BEFORE THE UNITED STATES
INTERNATIONAL TRADE COMMISSION

In the Matter of:
CERTAIN SOFTWOOD LUMBER PRODUCTS FROM CANADA, No. 701-TA-274 (Preliminary)

BRIEF OF THE FEDERAL TRADE COMMISSION

June 1986

TABLE OF CONTENTS

Brief by the Federal Trade Commission
on the Countervailing Duty Investigation of
Certain Softwood Lumber Products from Canada

INTRODUCTION AND SUMMARY

On May 19, 1986, the Coalition for Fair Lumber Imports, a group of United States softwood lumber manufacturers and associations representing United States lumber manufacturers, filed a countervailing duty petition with the International Trade Commission ("ITC"). The petition alleges that the domestic softwood lumber industry is threatened with material injury and is being materially injured by reason of imports of softwood lumber that have benefited from various subsidies provided by the Canadian federal and provincial governments. The major alleged subsidy concerns the level of fees ("stumpage fees") set by the provincial governments for the right to harvest softwood timber on government land ("stumpage rights").[1] The petitioners request that countervailing import duties be imposed on these products.

The purpose of this brief is to assist the ITC in making its preliminary determination on injury. In Section I, we argue that the countervailing duty law should be applied to reduce impediments to world trade and to preserve the benefits of

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1 The petition alleges that in addition to a stumpage fee subsidy, there are a variety of other subsidies to the Canadian timber industry. For example, petitioners allege that the Canadian government subsidizes its timber industry by paying for the reseeding of harvested timberlands. Petitioners also allege that several transportation programs and expenditures constitute subsidies to the Canadian timber industry. The analysis in this brief is limited to the alleged subsidy arising out of the Canadian stumpage fee systems.

competition for United States consumers while protecting domestic firms from unfair practices. In Section II, we argue that the ITC should examine the causal link, if any, between an alleged subsidy and injury to a domestic industry. If a domestic industry's lost sales are not traceable to an alleged subsidy, then no injury "by reason of" such imports should be found.

In Section III, we conclude on the basis of the analysis by our Bureau of Economics of the effects of the Canadian stumpage fee systems that, while the Canadian stumpage fee systems increase the profits of Canadian lumber producers, they do not increase the quantity of logs harvested in Canada or the quantity of lumber products exported to the United States. Accordingly, we conclude that the Canadian stumpage fee systems do not injure a domestic industry.

ARGUMENT

I. A Major Purpose of the Countervailing Duty Law Under the Trade Agreements Act of 1979 Is To Promote Free Trade to the Benefit of United States Consumers and Businesses.

The first United States countervailing duty law was enacted as part of a general tariff statute in 1890.[2] Over the next several decades, Congress modified the countervailing duty law several times[3] and supplemented it with antidumping laws in 1916

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2 Tariff Act of 1890, ch. 1244, § 237, 26 Stat. 584 (1890).

3 Tariff Act of 1894, ch. 349. § 182 1/2, 28 Stat. 521 (1894); Tariff Act of 1897, ch. 11, § 5, 30 Stat. 205 (1897); Tariff Act of 1909, ch. 6, § 6, 36 Stat. 85 (1909); Tariff Act of 1922, ch. 356, § 303, 42 Stat. 935 (1922).

and 1921[4] and with an unfair practices provision of the tariff law in 1922.[5] The countervailing duty law was amended in 1979, when the Trade Agreements Act of 1979 ("1979 Act")[6] added the "injury" test that the ITC is applying in this proceeding.[7] The tests for injury under the countervailing duty law are derived from those in the 1921 antidumping law, and Congress has stated that it expects the ITC will construe injury the same way under both laws.[8] The Trade and Tariff Act of 1984[9] further amended the countervailing duty law, including the addition of a provision that enumerated factors to be considered in determining whether an industry in the United States is threatened with material injury by reason of subsidized imports.[10]

The history of their enactment suggests that the basic purposes of these four tariff laws -- the countervailing duty law, the two antidumping laws, and the unfair practices law -- are consistent with the basic purposes of the antitrust laws.

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4 15 U.S.C. §§ 71-77; Tariff Act of 1921, ch. 14, § 201, 42 Stat. 11 (1921).

5 19 U.S.C. § 1337.

6 See 19 U.S.C. §§ 1671-1677g, 2501 et. seq., Pub. L. No. 96-39, 93 Stat. 144 (1979).

7 19 U.S.C. § 1671(b); see 19 U.S.C. § 1677(7). In 1974, Congress added an injury test for nondutiable imports. 19 U.S.C. § 1303(a)(2).

8 See H.R. Rep. No. 317, 96th Cong., 1st Sess. at 45-46 (1979) ("H.R. Rep. No. 96-317"); S. Rep. No. 249, 96th Cong., 1st Sess. at 57, 87 (1979) ("S. Rep. No. 96-249").

9 Pub. L. No. 98-573, 98 Stat. 2948 (1984).

10 19 U.S.C. § 1677(7)(F).

Both through these tariff provisions and through the antitrust laws enacted during the same era, Congress sought to create a legal environment that would foster an efficient allocation of resources.[11] Moreover, the legislative history of the tariff laws demonstrates Congressional concern about foreign companies unfairly expanding their sales in the United States at prices that United States firms of equal or greater relative efficiency could not match. That history does not show that Congress intended the tariff laws to exclude from the United States market those foreign firms that have a comparative advantage or are relatively more efficient than United States firms.

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11 The first countervailing duty statute was passed in the same year as the first federal antitrust law, the Sherman Act. Congress passed the first antidumping statute, 15 U.S.C. § 71-77, in 1916, two years after passing the other two major antitrust laws, the Clayton Act and the Federal Trade Commission Act. The purpose of the 1916 antidumping law was to place foreign firms selling in the United States in the same position "with reference to unfair competition" as domestic firms. H.R. Rep. No. 922, 64th Cong., 1st Sess. 9-10 (1916). In 1921, Congress passed another antidumping law, Tariff Act of 1921, Ch. 14, § 201, 42 Stat. 11 (1921); H.R. Rep. No. 1, 67th Cong., 1st Sess. 23-24 (1921). In 1922, Congress made minor changes to the countervailing duty law and enacted legislation prohibiting imports associated with unfair methods of competition. 19 U.S.C. § 1337. Senator Smoot, one of the sponsors of the 1922 tariff legislation, said that these provisions were an extension of the existing antidumping laws and the existing countervailing duty law in order to protect United States firms against "unfair competition." 62 Cong. Rec. 5874 (1922). See S. Rep. No. 595, 67th Cong., 2d Sess. 2-3 (1922). See also the statements of Senator Danforth and Senator Heinz in the debates on the Trade Agreements Act of 1979. 125 Cong. Rec. S. 10306, 10317 (daily ed. July 23, 1979).

The countervailing duty law is intended to eliminate the harm resulting from "unfair" competition and to assure that United States consumers realize the benefits of "fair" competition. Thus, if the Canadian lumber industry competes successfully in the United States because the Canadian firms have a comparative advantage or are more efficient, and not because of government subsidy, then United States consumers should receive the benefits of the heightened competition engendered by those imports. [12]

Both the language and the legislative history of the 1979 Act establish that Congress did not intend the countervailing duty laws to be narrowly protectionist. Rather, the purposes of the 1979 Act are "to foster the growth and maintenance of an open world trading system; to expand opportunities for the commerce of the United States in international trade; and to improve the rules of international trade and to provide for the enforcement of such rules." 19 U.S.C. § 2502(2), (3), (4). See also S. Rep. No. 96-249, supra, at 31 and H.R. Rep. No. 96-317, supra, at 38. In particular, Congress was concerned about "the use of practices which can distort trade or create unfair competition or

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12 However, domestic producers may allege they are seriously injured by an increase in fairly traded imports in section 201 escape clause proceedings. Such allegations are not at issue here.

trade discrimination, such as subsidies . . . ." H.R. Rep. No. 96-317, supra, at 11.[13] Congress has sought through the countervailing duty laws to discipline only those firms that are selling in the United States market on the basis of an unfair advantage conferred upon them by their government (or by other sources). On the other hand, Congress intended United States consumers to receive the substantial benefits that flow from unrestricted access to foreign firms that compete in United States markets on the basis of comparative advantage or relative efficiency.

Countervailing duties can be imposed on subsidized imports only if the ITC determines that there is material injury or the threat of material injury to a domestic industry. Trade Agreements Act of 1979, § 701(a)(2), 19 U.S.C. § 1671(a)(2). This injury standard does not indicate protectionist intent on the part of Congress. To the contrary, the injury standard was

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13 In the congressional debates on the 1979 Act, Senator Heinz said that the countervailing duty and antidumping provisions of the 1979 Act are aimed at countries that do not rely on "free market principles and . . . on competition and the law of comparative advantage as arbiters of the marketplace." Cong. Rec. S10306 (daily ed. July 23, 1979). In the same debates Senator Danforth explained that the countervailing duty and antidumping provisions were aimed at "adverse distortions of free trade." Id. at S10317. He said that subsidized imports are not in the best interest of the United States consumer, since "the long run impact is likely to be higher prices and greater profits for the foreign producers once the domestic competition has been crippled." Id. at S10317.

added by the 1979 Act to narrow the application of tariffs under the countervailing duty law.[14]

Congress was mindful of the potentially adverse effects on United States business of retaliatory tariffs imposed by foreign governments on United States exports, and Congress intended the 1974 Act "to expand opportunities for the commerce of the United States in international trade" by improving the rules of international trade. 19 U.S.C. § 2502. In passing the 1979 Act, Congress foresaw benefits to United States exports if the agreements it implemented were fairly carried out:

> These rules could be important in reducing the number of foreign subsidy practices, and thus the need for countervailing duties. Furthermore, if vigorously enforced by the United States and

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14 Before 1979, there was no requirement of injury to a domestic industry in order to impose countervailing duties on subsidized dutiable imports. In the Trade Act of 1974, Congress determined that "barriers to (and other distortions of) international trade" were adversely affecting United States exports and authorized the President to negotiate international agreements to harmonize, reduce, or eliminate these barriers and distortions. 19 U.S.C. § 2112(a). The United States subsequently negotiated, as part of the Tokyo Round of Multilateral Trade Negotiations, the Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade ("Countervailing Duty Agreement"). As part of this negotiation, the United States agreed to add to our countervailing duty law the requirement that such duties will be imposed only if a United States industry is injured by reason of the subsidized imports, and the countervailing duty provisions in the 1979 Act had the specific purpose of implementing "the international agreements relating to new disciplines on trade distorting subsidies and dumping practices and procedures for taking countervailing and antidumping measures." H.R. Rep. No. 96-317, supra, at 2. The requirement that an additional legal test be satisfied prior to levying a countervailing duty obviously was intended by Congress to make it more difficult for the United States to impose countervailing duties.

> fairly carried out by all parties, these provisions should expand the competitive opportunities of U.S. exporters who currently face subsidized competition in foreign markets.

S. Rep. 96-249, supra, at 38 (emphasis added). Congress realized in 1979 that, because of the precedential value of countervailing duty decisions by this country, such decisions could themselves have a significant impact on United States exports. If the ITC finds that an action by a foreign government has led to injury in the United States, and if comparable actions are regularly taken in the United States, then our exports may be impaired because of retaliatory countervailing duties, based on our own precedent. This potential impairment is relevant in determining whether Congress intended particular foreign practices to lead to the imposition of countervailing duties.

In sum, we suggest that in administering the countervailing duty law, the ITC should be guided by the legislative purpose of the law: to reduce impediments to world trade while preserving the benefits of competition for consumers and protecting domestic firms from unfair practices.

II. The ITC Should Determine Whether the Alleged Foreign Subsidy Actually Caused Any Material Injury That May Be Found To Exist.

We suggest that the language of the Countervailing Duty Agreement, the language of the 1979 Act implementing the Countervailing Duty Agreement, and the legislative history of the 1979 Act all require the ITC to apply a sensitive causation test: countervailing duties should be imposed only if the subsidy is determined by the ITC to be a cause of material injury

to a domestic industry.[15] In the instant case, the ITC should attribute to the alleged subsidy only the injury to the United States lumber industry that results from the alleged subsidy. Any harm to the domestic industry resulting from factors not attributable to the Canadian stumpage systems should not be the basis for a finding of injury within the meaning of the countervailing duty statute.

A. The 1979 Act Is Consistent with the Countervailing Duty Agreement's Requirement To Consider the Effect of the Alleged Subsidy.

The United States statutory scheme concerning subsidies, causation, and injury is in accord with the Countervailing Duty Agreement,[16] negotiated as part of the Tokyo Round of Multilateral Trade Negotiations. The article of the Countervailing Duty Agreement governing "determination of injury" provides, in pertinent part:

> It must be demonstrated that the subsidized imports are, through the effects of the subsidy, causing injury within the meaning of this Agreement.

Countervailing Duty Agreement, Article 6, Paragraph 4 (footnote omitted) (emphasis added). Several other provisions of the Countervailing Duty Agreement reinforce this provision. For

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15 As the petition recognizes at page 99, there are those who believe that a causal link must be established between an unfair practice and injury.

16 Reprinted in Agreements Reached in the Tokyo Round of the Multilateral Trade Negotiations, H.R. Doc. No. 153, 96th Cong., 1st Sess., Pt. 1 (June 19, 1979).

example, the preamble to the Agreement recognizes that "the emphasis of this Agreement should be on the effects of subsidies." Additionally, Article 2, governing domestic procedures for conducting investigations of alleged subsidies, provides that "[a]n investigation shall be terminated when the investigating authorities are satisfied either that no subsidy exists or that the effect of the alleged subsidy on the industry is not such as to cause injury." Id., Article 2, Paragraph 12.

The 1979 Act implements the Countervailing Duty Agreement, 19 U.S.C. § 2503, and adopts the requirement of a causal link between subsidy and injury by expressly authorizing the ITC, in examining an alleged threat of material injury, to consider "the effects likely to be caused by the subsidy." Act at § 771(7)(E)(i), 19 U.S.C. § 1677(7)(E)(i); 19 C.F.R. § 207.26(d) (1981).[17] It follows that the ITC should consider "the effects likely to be caused by the subsidy" not only when there is alleged to be a threat of material injury, but also when material injury is alleged to be actually present. The 1979 Act adopts a causal link between a subsidy and alleged present injury by requiring imposition of a countervailing duty only if the ITC "determines that an industry in the United States (i) is materially injured, or (ii) is threatened with material injury . . . by reason of imports of [subsidized] merchandise or by

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17 Section 771(7)(E)(i) is taken almost directly from the Countervailing Duty Agreement, supra at Article 6, para. 1, n. 17, which authorizes the use of inferences when there is no direct evidence because the actual injury is as yet only threatened.

reason of sales (or the likelihood of sales) of [subsidized] merchandise for importation." 19 U.S.C. §1671(a)(2).[18] Examining the nature and likely effect of the subsidy is especially appropriate when, as here, injury and threat of injury both are alleged. Petition, at 1, 102.

Factors other than a subsidy can cause injury, and the Countervailing Duty Agreement and the ITC's regulations are in accord that other factors should be considered. The Agreement recognizes that if "other factors" are causing injury to a domestic industry at the same time that the subsidy is causing injury, the injuries caused by such "other factors" need not be attributable to the subsidized imports. Countervailing Duty Agreement, Article 6, Paragraph 4. The Agreement lists some of these representative "other factors." This list is incorporated verbatim in the ITC's injury regulations, 19 C.F.R. § 207.27 (1981), in which the ITC states it will take into account information concerning such other factors.[19] In general, most of

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18 The 1984 Act amended this section to make explicit that the ITC may reach an affirmative injury determination if the harm is caused by sales for future delivery or by future sales. Trade and Tariff Act of 1984, § 602(a)(1), 19 U.S.C. § 1671(a)(2).

19 The "other factors" identified in the footnote to Article 6, Paragraph 4 of the Countervailing Duty Agreement, as listed in the ITC injury regulations, 19 C.F.R. § 207.27 (1981), are "volume and prices of non-subsidized imports or imports not sold at less than fair value, contraction in demand or changes in patterns of consumption, trade restrictive practices of and competition between the foreign and domestic producers, developments in technology, and the export performance and productivity of the domestic industry."

the ITC regulations implementing the injury requirement are the same as the language of the Countervailing Duty Agreement.[20]

The statutory language on causation and actual injury tracks the language of the Countervailing Duty Agreement, although it does not repeat verbatim the Agreement's language. Nevertheless, the statutory language on injury supports an interpretation that is consistent with the language of the Countervailing Duty Agreement, and the ITC should employ an interpretation of the statute that gives recognition to this congruity.[21] It is well-settled that when a treaty and statute "relate to the same subject, the courts will always endeavor to construe them so as to give effect to both, if that can be done without violating the language of either." United States v. Lee Yen Tai, 185 U.S. 213, 221 (1902); see John T. Bill Co. v. United States, 104 F.2d 67,

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20 In the "Factors considered in determination of material injury," 19 C.F.R. § 207.26 (1981), section (a) is taken directly from Article 6, Paragraph 1 of the Tokyo Agreement; sections (b)(1) and (b)(2) from Paragraph 2; sections (b)(3) and (c)(2) from Paragraph 3; and part of section (d) from Paragraph 1 (footnote).

21 While section 3(a) of the 1979 Act, 19 U.S.C. § 2504(a), states that the 1979 Act prevails if there is a "conflict" between the statute and the Countervailing Duty Agreement, Congress did not believe that there was such a conflict. S. Rep. No. 249, 96th Cong., 1st Sess. (1979) at 36. The Senate Report, in summarizing the Countervailing Duty Agreement, states that the Agreement provides for "a 'causal link' between the subsidization . . . and the injury (Article 2 of the [Countervailing Duty] Agreement)." Id. at 41. The Senate Report goes on to say that the 1979 Act "would establish the conditions for imposition of countervailing duties consistent with the [Countervailing Duty] Agreement." Id. at 44. In enacting section 3(a) of the 1979 Act, Congress was concerned that there might be a conflict in the future if the Countervailing Duty Agreement was amended. S. Rep. No. 249, at 36.

74 (C.C.P.A. 1939) (construing ¶ 371 of the Tariff Act of 1930 so as to be consistent with Article VII of the 1925 Treaty between the United States and Germany).

In sum, the language of the Countervailing Duty Agreement and the 1979 Act support an interpretation that the ITC should examine the causal link between an alleged subsidy and injury to a domestic industry.

B. The Legislative History of the 1979 Act Indicates that the ITC Should Examine the Effects of the Alleged Subsidy.

The legislative history of the 1979 Act[22] also indicates that Congress intended the ITC to determine whether an alleged subsidy is the actual cause of injury to a domestic industry.[23]

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22 Title VI of the Trade and Tariff Act of 1984 did not amend the portions of the countervailing duty law that are at issue here.

23 The legislative history may be used to construe a statutory phrase even when its meaning appears to be "clear." Train v. Colorado Public Interest Research Group, Inc., 426 U.S. 1, 10 (1976) (legislative history of Federal Water Pollution Control Act ("FWPCA") indicates that the Environmental Protection Agency ("EPA") does not regulate radioactive nuclear waste subject to regulation by the Atomic Energy Commission even though the FWPCA says the EPA regulates "radioactive materials"); Philko Aviation Inc. v. Shacket, 462 U.S. 406, 409-10 (1983) (legislative history of § 503(c) of the Federal Aviation Act of 1958 is a better indicator of the meaning of the statute than is the literal language of the statute); Al Tech Speciality Steel Corp. v. United States, 6 ITRD 1161, 1167-69 (Fed. Cir. 1984) (legislative history of 1979 Act indicates that "investigation" in section 776(a) of the 1979 Act, U.S.C. § 1677e(a), includes a "periodic review" under section 751 of the 1979 Act, 19 U.S.C. § 1675, even though the Department's regulations consider a "periodic review" to be a "proceeding" rather than an "investigation").

As discussed below, the drafters of the bill, in explaining its operation, frequently used the statutory phrase "injury . . . by reason of imports" as a synonym for the phrase "injury through the effects of a subsidy."

The President, in 1979, submitted to Congress both a trade bill and Statements of Administrative Action, which described "the manner in which the proposed legislation is to be administered." Statements of Administrative Action, 96th Cong., 1st Sess., House Document No. 96-153, Part II (June 19, 1979) [hereinafter "Statements"], at 389. In its discussion of the "determination of material injury," the Statements explained:

> It is expected that in its investigation the Commission will continue to focus on the conditions of trade and development within the industry concerned. For one industry, an apparently small volume of imports may have a significant impact on the market; for another the same volume might not be significant. Similarly, for one type of product, price may be the key factor in determining sales elasticity, and a small price differential resulting from the amount of the subsidy or the margin of dumping can be decisive; in others the size of the margin may be of lesser significance.
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> The petitioner must demonstrate, and the Commission must satisfy itself that, in light of all the information presented, there is the requisite causal link between the subsidization or dumping and material injury.

Statements, at 434-35 (emphasis added). Congress approved these Statements submitted to it by the President. Trade Agreements Act of 1979, § 2(a), 19 U.S.C. § 2503(a).

Both the House and Senate reports covering the 1979 Act indicate that Congress expected the ITC to determine the effects of a subsidy. The Senate report notes that in determining whether injury is "by reason of" subsidized imports, the ITC considers, inter alia, "how the effects of the [subsidy] relate to the injury." S. Rep. No. 249, 96th Cong., 1st Sess. (1979), at 57. The Senate Report elaborates on this point as follows:

> It is expected that in its investigation the Commission will continue to focus on the conditions of trade, competition, and development regarding the industry concerned. For one industry, an apparently small volume of imports may have a significant impact on the market; for another, the same volume might not be significant. Similarly, for one type of product, price may be the key factor in making a decision as to which product to purchase and a small price differential resulting from the amount of the subsidy or the margin of dumping can be decisive; for others, the size of the differential may be of lesser significance.

Id. at 88 (emphasis added). The House of Representatives Report contains nearly identical language.[24]

Accordingly, the legislative history of the 1979 Act supports the view that the ITC should evaluate the effect of an alleged subsidy on a domestic industry in order to properly determine whether the domestic industry is being injured or has been injured within the meaning of the statute.

In sum, the statutory language and legislative history of the 1979 Act are consistent with the language of the Countervailing Duty Agreement that the ITC should examine "the effects of the subsidy." We turn now to an examination of the effects of the major subsidy alleged in the petition.

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24 It is expected that in its investigation the ITC will continue to focus on the conditions of trade and development within the industry concerned. For one industry, an apparently small volume of imports may have a significant impact on the market; for another the same volume might not be significant. Similarly, for one type of product, price may be the key factor in determining the amount of sales elasticity, and a small price differential resulting from the amount of the subsidy or the margin of dumping can be decisive; in others the size of the margin may be of lesser significance.

H.R. Rep. No. 317, 96th Cong., 1st Sess. (1979), at 46 (emphasis added).

III. The Absence of an Auction for Stumpage Rights Is Likely To Have No Effect on the Price or Quantity of Exports of Softwood Lumber Products to the United States.

Economic analysis suggests that our domestic lumber industry is not injured by Canadian stumpage fees.[25] This conclusion follows from a sequence of four observations: (1) A domestic industry can be injured only if the alleged subsidies increase the quantity (and decrease the price) of a commodity imported in competition with the domestic output. (2) Here, however, the quantity of Canadian timber put up for harvest each year on public lands is set by a government decision, just as it is in the United States. It is not determined by market forces and, therefore, it does not depend upon the amount of timber that might be profitably produced at a particular stumpage fee. Consequently, a low fee cannot increase the quantity of timber ultimately produced. (3) A low stumpage fee may merely increase

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25 The United States timber industry filed a countervailing duty petition in October 1982 that is similar to the instant petition in many respects. In both petitions, the major allegation is that Canadian lumber producers are being subsidized by the methods used by the Canadian national and provincial governments to allocate and charge for the rights to harvest timber. In early 1983, Dr. David Tarr of the Federal Trade Commission ("FTC") staff conducted an economic analysis of this allegation. The results are contained in a brief that the FTC filed with the Department of Commerce on April 7, 1983, in connection with its investigation of the earlier petition. Prehearing Brief by the Federal Trade Commission before the International Trade Administration, Department of Commerce, Certain Softwood Lumber Products from Canada, Countervailing Duty Proceeding, April 7, 1983 (hereinafter "1983 FTC brief"). That analysis is reproduced in the appendix of this brief. The current petition does not allege that the Canadian stumpage fee system operates differently today than it did in 1983.

the profits of Canadian logging companies, because their total costs are lower while the market value of their timber is unchanged. Those companies cannot increase production, however, because the Canadian national and provincial governments, not the loggers, control the rate at which timber may be harvested. (4) This situation is, therefore, quite different from an ordinary subsidy because it does not increase production and hence does not increase exports to the United States.

For this set of reasons we suggest that the domestic lumber industry has not been injured, and that countervailing duties would not be appropriate here. These four considerations will be discussed in sequence.

A. Only Increased Imports Will Injure an Industry in the United States.

In evaluating an alleged subsidy, it is important to recognize that a United States industry can be injured only if the alleged subsidy increases the quantity of imports coming into the United States. If the subsidy does not increase the supply of imports at any particular price, then the subsidy will not cause the price of the product to be lower than it would

otherwise have been.[26] If the price of the domestic product does not fall because of the alleged subsidy, then the alleged subsidy does not cause the output of the domestic industry to decline. This, in turn, would mean that all other measures of industry well-being, such as employment and profits, will not be adversely affected by the alleged subsidy and any observed deterioration in the domestic industry's condition must be due to factors other than the alleged subsidy. Thus, in determining whether the alleged subsidy has caused injury to a domestic industry, the ITC should consider whether the alleged subsidy has increased the quantity of the good being imported into the United States.

B. The Stumpage Fee Does Not Increase Canadian Production.

Canadian stumpage fee systems do not result in an increase in the quantity of Canadian lumber imported into the United States because the stumpage fee systems do not lead to an increase in the quantity of logs harvested in Canada. In general, the quantity of logs harvested under the current

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26 When the imported and domestic products are homogeneous, they will sell in the domestic market at a single price determined by total supply (imports plus domestic output) and domestic demand. Domestic supply and domestic demand are not affected by a foreign subsidy. Therefore, if the supply of imports is not increased, the domestic price must be unchanged. If the products are non-homogeneous substitutes, it will still be true that the equilibrium price of the domestic product will not be reduced unless the supply of the import is increased as a result of the alleged subsidy. In this case, the domestic industry can be injured only if the price of the imported product declines, which in turn reduces the demand for the domestically produced good. However, the price of imports will fall only if the supply of imports is increased.

Canadian stumpage fee systems is the same as it would be if a competitive auction system like that used by the United States Forest Service ("USFS") were employed.[27]

Although the price charged for the right to harvest a tract of forest land is lower under the Canadian stumpage fee systems, a Canadian logger's ability to harvest more land is limited by the supply made available by the Canadian governments. Because the amount of land made available by the Canadian governments is determined without regard to price, the number of trees cut is independent of the price paid for public timberland. A price lower than market value will not result in additional harvesting because of the governmental limitations on the supply of timber land made available.

If the national and provincial governments of Canada were willing to make as much land available for cutting at a constant price as logging companies wanted to harvest, then lower stumpage fees would lead to additional harvesting. The Canadian governments, however, determine the amount of land to be harvested and then use the Canadian stumpage fee systems to

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27 For reasons discussed in more detail in footnote 31 below, the quantity of logs harvested in Canada might increase if the Canadian governments were to adopt a system closer to that used by the USFS.

allocate the land and to collect stumpage fees.[28] This governmental limitation on the available land for timber harvesting is not unlike the process in the United States.[29] Here the USFS determines what land should be cut and then holds competitive auctions to allocate the stumpage rights and to determine the stumpage fees.[30] Under either system, because the

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28 If the Canadian loggers could get as much timber land as they desired at a constant price, they would not be willing to purchase other timber at prices that exceed the government rate. However, petitioners cite evidence that Canadian mills located in Quebec purchase stumpage in Maine for several times the price of government stumpage in Quebec. Similarly they cite claims that stumpage on private lands in British Columbia sells for considerably more than the price of provincial stumpage. See Petition, at 63-65. Further, it appears that from an economic vantage point, the Canadian governments have allocated too little, rather than too much, of Canada's virgin forests for harvesting. See Western Transition (Economic Council on Canada, 1984), at 48-51 (hereinafter "Western Transition").

29 As Ken Drushka states in chapter 5 of his book Stumped, which is included as Exhibit 8 of the Petition, "our forests both in B.C. and the U.S. are administered by the name of 'even-flow sustained yield.' Sustained yield policies further compromise the free market. Restricting yearly harvests to an allowable cut in a particular sustained yield unit means that there is a point above which the supply cannot be increased no matter what price buyers are willing to pay." (As quoted in the Congressional Record (October 10, 1985, p. S13031, column 2). See also Western Transition, at 47-49.

30 We do not address the issue of how the United States or the Canadian governments determine the quantity of timber land to make available for harvesting. Of course, Canadian government decisions concerning the quantity of timber to be cut can affect the price of lumber imported from Canada and therefore the well-being of the United States lumber industry. However, as we understand petitioners' allegations, they are claiming that the subsidy arises only

land to be harvested is determined by an administrative process, the quantity will not vary with the system used to allocate the lands to specific purchasers or with the price paid under that system.[31] All of the land made available will be harvested under

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30 (footnote continued)

because the Canadians do not hold a competitive auction or otherwise charge a competitively-determined price for the right to cut the land that they have decided to make available. The petition does not argue that the Canadians subsidize their lumber industry by the quantity of land they make available for harvesting.

31 Indeed, there are three reasons for believing that the Canadian stumpage fee systems actually may lead to fewer logs being harvested and exported to the United States than would be the case under a competitive auction system. First, with some versions of the Canadian stumpage fee systems, the government establishes a fixed fee for harvesting a tract rather than having a fee that depends on the costs of harvesting the tract and the quality of the timber there. In such a case the government may set the stumpage fee too high and impose a fixed fee that exceeds the profit that could be earned by harvesting the tract. Such tracts will not be cut but will remain standing. With a competitive auction system, on the other hand, some firm would enter a bid which was lower than the fee required under the Canadian system but which would make harvesting that tract profitable. Thus, under a competitive auction system, the tract would be cut.

Second, the method used to charge loggers the appraised value of stumpage in British Columbia may also reduce the quantity of trees cut vis-a-vis a competitive auction, even if the appraised value were equivalent to the auction value. In a manner methodologically similar to the United States system, British Columbia determines the appraised value of a tract. If, as occurs in the United States system, the logger paid that value to the government in a lump sum, all trees for which the price from the sale of the logs exceeded the cutting and hauling costs would be

either system.[32] Thus, the total quantity of logs going to market in any period is unaffected by the stumpage fee system employed.

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31 (footnote continued)

harvested. Instead of the lump sum charge, however, British Columbia charges loggers the average appraised value of stumpage for each particular species on the tract, on a per-log basis. As a result, some trees for which the price of the logs would exceed the costs of cutting and hauling, and which therefore would be cut under a lump sum scheme, will not be cut if the average appraised value is greater than the difference between the log price and the cutting and hauling costs. See Western Transition, at 55.

Third, Canadian stumpage fee systems may be more likely than an auction to allocate harvesting rights to inefficient firms. It may not be profitable for the firm with the harvesting rights to cut a tract, although a more efficient firm would find harvesting profitable. Again, this can result in fewer trees sent to market.

We also note that the USFS establishes a minimum price in the bidding for United States lands. Establishing such a minimum price may mean that the harvesting rights to some tracts are not awarded if none of the bids is high enough. The purpose of the minimum price, however, appears to be to insure that the government receives the value of the timber being auctioned and not to limit the quantity of timber auctioned. If the minimum bid values are set correctly, there would always be bids that meet the minimum and all the land made available would be harvested.

If the USFS systematically overstated the value of timberlands, the quantity of land harvested could be reduced. Such a situation would represent a distortion in the United States system.

32 In order for this to be strictly true, it is necessary that, in addition to avoiding the problems discussed in footnote 31, the revenue that can be realized by selling the logs on any tract must be greater than the costs of building any roads needed to gain access to the timber, the costs of

C. The Effect of the Low Stumpage Fee Is Merely To Increase the Profits of Canadian Loggers.

If the low stumpage fee does not influence the quantity of logs produced, what effects does it have? The answer is that it merely reduces the total costs and increases the profits of Canadian loggers. Economic theory suggests that Canadian loggers, like their United States counterparts, seek to maximize their profits. Therefore, the prices that they charge for logs are determined not by what the logs cost to cut but, given a fixed quantity of logs, by the demand for logs. The mere fact that loggers are permitted to harvest a tract of timber land at an advantageous price does not affect the market price at which those logs are later resold.[33]

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32 (footnote continued)

actually cutting the trees, the costs of transporting the logs to market, and the cost of reforesting the area, if that is part of the obligation of the logging firm. If, for some tracts made available by the government, the costs of logging exceed the revenues that can be earned by selling the timber on the tract, these tracts will not be harvested under either a competitive auction or under the Canadian stumpage fee system. (For a discussion of the more general case where some tracts will not be cut, see the 1983 FTC brief in the Appendix). While all tracts may not be cut in this more general case, it is still true that there are no tracts that would be cut under the Canadian stumpage systems that would not be cut under a competitive auction system.

33 The price also would not be affected when a vertically integrated firm uses a log it has harvested because the firm would incur an opportunity cost equal to the price it would have received if it sold the log to another sawmill. See

In effect, Canadian logging firms are permitted to realize part of the economic rents resulting from the governmental limits on the quantity of trees available for harvesting in any period of time.[34] If the harvesting rights were sold under a competitive auction, these rents would go to the government in the form of increased stumpage fee payments. Thus, the Canadian stumpage fee systems reduce the payments received by the government for stumpage sales and increase the profits of the firms doing the harvesting.

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33 (footnote continued)

page 10 of the Appendix to the 1983 FTC brief. It would not make sense for the firm to put a log to an inefficient internal use when it could sell the log for a greater amount on the open market. The sawmill's production of lumber will be the same as if it was purchasing all of its logs from independent logging firms. The ITC made a similar observation in its report Conditions Relating to the Importation of Softwood Lumber into the United States, USITC Publication 1765, October 1985, at 80.

34 The payment to the government is an economic rent, and not a cost, because the availability of the land for harvesting does not depend on the price received by the government. By contrast, the price that the logger must pay for gasoline is a cost because if the price is not paid he will not receive any gasoline. (For a further discussion of why the payment for harvesting rights is a rent and not a cost, see the 1983 FTC brief in the appendix). The total economic rents resulting from the harvesting of a tract of timberland are the difference between the price for which the logs on the tract can be sold and the costs, not including a payment to the government, incurred in harvesting the logs and transporting them to market. This rent is the maximum a logger would pay for the right to harvest a tract of timber. In a competitive auction system, such as that in the United States, these rents would accrue to the government. If the stumpage fee systems in Canada result in payments less than those generated by an auction, a portion of the rents would be captured by the logging firms.

The petition itself contains information suggesting that the low stumpage fees are resulting in high profits for the Canadian logging firms rather than in an increase in the quantity of logs harvested or in a decline in the price of logs. Petitioners report that firms located in Quebec are purchasing Maine stumpage rights at an average price of $60.33 per thousand board feet at the same time that the charge for harvesting timber located on government lands in Quebec was only $11.96 per thousand board feet.[35] Similarly, the petitioners also refer to considerably higher prices being paid for timber on private lands in British Columbia than is paid for stumpage on public lands.[36] A profit-maximizing firm would only buy stumpage from private lands or from the United States at prices that exceed those charged under the Canadian stumpage fee systems if the prices for which the more costly logs can be sold is sufficient to cover their costs. That Canadian firms do purchase these logs is evidence that the prices charged under the Canadian stumpage fee systems are well below market prices; that the Canadian governments do not capture all of the economic rents in the sale of stumpage rights; and, hence, that the rents not captured by the stumpage fees must be appearing as increased profits for those firms given access to government forest land.

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35 See Petition, at 63-64.

36 See Petition, at 65-66 and exhibits 26 and 27.

D. The High Profits Earned by Canadian Loggers Do Not Have the Same Injurious Effects as the Grant of a Subsidy.

The high profits earned by Canadian loggers are not, in their effect on the United States industry, the same thing as a subsidy on either finished lumber or on logs harvested. The profits here are different from a subsidy because, standing alone, they will have no tendency to increase output to the detriment of the domestic industry.

First, the high profits do not have the same effect on production that a subsidy on finished lumber would have. Economic theory suggests that the supracompetitive profit is entirely captured at the logging stage, and so will have no tendency to increase output in lumber production or other downstream stages of the industry. In other words, because the quantity of logs being harvested is not affected by the Canadian stumpage fee systems, the price of logs is not affected. That the quantity of logs is the same under either an auction system or the Canadian stumpage systems means that the quantity of lumber produced from those logs will be unchanged. This in turn means that the price realized for that lumber is unchanged. The price and quantity of lumber produced in Canada are the same as if the Canadians employed a competitive auction system to allocate stumpage rights and determine the price to be paid for the right to cut that stumpage.

Because the price and quantity of lumber are not affected by the stumpage fee systems, the quantity of lumber Canadian firms will choose to export to the United States will not be altered by

the system. The choice between selling for export and selling for use within Canada will depend on the prices that can be obtained by selling in each country; and this in turn will depend on the demand for lumber in each country. Because the demand for lumber in each country is unrelated to the stumpage fee system employed, the quantity of lumber imported into the United States is not increased because the Canadian governments do not employ a competitive auction to determine the price of stumpage rights.

Similarly, the supracompetitive profit to loggers does not have the same effects as a subsidy given on logs cut. The profit brings no new timberland into production and does not increase Canadian exports to the detriment of our domestic industry.

Petitioners claim, at page 24 of the petition, that the Canadian stumpage systems are no different from a system in which a competitive price is charged for stumpage and then a subsidy of so much per log harvested is granted. It is therefore useful to consider how the two practices are in fact different.

In order to analyze this contention, it is useful to explore a slightly more complicated hypothetical situation. Up to now, we have assumed that all tracts of lumber offered by the government are logged. That is, we have assumed that the revenue that can be received for the logs on each tract is greater than the costs of harvesting those logs -- not including any economic rent paid to the government. However, some tracts made available by the government may be unprofitable because, for example, of location or accessibility. These tracts would remain unharvested

under either a competitive auction system or the Canadian stumpage fee systems.

If the government offered a payment for each log harvested, however, it might be profitable to harvest some tracts for which harvesting would not otherwise be profitable, because the revenues from selling the timber plus the payment from the government would exceed the cost of cutting. If there are tracts that are profitable to cut with the government payment but that are not profitable to cut without that payment, then payment of the per unit subsidy will increase the quantity of trees cut and reduce the price of logs. This, in turn, will lead to a lower price and a larger quantity of lumber produced and to a larger quantity of lumber being exported to the United States. As a result, the United States lumber industry could be injured.

Thus, payment of a per unit subsidy could cause injury to a United States industry because such payments could increase the quantity of imports into the United States. This, however, is not at all the same thing as the Canadian stumpage fee systems because those systems do not increase the quantity of logs harvested and therefore cannot result in injury to the United States industry.[37]

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37 There is another difference between the current Canadian stumpage fee systems and a competitive auction combined with a per unit subsidy. If it is known that the subsidy will be paid before the auction is held, this will cause the competitive bids to be increased to reflect the value of the promised subsidy. As a result, the logging firms will not earn any above normal profits as a result of the subsidy.

E. Conclusion: Canadian Stumpage Fee Systems Do Not Injure the United States Lumber Industry.

In conclusion, based on our understanding of the Canadian stumpage fee systems, it does not appear that the United States logging or lumber industries are injured by reason of the methods by which the Canadian national and provincial governments allocate timber land and charge for stumpage rights as compared with a competitive auction.[38] Injury could occur only if the

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37 (footnote continued)

Unlike the current Canadian system, the approach that petitioners suggest is analogous would not transfer any economic rents to the logging firms. Rather, all rents would be captured by the government, just as if a competitive auction were held without a subsidy.

38 We assume that the comparison between the Canadian stumpage fee systems and a competitive auction is the only relevant comparison for purposes of determining whether the alleged subsidy injures the domestic industry. This assumption seems consistent with the petitioners' complaints.

The Canadian stumpage fee systems could lead to an increase in the quantity of timber harvested if the timber companies successfully lobbied the Canadian federal or provincial governments to expand the quantity of cutting permitted because of the increased economic rents they would earn by cutting additional trees at the low stumpage fee.

At least one of the petitioners' exhibits suggests that this kind of behavior has occurred in the past. According to Peter Griffiths, Equity, April 1984: "[M]any mills overbuilt their capacity in relation to the actual timber supply, as a means of consolidating their domination of the resource. The British Columbia Forest Service was forced to exceed allowable cuts under pressure from politicians afraid of mill closures and lost jobs in their constituencies." (Petition, exhibit 12). This statement, if true, could imply that the low stumpage fees have, at least in the past, resulted in an increase in the quantity of timber harvested. Such behavior would not be profitable under a competitive auction system where loggers only earn a normal profit level. Evidence that sawmill capacity is being

Canadian stumpage fee systems resulted in a greater quantity of logs being cut than would be cut under an auction system. However, this does not appear to be the case. Based on the analysis of FTC staff, we conclude that the Canadian stumpage fee systems result in the same level of cutting as would a competitive auction system. As a result, the quantity of lumber imported into the United States is unaffected by use of the Canadian systems and the domestic lumber and logging industries are not injured by the alleged subsidy.

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38 (footnote continued)

expanded beyond the level necessary to process current allowable cuts in order to convince Canadian federal or provincial governments to expand the allowable cut could suggest that the low stumpage fee charged by the Canadians could be injuring the United States timber industry.

In evaluating claims of this kind of "rent seeking" behavior, it is important to differentiate between building new capacity to justify expansions in cutting and urging that cutting levels be maintained so as to utilize existing capacity and to avoid unemployment. While the former behavior is only rational when the firm can obtain economic rents by cutting timber, the latter is rational even if no return above a normal profit is earned by harvesting timber.

CONCLUSION

For the reasons stated above, the ITC should conclude that there is no injury to the domestic industry by reason of the Canadian stumpage fee systems.

Respectfully submitted
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APPENDIX

Prehearing Brief by the Federal Trade Commission
before the International Trade Administration,
Department of Commerce,
Certain Softwood Lumber Products from Canada,
Countervailing Duty Proceeding,
April 7, 1983