

CATO INSTITUTE POLICY FORUM

NAILING THE HOMEOWNER?
ASSESSING THE IMPACT OF TRADE
RESTRICTIONS ON SOFTWOOD LUMBER

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Featuring:

Rep. Jim Kolbe (R-Arizona);
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Cato Institute; and
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P R O C E E D I N G S

MR. LINDSEY: Good morning. Welcome to this Cato Institute-sponsored event. My name is Brink Lindsey. I am the Director of the Center for Trade Policy Studies at the Cato Institute. We are having an event today to look at the U.S.-Canada softwood lumber dispute. The fact that you are here, I think, indicates that you realize the importance of this dispute, the importance of this issue.

I want to start our proceedings by underscoring the importance of this issue, so you can go out and tell your colleagues why they should care about this as well. I was talking with a journalist not too long ago, trying to sell him on the importance of this story. He was a little skeptical. He said, "I am hard pressed to think that my editors are going to be terribly excited about any story whose primary elements are Canada and wood." But I swung him around. The reason is that this is a very big deal. It has implications far beyond the direct players.

First of all, just on its own terms, this is an enormous trade dispute. It is our biggest ongoing dispute with our biggest trade partner. In dollar terms, the amount of softwood lumber that we import from Canada is roughly equal to

the amount of carbon steel that we import from the whole world. And we all know the kind of attention that steel imports get and are getting right now. The lumber issue is every bit as big. It is just that it is with one country rather than dozens.

Furthermore, this is a big deal to many, many people who really have no idea that this dispute is even going on. Because as our research and others' have shown, relatively small increases in the price of a home can mean exclusion from the dream of home ownership for hundreds of thousands of Americans. So, their dreams and hopes hang in the balance of how this dispute is resolved.

Furthermore, it is big for our involvement in regional and multilateral trade liberalization. Next month we are going to have a big summit in Quebec, to try to revitalize the Free Trade Agreement of the Americas. The host country for that event, Canada, is of course the other principal in this dispute. If this dispute goes badly, then we risk alienating the biggest FTAA partner we have, and setting a bad example to other countries about caving in to protectionist interests.

And furthermore, if we handle this dispute in a way that does not take seriously our existing obligations under NAFTA and the WTO, we will end up adding to the growing threat to the integrity of the U.S. commitment to those agreements, and

therefore to the world trading system that is so profoundly in our interest.

I am going to wrap up at the end with a few concluding comments, but right now I would like to turn the podium over to Congressman Jim Kolbe, who is a representative of Arizona's Fifth Congressional District and a real hero to the free trade cause.

I first had the opportunity to work with Congressman Kolbe back in 1993. The two of us were paired up as debate partners on NAFTA. It was the Congressman and myself against Duncan Hunter and Pat Choate. Not to put too fine a point on it, we won.

REPRESENTATIVE KOLBE: Well, subsequently, we won it legislatively.

MR. LINDSEY: Absolutely. And ever since the NAFTA fight, where Congressman Kolbe was a real leader in the bloody battle to get NAFTA approved, he has taken a leading role, particularly striking for the fact that he is not a member of Ways and Means or the Trade Subcommittee, but he has taken this as a labor or love to push for free trade in a variety of different ways. He was very important in last year's successful battle to get permanent normal trade relations with China.

He has been constantly putting his shoulder to the boulder of what sometimes seems to be the Sisyphean task of renewing fast track, or what we now call "trade promotion

authority." And now he is the lead cosponsor of a House resolution calling for the end of trade restrictions on softwood lumber. There was an equivalent resolution in the last Congress which attracted well over 100 cosponsors.

Currently, this new one, I think, is up to 70-something, and indicates a real strength of support for the free trade cause, which is sometimes unusual in these kinds of trade disputes. It is a credit to the Congressman's leadership that this strength has been displayed.

So, now I will turn the podium over to Congressman Jim Kolbe.

REPRESENTATIVE JIM KOLBE

(R-ARIZONA)

REPRESENTATIVE KOLBE: Well, Brink, thank you very much. You just gave away the suspense. I know everybody here was in doubt as to which position I was going to take on the softwood lumber agreement. You just said I was the cosponsor of the resolution to do away with it. So, the suspense is gone. You know what the conclusion is here, so we can cut away to the chase here.

It is true, all the years that we worked together on those trade things, I didn't have a portfolio on trade. I have

always argued that I had to kind of elbow my way into the room to get a place at the table. Well, it is kind of an ironic thing, because now I have a place at the table by virtue of the fact that I chair the Subcommittee on Foreign Operations. And my place at the table is assured by the fact that we fund two agencies that this organization doesn't care too much about, which is the Export-Import Bank and OPIC. But at least it gets me a place at the table when it comes to talking about trade.

Well, let me just say that I am an unapologetic, unregenerate free trade advocate. I have an hour-long speech, a Castro-style speech, which I could give you about why free trade is both important and beneficial and why it is holy and right and all those good things there. But today we are focusing on one particular example of limitations on trade, whether they come in the form of tariffs or quotas or licensing agreements, and why they are so bad.

I think that when Brink was talking about "this is big" and "this is important," he is absolutely right. He is talking in terms of its macro implementations. But it is big and it is important also because it illustrates all the things that we need to understand about trade and what is wrong when you try to interfere with the marketplace.

Now, what is the background of this? Well, really, it goes back a long ways, to the time when we were first negotiating

the U.S.-Canadian Free Trade Agreement, back in the mid-1980's. Somehow lumber, a rather big product when you talk about trade between the United States and Canada, lumber got left out of the agreement. It was removed.

There are lots of stories about how that happened, but the bottom line is that the lumber industry here in the United States hired a couple of big, big high-powered law firms here in Washington to make sure that that happened. And sure enough, it did happen.

So, even though we have had a Free Trade Agreement with Canada since 1989, when that came into being, and of course the North American Free Trade Agreement which supplanted that between Canada, Mexico and the United States, since 1994, even though we have that, we still don't have anything that covers lumber. So, lumber is kind of dangling out there as this issue which can always be brought up and be subject to the kind of manipulation which you see precisely is going on.

As a result, three times the opponents to the trade with Canada on lumber brought up countervailing duty cases before the Commerce Department and the International Trade Commission, the ones that have the responsibility for investigating those. And twice they lost. The third one was dismissed in 1996, when we entered into the Softwood Lumber Agreement.

That brings us to the current situation that we are in now. It was 1996 when we entered into this. Canada just got tired of fighting these things and said, all right, let's just enter into an agreement with the United States about how much we will export to the United States in the way of softwood lumber. And that is what we agreed on. And it was reminiscent, I might add, of the voluntary quotas that Ronald Reagan initiated or agreed to with Japan on automobile imports back in the 1980's. Which, by the way, cost the American consumer, including most of the people here in this room, if you bought a car over a five-year period during that time, it cost literally hundreds of millions of dollars. But you never saw it. You didn't realize it. But we could get into a whole other issue here if we start talking about this.

The whole purpose of this Softwood Lumber Agreement was of course to supposedly protect the American timber industry by limiting the amount of this softwood lumber. Softwood lumber is how we refer to it because it is what is used mostly in construction, the building of homes and framing and so forth, and also for furniture and other things. There is hardwood lumber, but that is tiny, much, much smaller, and not a big issue between Canada and the United States.

By limiting the amount that could enter into the United States at a competitive price, the rationale was that this was

going to offset the impact of the Canadian Government's subsidization, purported subsidization, alleged subsidization of their domestic timber industry. And it's a whole other issue about whether or not that is accurate or not. If it is, and that is very much open to question, that can be addressed. But there are other mechanisms for doing that.

Ambassador Zoellich has assured us that he will ensure scrupulous and timely and effective enforcement of U.S. trade laws. You know, the Ambassador to the USTR has got to say that kind of thing. If I had my way about it, I would repeal all of those things, so that he wouldn't have anything that he could say he was going to be scrupulous about enforcing, and we would get rid of all of that stuff out there.

But the bottom line is that this is designed to help 217,000 workers. That is roughly the number that are in the U.S. timber industry. But the bottom line is that it has ended up having a negative effect on approximately 4 million other workers in lumber-dependent industry, not to mention the consumer, which I will come back to, which is the bottom line of all of this.

There are thousands of workers that are involved. Against those 217,000, there are 600,000 or so workers that are involved in building trusses and frames and all that kind of thing here in the United States that are impacted when the cost

of the lumber they could use is higher. Steel and aluminum get substituted for it, so they are directly effected by that.

Then you have all the people that are in the business of retail selling, people down at the Home Depot that sell lumber. They are directly affected by this. Again, they are directly affected but it is hidden. They don't see it. They don't see it.

Then there are the 6 million people who work in the home building industry, the construction workers. They are directly affected. So, you have this huge number of people out there that are very directly affected by this, but they don't see it in quite the most direct spotlight or highlighted way that somebody who is in the timber industry does and who can say when they get laid off, "I got laid off because of lumber imports from Canada." Never mind the fact that lumber imports from Canada ended up creating 100 jobs over here in the home building industry. Those people didn't get hired and say, "I just got hired because of lumber imports from Canada."

You can understand that. You can figure that out. And you see that that is the great problem we have in this issue of trade always. Making the case for trade is much more indirect and much harder to make in a direct way.

Well, the bottom line on consumers is that it has been estimated, variously estimated, by groups that this has added

between \$800 and \$1,300 to the cost of a new home. That obviously, o it seems obvious to me, I should say, but that prices a certain number of people out of the market for buying a new home.

I had somebody in my office the other arguing against this thing. They said, "Well, \$800, that is not going to make anybody ineligible to get a mortgage loan." I said, "Well, let me ask you this. If it was \$100,000 more, would you agree some people probably couldn't qualify for a loan?"

"Yeah, that's right." I said, "Well, it's somewhere. Where is the mark where anybody is affected by this?"

So, there are people. In fact, it has been estimated that more than a couple of hundred thousand families a year are not eligible for a loan simply because of the added cost of the lumber in here. So, there are people at the marginal end that are just there, whether they can qualify for a loan, and don't make that home mortgage loan because, thank you, for their comrades up in the Northwest and a few lumber States that have this protectionism for softwood lumber.

I might add that the final point in all of this is that this agreement hasn't worked. I mean, it is bad enough that it is a terrible bureaucracy and it is horrible in the way this kind of thing gets implemented. But it hasn't worked. What they found out was that the softwood lumber classification that we

agreed on applied to board lumber. So, what they said was, "Aha, we drill one hole through it, and now we have a finished stud here. That doesn't come under the qualification." So, of course, we rushed around to redraw the classification and say, "Oh, it applies to that." So, then they went to the other end and they drilled another hole through the other end of it, and then it was outside of that classification.

So, what you have, of course, is a cottage industry for Washington lawyers in the trade industry here who have figured out ways to get around the softwood lumber classifications, to figure out just exactly what they could do, if they sawed a little corner off or something like that, then it wouldn't qualify for the limitation there. Again, it just illustrates the whole craziness of all of this kind of thing. So, we have government-regulated trade that harms consumers, drives up the prices, pushes homeowners out of the market, and encourages manipulation of our Customs declassification system, and jeopardizes the economic well-being of all of us.

It is time for it to end. And I am happy to be able to say tomorrow night at midnight, on March 31st, it is over. It is done with and this administration is not going to continue it.

Understanding the importance of this to home builders and homeowners and everybody else out there who is affected by this, Steny Hoyer and I introduced House Concurrent Resolution

45, which calls for an end to the U.S.-Canada Softwood Lumber Agreement. We can kind of put that in the dust bin over here on Monday. But we will be able to put it in the dust bin knowing it has been successful. It was just put out there as a marker to anybody on the other side, because you have the letter from Senator Baucus and a bunch of other Senators saying it should be renewed or we should do other kinds of things, impose other taxes on softwood lumber. We just want to put it out there as a marker to show that there are a lot of people out there who believe that no, this is not a good deal, that we should not have this continued.

So, I applaud the administration, and thank God for this administration having the guts to say no to this industry, we shouldn't continue this thing. I hope that this case illustrates to all of us in a very clear way why free trade is important, how it benefits us, and how these kinds of manipulations of the market end up hurting consumers, end up hurting people in the industry, and distorts the marketplace, which all of us, at least in theory, say that we believe in.

So, I urge the administration not to cave in by giving in to new taxes or new ways of providing for these limitations. If we can have the Commerce Department and the International Trade Commission that has some guts and they can stand up to the pressures to do something about countervailing duty cases, I

think we can see the American consumer be able to go down to their Home Depot in a few weeks and buy lumber at a less expensive cost than was the case before.

So, that is the bottom line of this. The good news is on the way here. And it is an illustration as to why this kind of agreement should never have been done in the first place, and why the sooner we let it expire, the better off we are.

Thank you very much, Brink.

(Applause.)

MR. LINDSEY: Back in July, the Cato Institute published a study on the soon-to-expire Softwood Lumber Agreement, a study whose title gave the title to today's event, "Nailing the Homeowner? The Economic Impact of Trade Protection of Softwood Lumber."

Here to tell us about that study and our findings is one of its coauthors, Mark Groombridge, along with myself, another coauthor, and Prakash Loungani, of the IMF, who is in the audience here today.

Mark is a Research Fellow with the Center for Trade Policy Studies at Cato. He has been here for a couple of years. We stole him from the American Enterprise Institute, where he was Assistant Director of their Asian Studies Program.

He has a doctorate from Columbia in Political Science. And he will tell you what we found out about softwood lumber and the costs of trade restrictions.

Mark Groombridge.

MARK GROOMBRIDGE,
CENTER FOR TRADE POLICY STUDIES, CATO INSTITUTE

MR. GROOMBRIDGE: Thanks, Brink.

I want to describe our study in a little bit more detail, but I wanted to acknowledge Prakash, just as Brink did, who was a coauthor of the study and who helped with a great deal of the econometric analysis. So, if you have any in-depth or in-detail questions about multicollinearity or heteroskedasticity, I am going to defer to Prakash on that.

Before I begin, though, I have to pay tribute to a higher authority. And it might get me into a little bit of trouble with the Trade Policy Center, but my mother heard that I was speaking alongside Congressman Kolbe. And she and my father live in his District. She asked me to inform you that on Oracle Road and Saddlebrook Road, there is a stop sign. They would prefer a stoplight. So, they want to direct your attention to that.

(Laughter.)

MR. GROOMBRIDGE: As Julia Roberts said, I may not get this chance up here again, so I am going to take advantage of that.

The central message we have in the Center for Trade Policy Studies at Cato is one that is not often heard in the United States. Quite simply, that message is: Imports are good.

I don't think there is very much doubt that trade policy in the United States, the rhetoric of it, is so often export-oriented focused. When you talk about the trade deficit, you talk about it being bad for U.S. exporters. Or when you talk about the importance of WTO agreements or bilateral free trade agreements, so often that language is focused on export opportunities for U.S. industries.

The other side of the story, though, is the U.S. consumer. Frankly, that is a side that in this particular debate has not been heard, or has been neglected. A lot of people in the past few years, I know Susan, with the Alliance, and Jenna and Kyle, you guys have been, particularly in the past few years since the SLA was signed in 1996, have been refocusing our energy on the other neglected side of the story. And that is the U.S. consumer. We certainly applaud the work that you are doing.

The reason is because, as Brink articulated, this is an important issue. About 300,000 families, according to our data and analysis, are priced out of the housing market every single

year. Needless to say, this has a disproportionate impact on lower-income families. It is not the family that is buying the \$300,000 house that this has a significant impact on. It is families which do not have high incomes, and oftentimes those happen to be minority communities, as well. So, this is an important issue, both from an economist's perspective, but also from a social justice perspective, as well.

Let me begin just by saying, then, that the central message I want to deliver today is that, first off, there is little evidence that Canada unfairly subsidizes its lumber industry. I will go into more detail on that in a moment.

However, even if you do agree that Canada subsidizes its lumber industry in an unfair way, the best policy for the United States is to continue a policy of free trade. The economic analysis has made very clear that just because other countries choose to throw rocks in their harbors does not mean that we should throw rocks in our harbors, as well. And if you take into account the interests of the U.S. consumer, I think the message is pretty clear that trade restrictions against Canadian lumber imports have a negative impact overall on the U.S. economy, and, in particular, some of the poorest communities.

Let's discuss briefly, though, a little bit of the history of the trade restrictions we have had against Canada on lumber imports. Essentially, we have had what has been popularly

known as Lumber 1, 2, and 3. The first CVD case was filed in 1983. At that time, the U.S. Commerce Department actually ruled that Canada did not confer a subsidy through its stumpage system.

For those of you who might be a little bit unfamiliar with the topic, just to illustrate briefly, most of Canada's forests are Crown lands, or are essentially owned by the government. What individual Provinces do is they set a stumpage rate, where they tell a lumber producer or a timber harvester that for each tree you cut down, you must pay the government a particular fee. Some in the United States say that Canada charges too low of a fee for each stump that they cut down and that, in effect, constitutes a subsidy.

In 1983, Commerce ruled that in fact Canada's system did not confer an unfair subsidy. Three years later, in what was popularly known as Lumber 2, Commerce did reverse itself and did find a 15-percent subsidy. But what is important to note about this particular reversal is that it is not that Canada changed its practices in any way whatsoever. What happened was that Commerce changed the rules by which it determined whether or not a subsidy was actually being conferred.

In other words, Commerce unilaterally made the decision to make it easier to find evidence of a subsidy. A memorandum of understanding was signed in 1986, whereby Canada voluntarily agreed to impose an export charge on its lumber exports to the

United States, roughly in the neighborhood of 15 percent, similar to the subsidy rate that Commerce found.

When Canada unilaterally terminated that memorandum of understanding in 1991, it was not surprising that another CVD case followed. Given that the rules were sort of stacked against Canada, it is not surprising that both Commerce and the ITC found that dumping, if you will, was taking place and that Canada was subsidizing its industry.

What happened after that, though, is notable. At the time, the U.S. and Canada had a free trade agreement, and therefore there was essentially a dispute settlement mechanism by which you could have a binational panel review the findings of both Commerce and ITC. At every appellate level decision, the binational panel ruled against Commerce and ITC in their finding that a subsidy actually was in place. Consequently, the United States was forced to return roughly \$800 million in duties collected to Canadian harvesters.

In 1996, however, it seemed that Canada caved. And if there is another message that I want to send to some of my Canadian friends here in the audience, that would be "Don't cave this time."

Yes, the legal fees will be exorbitant and it is going to be a long, drawn-out battle. And while it is pretty clear that the agreement might expire tomorrow at midnight, I don't

think it is going to be an April Fool's Day joke when they file the CVD case against Canada. I think the producers have already made that position pretty clear. Fight the case.

I think the economic evidence will clearly support you, and it will be a long, drawn-out battle, and it might take several years. But, over the long term, I think you will win, and that will be a strong victory for free trade and also for U.S. consumers. That is the area that I would like to focus on right now. That is: Who suffers from softwood lumber protection here in the United States? The answer in short is: U.S. consumers, particularly the poorest in our country.

When we did this detailed econometric analysis, it is difficult to quantify the exact impact that a particular trade restriction has on the price of a home. Common sense tells you there are a lot of variables which go into the price of a home. Some of it might just be the overall economy, inflation, et cetera. There are a number of variables that go into the price of a home. One thing which we made a point of doing in our study, which was attacked, and I will respond to those criticisms in a moment, is that we tried to be very up-front and very clear about how we conducted our study, in terms of the methodology.

We had a very detailed list about the variables that we used, both the independent and the dependent variables. And I will stop the jargon in a moment, I promise. But the point is

that everything is out there for everybody to see. To be sure, some people say, well, you say it is a range of \$50 to \$80 per thousand board feet that the price goes up because of our trade restrictions against Canada. That is a pretty broad range.

The answer is: Well, yes, but it is at minimum, we think, \$50 per thousand square board feet. I would also say that several other studies have concluded in a similar fashion to us.

But, more importantly, if you wish to question the methodology, it is all outlined right there in the paper. If you have, as our study concludes, this particular increase in lumber prices upwards of about 20 to 35 percent above their free trade level, what does this actually mean?

Well, as Congressman Kolbe was suggesting before, about when he was debating with a member in his office, well, gosh, it is only \$800 to \$1,300 per home and that is really not that much. What is the threshold? Who does this have an impact on?

Well, here I am going to rely on what the U.S. Government says. That is, according to the U.S. Census Bureau, for every \$1,000 that the price of a home goes up, the U.S. Census Bureau concludes that 300,000 American families are priced out of the housing market. That is a statistic that the U.S. Government puts forward.

So, in other words, there are 300,000 families in the United States that are denied the dream of owning their own home

every single year. That is something that I think is of profound public policy importance here in the United States. And Brink and I have talked about this a lot before when we talked about trade protectionist policies. When you see oil or gas prices go up, consumers immediately know this because there is a direct impact because you see it at the gas station.

Sometimes this message gets lost, though, when you are talking about steel as an input into a car. And this is certainly the case here in terms of softwood lumber and its impact on the price of a home. It might seem to you insignificant, but when you begin to add up this cost and you look at the aggregate impact nationwide, it actually is quite significant.

The other important point to remember, and Congressman Kolbe already mentioned this and I will just reiterate it, is that there are roughly about 217,000 payroll jobs in the logging and the sawmill industries here in the United States. This contrasts with about 6 million workers in lumber-using industries. In other words, employment in lumber-using industries exceeds employment in lumber production by a ratio of 25-to-1.

To be sure, you can say that these 217,000, there is a more concentrated impact on them. But I am saying you need to look at the other side of the picture, too. There are a number

of homebuilders, employees at Home Depot, et cetera, and just independent contractors, who feel the pinch because of our trade policy restrictions.

The other thing that I just want to mention, too, and here just to provide a little bit of ammunition, hopefully, to our Canadian friends, is to some extent the hypocritical position of the United States. The United States is required to report subsidies to the WTO as part of our obligations to that international trade organization, which, I think, everyone here will agree has served the case and cause of free trade well. According to the U.S. Government's own figures, we essentially confer the equivalent of \$600 million at the Federal level in subsidies to our own harvesters here in the United States.

Here you can get into this sort of game of semantics about what is a subsidy and what is not. The way the United States typically confers the support is actually through capital gains, or changes in the way you calculate capital gains taxes, special loan provisions. So, essentially one way to think about it in layman's terms is: If you are a lumber producer here in the United States, I might change the way you calculate your taxes or the tax schedule by which you have to pay such that you don't have to give me as much money in a given year.

Essentially, it is a question of, well, you may not be giving me that money; is that really synonymous or the equivalent

of me writing a check out to you for X amount of money, which would be a direct subsidy? From an abstract level, I would say the answer is yes. And the U.S. Government agrees, which is why we report that figure to the WTO.

At the local and State level, there are a number of more specific subsidies that we give, as well. Both Georgia and Montana give direct assistance, financial assistance, in the purest form of subsidy possible to their producers. And several other States, such as Idaho and Alaska, place export bans on particular types of wood. The United States has accused Canada before of this practice and has said that that constitutes an illegal subsidy under WTO rules.

So, I would just point out that, to some extent, we are living in a glass house here in the United States, and we should be careful about criticizing the practices of other governments when we ourselves are guilty of many of the same policies.

Finally, I would just like to respond briefly to a letter that some of you Hill staffers might have received from Representative Charlie Norwood of Georgia. When our study came out, he issued a "Dear Colleague" letter against our study, questioning its methodology and questioning some of the conclusions we raised. I would just say that in terms of the methodological defense, everything is outlined on the paper. Also, Brink, myself and Prakash have written a response to that,

where we get into the really jargonish topics of multicollinearity and heteroskedasticity. If you are at all interested in that, please consult Cato's Web site and you will be bored to tears, but maybe not. And the response is out there on the table.

I want to conclude by saying that in this letter Representative Norwood made clear that he didn't think that the impact was that significant, and that lumber prices haven't been severely affected because of the trade restrictions we have in place against Canada. And here I just want to take this approach. Pretend you are a man from Mars, objectively looking at the situation, or just the common sense approach. Why would the lumber industry in the United States be lobbying so hard for this, spending millions of dollars in lobbying fees and lawyer's fees to impose restriction on Canadian wood unless it was going to raise prices here in the United States? That is the only reason why they would be doing that. That is just common sense.

When they say that it doesn't have a significant impact, it begs the question, well, then why are you fighting so hard to do this? If it is not going to have any significant impact on the price, why are you spending millions of dollars on lawyers and lobbying fees? I have yet to hear a good answer from them on that question.

Now, I will turn it over to my colleague, Brink Lindsey.

(Applause.)

MR. LINDSEY: The Congressman is under a time constraint, so we are going to let him field a couple of questions now before I wrap up.

REPRESENTATIVE KOLBE: Go ahead.

MR. WHITNEY: Peter Whitney. I work with a consulting firm and I teach economics.

REPRESENTATIVE KOLBE: Well, you have a head start on me. I am not a professional economist.

MR. WHITNEY: My family has a small tree farm in Georgia. I agree with the free trade benefits to our economy. I teach that in my class. But our laws and the WTO does allow protection against unfair trade practices. Otherwise we could never even get those agreements signed.

In the study here it says that only a few hundred producers would be hurt in the U.S. My question is, in saying this, have you not ignored the many thousands of growers of loblolly pine who have grown this in many, many States for 35-40 years before harvesting? They use our private lands, so they pay taxes on the land every year. In Canada, it is Crown lands and I don't know how the taxing works. And I can't give it to you

right now, but I have heard that the stumpage fees -- you say that they are not a subsidy -- I don't know.

I love Cato. I am an admirer of Cato, but you usually you have both sides, and you don't have both sides here today. I would like to hear the argument on the other side. Because I have seen that and heard that, in south Georgia and Alabama and North Carolina and Mississippi, that there is a real subsidy. In that case, our laws call for a countervailing duty.

Why do you say it is only 300? It is probably way over that. It is in the tens of thousands. So, people who own 50 acres to 1,000 acres and are saving that for all these years, including the environmental benefit, if you will, to make a product to pay for when junior goes to college or what have you. And if it is unfair, and I am willing to study it, if you allow an unfair subsidy to come in here, you are killing those people, as well.

REPRESENTATIVE KOLBE: I am glad you spoke. Because I think you are right, I think we need to be able to hear the other side. And at least you are pointing out some questions here.

I am going to duck the specifics of their study, because I didn't do that study. But I would ask a rhetorical question, I guess. I don't know how many thousands, either, whether it is hundreds or it is thousands of people who raise loblolly pine. But whatever it is, does that still justify harming

and putting a restriction on the price of lumber that harms millions of American consumers who use lumber? Clearly, a larger number use it than are producers or are directly in the logging industry. How can you possibly justify that?

Now, as to the subsidy that the Canadians have, I will leave it to them to argue whether or not it is greater. I think the studies are fairly convincing to me that the Canadian subsidy is not that much greater than the United States. It is very hard to compare. It is not apples to apples. Because on our lands, which are mostly private, there are different kinds, as he pointed out, mostly through the tax code.

On the Federal lands we have all kinds of subsidies, where there is harvesting on the Federal lands. The reforestation is done by the U.S. taxpayer. The building of all the roads -- and serving on the Interior Subcommittee of Appropriations as I do -- is a controversial issue every year as to how much building of roads for forestry should we be doing. Carving these roads through these wonderful forestlands there, the Federal Government, the taxpayers, pay for that. The U.S. Forest Service pays for that cost. Those are clearly subsidies that are involved in that. So, there are subsidies and there are subsidies in this.

I don't know that you can ever find exactly whether they are equal, because they are not the same kind of subsidy.

But I would say that, regardless of what they are, they don't justify, in my opinion, putting the kind of harm on American consumers that this does. That would be my argument.

I will certainly let you respond. Then I will take one more question before I have to go.

MR. WHITNEY: I think the rhetorical question for us is: Would we have WTO and NAFTA, these agreements which I support, if we couldn't get people to sign them? When we did the Kennedy round in 1962, we had to do that horrible thing to protect textiles to get Congress to be able to give the President the authority. And that is always the case in our democracy. What are you going to say to these people who have been growing these trees for all these years?

And as to the numbers, I have given a speech to one of the softwood lumber associations in Mississippi, and they had many thousands of growers. I don't remember the number, I am sorry, but it may have been 3,000 or 8,000. I don't remember. That was just one area. Those people, I think you could convince them, if someone did the study and really compared the subsidies. I know it is hard.

REPRESENTATIVE KOLBE: Since you came back around in a circle again with the same argument again, I am going to take the first part of that, which we didn't talk about. And that is, could we have gotten the WTO agreements, or the original GATT

agreements, or the NAFTA agreements, the WTO agreements, without the kinds of dispute settlement mechanisms that we have or the issues of countervailing duties, those kinds of provisions and anti-dumping laws?

As far as dispute settlement, I favor that. I think you have to have a mechanism for resolving disputes. But on the kinds of sanctions that we have in countervailing duties and anti-dumping provisions, you have to understand, I can say this because I am not the USTR. He has to be more political about this. But I can say it. I am for unilateral disarmament on this issue. I would get rid of those things.

No, we could not have passed them. I recognize that politically. I understand it. I know why they are there. But from purely an economist's point of view, they do not make any sense, those provisions. So, I would personally get rid of them. I think they are bad, and I think they have been terribly distorting to the marketplace.

By the way, I think they are now being abused terribly in the WTO. And I am very worried about that. Because I see an unraveling of a lot of this going on in the WTO. The idea is to bring a case against the other side, and the other side says, "Go stuff it," and "Stick it to us if you want." So we sanction them, and then they sanction us.

So, while it is provided for under the terms of the WTO, you have completely negated what we were trying to do in opening up trade. We have this right now. Try going out and buying Roquefort cheese. You can buy blue cheese, but it is not Roquefort cheese, because we have a ban on that because of bananas. There is a 100 percent tariff on Roquefort cheese because of our banana dispute. So, you can't get Roquefort cheese here in the United States right now.

These are the kind of crazy things that go on, and these kinds of distortions. I just disagree with them.

Yes, sir. Then I really will have to go.

QUESTION: Could you give us your message in government? Do you share Mr. Groombridge's view that Ottawa should stay and fight, stand its ground and not compromise?

REPRESENTATIVE KOLBE: I would completely agree with that. As he said, tomorrow is a significant day, in my opinion, because formally we end this agreement. But we go right back to where we were before with these kinds of disputes, the filing of the CVD, the countervailing duty, in the case against Canadian lumber. And my view is we should not cave on that.

Don't say, okay, let's talk about a new agreement, or let's talk about a substitute, which you hear people talking about. It's a new kind of an export tax which Canada would impose. I think that would be very wrong and harmful to the U.S.

consumer, so I don't want Canada to do that. I think we should stand up here and fight this thing. I hope we will do so.

Thank you very much, Brink.

(Applause.)

BRINK LINDSEY,

CENTER FOR TRADE POLICY, CATO INSTITUTE

MR. LINDSEY: Thank you.

I want to address a few ancillary issues that we have not touched on so far. But, before I do, I want to say just a couple of things about your question. You raised the number of timber owners in addition to the number of sawmill jobs.

The fact is the product in dispute is softwood lumber. The product dispute is not logs. Producing logs and producing softwood lumber are two different industries. So, yes, protectionism of softwood lumber helps upstream suppliers of softwood lumber products. It helps loggers or timber owners.

But, in the same way, we can take all of the lumber-using jobs that we calculated and bump them up with all of their suppliers. So, you still have, industry to industry, lumber producing to lumber using, a 25-to-1 ratio. Fluff up lumber producing with its suppliers, fluff up lumber using with

its suppliers, and I don't think you are going to gain a lot of ground.

As far as the politically necessary existence of U.S. trade laws, I think it is worth pointing out that U.S. trade laws have absolutely anything to do with the Softwood Lumber Agreement. The Softwood Lumber Agreement's trade restrictions were not arrived at pursuant to any countervailing duty investigation or pursuant to any known reasoning process. The quota limits and the fee structure for above-quota shipments were plucked out of a hat. They had no basis in anything. There was no CVD case. The numbers were just negotiated politically, period.

QUESTION: Commerce investigated it.

MR. LINDSEY: Commerce had nothing to do with it.

Let me address another issue that has come up in this recent go-around to the softwood lumber dispute. Traditionally, it has been just a head-on confrontation between lumber producers and lumber users, but now environmentalists have entered the fray. And there are many environmental groups that are defending trade restrictions on the ground that the Canadian forestry practices subsidize logging and subsidize lumber production, and thereby encourage over-cutting and environmental defoliation.

So, a number of environmental groups have supported trade restrictions, at least until Canada agrees to dramatic

changes in its forestry practices. This environmental issue is a 100 percent red herring, because there is no connection at all between the policies in dispute and any possible environmental effects.

The two main alleged subsidies are low stumpage fees and a ban on exports of logs. Low stumpage fees don't have anything to do with how much lumber is cut in Canada. The system is not "Set stumpage fees and then let producers decide how much to cut down." If that were the case, then indeed it might be true that below-market stumpage fees would result in above-market harvesting, thereby encouraging over-cutting and, by the way, encouraging, from a market perspective, excessive exports to the United States. But that is not how the system works.

There are two administrative decisions made by Canadian officials that are totally independent of each other. One is the stumpage fees and two is the harvest amounts. Every year a different part of the Canadian Government tells loggers how much timber they can haul away. And that isn't influenced by stumpage fee.

So, you can have a low stumpage fee, but it doesn't encourage over-cutting and it doesn't encourage excessive production, because there is another government agency telling them how much they can cut and how much they can produce, and it doesn't have anything to do with the price. So, that is the

bottom line of why economists say that there isn't any subsidy. Because it doesn't have any effect. The only thing that is going --

[End Side A. Begin Side B.]

MR. LINDSEY: The fact is that stumpage fees, which is what the industry complains about, don't have any effect on over-cutting.

Likewise, a ban on exporting logs, I think, discourages logging, because it eliminates one of the possible uses for cutting timber. So, the argument that that is encouraging over-cutting, I think, is just obviously specious.

Meanwhile, totally ignored is the effect of trade restrictions on the U.S. environment. Forget about Canada for a second. We are Americans. What is happening here? If Canada is artificially restrained in the amount of our lumber needs it can supply, then obviously we are cutting more of our forests to supply needs. So, if you are worried about over-cutting here in the United States, you ought to be on the free trade side.

What the environmental argument really boils down to, then, is that some groups in the United States, rightly or wrongly -- and I am agnostic on the issue -- they disapprove of Canadian forestry practices, and they think we ought to punish Canada with trade restrictions until they change their ways. This is the most blatant kind of protectionist idea, which is

that we should only trade with countries who have all the policies we agree with. And if they have any policies we disagree with about anything, environmental or whatnot, then we should cut imports from that country to punish them.

If we followed that line across the board, we wouldn't trade with much of anybody. In particular, not even the steel industry, which is second to none in its aggressive pursuit of protectionist remedies, not even the steel industry pursues this argument. They could argue, let's cut imports of steel from any country whose steel mills exceed some sort of limit for emissions of pollutants into the air. That would be the same logic as the environmental case for restricting lumber from Canada.

I hope I haven't given steel lawyers any ideas. But they haven't even had the guts to try that one out. Yet, the environmental groups and their current friends in the lumber industry are trotting that out with a straight face.

What should the U.S. do? Let's say that it is politically impossible to ignore these allegations of subsidies and over-cutting. What should they do? What is constructive to do about this?

I don't think a CVD, a countervailing duty, or anti-dumping duties, are a constructive approach. The whole theory of those laws is that two wrongs make a right. Another country is doing something bad and so we will offset that with

trade protectionism. So, at the end of the day, we still have the bad thing going on in Canada, assuming it is bad, plus, now we have a bad thing going on in the United States, protectionism and hurting downstream industries and hurting consumers.

That doesn't strike me as a proposition whereby anybody wins. If we think there is something wrong with Canadian practices, let's do something that would actually have some chance of influencing Canada to change them, which would be to take Canada to the WTO. Canada, like the United States, is a signatory to the WTO agreement on subsidies and countervailing measures. There is a provision for actionable subsidies, subsidies that are not export subsidies, not banned subsidies, but, nonetheless, have a detrimental effect on other members.

The United States could say that stumpage fees or log export bans or whatever are actionable subsidies. They could go to a disinterested group of experts that would have legitimacy on both sides of the border, and they could hash it out. And if the WTO found that Canada was in violation, then Canada, for the first time ever, would be under an international obligation to mend its way. That strikes me as a constructive approach to the problem. The CVD approach, I think, is just two wrongs to make a right.

But what is going to happen, according to the industry at least, is that anti-dumping and countervailing duty cases are

going to be filed on Monday. This will present the administration with a very important choice. Thus far, they have been standing back and saying, "No new agreement." Which is a good thing and we are happy to see it expire. But this issue is by no means over.

Now, the fun part begins, which is these anti-dumping and countervailing duty cases. The administration has a choice. It can either conduct these investigations according to the law, conduct them fairly and scrupulously, with attention to living within our existing NAFTA and WTO obligations; that is, to apply our law as we have agreed to apply it in NAFTA and in the WTO. In which case, I think it is quite likely that we will end up with very low dumping findings and subsidy findings, if any at all.

Or the administration can decide to just give the industry what it wants. There is a lot of discretion in these investigations. They can exercise this discretion in a way to pump up the findings of subsidies or dumping. And then they can just leave it for the NAFTA binational panel or the WTO dispute panel to sort it out. Or even worse, even more cynically, they can come up with such egregiously unfavorable results that Canada is forced to knuckle under and settle the dispute so that it never, ever gets reviewed.

If it does that, then shame on the U.S. Government, shame on the administration. It will set a terrible example to our FTAA partners. It will set a terrible example as we are trying to rev up a new WTO round. Indeed, if this does get reviewed and gets overturned by a NAFTA panel or a WTO panel, then what the U.S. Government will have chosen to do is put all the heat on those bodies, and force them to take all the political flack that they should have taken in the first instance to do the right thing.

So, we already have a huge string of losses at the WTO regarding our trade laws. And it is getting bigger every time. With every one, there is increased intensity of political opposition to the WTO for having the temerity to overturn U.S. laws and U.S. decisions. So, we will just add some more fuel to that fire. And, before you know it, we will have trashed the WTO dispute settlement system that we worked so hard to create.

So, I think those are the big stakes coming up in this dispute, beyond the stakes simply for American downstream industries and consumers.

With that, thank you very much. We would like to have some questions.

QUESTION: The speakers referred to tax assistance to the domestic producers and road construction assistance. Have domestic producers asked for any other form of government aid to

help them adjust to the facing of the inequity of this? And how successful have they been in getting such government assistance?

MR. LINDSEY: In the \$600 million that the U.S. reports to the WTO, the main thing is a tax provision. That accounts for the main dollar amounts. Sub-federal assistance is not included in the U.S. reports. So, the State level or local level assistance, in terms of just outright grants or free logging roads, that is not covered in that amount. And it is very difficult to dig out that information and put a total price tag on it.

The main approach the U.S. industry has taken has been trade remedies. But the details of that approach have been changing over time. First off, it was stumpage fees, and that was the big deal. First, they got a "no" answer. Then they got the answer they were looking for. But the next time around, they were worried that a methodologically sound decision on stumpage wouldn't give them much satisfaction. So, they added the log export ban to the mix.

Now, Canada has preemptively brought a case to the WTO, challenging whether or not log export bans would be a subsidy. So, the industry is worried about that. They are also worried about stumpage. So, now they have decided, for the first time, to threaten, and presumably to bring, an anti-dumping case. So, they have been broadening the arsenal of trade weapons that they

have been using, and we will see what else they will come up with if these don't work out to their satisfaction.

QUESTION: I wanted to ask you about this idea -- [off microphone]. Secondly, on the question of "stick to your guns and live through it," obviously the Canadian industry is hurting enormously with these constant pressures that are put on them. They don't see the ITC -- [off microphone]. They see them as rigging the outcome and coming back with more -- [off microphone].

So, what gives here? Obviously, in the end, one of the things that you have to look, after it goes on, is settling things in some way.

MR. LINDSEY: The suggestion of an eminent persons group, I think, goes to a fundamental problem with U.S. laws that maybe many folks in Washington are not excited to admit. Which is that the findings of U.S. agencies, under U.S. trade laws, have no legitimacy outside our borders. No one gives them any respect. They think they are politically fixed determinations. And sometimes they are and sometimes they are not. Often, though, even if they are done dutifully and in good faith, they are done under standards that tend to be heavily slanted toward findings of unfair trade.

So, because of that, the theory behind the countervailing duty case, which is that it will give an incentive

to the subsidizing party to change its ways, doesn't really pan out. Because Canada doesn't believe in the findings of the Commerce Department. So, instead of saying, yes, you are right, you caught us with our hand in the cookie jar. We have been subsidizing our industry, and we all know that industrial subsidies are wrong, they say, your findings are bogus.

So, an eminent persons group is one idea for coming up with a factual analysis of the dispute that has legitimacy on both sides of the border. I think that is an ad hoc arrangement. I think we already have an institutional arrangement that can fill the bill, which is the WTO. I think a WTO case has more going for it, because the WTO is already up and running. There have been hundreds of disputes brought before it, indicating that countries around the world regard its judgment as sound.

QUESTION: But you yourself mentioned that you equally have the right to ignore the WTO, which you have done on many occasions.

MR. LINDSEY: Right. But if we won, if the U.S. Government won and Canada lost, then, for the first time, Canada would be under the onus of having been found guilty by an authority it respects. So, from that perspective, from the U.S. perspective, it is much more constructive to go to the WTO if the goal is really for Canada to change its ways. If the goal, as I suspect it might be for some people, is just to hand out

political favors to the lumber industry, then obviously the WTO doesn't do them a lot of good.

As far as sticking it out, it is tough. Provisions in the U.S. law have been changed now to make it more difficult to give refunds to industries, assuming the U.S. ultimately lost. So, the industry would have to hunker down and survive a couple of years of an unfavorable situation before it finally prevailed. The question is whether you are going to give up your lunch money every day or eventually take a few punches in the face to get rid of the bully.

QUESTION: I know that you have tried to disassociate the lumber industry with some of the upstream industries, but absent the stumpage rates, wouldn't you suggest that the log export ban, in conjunction with the harvest number, has actually created a subsidy or a full utilization program for the sawmill industry in Canada; and, as a result of that, competition for sawmills just north of the border we could say, or approximately just south of the border, has sort of been unfair and is having the effect of closing the mills that are just south of our border?

MR. LINDSEY: Let me say, just to back up, I am from the Cato Institute. Any system that has the government owning 95 percent of a resource is not one that is going to get the Cato Institute's seal of approval. We are not up here at all to

defend Canadian forestry practices. And there are many of them that are certainly prima facie objectionable from a Cato perspective, and many of which are market distorting.

Of course, a ban on exports of logs is bad policy. We have it, too. Many of our States have bans on the export of logs. It is a bad policy here. It is a bad policy there. The issue is: Is it a subsidy under the rules that the U.S. has negotiated with other countries that define what actionable subsidies are?

I think it is a very serious question as to whether an export ban, which, even if it is meant to favor a downstream processing industry, as surely this one is, there is a serious dispute as to whether a ban of exports of an upstream product counts as a subsidy under currently negotiated definitions. Canada is trying to sort that out right now in the WTO.

If the U.S. loses that fight, that is, that under current rules bans on exports of upstream products are not actionable subsidies, then our solution is to go out and negotiate agreements that cover this loophole. Our solution isn't to compound the problem with protectionism at home in addition to bad policies abroad.

QUESTION: If it has created a situation where all the mills in the north part are closed, which means that timber producers and loggers in the north actually ship their raw logs

out for cutting, we are in a unique position where, since they are processed up there, it now falls under the -- [off microphone]. What would be the economic effect to our timber producers be if they export, if they send their logs to Canada for processing, upon the expiration of this agreement? It almost seems like we should be happy to just have it in place.

MR. LINDSEY: Again, our take on this is not dependent on whose ox is getting gored. We want good policy. And bad policies distort economic outcomes. And clearly distortions are going on where you are talking about.

There are definitely interests on both sides of the border that love the current arrangement. Because if you have quota under the current Softwood Lumber Agreement, if you are a Canadian producer and you have quota, and you have artificially inflated prices because of the trade restrictions, then you are doing great. So, there are internal disputes within the Canadian industry between quota-haves and quota have-nots. There are disputes in the U.S. between U.S. lumber producers that have substantial assets in Canada and those that don't. And they are located in different parts of the country, so that these kinds of very complex cost/benefit analyses work out, "Hey, I'm for free trade," or, "Hey, I'm not."

As far as the details of that, I really have not thought it through. But the interests are very complex. I think the ideas are pretty straightforward.

QUESTION: I question whether the study got into the potential effects once the agreement ends this weekend. Certainly the domestic industry is predicting a resurgence of exports from Canada. Do you have any idea what the scope will be?

Because if you look at what the effect of the agreement has been, I think the market share for Canadian producers was roughly 20 to 25 percent sometime ago, and now it is well over 30 percent. So, what effect will that have when the agreement goes out? Could you get into the pricing effects and the volume effects?

MR. GROOMBRIDGE: We didn't for a number of reasons when the study was written. And one of the things that I tried to make clear during my presentation was that there are a number of variables which go into the imports of lumber and lumber prices.

I think it is logical to predict two things, though. And this speaks to one of our central messages, which is sort of the unintended consequences or even the threat of a CVD case. One, I think Canadians are going to exercise self-restraint, and there won't be this wall of exports that has been spoken of.

Again, that is market distorting and that is something that is not a formal law of the United States, restricting imports from Canada, but I would certainly be critical of that.

The other big variable going on right now, of course, is housing starts in the United States. Which is to say that, given our economy right now, I am not building a new home. So, I don't anticipate a great deal of fluctuation, personally. But that is a little bit of using a Ouija board.

MR. LINDSEY: All things being equal, free trade will lower prices and increase imports from Canada. But all things are not equal. There are many other factors that could swamp this particular one, including, I think, the sort of under-the-table export restraint. Which means that the protectionist win even without flaws. They win just from the fear of protectionism. They get the results that they want.

MR. GROOMBRIDGE: In which case the consumers here still suffer.

MR. LINDSEY: I think we will wrap it up there. Thank you very much for attending and stick around for sandwiches.

(Applause.)

(Whereupon, the Cato Policy Forum was concluded.)