

CATO INSTITUTE POLICY FORUM

NAILING THE HOMEOWNER?

ASSESSING THE IMPACT OF TRADE RESTRICTIONS

ON SOFTWOOD LUMBER

Thursday, October 26, 2000

Featuring:

Michael Carliner, National Association of Home Builders;
Christopher Boesen, National American Indian Housing Council;
Dave Modi, Georgia Pacific; and
Scott Cameron, CHEP USA, Inc.

The Cato Institute
1000 Massachusetts Avenue, NW
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P R O C E E D I N G S

MR. LINDSEY: Welcome to the Cato Institute. My name is Brink Lindsey. I am the Director of the Center for Trade Policy Studies here at Cato. The subject of our forum today is the future of the U.S.-Canada softwood lumber dispute.

I sometimes forget to say this at the end, so let me say it at the beginning. If, at the end of today's session you find yourself interested in learning more about the Cato Institute and, particularly, learning more about the Cato Institute's trade policy work, I think there is no better resource to go to than our Web sites. The main Cato Web site is www.cato.org, and the main trade policy Web site, a stand-alone site which you can get to through the Cato site but you can also get to directly, is www.freetrade.org. "Freetrade," one word, easy to remember. And there you will find all of our materials.

Also, if you have colleagues who would be interested in today's session, this event is being Webcast live right now and will be video-archived so it can be downloaded with Realplayer software afterwards. Also, we're transcribing events now, so a transcript should be up on the Web site pretty soon.

The subject of our meeting here today is the long-running U.S.-Canada lumber dispute. It's one of those

endless and endlessly complicated legal wrangles for which U.S. trade policy is justly notorious. This particular two-decade tussle has turned on allegations by some U.S. lumber producers of unfair trade by their Canadian rivals.

In particular, the allegations center on Canadian forestry practices, especially the pricing by the Canadian Federal and Provincial governments of rights to harvest timber from Canadian Crown lands. These so-called stumpage fees are, according to some members of the U.S. lumber industry, unfairly low, giving Canadian lumber producers an unfair cost advantage, and setting up the well-known unlevel playing field.

So, just to give you the Reader's Digest condensed version of this dispute, things got rolling back in 1982, with an original countervailing duty, or CVD, investigation by the United States against Canada. In that case, the Commerce Department found that there were not countervailable subsidies by the Canadian Government. Commerce, however, flipped in 1986, in a second CVD case, and issued a preliminary determination that the stumpage fees did indeed constitute a subsidy.

Under the threat of that finding, the U.S. and Canada reached a memorandum of understanding, which imposed a 15 percent export tax on Canadian lumber exports to the United States. That regime continued into effect until 1991, when Canada terminated the arrangement, which was then met immediately by a U.S. Section

301 action and, following that, a self-initiated third CVD case. That third CVD case then ended up in a new level of legal wrangling at the U.S.-Canada Binational Dispute Settlement Process, under the Free Trade Agreement, the end result of which was a finding that the U.S. had misinterpreted the countervailing duty law and was required to refund Canadian producers to the tune of \$800 million.

Nevertheless, in anticipation of further carnage, both sides agreed, in 1996, to another truce. This is called the Softwood Lumber Agreement, which imposes a quota arrangement on exports from Canada's four largest lumber exporting Provinces, and then a series of fees on above-quota shipments. That agreement, the SLA, is due to expire on March 31st of next year. And so all sides are gearing up to anticipate and argue about the future of U.S.-Canada lumber trade after the SLA expires.

It is at this point, at this rather late date in the controversy, that the Cato Institute has gotten involved in this matter. We published a study, which I co-authored with my colleague, Mark Groombridge, and with IMF economist Prakash Loungani. We issued this study in July, which focused on the harm that trade restrictions on lumber have caused to downstream lumber-using industries and consumers. The econometric analysis by Prakash Loungani found that trade restrictions from 1986 through 1998 had caused an increase in lumber prices of between

\$50 and \$80 per thousand board feet, or approximately a 20 to 35 percent hike over prices at their free trade level. This translates into an increase in the cost of new housing of between \$800 and \$1,300.

We further found that although there are about 217,000 jobs in logging and sawmills, the jobs that presumably benefit from trade restrictions, there are, on the other side of the equation, about 6 million jobs in lumber-using manufacturing, the lumber wholesale and retail trade, and home building. So that, for every one job that potentially benefits from trade restrictions, there are more than 25 jobs that are potentially harmed on the other side.

Before turning the event over to the speakers, let me explain a little bit about why Cato decided to get involved in this particular dispute. First of all, the trade restrictions on Canada are a major trade barrier. We import about as much lumber from Canada as we import carbon steel from the whole world. And those of you who follow trade policy have seen what contortions Washington has gotten in over steel trade issues of late. By contrast, the lumber issue receives a lot less press and a lot less attention, and we wanted to shine a spotlight on this comparably sized trade policy issue.

Second, and more basically, the whole reason why we founded the Center for Trade Policy Studies was to challenge the

trade policy conventional wisdom: that free trade is a favor that we bestow on other countries, contingent upon their good behavior. We see this attitude everywhere in trade policy. We see it in the position that we should only reduce our trade barriers if other countries agree to do the same. Anything else would be, according to the conventional wisdom, unilateral disarmament.

We see this attitude in the trade sanctions that we gleefully impose on the Europeans, to "punish them" for their transgressions on bananas and hormone-treated beef, ignoring the fact that we are simultaneously punishing our own import-using industries and consumers. And we see this attitude in the 20-year campaign to block lumber trade with Canada, on the grounds that some of their forestry practices are not to our liking.

But this conventional wisdom, however dominant, is dead wrong. Free trade is not a favor we do to others. Free trade is a favor we do to ourselves. By opening our markets to the best and cheapest goods the world has to offer, we expand consumer choice, we specialize our industries into things we do best, and we intensify the competitive pressures that lead to higher productivity and higher standards of living.

The sad fact is, if we retaliated against every country with dumb and dysfunctional policies in the world, we would have

nobody left to trade with. And so the beginning of trade policy wisdom is the recognition that we need to pursue trade measures on the grounds of what's good for America, not on the grounds of what will show up the rest of the world for their shortcomings.

In the past year or so, an impressive coalition of lumber-using constituencies have banded together to make the case that trade restrictions on lumber are not good for America. These constituencies include home builders, lumber dealers, downstream lumber-using manufacturers, and affordable housing groups. Three representatives of these constituencies are here on the panel today. We also have on the panel today a representative of the U.S. lumber producing industry, who will argue that trade restrictions are good for America.

With the issue thus framed properly, we're looking forward to an interesting and spirited debate. Our first speaker will be Michael Carliner, of the National Association of Home Builders, where he serves as Staff Vice President for Economics. Michael is responsible for economic analysis and forecasting, survey research, and analysis of government policies affecting the housing industry. Before joining NAHB in 1984, Michael was Director of Regional Real Estate and Construction Economics at Chase Econometrics. He has also served as Vice President of Regional Data Associates and Senior Economist at Dynamics Associates.

Ladies and gentlemen, please welcome Michael Carliner.

(Applause.)

MICHAEL CARLINER,
NATIONAL ASSOCIATION OF HOME BUILDERS

MR. CARLINER: Thanks. I was looking at the list of who is here today, and I was kind of intimidated by the number of people that are quite expert in this already. But let me go through some of the underlying situation in terms of the lumber trade, which may be old news for many of you.

About a third of the lumber we use in the U.S. comes from Canada. U.S. producers could not fulfill U.S. demand, given current forest policies. Although there are a lot of trees growing on Federal land -- about half of the softwood timber in the country is on public lands -- not very much of that is made available for production of lumber. And the timber from private lands is being used about as fast as it grows.

Lumber is the most important, by far, material going into new homes. And new homes and improvements to existing homes represent about two-thirds of the consumption of lumber in the U.S. I don't want to spend a lot of time -- or I won't spend any time because Chris is going to talk about this -- on the effect of higher lumber costs on home buyers and on the cost of housing.

A lot of that is covered in the handout that I brought along. That is outside. It says "NAHB" on it.

The Softwood Lumber Agreement imposes a quota, basically, but it's not exactly a quota, for lumber shipped from Canada. Anything shipped beyond the quota is subject to a fee of up to \$148 per thousand board feet. The average price of framing lumber now is about \$280 per thousand board feet, so not very much is shipped at that fee.

The effect of a quota -- this quota or any quota -- is both to increase the price and also to make the price more volatile. Because the supply then becomes less elastic, less responsive to demand, demand goes up. Supply doesn't respond in the same way, because once it hits the quota and there are these high fees, it doesn't come. And the way that the quota is being administered in Canada, in fact, it's both a ceiling and a floor for their shipments; so that when prices go down, they go down further.

Recently, they've gone down, in fact. They were about \$480 last summer and they're about \$280 now. When it's going down like that, it's fine for builders and not so great for lumber dealers. When it's going in the other direction, it's very disruptive to the home building business. Most homes are sold before they are built. And builders usually quote a fixed price to build them. They don't buy the materials in advance.

Because if they bought the materials and took it out to the job site, it tends to disappear unless it's nailed down.

The full value of that \$148 maximum fee does not pass through into the cost of lumber in the U.S. Our estimate is that, on average, but not right now, it adds about \$50 per thousand board feet. The Cato estimates are a little bit higher. But not only does it make the price in the U.S. higher, it makes the price in Canada lower. So the differential between the cost of buying the same lumber in the U.S. and Canada is more like \$80 to \$100. And therefore, for manufacturers that use lumber as an input, they're in a very poor competitive position relative to their Canadian counterparts.

As Brink mentioned, there are a lot more jobs that depend on lumber than there are producing lumber. There are about 500,000 jobs involved in manufacturing industries where lumber is an input, compared to the 200,000 in logging and sawmilling.

Now, the benefit of these quotas does not generally accrue to the workers in lumber mills. It doesn't provide more jobs, because we don't have any more trees to run through the mills. It may have a little bit of short-term effect, but that's not a significant amount. And in fact, in general, it doesn't help the mills all that much.

The benefits of this pass through to the owners of timberlands, of private timberlands. And the benefits to them are indeed substantial. But it's not clear to me that home buyers should be spending substantial amounts to subsidize the owners of timberlands.

In Canada, most of the timber is owned by the Provincial governments. Here, about half the timber is owned by governments, but they don't sell that timber. So that most of the timber going into producing lumber is on private lands. The U.S. lumber producers -- and this will no doubt be explained to you more fully in a few minutes -- believe that the Provinces sell that timber to lumber mills there at below fair market prices, injuring, therefore, U.S. producers.

As I describe to some extent in the handout -- although, if people are interested, I have some further literature on the subject -- if the price is lower than a fair market price, it should have no effect on the amount of lumber produced, in the amount of lumber shipped to the U.S., or on the price of lumber. That will depend only on how much timber is being sold by the Provincial governments. If it's below what is the maximum price at which a mill could profitably operate, it means the mills make more profits. But they don't give it to home buyers, they give it to themselves. If the price is above

that level, then it's not a fair market price. It's above the fair market price.

Now, I don't know whether the prices in Canada are fair market prices. It's not easy to make it a competitive market. In many cases, there is usually like one lumber mill anywhere near the forests they're selling the trees from. And so there isn't much potential competition if they were to open it up, although I think there could be some changes in the system there. My point is that the only thing that affects the price is how much is sold.

Our view is that if there is an allegation of subsidy, even though we believe that it should be based on whether or not it affects the price and the quantity, and whether -- well, I don't want to go too far into the CVD policy -- but, anyway, while we think that the CVD policies are biased against downstream industries and consumers and are not exactly fairly administered, that is the appropriate way in which to deal with this issue, rather than have the government assume that there is some subsidy, that there needs to be something done about it -- which we think there is no problem and therefore there is no solution needed -- that that would be the appropriate approach to it.

That isn't what's in place now. Instead, we have this quota. And someone, if they want, can argue about whether this

is actually a quota rather than a tariff. This is something that in fact was suggested by Canadian producers, in part, because they were afraid of the countervailing duty. But this is like if the producers of lumber in Oregon and the producers of lumber in Georgia got together and said, "Let's reduce the supply and raise the price on builders and home buyers." They would end up in jail if anybody found that out.

And it would be true that in fact if they just talked to each other, between British Columbia and Georgia, that would be true. The involvement of the U.S. Government said, well, even though this would be illegal for a private party to do it, because the governments are involved, therefore it's legal, it's okay, in fact, it's in the national interest, by some peculiar definition of national interest. And I guess it's our view that that probably is a very peculiar public policy and one that needs to be revised.

MR. LINDSEY: Thanks, Michael.

Our next speaker is Chris Boesen, who serves as Executive Director of the National American Indian Housing Council. As the Director of the Council, Mr. Boesen is responsible for the operation of the Nation's largest service provider to tribes on low-income housing, mortgage lending and economic development issues. Based in Washington, D.C., NAIHC provides training and technical assistance to hundreds of tribes

and tribal organizations nationwide, and operates the Native American Housing Resource Center.

While at NAIHC, Chris created and serves as CEO of the Coalition of Indian Housing and Development, which is NAIHC's sister organization for advocacy.

Ladies and gentlemen, please welcome Chris Boesen.

(Applause.)

CHRIS BOESEN,

NATIONAL AMERICAN INDIAN HOUSING COUNCIL

MR. BOESEN: Thank you very much. I would like to thank all of the participants who are here today. And I would also like to thank all of the members of the audience who are with us. This is an important debate, and one that I'm sure is not going to end here today, but I'm glad to see it's getting so much attention. I would also especially like to thank Scott Lincicome, and Brink Lindsey here, for putting on this event.

The most important element in my introduction is that I am not an economist. I am not the author of a study. And I studied political science, but the only thing I took away from that was the recognition that two people could look at the same set of statistics and come away with two completely different ideas of what they mean. I'm simply an advocate who represents

the families living at the fringes of the housing market in the United States today.

There is no community in the country that faces more challenges with regard to housing than Native Americans. Forty percent of the housing in tribal areas is substandard, meaning that it is either overcrowded or has serious physical deficiencies, lacking heating systems, plumbing, or other basic elements that the rest of us take for granted. Sixty-nine percent of Native Americans in tribal areas live in what is termed severely overcrowded conditions, with as many as two dozen people living in a single-family house. In fact, the percentage of overcrowded homes in tribal areas is seven times the national average.

More than 30,000 families are currently on waiting lists for rental housing, which is built by tribal housing programs receiving Federal assistance. NAIHC estimates that there is a need for more than 200,000 new homes in Indian country, including replacements for existing substandard structures. An important factor in assessing the impact of the Softwood Lumber Agreement for Native Americans is that the construction of housing in Indian country, whether it's done by the tribe or a tribal program, or through one of the few bank loans available to individuals in tribal areas, is more sensitive to the cost of construction materials than other housing.

The three principal costs associated with home construction are land, materials and labor. Most home construction in Indian country is on reservation land, which is land that's held in trust by the Federal Government on behalf of tribes or individuals. Also, because most of the housing is through the tribal housing program, that are subject to the Davis-Bacon Act and its prevailing wage requirements, labor costs are set, as well. So it does make a difference if you're paying more for lumber, because it becomes the only real variable in determining construction costs.

For most of us in this room, the SLA may not have a big impact on our everyday lives. Whether or not we get a home or a place to raise our family is not dependent on a few hundred or even a few thousand dollars. Those who would have us maintain the SLA say that the difference is only about the cost of a home appliance. But for tens of thousands of Native Americans and for hundreds of thousands of other Americans, a few hundred or a few thousand dollars can be the difference between having a home or not having a home.

The proponents of maintaining the current trade practices do not argue that there is no impact on the cost of lumber by renewing the SLA. They argue that the impact is smaller than the members of the American Consumers for Affordable Homes would estimate. So we all agree that it does affect cost.

We are simply here to decide whether or not that cost is significant.

According to NAIHC's estimates, renewing the Softwood Lumber Agreement could cost us nearly 500 new rental units in Indian country over the next five years. This figure includes only construction under the Indian housing block grant program. It does not even include the cost associated with developing homes through the private mortgage markets or the government-guaranteed market.

The opposition estimates that the impact would be smaller, somewhere in the vicinity of 36 to maybe just over 100 homes, during the same five-year period. While we disagree with those numbers, even if we accept them, 100 homes is not insignificant. That's 100 families who won't have a decent place to live.

Let me tell you what it means in human terms, not the economic terms that these folks here are better at providing than I am. I would like to explain the cost in terms of a single home and, really, of a single family. The letter that I'm about to read from was written to Senator Byron Dorgan, from North Dakota. And Senator Dorgan read it at a hearing that I was testifying at, in front of the Senate Indian Affairs Committee last year. It's one of the most poignant examples of the challenges we face and the real cost of our lack of affordable housing in this country.

"Sarah Swifthawk died needlessly on the Rosebud Sioux Reservation in South Dakota. She froze to death. On the night of January 2, 1999, it was a truly dreadful night for that family. They had run out of propane to heat their house. They had no wood for their wood stove. And though they tried desperately to find some wood, they didn't meet with success. The Swifthawk house is one of approximately 100,000 terribly substandard homes that exist on our reservations.

"The house had only thin plastic sheeting covering two large openings where windows were supposed to be. As night fell and the temperature plummeted from 16-below to 45-below, Sarah's daughter and son-in-law, who live in the same house with their six children, put two blankets on Sarah, in an attempt to keep her warm. The mother then took the other two blankets they had and placed them over her six children, who were huddled together on the floor where she and her husband would sleep.

"Since there was only one cot in the house, that bed was given to Sarah, who was the grandmother of the family. Everyone else in the Swifthawk family slept on the floor, because the family didn't have any furniture. When the sun came up on Sunday morning, the daughter got up from the floor to check her mother, and found her mother had died during the night, frozen to death as a result of exposure and extreme cold.

"Fortunately, the body heat from the parents and children, all huddled together on the floor, kept them alive that terrible night."

I think we can all agree that no one, whether they're Native American, African American or Anglo, no one in the United States should freeze to death in their own home simply because there's not enough money for housing or because housing is too expensive for tribes to provide for their members. That few hundred dollars we are talking about could have given them a functioning heater and new windows, instead of plastic sheeting.

I don't believe there is one person in this room who could look at Sarah's grand kids in the eye and tell them: Sorry, we don't think a few hundred dollars matters to you. We don't think having your grandmother here to tell you one more story or sing you one more song matters to you.

This debate is not really about numbers and trees and lumber companies. It's about people who can't afford homes, and tribes who want to provide housing but have to stretch their meager Federal resources to try to cover a burgeoning housing crisis.

So, is the cost significant? I think it is. I bet that if they understood what housing affordability is, that Sarah Swifthawk's grandchildren think it pretty significant. We here in Washington need to make sure that what seems to be an

unrelated issue, like a trade agreement, does not rob families of a decent home or a loved one. In my opinion, the SLA is not worth 500 homes in Indian country, because it's not worth 500 families. And in fact, I don't think it was worth Sarah Swifthawk's life.

Thank you.

MR. LINDSEY: Thanks, Chris.

Before introducing the next speaker and leaving the issue of affordable housing, let me just throw out a couple of numbers about the broader effect of relatively small changes in housing prices on housing availability. I have two figures to cite to you. First, the Bureau of the Census has calculated that for every \$1,000 increase in the price of a new home, approximately 300,000 families will be priced out of qualifying for a mortgage.

Using slightly different assumptions, Fannie Mae has calculated that for every \$10 increase in monthly mortgage payments, you get 250,000 families who no longer can qualify for a mortgage. So, what may seem to us as relatively trivial numbers have rather large impacts at the margins on housing availability.

Now, however, we are going to switch gears and talk about the effect on downstream manufacturers. And here to share his perspective on this issue is Scott Cameron, who is Director

of Government and Regulatory Affairs for CHEP, the national leader in the emerging reusable pallet and container pooling business. Scott is also Co-Chairman of the Legislative Action Committee of the Reusable Pallet and Container Coalition, the trade group for reusable commercial packaging.

Previously, Scott represented the Governor of the State of California in Washington, D.C. In that capacity, he dealt with Congress and executive branch agencies on issues involving environmental, energy, and natural resource policy.

Ladies and gentlemen, please welcome Scott Cameron.

(Applause.)

SCOTT CAMERON,

CHEP USA, INC.

MR. CAMERON: Thank you very much. I appreciate all of your being here this afternoon. I've got to say, my presentation is not going to be quite as compelling on a personal level as Chris' was just a few seconds ago. But I do have a couple of significant points that I would like to share with you and get you to think about.

The first is the Softwood Lumber Agreement, I would argue, doesn't just hurt homeowners, but in fact it hurts consumers more generally in the United States. It even hurts

consumers who live in brick houses or concrete apartment buildings or who already own their house and don't plan on buying another one for another 20 years. The way it does that can be explained by describing my company and our business and our industry a bit more generally.

CHEP, as was mentioned, is in the business of renting reusable shipping pallets. We've got about 35 million pallets that we rent to grocery manufacturers, to farmers, and to other manufacturers here in the United States. And globally, we operate in about 31 countries on every continent except for Antarctica, and we control something like 100 million pallets globally. We also have operations in Canada as well as the United States. I should indicate that for purposes of full disclosure.

But our pallets are made out of wood; typically, in North America at least, softwood: Southern yellow pine and Doug fir. The Softwood Lumber Agreement has the effect of raising the price of lumber. That means it raises the cost that CHEP incurs in purchasing our heavy-duty reusable wooden pallets. CHEP only has around 2 percent of the national pallet market, which, ironically, makes us probably the biggest player in the pallet business in the U.S.

But, having said that, my corporate management tell me that the Softwood Lumber Agreement costs our relatively small

company about \$11 million a year. That means that our customers, Proctor & Gamble, Kraft, Nestle, are being charged \$11 million more than they would have to be charged if the Softwood Lumber Agreement were not in place. That, in turn, means that when someone goes and buys some Crest toothpaste or some Tide detergent or Kraft macaroni and cheese or Nestle hot chocolate, you're paying for the Softwood Lumber Agreement.

Now, it's not going to be 20 cents on your tube of Crest toothpaste, but the point is, that \$11 million, just in terms of the cost on my company's customers, is moving through the system. And if the SLA were not in place, those costs would not be there and consumer prices, at least at a national aggregate, would end up going down some measurable extent.

Now, one could argue that, well, somebody else in this long supply chain would simply pocket that \$11 million. Well, let me tell you that the major players in the grocery manufacturing business are very, very cost conscious. They compete with each other on cost all the time. Companies like Wal-Mart are proudly, or perhaps even notoriously, competent at squeezing costs out of a supply chain and reducing costs to consumers. So I think it's quite plausible that any cost reductions in the supply chain would flow down to the consumers and benefit the consumers.

So, CHEP is involved in the Softwood Lumber Agreement because we're in the business of trying to reduce the costs of our customers and their operations in the supply chain. And we would like to see the Softwood Lumber Agreement expire so that we can help our customers reduce their costs and, therefore, provide better service, in turn, to their customers, the American consumer.

Let me switch gears a little bit, in that, in the last week or so, there was at least one formal presentation made up on Capitol Hill, along the lines of, if the Softwood Lumber Agreement were to go away, the environmental impact in Canada would be very significant. The allegation has been made that Canadian environmental regulations, environmental laws, environmental standards are far inferior to those in the United States. Now, perhaps not everyone in this crowd is interested in the environmental argument, but since the issue has been raised up on the Hill, I thought it would be worth addressing briefly.

First of all, I would argue that it's a false premise that the sheer volume and weight of regulations affecting the environment is necessarily a good indicator of ambient environmental quality. For instance, which area do you think has tougher environmental regulations in North America: Southern California or Canada's Northwest Territories? I suspect most would say probably Southern California. On the other hand, who

thinks seriously that the air quality and the water quality is better in the L.A. Basin than it is somewhere in Canada's Northwest Territories?

My point here is that simply looking at the stringency or the volume or the weight or the level of bureaucratic burden associated with environmental regulations does not necessarily mean that environmental quality follows directly from that. One could argue back and forth in terms of which regulations are better, which regulations are more stringent. But I would suggest that perhaps, rather than, again, looking at the length of the regs or the wording of the regs, it's better to look at ambient conditions.

One way of doing that is to focus on the ecological issues. Which country has more endangered species: Canada or the United States? It's probably the United States. Which country's salmon runs are in greater trouble? It's the American ones; it's not the Canadian ones. In which country are grey wolves in danger? Well, we're importing wolves from Canada into the United States to put them back into Yellowstone.

So, clearly, the Canadian fauna are in fairly good shape compared to the American fauna. Not that necessarily everyone thinks it's a great idea to have wolves back in Yellowstone, but the point is that it's not plausible to argue that environmental quality would deteriorate in Canada if the

Softwood Lumber Agreement were to go away. That, in my mind, at least implies a certain amount of paternalism that is simply inappropriate. The Canadians are fellow North Americans. They have got very strong environmental groups up there, and I think it's foolish to assume that the Canadian public is not as interested in protecting their environment as we are down here.

Another thing to consider is, to the extent one restricts the amount of timber entering the United States from Canada, but U.S. demand for lumber increases, where else is that demand going to be met? It's going to be coming from imports from other countries, to a large extent. You're going to see imports from Chile increase. You're going to see imports from the Russian Federation increase.

Let me ask you another question. Who in this audience thinks that environmental performance and standards and enforcement is better in the Russian Federation right now than it is in Canada? I think that's a no-brainer. All I have to do is look at the condition of the Siberian tiger, which is probably heading toward extinction if the situation doesn't turn around, and compare that with the Canadian grizzly bear or the grey wolf or the Canada lynx.

So I would like to make a brief plea here in defense of our fellow North Americans. I think it's fallacious to suggest that environmental standards and environmental performance in

Canada is inferior to that in the United States, and a real stretch to say that, were the SLA to go away, that would produce significant environmental damage north of the border.

Thank you.

MR. LINDSEY: Thanks, Scott.

Now it's time for the other side of the fight. It is with a great deal of personal sympathy, if not sympathy for his position on this particular issue, that I want to introduce Dave Modi. I know what it feels like to be the designated skunk at the garden party.

(Laughter.)

MR. LINDSEY: My own worst experience was during the height of Ross Perot's anti-NAFTA jihad back in 1993. I was called upon to do a debate with a protectionist policy wonk on free trade versus fair trade at a UAW union hall in Flint, Michigan.

(Laughter.)

MR. LINDSEY: So it's not going to be that bad.

Dave Modi is Vice President for Government Affairs at the Georgia Pacific Corporation, here in Washington, and has been in that position since about this time in 1998. In this capacity, Dave manages all of Georgia Pacific's government affairs efforts for the company.

Before holding this position, he was Senior Director of Government Affairs here in Washington, where he had responsibility for issues including solid waste recycling, the Clean Air Act, the Clean Water Act, Super Fund, taxes, antitrust, product liability, global warming, and corporate governance, almost all of which we would probably find great deals of common ground here at Cato. But today, Dave gets to play dissident.

Everybody, please welcome Dave Modi.

(Applause.)

DAVE MODI,
GEORGIA PACIFIC

MR. MODI: Brink, thank you at least for offering me your personal sympathy. I appreciate that.

The source of this problem -- and I didn't hear any of the speakers before me dispute this -- is the fact that Canada subsidizes its timber industry. As Brink mentioned, over 90 percent of the land in Canada is owned by the government. The government does not sell this timber to the timber mills at a market price. It is kind of administered to them at a government-set price. It is, if you will, classic Eastern European, Soviet-style economics. And even folks in Canada admit that.

The way the timber process works here in the U.S., if a timber owner has timber that they want to sell, they open it for a competitive auction. And if the market is robust, as it is not now, you may get 10 or 12 companies or individuals show up to bid on that auction and it goes to the highest bidder -- pure market price. If the market is lousy, as it is now, you may not get so many companies show up. Three or four maybe show up. Maybe even fewer than that.

Even what timber is sold from the Federal Government lands now, public lands, is sold in the same way. They'll offer that for auction, and whoever is interested in bidding will come bid on it. In Canada, that's not the way it works. In Canada, the price is set by the government, given to the mill at "the" price, and "the" price is set based upon what they can get for it at the other end.

One of the handouts outside had a list of charts. If you look at chart one, it looks like this. You can see the difference in the stumpage -- the stumpage price, by the way, is the price that's paid for the timber -- the difference between stumpage in Canada and in bordering States in the U.S. And this is an apples-to-apples comparison. It is roughly the species in Canada versus the comparable species in the U.S. down below. And you can see pretty clearly that the Canadians offer their timber

at a much lower price than it is sold for at market prices in the U.S.

The other point that's important to make here is that the Softwood Lumber Agreement, as it is now, applies only to four Canadian Provinces. That's British Columbia, Alberta, Ontario, and Quebec. In the other Provinces, not all of them practice market economics. Saskatchewan and Manitoba have a few problems. But in the Maritime Provinces, for example, most of the timberland there is owned by private individuals, and it is sold at competitive market prices, the way it is in Maine.

And we have a mill in Maine that is on a river. Right across the river is New Brunswick. And we buy wood over in New Brunswick, on Prince Edward Island. We bring it back across the border in Maine. Canadian mills come into Maine and buy wood. And it's the way the market ought to work. It's a back-and-forth system, the way it should work.

The other part of the subsidy system in Canada that operates is that they do not allow exports of this subsidized wood to come to the United States. You can understand why. Why would the Canadian taxpayer want to have their subsidized timber going to U.S. mills? So not only do they give the timber away to the mills, but they don't allow any U.S. mills to come up there and have the opportunity to bid on or to even get access to any of the timber up there.

And there has been a lot of talk about what this may do to housing prices. Again, if you look at this same thing, chart number two, you'll see at the very bottom, that little dark line -- it didn't copy very well -- that is the lumber cost. The line above it, this big gap here, that's the cost of housing. You can see that the cost of lumber has not had a very big impact at all in the cost of housing.

Chart three, on the next page, has it in a table form. And you can see, again, pretty clearly the numbers there. The price of lumber is not a very big impact on the price of housing. In fact, if you look at the numbers, get into this a little bit, you'll see there was a fairly significant jump in lumber in the early nineties. The Home Builders have on their Web site that the primary cause of that was the restrictions on lumber in the Northwest as a result of the spotted owl. So, again, not much of an impact on housing prices.

The way the Softwood Lumber Agreement works now is 14.7 billion -- that's "b," billion -- board feet of lumber from the four Provinces that are covered by the Agreement are allowed to cross the border tariff-free. Above that, as I think Michael mentioned, 650 million board feet are subject to a fee, a tariff. And imports above that are subject to a higher fee.

The impact of all this is that of all the lumber consumed in the United States -- and it's about 55-56 billion

board feet; that's with a "b" again, billion -- over 98 percent of that is sold without any sort of tariff attached to it at all. It's either lumber produced here in the U.S., lumber that comes in under the 14.7 billion board feet that's allowed in tariff-free, or lumber that comes in from the Canadian Provinces that are not covered by the Agreement. Less than 2 percent -- in other words, of all the lumber consumed in this country -- has any kind of fee attached to it as a result of the Softwood Lumber Agreement.

Now, let me make one thing perfectly clear -- as the President once said -- the lumber industry in this country does not want trade restrictions with Canada. We don't like the Softwood Lumber Agreement and we don't want this. Our goal -- and I hope everybody on the panel would agree with me -- the goal was to eliminate the subsidies in Canada.

If you were to eliminate the subsidies in Canada, this issue would go away. Home builders would have to find something else to complain about, Cato would find some other industry to bash, and we would no longer have a complaint to make with this thing. That is the source and root of the problem. The Softwood Lumber Agreement is, at best, second best. Our solution, our goal, our desire is to get rid of the subsidies in Canada, to put it on a level playing field.

Finally, there has been some discussion -- and I have to, as Chris did, caveat that I'm not an economist and I'm not a statistician, but I'll throw the big words out, if I can, because I like to use them -- in my thing in chart six, I was going to talk about what the Softwood Lumber Agreement does to the volatility to lumber prices. This chart shows that there really has not been. If you look at the coefficient of variation -- don't ask me what that is -- you'll see that the variation in lumber prices has not been significant. No more variation before the Agreement than after the Agreement.

The fact is that lumber prices in this country are set by the old-fashioned invisible hand that Adam Smith once described, which is supply and demand. When supply is high and demand is low, you're going to have prices go down, as they are now. When supply is low and demand is high, the exact opposite will happen: prices are up. As it is now, and Michael referred to it briefly, prices are at a low. They are the lowest they've been now since the early nineties, since 1991-1992. They are so bad now that we at Georgia Pacific, by the end of this year, we will have shut down 20 percent of our capacity, because we simply can't make any money at these prices.

Now, when the market returns and if supply goes up and demand constricts, that price will go back up and we'll be there again. But the bottom line is that if Canada did not subsidize

its industry -- you have to look at what the impact on housing prices would be if that were to happen. If Canada had an open, free system, the way that we do in this country, where the timber were offered at a market price, and they were forced to compete according to the market dictates, how much Canadian lumber would come across the border?

As Michael said, and we would agree, we need Canadian imports in this country. The U.S. lumber industry understands that. We could not survive. We do not have the capacity, in this capacity in this country, to supply all the lumber that this country needs. But we have the capacity to supply enough, and we have the capacity to supply enough to compete, with those countries that compete with us on a fair basis.

Brink, thank you.

MR. LINDSEY: Thanks, Dave.

I'm going to open it up to questions in just a second. Let me just make one comment on the subject of subsidization, because I want to be quite clear that we at the Cato Institute hold no brief for a system in which the government owns all the land. But, nevertheless, it needs to be pointed out that the current levels of quota levels and the fee levels set by the Softwood Lumber Agreement are not based on any kind of calculation of the degree of subsidization, real or imagined, in Canada. They are numbers plucked out of a hat.

There are mechanisms for calculating whether Canada does engage in market-distorting subsidies. One unilateral U.S. avenue is the U.S. countervailing duty law, which has been used in the past -- not terribly satisfactorily in this dispute because of politicization of the dispute -- but at least there are mechanisms in place for measuring whether a subsidy exists and measuring how big it is. Those mechanisms were not used in negotiating the SLA.

A superior alternative is to go the World Trade Organization, which has an agreement on subsidies and countervailable measures, under which the Canadian system could potentially be challenged. If an impartial WTO tribunal found that Canada was subsidizing its industries to the detriment of the United States, then Canada would be under an international obligation to change its practices.

So, if we are truly interested in finding out definitely whether Canada subsidizes its forestry industry and then doing something about it, rather than using Canadian forestry practices as an excuse for trade barriers, I would suggest the best alternative is to urge the U.S. Government to take this case to the WTO.

Right now, I would like to open the floor up --

[End Side A. Begin Side B.]

MR. LINDSEY: We've got an intern coming around with a microphone. So, after I recognize you, wait until he comes around. Then give your name and affiliation, and direct your question to one of the panelists, or to all of us. If any of you happens to have a question about our Cato paper, I'm happy to field questions on that.

Questions?

MR. MERCURIO: Thank you. My name is Matthew Mercurio. I'm with Economists, Incorporated.

I have a two-part question, which refers to some points brought up in your paper, but it's basically to anyone here on the right-hand side. In the first place, as to the issue of the Canadian subsidies, isn't invoking a Commerce result sort of a clear indication that maybe the argument there has gotten a little bit desperate -- if we're relying on Commerce to say what the effect of the subsidy is?

And, second, looking here with regard -- it seems that the point about the log export restriction in Canada seems to be especially quickly dismissed. Isn't the fact that the Canadians are categorically unwilling to get rid of the subsidy and the log export restrictions at odds with the notion that they don't have any effect?

MR. LINDSEY: Let me handle your first question, and then maybe Michael might want to talk about the log export ban.

As to citing Commerce's opportunity, I did that for a particular reason. The Commerce Department is historically widely recognized for a nimbleness in bending over backwards in favor of the U.S. industry and to find unfair trade practices. So the fact that the Commerce Department, in its initial investigation, before the subsequent political firestorm, in its initial investigation, found that there was no subsidization, to me, is extremely telling on log exports.

But, of course, it's not the end word on the subject, but it's an interesting datum on the log export ban. Do you want to talk about that, Michael?

MR. CARLINER: Yes. In terms of the Commerce Department finding, I'm not quite sure which paper you are referring to, but listening to Brink's explanation, I was just looking at a paper that was written by the Congressional Budget Office a few years ago that indicated that between 1980 and 1992, in 93 percent of the cases where a U.S. industry said that a foreign industry was subsidized, the Commerce Department agreed. So they don't tend to say that there is no subsidy.

In terms of log exports, I think there are a couple of things that are interesting about that. One of them is that we have log export restrictions, as well. Not only are there restrictions on exports of unprocessed logs that come from public lands in the U.S. -- restricted from export -- in fact, it's a

more stringent restriction, I believe, than the Canadian. There are restrictions on exports of logs from Idaho to Washington, from Alaska to other States -- which I don't understand why that's legal, but anyway. So that what we're saying is, well, ignore the fact that we do the same thing, but if you do it, it's an unfair practice. Which I guess is peculiar.

Secondly, the 1994 Uruguay Round Agreement defined what were subsidies. And it was written with the intention that log export restrictions would not be a basis for saying that that's a subsidy. The U.S. Government said, well, we're going to interpret that as the exact opposite of what the WTO said, and we're going to say that can be a subsidy.

We were kind of looking for somebody else to get us a test case on this, some other product, where restrictions on exports of raw materials were a subsidy. Because when it was first imposed, it was based on a precedent on leather from Argentina. But the U.S. has dropped that duty on leather from Argentina. So there was no other case where we could try to challenge this interpretation of the law. But I think that there are several reasons, then, for thinking that this is not a basis on which to allege subsidy.

As I said, I've only got two under the foreign countervailing duty law, but there are some limits on where you can impose a countervailing duty. But there are certain common

sense kinds of considerations that I think should be countervailing duty policy but are not. One of them, as I discussed earlier, was it should have some effect on the price or the quantity of the goods imported into the U.S. That's not a requirement. Another is that there should not be comparable benefits provided to the U.S. industry, but that's not a requirement. Another is that it should be consistent with international agreements. That's not exactly a requirement; it's sort of a requirement -- you know, there is some reference to that.

But, I think most importantly, there should be some consideration about whether a trade restriction would have an adverse impact on downstream industries to consumers that goes far beyond the benefit that might accrue to the complaining domestic producers. And that is not a requirement. In fact, we were involved in this 1992 case, and we wanted to testify. And we were able to testify kind of as a member of the public. But there is a certain category of people who participate that are called interested parties. And even though we buy two-thirds of the lumber, we're not considered an interested party. So I think all of those things ought to be part of any sensible trade policy, and none of them are.

MALE VOICE: Let me just add, on the log export issue, that Michael is correct. Some States in the U.S. do restrict

exports of raw, unprocessed logs from their State. But the effect is that there are no restrictions on private lands in the U.S. And as a result, the U.S. is the largest exporter of unprocessed logs and timber in the world.

MR. LINDSEY: Questions?

MR. MCGUIRE: Robert McGuire. I'm an international lawyer.

I was listening to the debate. And we talked about how all the consumers and the carpenters are hurt from this. And I think, as a matter of both U.S. domestic law and WTO law, those people are not factored into the analysis; it's the producers of like product. But, leaving the law aside, it seems like the real problem is this Canadian subsidy, whether or not it's a subsidy.

So, since they're our neighbors and we want to help them out, why don't we give them the benefit of our experience, when we were selling the crude oil from the Strategic Petroleum Reserve or from our Naval Petroleum Reserves? We sold it at auction. We got a fair price. It went into the U.S. marketplace. It depressed the price. It seemed to work pretty well for us. Maybe the Canadians might benefit from that and use that same type of auction process to sell their timber and also reap the same monopoly profits.

But the other one is, if they didn't like that thought --

MR. LINDSEY: A great idea, by the way.

MR. MCGUIRE: Yes, a great idea. It worked. It's what we're all trying to do to get around this problem.

Or be more imaginative -- because there are a lot of people who are more imaginative than I am here -- and come up with some sort of commodity futures contract that they can sell on some commodity futures exchange for Canadian timber. But there are a lot of ways that they can get away from their current practice of setting an administered price.

I used to sell crude oil for the U.S. Government, and we were held accountable on how well did the sale go, how many participants, did you get the market price. And as long as we could show that it was a willing buyer and a willing seller, that was the market price. It might be low, it might be high, it might be indexed over the life of the contract, but you can come up with some pretty creative ideas, rather than the government arbitrarily setting a government-administered price.

Have we tried to do that to them?

MR. LINDSEY: Well, I did not invite to join on our panel any representative of the Canadian Government, and so I don't believe you're going to find on this panel or in the moderator a defender of the current Canadian policies. There is no doubt that a better administered system could be devised. The question is, what effect does it have on the U.S. industry? And,

furthermore, the question is, does the fact that country A does dumb things entitle or justify country B to compound those dumb things by doing further dumb things; namely, hurting its consumers with trade restrictions?

On the first point, the effect on the U.S. industry, I think it's worth hammering down this disconnect between stumpage levels and the price and import volumes of softwood lumber. If the Canadian Provinces set stumpage fees and then let folks come in and harvest as much timber as they wanted at that particular price, then of course below-market stumpage fees would increase the volume of timber cut and depress prices. But that's not how it works. One decision is made as to stumpage fees and a separate decision is made as to how much is harvested.

So even if the prices are below market, that does not necessarily cause above-market harvesting levels, because the harvesting amounts are set administratively, as well as the price. And so what the effect then is, is that if stumpage fees are set at below-market levels, then loggers may have super-normal profits; but then, in their downstream profit-maximizing capacity, they're going to sell their timber at market-clearing rates.

So, according to economic logic, there is no reason to expect, in a regime of administered stumpage fees and administered cut allowances, that you're going to have any

connection between the stumpage fees and the lumber production volumes. So I just wanted to hammer down that point.

MR. CARLINER: I just wanted to mention one other thing. I'm not sure that I want to defend the Canadian practices. I'm not sure I could even figure them out. But there is one other complication in addition to what I mentioned about kind of there not being very many mills to compete, which is that the way that the Canadians administer the public forests, unlike what's done in the U.S. These companies that have licenses in the forests are responsible for building the roads themselves, they're responsible for planting trees and replanting trees and doing other things, fighting fires, which all of this is done at the taxpayer expense in the U.S. or by the private landowner.

It's kind of hard to say, well, you went in and built the roads, but now we're going to open this timber up to everybody and it will probably go to a different mill. So it is complicated for them to make a change. I'm not sure that we would have any problem with them doing so.

MR. LINDSEY: Yes?

MR. BRISCOE: Pat Briscoe; Garvey, Schubert and Barer.

I just had a quick question. If a new agreement were reached, what sort of changes would any of you be willing to see as compared to the current agreement with regard to, for example, the tariff levels, the quotas, that kind of thing?

MR. MODI: Well, as I mentioned, our goal is not to get another agreement. Our goal is to eliminate the subsidies in Canada. And we have been Johnny-One-Note on that, maintaining that drumbeat for as long as we could. If the Canadians are unwilling or unable politically to do that, then we would listen to what they propose to countervail the effect of the subsidies. And I can't begin to speculate as to what that might look like.

MR. LINDSEY: Michael?

MR. CARLINER: We don't want to see another agreement, but we particularly don't want to see another quota. For one thing, the situation now is one where we feel the U.S. producers and the Canadian producers ganged up on the consumer. And so we want at least that any negotiation where the Canadians don't have an interest in making things worse for consumers, and that the cost of any trade restriction is borne by them rather than by the consumers primarily.

MR. LINDSEY: So if indeed the Agreement does lapse, the reality is that Georgia Pacific and others will very likely file a countervailing duty claim against Canada? You're willing to hash it out there rather than in negotiations between USTR and Canada?

MR. CARLINER: Given the choice between those two options, absolutely.

MR. LINDSEY: Yes?

MR. HERMAN: Chris Herman, with the Environmental Protection Agency.

How would a new package approach -- would it include or how could it include incentives -- how should I put it -- efforts to neutralize the incentive that the Canadian producers have to over-produce under the current regime, or deal with the under-regulation situation there?

MALE VOICE: That's a difficult question to answer, but let me at least take a stab at it. First of all, under NAFTA, there are environmental side agreements, environmental protocols. Presumably, the two governments could deal with each other in that diplomatic context rather than through something like a trade agreement, which I would argue is an inappropriate vehicle for dealing with these environmental issues.

Secondly, I think one has to acknowledge the fact that the Canadians are likely to say, well, you've got some subsidies that are producing environmental problems in your own forest products industry in the United States. This is not a situation where we are perhaps totally without some opportunity for criticism here. In fact, I hate to be an apologist for the environmental groups, but most people in the U.S. environmental community would say there are a whole stream of policies that are in place, tax incentives that are in place, patterns of appropriated funds that are in place, that are doing

environmental damage domestically and that are benefitting the forest products industry.

I'm not saying that's true or not. What I'm simply saying is it's a matter up for considerable debate. And in fact, it has been vibrantly debated from time to time just a few blocks away from here and other places. But I don't think that the forum for resolving essentially an environmental issue is through a trade deal. You should use existing environmental mechanisms that exist between the two nations.

MR. LINDSEY: I just want to clarify something. Dave, you say that your Johnny-One-Note position is to get rid of the subsidies. Does that mean just go to an auction-based system and then, if all the Provinces went to a pure auction-based system for selling of harvesting rights, that's the end of your list of demands?

MR. MODI: I would say yes. I don't know whether alternatives to an auction-based system would be just as market based and just as competitive, but our goal is competitive pricing of timber in Canada, yes.

MR. MINC: Alan Minc, with the Canadian Embassy.

I notice that there is this flurry of interest in the issue of the crossover between the allegations, true or not, of subsidization in Canada and the impact or implications in terms of Canada's stewardship, from an environmental point of view, of

its forests. I find, really, the rationale behind that argument is basically fallacious, the reason being as follows: Basically, we're being accused, on the one hand, as someone mentioned, of having a system of forestry in Canada that replicates an Eastern European command or centralized system; and then, on the other hand, we are being accused of pillaging the forests and not having any controls.

Now, either we have a highly controlled centralized system or not. In fact, Canada does have a very highly regulated system in place to manage the forests. There is an enormous amount of government regulation, both at the Federal and Provincial level, to manage forests, and there is extensive consultation. Someone used a metaphor of weight. The B.C. Forest Practices Code is the largest piece of legislation, I think, of any Provincial piece of legislation in Canada. When it comes to enforcement, the B.C. Forestry Service is larger than the Provincial police.

So I think it's good to really take a step back from this idea -- I mean, just take a simple, common sense view of it -- and say the concept that Canada is not regulating these forests, is not policing it, is something that is circumspect. That was just a comment. I'm sorry it's not a question. But I didn't say anything the other day on the Hill, but I couldn't resist it now.

MR. LINDSEY: Any responses?

(No response.)

MR. LINDSEY: I think then we'll wind it up on that note. Thanks again to all of our speakers for coming here and presenting their views. I don't think we settled anything today, but I do hope that we cast some light on this debate as it goes forward. And I thank all of you for coming. There is a reception upstairs for further conversation.

Thank you.

(Applause.)

(Whereupon, the Policy Forum was concluded.)