SOFTWOOD LUMBER FROM CANADA

Softwood lumber includes a wide variety of products, such as boards, planks, timber, framing materials, flooring, and siding, which are produced from coniferous species of trees.[232] U.S. production of softwood lumber occurs largely in the West (primarily in Oregon, California, Washington, Idaho, and Montana) and the South (primarily in the Carolinas, Georgia, Alabama, Mississippi, Texas, and Arkansas).[233] The major U.S. species of softwood lumber are the southern yellow pine, douglas fir, hem-fir, and ponderosa pine. In 2000, these species accounted for approximately 85 percent of U.S. production.[234]

Logs are removed from the forest and transferred to a sawmill, where they are debarked, bucked, and sawn to rough sizes. The roughly sawn logs are then transferred to a secondary breakdown area, where they are re-sawn to suitable dimensions and then sorted. The final steps are kiln-drying, planing, and packaging.[235] This is a capital-intensive process; annual capital expenditures during the 1999-2001 period ranged from $253 million to $474 million.[236] The U.S. industry producing softwood lumber reported approximately 30,000 production workers who received wages totaling more than $1 billion per year.[237]

Canada-U.S. softwood lumber trade has been a source of friction for many years. At the core of the dispute is a difference in forestry systems – more specifically, the Canadian practice of administratively setting the price of harvesting timber (the main softwood lumber production input) rather than allowing prices to be set by market forces. By setting a very low administered price, Canadian authorities provide a "subsidy" on softwood lumber production for purposes of U.S. and international trade law. The subsidy has signif-

232 *Softwood Lumber from Canada,* USITC Pub. 3509, Inv. No. 701-TA-414, 731-TA-928 (Final) (May 2002) at I-11.
233 USITC Pub. 3509 at III-3 to III-4.
234 Id. at III-14.
235 Id. at I-12 to I-13.
236 Id. at C-4.
237 Id. at C-4.

icant trade effects, and the past 25 years have accordingly seen a succession of trade remedy investigations alternating with negotiated settlements limiting Canadian lumber shipments into the U.S. market. To summarize briefly:

- The U.S. softwood lumber industry filed a CVD petition in 1982. The U.S. Commerce Department determined (under then-prevailing law) that the Canadian subsidy was not specific to the softwood lumber industry.

- Another CVD petition followed in 1986, but a Memorandum of Understanding resolved the dispute until 1991 when Canada announced its withdrawal from the MOU and the Commerce Department self-initiated a CVD investigation. [238] During a controversial appellate process over the affirmative subsidy and injury findings that followed, another negotiated settlement, the Softwood Lumber Agreement ("SLA"), was concluded in 1996.[239]

At the end of the SLA's 5-year effective period, during which Canadian stumpage practices were not brought into line with market principles, the U.S. industry filed trade remedy cases again – this time claiming both dumping and subsidization, and threatened material injury by reason of the unfairly traded imports.

The dumping claims brought into focus, for the first time, the additional harm caused by Canadian firms' sales into the U.S. market at prices below their production costs. The Commerce Department's initial calculations found that prices of Canadian lumber sold in the United States during the period April 2000 - March 2001 averaged 12.58% less than the average production cost measured in several Canadian regions. (The final dumping margin in the original investigation was just under 10 %.) Underlying this phenomenon are regulations that mandate harvesting and production regardless of market conditions, at the risk of losing long-term timber licenses. While mills in a commercial setting sometimes operate below variable cost for a period of time, Canadian government regulations mandate continued high levels of production — in some cases requiring government approval if a mill wishes to reduce capacity.

Original investigation and determination

Imports from Canada are an essential part of the U.S. lumber market. However, the potential for unfairly traded Canadian lumber to surge into the U.S. market and harm domestic producers has been demonstrated repeatedly. The most recent trade remedy findings and measures – the ones currently in effect — were based on the imminent threat of material injury which was shown to exist at the time the SLA expired in 2001. The U.S. agency findings involved

238 Id. at I-7 to I-8, fn. 19.
239 Id. at I-8.

actual, not merely threatened, subsidization and dumping; significant levels of dumping and subsidization were found to exist during the original period of investigation and in subsequent 1-year periods examined in administrative reviews. Only the injury determination was based on "threat."

The USITC found imminently threatened material injury on the basis of the following factors:

- The market share of subject imports increased during the 1999-2001 period of investigation, at the expense of the market share of U.S. producers.[240]

- The U.S. industry was vulnerable to import-related injury in light of declines in its performance over the 1999-2001 period. Significant declines were observed in, for example, the U.S. industry's (1) production, shipments and capacity utilization, (2) number of mills in operation, (3) production workers, hours worked, and wages paid, and (4) ratio of operating income and net income to net sales.[241]

- There was a high likelihood that imports would increase significantly. Canadian producers in the post-SLA environment had significant ability to increase shipments to the U.S. market (excess capacity), coupled with a demonstrated inclination to do so (export orientation). Moreover, mandatory cut requirements in many Canadian provinces "increase production even when demand is low and thus increase the incentive to export more softwood lumber to the U.S. market."[242]

- Additional imports were likely to have a "significant price depressing effect" in the U.S. market.[243]

240 USITC Pub. No. 3509 at 42, 45.
241 Id. at 41-43.
242 Id. at 43-46.
243 Id. at 48.

Table 37. Softwood Lumber from Canada:
Selected Data Collected by the USITC

Item	1999	2000	2001
U.S. shipment ($ mil.)	13,922	10,818	10,355
U.S. market share (percent, by value)	64.1	60.7	60.2
Subject imports ($ mil.)	7,116	6,280	5,980
Subject import unit value ($/mbf)	395.71	347.88	323.54
Wages paid ($1,000)	6,380	8,519	10,008
Sources: USITC Pub. 3509 at to C-3 to C-4.			

Estimated revenue impact of unfair trade

The Department of Commerce's final determination found a subsidy margin of 18.57 percent. As a result of appeals and reviews, the subsidy margin had been reduced to 8.7 percent by September 2005. [244] This rate was applied to the model for data covering 1999 to 2001 even though the SLA was operative during those years.[245] According to the model, the three-year revenue cost to U.S. firms was $2.2 billion, with losses ranging from $666 million to $871 million.[246] These losses are large, surpassed only by the lost revenue related to hot-rolled steel among the industries covered in this study. Losses grew progressively smaller during the period of investigation, in part because market prices were declining due to an increase in lumber supply relative to demand.[247]

Table 38. Softwood Lumber from Canada:
Estimated Lost Revenue due to Subsidies

Item	1999	2000	2001	Total
Estimated subsidy margin (percent)	8.70	8.70	8.70	N/A
Lost revenue due to dumping ($ mil.)	871	707	666	2,244
Sources: USITC Pub. 3393 at I-2 to I-3 and author's calculations.				

244 *Certain Softwood Lumber Products from Canada, Notice of Final Results of Countervailing Duty Administrative Review,* 70 Fed. Reg. 73,448 (Dep't Comm. Dec. 12, 2005).
245 This methodology seems appropriate in light of the fact that the subsidies remained in existence during the SLA. Canadian firms had to pay fees once the export baseline of 14.7 billion board feet was surpassed, and the baseline was surpassed in each year of the Commission's period of investigation.
246 Antidumping duties were also applied to Canadian lumber, but revenue losses due to dumping have not been estimated here.
247 USITC Pub. No. 3509 at 47.

The table below shows the indirect revenue losses resulting from the unfairly traded imports, as well as the financing costs of the increase in imports. The indirect effect of a one dollar change in U.S. lumber industry output on other domestic industries is $0.73.[248] Given the large direct losses to the logging industry due to the subsidies and dumping, the indirect losses are also substantial, ranging from $486 million to $634 million. As would be expected, the largest beneficiaries of domestic lumber industry output are forest nurseries, forest products, and timber tracts; and agricultural and forestry support activities. The financial cost of consuming more imports is estimated to equal the one-year Treasury bill rate multiplied by the increase in import value resulting from the dumping. The annual financial costs during the 1999-to-2001 period ranged from $15 million to $28 million.

Table 39. Softwood Lumber from Canada:
Indirect Costs and Interest Costs due to Dumping

Item	1999	2000	2001	Total
Indirect industry output multiplier	0.73	0.73	0.73	N/A
1-year T-bill rate (percent)	5.08	6.11	3.48	N/A
Lost indirect activity ($ mil.)	634	515	486	1,635
Interest on borrowed funds ($ mil.)	28	28	15	71

Sources: Bureau of Economic Analysis at http://www.bea.gov/bea/dn2/i-o.htm#benchmark (data for multiplier); Federal Reserve Bank of St. Louis at http://www.research.stlouisfed.org/fred2/series/GS1/downloaddata (interest rates); and authors'

Consumer gains from increased consumption of imported lumber due to Canadian subsidies and dumping are shown in the table below. At $33 million, they are not very large relative to the losses experienced by the domestic industry, and they are actually smaller than the interest payments resulting from the increased imports resulting from the subsidies. In this case, because imports from countries other than Canada are not large, one could argue that the "gift" to consumers is coming directly from Canada's unwillingness to charge a higher, market price that reflects the true value of the lumber being harvested, and should be larger than the amount calculated by the model.[249] On the other hand, the distortion of undervalued timber caused by Canada's practice leads to greater use of a natural resource than would occur absent the subsidy. In other words, the condition that the consumer gains associated with area C come at the expense of another entity in the system still holds.

248 This estimate is based on detailed estimates from the U.S. 1997 Benchmark Input-Output industry-by-industry total requirements table. The total requirements multiplier for vegetable and melon farming is 1.78. The detailed data are available from http://www.bea.gov/bea/dn2/i-o.htm#benchmark.

249 In terms of calculating the pure consumer gains, this would require that we add a portion of area C to area D. See Figure 1.

Table 40. Softwood Lumber from Canada:
Summary of Costs and Benefits of Dumping

Item	1999	2000	2001	Total
Lost revenue due to dumping ($ mil.)	-871	-707	-666	-2,244
Lost indirect activity ($ mil.)	-634	-515	-486	-1,635
Interest on borrowed funds ($ mil.)	-28	-28	-15	-71
Consumption gains ($ mil.)	13	9	10	33
Sources: Author's calculations.				

Long-term impact of the order

It is difficult to estimate the impact of trade remedy "orders" in this sector based on prior experience, because the relief imposed through the administrative process has in each case been quickly replaced by negotiated import restraints. No orders have remained in place long enough to undergo a "sunset" review in which their impact would have been quantified. This pattern appears likely to continue, as a 3-7 year agreement settling the current litigation on the basis of (mainly) a price trigger has been negotiated by the two governments and is now awaiting formal approval in both countries.

Although a cause-and-effect relationship cannot yet be definitively established, there is strong circumstantial evidence that one exists, as the U.S. industry's performance has improved markedly since the current round of litigation was launched in 2001. For example, from 2001 to 2005, U.S. manufacturers' shipments of softwood lumber rose from 34.7 billion board feet to 40.5 billion board feet.[250] And the $1 billion of collected duties earmarked to benefit the U.S. industry under the pending settlement – half to go directly to affected U.S. producers, and half to be used to promote the use of lumber in the U.S. market – should facilitate continued recovery.

250 AF&PA Statistical Roundup, Q1 2006, page 2.