

**Prepared Testimony of
Under Secretary of Commerce for International Trade
Franklin L. Lavin
Before the Senate Committee on Commerce, State and Justice
Subcommittee on Trade, Tourism and Economic Development**

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Thank you Chairman Smith, Senator Dorgan, and Members of the Subcommittee for inviting me to discuss the Administration's efforts to negotiate a settlement to the long-standing trade dispute regarding softwood lumber from Canada. I appreciate your dedication to this issue, and I further appreciate your giving me the opportunity to discuss the Administration's efforts in this regard. With me today from the Department of Commerce is David Spooner, the Assistant Secretary for Import Administration. I am also honored to be here with Deputy USTR Sue Schwab and USTR General Counsel Jim Mendenhall, with whom we have worked very closely on the softwood lumber issue.

Where We Are Today

Before I get into the specifics of the softwood lumber trade dispute with Canada, I would like to mention five general principles to keep in mind when considering this issue.

First, Canada is a good friend and ally of the United States, and our largest trading partner. One of our oldest and most successful free trade agreements is with Canada. The importance of our economic relationship is demonstrated by the fact that U.S. exports to Canada today equal total U.S. exports to the entire world in 1979. Softwood lumber only accounts for some 2% of total trade. Thus, this particular dispute should not define our relationship with Canada. However, we view it as an important issue that merits resolution, and that can be resolved by good faith efforts. We look forward to working with the new Canadian government to find a solution.

Second, we believe that the Canadian lumber industry is subsidized. Five times over the past 20 years, the Commerce Department has formally examined this question, and each time we found the Canadian lumber industry to be subsidized. Canadian officials acknowledge that support for their lumber industry took place even as recently as their campaign several weeks ago.

Third, these subsidies are not in anyone's interest. When interfering in market decisions, governments misallocate their own money and limit opportunity for their citizens. Let's not perceive this issue as Washington versus Ottawa. The objective is to help everyone move toward market economics.

Fourth, the International Trade Administration will continue to aggressively uphold the law and vigorously defend against unfair trade laws before every judicial

forum. We make no apologies for defending American workers and businesses against unfair trade practices, and we will continue to actively pursue those objectives.

Fifth, a negotiated solution is in the best interest of companies and workers in both Canada and the United States. A successful outcome will involve some compromises on both sides, but the mutual benefits of an agreement are far greater than the costs and risks of the ongoing litigation. We also believe that allowing workers and industry on each side of the border to compete in a fair environment will bring the most benefits to consumers. In addition, free trade in lumber products should include the ability to compete and trade in all forest products.

History of Softwood Lumber Dispute

A brief history of the softwood lumber dispute is in order to give context to the complexity of this dispute and to review how we have attempted to resolve it in the past. I will first outline our past administrative proceedings regarding softwood lumber from Canada and their resulting bilateral agreements, and then summarize the current cases, the accompanying litigation, and our recent efforts to date to reach a negotiated solution.

Commerce initiated the first softwood lumber countervailing duty (CVD) investigation in 1982 in response to a petition filed by the U.S. industry. However, the Department determined that the investigated programs bestowed *de minimis* subsidies and issued a negative determination finding no countervailable subsidies. This case is the only one in which no subsidies were found.

Commerce initiated a second CVD investigation of softwood lumber from Canada in 1986, again in response to a petition from the domestic industry. Although Commerce issued an affirmative preliminary determination, that proceeding ultimately settled without the issuance of a final determination. In December 1986, the United States and the government of Canada signed a Memorandum of Understanding (MOU), which required Canada to impose an export tax on softwood lumber exports to the United States. In October 1991, Canada terminated the MOU.

Commerce self-initiated its third CVD investigation of softwood lumber products from Canada in 1991. The Department issued its affirmative final determination in 1992. Commerce's determination was ultimately rescinded in connection with litigation under NAFTA.

In 1996, the United States and Canada signed the Softwood Lumber Agreement (SLA). Under the terms of the SLA, Canada agreed to limit exports of softwood lumber to the United States, and in return exports up to a certain level entered the United States tax-free for a five-year period. Exports above this level were subject to an export tax. The SLA expired in April 2001.

Most Recent Cases

The day after the expiration of the SLA, the U.S. industry filed its third petition alleging that Canada unfairly subsidizes softwood lumber. The U.S. industry additionally

filed a petition alleging that Canadian producers were dumping softwood lumber into the U.S. market at less than fair market value. Commerce subsequently initiated its fourth CVD investigation and its first antidumping duty (AD) investigation in 2001.

In the CVD investigation, the Department found a subsidy rate of 18.79% for Canadian softwood lumber. Canada challenged this result before panels constituted under both the NAFTA and the WTO. The United States was generally successful in defending its determination at the WTO. As a consequence of the NAFTA litigation, however, Commerce has issued five remand determinations. The subsidy rate has decreased with each remand, ultimately becoming *de minimis* in the last remand submitted on November 22, 2005.

Although we did not agree with the Panel's rationale, consistent with our NAFTA obligations, we complied with the Panel's instructions. If the NAFTA Panel ultimately affirms Commerce's fifth remand determination, the United States will decide whether to request review by an Extraordinary Challenge Committee (ECC). No decisions have yet been made on whether to pursue review by an ECC, but all options will be considered.

The softwood lumber AD investigation, which resulted in an order being issued in May 2002, has likewise been challenged in both the NAFTA and the WTO. The NAFTA Panel remanded the case a third time to Commerce in June 2005. The Panel found that Commerce was required by law not to use "zeroing" in the context of the comparison methodology used in that particular investigation. Last July, Commerce subsequently filed its remand with the Panel, revising its calculations in a manner consistent with the Panel's analysis. Commerce is currently awaiting the NAFTA Panel's decision on this latest remand determination.

In the WTO dispute, the United States has been generally successful. However, the WTO Appellate Body determined that Commerce's "zeroing" methodology, as applied in the investigation, was inconsistent with the United States' international obligations. Commerce accordingly modified its methodology. A new WTO compliance panel is now considering that determination, and we are awaiting the interim decision.

Latest Negotiations

The Coalition for Fair Lumber Imports Executive Committee, which represents more than 200 forest product companies throughout the United States, is the petitioner in the current AD and CVD investigations. Consumer trade groups such as the Alliance of American Consumers for Affordable Homes, the National Home Builders Association, and others oppose the orders. Recognizing the needs of both these groups is crucial as we continue to work toward an agreement that is beneficial for all parties, and addresses the concerns of both producers and consumers. However, this concern cannot detract from the need for a negotiated solution that effectively addresses the Canadian lumber industry's unfair subsidization.

Since June 2002, Commerce and USTR have engaged in discussions with Canadian government officials and U.S. and Canadian industry representatives in an

effort to identify a durable, long-term solution to the dispute. Both sides have made proposals for different types of interim agreements; however, further discussions will be necessary to reach an agreement. A major issue is the disposition of the more than \$4 billion in deposits collected by the United States since 2002 and whether any portion of it would be returned to Canada.

In mid-July 2005, U.S. and Canadian industry representatives and government officials met to discuss the possibility of reaching a negotiated settlement based on the imposition of an export tax by Canada. The United States, with U.S. industry support, suggested several new approaches. However, the Canadian government was unable to reciprocate at that time and has not done so at this point.

While formal negotiations have been at a standstill since July 2005, it is our hope that serious discussions will resume soon. In recent negotiations, several components of a possible agreement guided the discussions. The first was a border measure, imposed on the Canadian side of the border, to manage the impact of Canadian lumber imports until market forces play a greater role in setting Canadian stumpage prices. A second was a prohibition against the filing of more trade complaints during the life of the agreement. A third involved the disposition of the more than \$4 billion in duty deposits currently being held by U.S. Customs and Border Protection. In addition, some formula would need to be developed through which individual provinces (or Canada as a whole) could export to the United States free of the border measure (for example if they went to truly market-based pricing of government timber). Finally, a possible aspect of an agreement would be to identify and eliminate other obstacles (besides subsidized timber and corresponding border measures) to free and open trade of all forest products between the United States and Canada.

Our negotiations are complex because management of forestry resources in Canada falls under provincial jurisdiction. Thus, any agreement will need the consent of all relevant provinces. The Federal government is constitutionally responsible for foreign policy (including international trade negotiations), which adds a complex inter-governmental component to resource-related negotiations.

The softwood lumber negotiations must also take into consideration the environmental and economic political diversity among Canadian provinces and provincial forest products industries. Only six of Canada's 10 provincial forest management regimes (Ontario, Quebec, British Columbia, Alberta, Manitoba, and Saskatchewan) are currently at issue in the Softwood Lumber dispute, and many differences exist among them. Nonetheless, U.S. negotiators are limited in their ability to enter into international agreements with sub-national governments, thus eliminating the option of purely regional or province-specific solutions.

The Changing U.S. Industry

In considering how to approach achieving a long-term durable solution, we need to take into account certain significant industry developments. Two of the most

important developments are the recent changes in industry structure, and the transfer of forestland from forest products companies to Real Estate Investment Trusts (REITs).

Our American lumber workers and industry are among the most competitive in the world. Like many other sectors of our economy, the industry has been going through consolidation since the early 1980s that have further increased its efficiency. Independent of the trade issue, we are likely to see additional consolidation and strong competitive pressures in this industry through the near term. Currently, the 10 largest companies account for nearly 40% of North American production. There have been two significant recent mergers. One involved Koch Industries purchasing Georgia-Pacific, a large U.S. producer. The other involved Canada's largest forest products company, Canfor, purchasing New South Company, a significant U.S. producer.

Further, in fall 2005, International Paper (IP) announced that it was considering selling off a significant portion of its 6 million acres of forestland. IP is the second largest private landowner in the United States.

The transfer of forestland to REITs has become increasingly common. From 1998 to 2004, about 25 million acres of timberlands changed hands, from forest products companies to other types of ownership. Roughly one-half of this land has gone to REITs or a similar entity called Timber Investment Management Organizations (TIMOs). John Hancock Timber Resources Group and Grantham Mayo are prime examples of major TIMOs – i.e., investment firms, pension funds and insurance-based companies that are looking for long-term assets. Plum Creek, a major U.S. producer, member of the Coalition, and the largest private landowner in the United States is now a REIT.

These developments will impact the U.S. approach to a long-term solution. Previously, forest product companies used logs from their own forestland. Now, these same producers are purchasing a larger portion of their log supply from the new forestland owners (i.e., REITS and TIMOS) changing the market dynamics around supply and demand of logs, and requiring us to explore new areas in our negotiations.

Next Steps

The Administration remains committed to bringing this dispute to a close. We pledge to work with our Canadian counterparts to find a solution that is fair to all parties, and addresses the concerns of both producers and consumers. A deal can be reached. This is not the place for me to speculate on the specifics of such a negotiated solution, but I can say that these negotiations should take place with a spirit of accommodation, avoiding rhetoric and public posturing. Hopefully, now we have the opportunity to do so. It is important to note that it was in this spirit that we were able to resolve similarly vexing disputes regarding textiles from China and cement from Mexico.

Thank you for giving me this opportunity to testify on this important topic. I appreciate your support for our efforts and welcome your questions.