁶⁹ Analysis of the Lumber Agreement using the International Trade Commission' COMPAS on file with the author. Available upon request.

⁷⁰ *Random Lengths*, "Volatile Lumber Prices? Not so far in 1997" Vol. 53 Issue 25, June 20, 1997.

**Chart 5. Relative Volatility of Lumber Prices 1991-1999
(Standard Deviation of Weekly Prices/ Annual Mean Price)**



Source: *Random Lengths*

In light of all the above flaws, it is difficult to treat the Cato Institute estimate, indeed the entire report seriously. Its methodology is deeply flawed, it accepts theoretical analysis by Canadian industry consultants (without identifying them as such) uncritically, and the report seems inconsistent with the positions of the Cato Institute in other areas.

CONCLUSION

The goal of U.S. policy with regard to lumber trade with Canada has been and should remain achieving true free trade. This means a situation where lumber production is not subsidized, timber is sold in the open market at competitive auction prices, and duties are not applied. Free trade would benefit the U.S. lumber industry, ensure efficient allocation of resources, protect the environment from overlogging and support long-term consumer interests.

With the current Softwood Lumber Agreement scheduled to expire in April of 2001, the policy question is how best to achieve these goals. Unfortunately, it appears that Canadian policy is largely controlled by Canadian timber interests. This means that it will be very difficult for

Canadian taxpayers and others who suffer from subsidies to overcome the timber lobby and install a meaningful and permanent effort to auction or competitively price stumpage rights in Canada. Canada's log

“Despite the fact that the Canadian industry and U.S. homebuilders groups are pushing for free markets for their wood products and an end to the Agreement, they are benefactors of a system that is anathema to free markets. It is a system that prices raw materials in ways that have little to do with market value or the true cost of ‘mining’ ancient forests.”

Northwest Ecosystem Alliance
Earthjustice Legal Defense Fund
Defenders of Wildlife
April 2000

export ban also is likely to remain in place without outside pressure for reform. Thus, unless the United States - the primary consumer of Canadian lumber - takes action to create a level playing field, Canadian lumber subsidies will continue to disadvantage U.S. producers and destroy the environment.

In light of this reality, the United States must continue to press Canada to reform. Since that effort is likely to fail if it is strictly rhetorical, the United States should impose a countervailing duty to offset the likely benefit of the subsidy on all Canadian softwood

lumber imported into the United States if Canada will not agree to phase out or offset the subsidies. This would insulate U.S. producers from the injurious effect of the subsidies, help to curb environmentally dangerous Canadian overlogging, and give the Canadian provinces a real incentive to eliminate their subsidies and move toward true free trade.

Such a duty would be consistent with both U.S. law and international trade agreements, but experience has demonstrated that it may also spark litigation in a number of forums. This reality may push U.S. policymakers to consider a new softwood lumber agreement as a second best alternative. Properly structured, such an agreement would capture many of the benefits of a subsidy offsetting duty and would certainly be far superior to simply allowing Canadian subsidies to continue with no U.S. action.

The softwood lumber dispute is the rarest of trade disputes from the perspective of U.S. policymakers. It provides the U.S. government with the opportunity to protect a U.S. industry from an unfair foreign subsidy while protecting the environment and incurring little adverse impact. Further, if the strategy worked in convincing Canada to finally drop its subsidies, it could result in truly free trade in lumber. It is a true win-win-win opportunity, one that should not be missed in April of 2001.

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