FOREST PRODUCTS INDUSTRY ISSUES

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

AND

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

NOVEMBER 24, 1981

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FOREST PRODUCTS INDUSTRY ISSUES

TUESDAY, NOVEMBER 24, 1981

U.S. SENATE, SUBCOMMITTEE ON INTERNATIONAL TRADE AND SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT OF THE SENATE FINANCE COMMITTEE,
Washington, D.C.

The hearing was convened, pursuant to notice, at 9:30 a.m., in room 2221, Dirksen Senate Office Building, Hon. Bob Packwood (chairman of the Subcommittee on Taxation and Debt Management)

Present: Senators Packwood, Danforth, Symms, Byrd, Baucus, and Mitchell.

[The committee press release, the bill S. 1824, and the description, and the statements of Senators Bob Packwood and Steven Symms, follow:]

Press Release No. 81-177

P R E S S   R E L E A S E

FOR IMMEDIATE RELEASE
November 6, 1981

COMMITTEE ON FINANCE
UNITED STATES SENATE
Subcommittees on Taxation and Debt Management and International Trade
2227 Dirksen Senate Office Building

FINANCE SUBCOMMITTEES ON TAXATION AND DEBT MANAGEMENT AND ON INTERNATIONAL TRADE SET JOINT HEARINGS ON FOREST PRODUCTS INDUSTRY ISSUES

Senator Packwood, Chairman of the Subcommittee on Taxation and Debt Management, and Senator John C. Danforth, Chairman of the Subcommittee on International Trade, of the Senate Committee on Finance, announced today that the Subcommittees will hold a joint hearing on November 24, 1981, on issues of concern to the forest products industry.

The hearing will begin at 9:30 a.m. in Room 2221 of the Dirksen Senate Office Building.

The hearing will provide an opportunity to review several trade and tax issues important to the forest products industry. Imports of Canadian lumber will be examined. Senator Packwood and Senator Danforth noted that in 1975 Canadian lumber represented 19 percent of consumption in the United States, but that this had increased to 32 percent by the first half of 1981.

The hearing will also explore possible changes in the reforestation tax incentives trust fund, which came before the Finance Committee in 1979 and was enacted in 1980 (P.L. 96-451 Title III; I.R.C. secs. 48(a)(1)(F) and 194). Senator Packwood noted that he is particularly interested in receiving testimony on his bill, S. 1824 which proposes increasing the $10,000 limit on reforestation amortization to $100,000, and changing the funding source for the trust fund from certain forest products tariffs to cutting fees from Federal timber sales.

The Senators also invited testimony on the use of public timber as a tax shelter by limited partnerships. Senator Packwood noted that he is particularly interested in hearing testimony on the problems of the forest products industry in the Pacific Northwest.

Legislative Reorganization Act.--Senators Packwood and Danforth stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify should comply with the following rules:

(1) All witnesses must submit written statements of their testimony.

(2) Written statements must be typed on letter-size paper (not legal size) and at least 100 copies must be delivered not later than noon on Monday, November 23, 1981.

(3) All witnesses must include with their written statements a summary of the principal points included in the statement.

(4) Witnesses should not read their written statements to the Subcomittees, but ought instead to confine their oral presentations to a summary of the points included in the statement.

(5) Not more than five minutes will be allowed for the oral summary.

Written statements.--Witnesses who are not scheduled to make an oral presentation, and others who desire to present their views to the Subcommittees, are urged to prepare a written statement for submission and inclusion in the printed record of the hearing. These written statements should be typewritten, not more than 25 double-spaced pages in length, and mailed with five (5) copies to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510, not later than Tuesday, December 15, 1981. On the first page of your written statement please indicate the date and subject of the hearing.

P.R. No. 81-177

DESCRIPTION OF S.1824 (RELATING TO REFORESTATION EXPENSES)

AND OTHER TIMBER TAXATION ISSUES

INTRODUCTION

The Subcommittees on Taxation and Debt Management and on International Trade have scheduled a joint public hearing for November 24, 1981, on several trade and tax issues affecting the forest products industry. This document, prepared in connection with that hearing, describes the tax issues that arise in connection with the hearing. The first part of this document is a summary of these tax issues. The second part of the document describes S.1824 (Senator Packwood) relating to reforestation expenses and the relevant features of present law. The third part of this document describes certain timber tax shelter syndicates that hold rights to cut timber on public lands.

I. SUMMARY

S.1824

Under present law, a taxpayer who makes forestation or reforestation expenditures on qualified timber property may elect to amortize up to $10,000 ($5,000 on a separate return of a married person) of the expenses incurred during that taxable year over an 84-month period. There is no carryover of excess expenditures or unused limits to prior or subsequent taxable years.

In S.1824, the maximum annual limit on expenditures eligible for 84-month amortization would be increased to $25,000 ($12,500 on a separate return of a married person) after December 31, 1981. A taxpayer who has unused amortizable amounts under the annual limits going back to January 1, 1980, could carry over the unused limits to subsequent taxable years and apply the unused amounts in addition to the then current maximum limitation.

Present law includes a Reforestation Trust Fund financed by up to $30 million annually of revenues received from tariffs on imported timber products, chiefly lumber and plywood. The trust fund is to be used to supplement congressional appropriations for reforestation and timber stock improvement in publicly owned national forests. Under S.1824, timber tariff revenues no longer would be dedicated to this trust fund. Instead, the trust fund would be financed from receipts from sales of trees, portions of trees or forest products from Federal lands (other than those held in trust for any Indian tribe) and 65 percent of such sales from national forests. The $30 million limitation would continue to apply.

Timber tax shelter syndicates

Under a public timber cutting contract, a person contracts with the Federal or State government to cut and purchase timber under the jurisdiction of the government. The contract price for the timber is determined under a bidding system and is payable when the timber is cut. Most public timber cutting contracts do not require the payment of interest for the period between the contract date and the date the timber is cut.

In some instances, the holders of public timber cutting contracts have assigned the right to cut timber to tax shelter syndicates. In these transactions, the syndicate may agree to pay a price for the timber that is less than the price specified in the public contract and to offset this through the payment of interest. The advantage of this syndication is the conversion of a capital cost (the cost of timber) into a deductible cost (interest).

II. DESCRIPTION OF S.1824--SENATOR PACKWOOD

AMORTIZATION OF REFORESTATION EXPENSES AND REFORESTATION TRUST FUND

Present Law

In 1980, the Congress enacted (Title III of P.L.96-451) provisions relating to amortization of reforestation expenses and establishing a Reforestation Trust Fund. These provisions are described in more detail below.

Amortization of reforestation expenditures

A taxpayer may elect to amortize, over a 7-year (84-month) period, up to $10,000 ($5,000 on a separate return of a married person) of qualifying reforestation expenditures incurred during a taxable year in connection with qualified timber property. The half-year depreciation convention applies, i.e., the 84-month period begins on the first day of the first month of the second half of the taxable year in which the amortizable basis is acquired. Thus, the amortization period begins on July 1 for a taxpayer who uses a calendar year for tax purposes, regardless of whether the reforestation expenditures were incurred in January or December of that year. The maximum annual amortization deduction for qualifying expenditures incurred in any taxable year is $1,428.57 ($10,000 ÷ 7) and total deductions for any one year under this provision will reach $10,000 only if a taxpayer incurs and elects to amortize the maximum $10,000 of expenditures each year over an 8-year period. The full $10,000 deduction would be reached in the 8th year.

The election is to be made annually on a property-by-property basis. However, the maximum amount of qualifying forestation or reforestation expenditures paid or incurred during a taxable year which may be amortized is $10,000 for all of the taxpayer's timber properties, and there is no carryover of excess or unused expenditures to subsequent years. For a taxpayer who incurs more than $10,000 in qualifying costs in connection with more than one qualified timber property during a taxable year and elects to amortize the costs attributable to these properties, the Secretary will prescribe regulations concerning the allocation of this amortization basis among these timber properties.

With regard to a partnership, the limitation applies with respect to the partnership and also each partner. The amortization deduction is allowed to an estate in the same manner as to an individual, and the allowable deduction must be apportioned between the income beneficiary and the fiduciary under regulations prescribed by the Secretary.

Qualified timber property means a woodlot or other site, measuring at least an acre, located in the United States which contains trees in significant commercial quantities and which is held by the taxpayer for planting, cultivating, caring for or cutting down trees for sale or use in the commercial production of timber products. The amortizable basis is that portion of the qualified timber property that is attributable to reforestation expenditures. These expenditures refer to the direct costs incurred in connection with forestation or reforestation by planting or seeding, including costs for the preparation of the site, for seeds or seedlings and for labor and tools (including depreciation of such equipment as tractors, trucks, tree planters, and similar machines used in planting or seeding). Reforestation expenditures do not include any expenditures for which the taxpayer has been reimbursed under any governmental reforestation cost sharing program, unless the amounts reimbursed have been included in the gross income of the taxpayer. For any taxable year in which the amortizable basis of qualified timber property exceeds the limitation on amortization, the taxpayer must allocate the amortizable basis to each property as prescribed by regulation.

Reforestation Trust Fund

There is, under present law, a Reforestation Trust Fund, the funds of which are to be used to supplement congressional appropriations for reforestation and timber stock improvement on publicly owned national forests, in order to eliminate and prevent a backlog in reforestation of the National Forest System. Funds for this trust fund are derived from import duties on plywood and lumber. The Secretary of the Treasury is required to transfer receipts from these tariffs to the Reforestation Trust Fund in maximum amounts of $30 million for each fiscal year during the six-year period from October 1, 1979, through September 30, 1985. Transfers to the trust fund are made at least quarterly and are based upon estimates made by the Secretary of the Treasury, with adjustments in subsequent transfers to reflect the amount by which earlier estimated transfers were over or under the amounts which were required.

For each of the five fiscal years from fiscal year 1981 through fiscal year 1985, appropriations have been authorized from the trust fund to the Secretary of Agriculture to pay estimated necessary direct costs and properly allocable administrative costs for reforestation and related programs (under section 3(d)(2) of the Forest Rangeland Resources Planning Act of 1974 (16 U.S.C. 1601(d)(2)), but only to the extent these estimated costs exceed amounts appropriated out of the general fund for these purposes. After consulting with the Secretary of Agriculture, the Secretary of the Treasury must submit annual reports to the Congress setting forth the financial condition and operating results of the Reforestation Trust Fund for the preceding fiscal year and the expected condition and results of the trust fund for the next year.

The Secretary of the Treasury is authorized to invest trust fund proceeds, in excess of amounts needed for current withdrawals, in interest-bearing obligations of the United States or guaranteed by the United States. At the termination of the trust fund on September 30, 1985, unexpended amounts, including interest earned on invested proceeds, are to be returned to the general fund of the Treasury. The Reforestation Trust Fund provisions require transfers to the trust fund for the period October 1, 1979, through September 30, 1985, and authorize appropriations from the trust fund for the period October 1, 1980, through September 30, 1985.

Issues

The first issue is whether the present law $10,000 limit on the amount of reforestation expenditure that can be amortized should be increased to a higher level, such as $25,000.

The second issue is whether amounts that are unused under the limit, in any taxable year, should be carried forward to increase the limit in future years.

The third issue is whether the source of funds for the Reforestation Trust Fund should be changed to sales by the United States of trees, portions of trees, or forest products from Federal lands or forests in place of receipts from tariffs imposed on imports of timber products, chiefly lumber and plywood.

Explanation of the Bill

Amortization of reforestation expenses

Maximum amortization amount.--The bill would amend section 194(b) to raise the limit on the amortizable basis for reforestation expenditures from $10,000 ($5,000 in the case of a separate return by a married person) to $25,000 ($12,500 in the case of a separate return by a married person).

Carryover of unused limits.--Under the bill, a taxpayer could increase the $25,000 limit by the amount of any unused limit carryover from prior years. The unused limit would be the excess of the $25,000 limit ($12,500 on a separate return) over the aggregate amount of qualifying reforestation expenditures for which the taxpayer elects the amortization deductions allowable under section 194. The carryover of unused limit to any taxable year would be the total of unused limits from prior years reduced by the amount of carryovers used in prior years.

For example, assume a calendar year taxpayer incurs $15,000, $10,000 and $20,000 of reforestation expenditures in 1983, 1984 and 1985, respectively, for which he elects 84-month amortization incurred under a $25,000 annual limit on such elections. As a result, he would have $30,000 of unused limit, for carryforward to 1986. The taxpayer could elect to amortize up to $55,000 of reforestation expenditures that he incurs in 1986; the $55,000 would consist of $25,000 of current year (1986) qualified reforestation expenditures plus the $30,000 carryforward of past years (1983, 1984 and 1985) unused limits.

In any taxable year, the amount of amortizable basis that had been acquired would be treated as first using up the $25,000 limit and then treated as using up carryovers of unused limits from prior years from the earliest taxable year first. For taxable years beginning after December 31, 1979, and before January 1, 1982, the limit for determining the amount of unused amortizable basis would be $10,000 ($5,000 on a separate return).

Technical amendment.--The bill also would correct a duplication of section 194 by redesignating the section entitled, "Contributions to Employer Liability Trusts" as section 196.

Reforestation Trust Fund

Section 2 of the bill relates to the Reforestation Trust Fund. Instead of the present law requirement for the transfer to the Trust Fund of up to $30 million from revenues attributable to tariffs on timber, the bill would transfer revenue received from timber sales and forest products on Federal lands.

Specifically, the Secretary of Treasury would transfer up to $30 million to the trust fund 65 percent of the amounts received from sales made by the Secretary of Agriculture of trees, portions of trees, or forest products located on National Forest System lands, and all amounts received from such sales made by the Secretary of Interior from Federal lands (other than lands held in trust for any Indian tribe). This will not effect existing commitments for uses of these funds. This change would apply to sales made after December 31, 1981.

Effective Dates

The amendment increasing the limit on annual additions of amortizable basis would apply to additions to capital account made after December 31, 1981.

The amendment adding carryovers of unused limits would apply to taxable years beginning after December 31, 1979.

The technical amendment making Code section redesignations would take effect on the date of enactment.

The amendment changing the source of funding for the Reforestation Trust Fund would take effect on January 1, 1982.

Revenue Effect

It is estimated that the tax provisions of this bill would reduce fiscal year budget receipts by $2 million in 1982, $5 million in 1983, $7 million in 1984, $8 million in 1985, and $10 million in 1986.

III. DESCRIPTION OF CERTAIN TIMBER TAX SHELTER SYNDICATES

Description

Under a public timber cutting contract, a person contracts with the Federal Government (i.e., the U.S. Forest Service) or a State government to cut and purchase timber that is under the jurisdiction of such government. The contract price for the timber is determined under a bidding system. A successful bidder for a timber cutting contract has the right to cut timber at any time during the term of the contract, which may be for a period of four or five years. Typically, the successful bidder must post a bond to insure performance under the contract, but is not required to pay for the timber until it is cut. Thus, although the contract holder has an immediate right to cut the timber, there typically is no obligation to pay for the timber until it is cut.

Under present law, a taxpayer who holds a contract right to cut timber for a period of more than 1 year may elect to treat the cutting of the timber as a sale of such timber (sec. 631(a)). Gain or loss on the cutting of the timber is the difference between the fair market value of the timber (as of the first day of the taxable year of cutting) and the adjusted basis of the timber for depletion of such timber. Under section 1231(b)(2), timber to which section 631 applies is treated as "property used in the trade or business;" thus, gain arising from the cutting of the timber is treated as capital gain. Gain from converting cut timber into forestry products is ordinary income. For a taxpayer that acquires a public timber cutting contract, the adjusted basis of the timber for purposes of depletion is based on the contract price paid for the timber.

In some instances, the holders of public timber cutting contracts have assigned the right to cut the timber to tax shelter syndicates. The tax shelter syndication of public timber cutting rights is distinguished by the conversion of some of the future capital cost of timber into a present interest cost. In this manner, a current deduction against ordinary income is generated that would not have been available to the original contract holder. When the syndicate cuts the timber, the lower cost of the timber results in a realization of a corresponding amount of capital gain that the original contract holder would not have realized.

Typically, such a syndication would consist of investors as limited partners and the original contract holder as the general partner. The contract holder assigns to the syndicate the right to cut the timber that is subject to the public timber cutting contract. The syndicate pays the contract holder for the cutting rights, plus interest, and then has the right to cut and sell the timber. The original contract holder remains contractually obligated to pay for the timber as it is cut. The syndicate usually would be doing business as a limited partnerhsip, so that the losses and profits of the syndicate could be passed through to each of the syndicate members.

The syndicate, which does business in the same way the original contract holder would have done business by itself, will generally incur the same expenses of doing business and will be allowed the same decutions, which will be passed through to the syndicate partners. However, the syndicate will incur the expenses of interest on the purchase of cutting rights which is an expense the original contract holder would not have incurred. Typically, this would be offset by a reduction in another expense, i.e., the purchase price of the timber.

For example, if the original contract holder had the right to cut public timber at a purchase price of $105, he might sell the right to the syndicate for $60 plus 15-percent interest, to be paid when the timber is cut or at the end of the term of the contract. If the timber were cut after 4 years, the contract holder would then pay the Forest Service $105. The syndicate would pay the contract holder $60 plus $45 interest. For four years, the syndicate would have accrued total interest expenses of $45 that were deductible as they accrued. When the timber was cut, the syndicate would have a capital investment in the timber that was $45 less than the contract value of the timber and a corresponding increase in capital gain. Thus, the net effect with respect to the syndicate partners is to convert current ordinary income into future capital gain by characterizing part of the purchase price of timber as interest expense. Of course, the original contract holder would receive some additional consideration to reflect the value of the tax savings gained by the syndicate and to offset any increase in its income tax liability.

Issues

The syndication of public timber cutting rights to investors for tax shelter purposes raises several issues regarding tax policy and the management of public resources. The system of competitive bidding for public timber cutting rights is intended to provide for the efficient use and conservation of public timber resources. The committee may wish to consider whether use of timber cutting contracts to shelter other income could lead to the uneconomic use of public resources. In addition, consideration could be given to the practive of recharacterizing part of the cost of the timber as an interest expense.

II

97TH CONGRESS
1ST SESSION

S. 1824

To amend the Internal Revenue Code of 1954 to increase the amount of reforestation expenditures which may be amortized in any taxable year, and for other purposes.

IN THE SENATE OF THE UNITED STATES

NOVEMBER 9 (legislative day, NOVEMBER 2), 1981

Mr. PACKWOOD introduced the following bill; which was read twice and referred to the Committee on Finance

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A BILL

To amend the Internal Revenue Code of 1954 to increase the amount of reforestation expenditures which may be amortized in any taxable year, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. AMORTIZATION OF REFORESTATION EXPENDITURES.

(a) IN GENERAL.—Paragraph (1) of section 194(b) of the Internal Revenue Code of 1954 (relating to amortization of reforestation expenditures), as added by section 301(a) of the Act of October 14, 1980 (94 Stat. 1989), is amended to read as follows:

"(1) MAXIMUM DOLLAR AMOUNT.—The aggregate amount of amortizable basis acquired during the taxable year which may be taken into account under subsection (a) for such taxable year shall not exceed the sum of—

"(A) $25,000 ($12,500 in the case of a separate return by a married individual (as defined in section 143)), plus

"(B) any unused limit carryover to such year.".

(b) CARRYOVER OF UNUSED LIMIT.—Subsection (c) of such section 194 (relating to definitions and special rules) is amended by adding at the end thereof the following new paragraph:

"(5) CARRYOVER OF UNUSED LIMIT.—

"(A) GENERAL RULE.—The excess of—

"(i) $25,000 ($12,500 in the case of a separate return by a married individual (as defined in section 143)), over

"(ii) the aggregate amount of amortizable basis acquired during the taxable year which is taken into account under subsection (a),

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shall be an unused limit carryover to each of the three succeeding taxable years.

"(B) AMOUNT CARRIED TO EACH YEAR.—The amount of the unused limit carryover from any taxable year which may be taken into account in any succeeding taxable year shall be the amount of such carryover reduced by the amount of such carryover which was used in prior years.

"(C) SPECIAL RULES.—For purposes of subparagraph (B)—

"(i) the amount of amortizable basis acquired during the taxable year shall be treated as first using up the $25,000 (or $12,500) limit of subsection (b)(1)(A), and

"(ii) then shall be treated as using up unused limit carryovers to such year in the order of the taxable years in which the carryovers arose.

"(D) TRANSITIONAL RULE.—For taxable years beginning after December 31, 1979, and before January 1, 1982, subparagraph (A)(i) shall be applied by substituting '$10,000 ($5,000' for '$25,000 ($12,500'.".

(c) TECHNICAL AMENDMENTS.—

(1) Part VI of subchapter B of chapter 1 of such Code is amended by redesignating section 194 (relating to contributions to employer liability trusts), as added by section 209(c)(1) of the Multiemployer Pension Plan Amendments Act of 1980, as section 196.

(2) The table of sections for part VI of subchapter B of chapter 1 of such Code is amended—

(A) by striking out the item relating to section 194, as added by section 209(c)(2) of the Multiemployer Pension Plan Amendments Act of 1980, and

(B) by adding at the end thereof the following new item:

"Sec. 196. Contributions to employer liability trusts.".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by subsection (a) shall apply with respect to additions to capital account made after December 31, 1981.

(2) DETERMINATION OF CARRYOVERS.—The amendment made by subsection (b) shall apply with respect to taxable years beginning after December 31, 1979.

(3) TECHNICAL AMENDMENTS.—The amendments made by subsection (c) shall take effect on the date of enactment of this Act.

SEC. 2. REFORESTATION TRUST FUND.

(a) IN GENERAL.—Paragraph (1) of section 303(b) of the Act of October 14, 1980 (94 Stat. 1991) is amended to read as follows:

"(1) Subject to the limitation in paragraph (2), the Secretary of the Treasury shall transfer to the Trust Fund—

"(A) 65 percent of the amounts received in the Treasury during any fiscal year from any sale made after December 31, 1981, by the Secretary of Agriculture under section 14(a) of the National Forest Management Act of 1976 (90 Stat. 2958; 16 U.S.C. 472a(a)), and

"(B) all amounts received in the Treasury during any fiscal year from any sale of trees, portions of trees, or forest products located on Federal lands (other than lands held in trust for any Indian tribe) by the Secretary of the Interior which is made after December 31, 1981.".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on January 1, 1982.

Statement by Senator Bob Packwood

Our purpose today is to address the causes of the deep depression in this nation's housing industry.

All of us in this room understand what we are facing. And certainly I did not need to ask Oregonians to cross the continent to tell us how serious the problems are.

Those problems are writ large and clear in terms of both the cold, impersonal statistics and the extraordinary human suffering. You know it, and I know it. And so does every resident of my state.

But this hearing today does not deal only with the problems of Oregon's timber and housing industries. The fact is that Oregon is a microcosm of the nation. The curse of high interest rates is felt in every state of the Union. And those of us in timber-producing states know just how painful that curse is.

We are here today to get those facts on the official record of this Congress. Today's witnesses will help us lay the foundation for actions that must be taken to ease the immediate problems, and—equally important—to eventually restore this vital industry to full health.

Specifically, we are focusing today on four key matters:

First, we will explore the impact of Canadian imports upon our domestic timber industry.

Second, we will examine the Reforestation Trust Fund and its impact upon our efforts to ensure an adequate long-term supply of marketable timber.

Third, we will examine the reforestation tax credit as it applies to small private timber owners.

And, fourth, we will consider the impact on the timber industry of certain provisions of our tax laws.

Let me emphasize as we begin that this hearing today is but one of the steps down the difficult road we must travel. But it is a vital step and I appreciate your presence here today, even though the notice was short.

Statement by Senator Steven D. Symms

Good morning. It is a pleasure to be here today to discuss various trade and tax issues relating to the forest products industry, a major industry in the State of Idaho.

At the outset, I would like to state that our principal public policy objective should be the attainment and preservation of equitable Federal tax provisions that reflect the long-term nature of forest investments and the unique risks involved. In addition, forest taxation policies should encourage forest conservation, reforestation and stable land ownership patterns.

Despite the current slump in the timber industry, the Forest Service has estimated that the demand for paper and wood products will double in the next 50 years. If we are to prevent severe shortages in the future, it is important that we carefully plan now for our future needs.

In any discussion of the impact of tax policy on forest productivity, it is essential to emphasize at the beginning that absent the same capital gains treatment that is applicable to all capital assets, there are no ongoing special tax benefits for growing timber. There is nothing, for example, in timber tax treatment comparable to percentage depletion. The "cost depletion" applicable to timber is nothing more than the same "cost recovery" applicable to other capital assets and is not taken into account until the timber is sold.

Since 1944, when Congress extended capital gains treatment to the full range of qualified timber transactions rather than only to lump sum, liquidation type sales, the most dramatic change in growth and planting in the history of American private forestry occurred.

Last year, the Congress passed legislation providing reforestation tax incentives, and there seems to be evidence that these new incentives are working. Under the provision passed last year, up to $10,000 per year of reforestation expenses are eligible to be amortized over seven years and to be taken into account for purposes of the investment tax credit.

However, while Congress certainly took a step in the right direction last year, I am not sure that the $10,000 limitation is sufficient to fully achieve what we had intended. Consequently, I have co-sponsored Senator Packwood's bill, S. 1824, which will expand to $25,000 the amount of reforestation expenditures that could be taken into account in any year for purposes of the amortization deductions and tax credit. In addition, this bill will enable a taxpayer who incurs less than $25,000 in reforestation expenditures in any year to carry over the unused limitation to each of the three succeeding years.

The investment requirements and incentives to improve our timber supply are substantial. The length of time before a profit is realized; the risks of storms, disease, and fire; the initial capital investment costs for land preparation, roads, plantings, and annual maintenance; and the likelihood that a significant portion of the investment will be estate-taxed away make forest investments extremely hazardous.

As a result, it is very important that our tax system recognize these risks. S. 1824 provides timber farmers with more realistic incentives and flexibility in planning their replantings. In addition, the costs of providing these changes are recaptured in future years when the timber is harvested.

I noticed in the testimony that will be given by the Forest Industries Committee today that they have recommended reducing the corporate capital gains rate to 20 percent and expand the reforestation incentives to trusts, the only taxpayers not now eligible to use them.

I strongly supported reducing the corporate capital gains rate during the discussion of the recently passed tax bill. If we expect to encourage venture capitalism in this economy, it is essential that this rate be reduced so that it will be brought into historical balance with the individual capital gains rate.

In addition, I fully agree that a technical amendment should be attached to the next tax bill expanding the reforestation incentives to trusts.

Insofar as the growing concern over Canadian wood products exports to the United States is concerned, I am anxious to review the testimony presented here today on this matter. In reviewing the facts of this case myself, it seems to me that the basis of the complaint stems from the fact that the Canadian Government is charging private timber companies less to cut on their federal lands than does the U.S. Government.

I am not aware that the Canadian Government is subsidizing their exports and I therefore have not found at this time that Canadians have violated their trade agreements with the United States.

Nevertheless, the fact of the matter is that the Canadians are selling certain wood products in the United States at a lower cost than United States wood products. The Canadians are definitely increasing their market share in our market.

The answer to this problem seems very clear to me—we need to give the Canadians some competition. Presently, the revenues received by the Forest Service from timber auctions are contributed to the general revenues, minus a portion that is given to the counties where the timber is located. The percentage given to the counties is determined on a percentage based a formula.

My suggestion is to change the formula so that the revenues directed to the counties are not reduced, and let the shortfall occur at the Federal level. As all of you know, county governments will be facing financial shortages themselves next year due to a decrease in revenue sharing funds, etc. Also, county governments are generally relatively frugal with the funds they receive and are usually very responsive to the needs of their population. Whereas, at the federal lever, we all know that there is a great amount of waste and reducing revenues to the Federal Government would not be as damaging.

Restraining Canadian imports would only result in increased prices to consumers. Increasing competition in the marketplace would not only be more beneficial to consumers but would also help U.S. timber companies and their employees from facing impending bankruptcy or unemployment.

I am pleased that both Senator Packwood and Senator Danforth are holding this hearing today to address some of the issues facing an industry that manages one of America's [illegible] resources. Thank you.

Senator PACKWOOD. The hearing will come to order, please. I will have an opening statement, and Senator Danforth may have one. But before I make my opening statement, let me explain our time constraints and the normal rules of this committee.

The normal rules are to limit witnesses to 5 minutes, with the exception of Governors, Senators, or officials from the administration, and certainly we will put no time limit on Senator Cohen or Governor Atiyeh. But as all of you can see from the length of the witness list, if we are going to finish the hearing this morning, and it would be my intention to go through until we finish rather than breaking for lunch, I will have to urge you to abbreviate your statement. The entire statement will be in the record, and I can assure you that I will read every word of every statement. But if every one of you reads every word of every statement, we are not going to finish today, let alone perhaps tomorrow. So those are the ground rules as we start.

I am very appreciative of Senator Danforth agreeing to co-chair these hearings. Two subcommittees of the Finance Committee are meeting today: his International Trade Subcommittee and my Taxation Subcommittee, because the particular issues before us cross both of those committees. Now let me simply say, as far as I am concerned, if I can stop them, I am not going to let housing become the scapegoat for any kind of pseudo-economic philosophy of any administration, Republican or Democrat, this or any other.

To date we have seen the policies, with the high interest rates, devastate the State of Oregon. We are in excess of 10½-percent unemployment in the State generally. In the timber products industry alone it is approaching 20 percent, and it is approaching it principally because of interest rates.

This hearing today is not going to result in the interest rates being lowered by 5 percent.

There are other problems as well. The question of whether or not Canada is competing unfairly is a problem. The question of reforestation and whether the trust fund which was set up last year will be adequate is a problem. The timber tax credit, which was part of the reforestation bill last year, is a problem. And all of those will be addressed by different witnesses.

But I will come back to what I said at the start of this statement: Interest rates are the principal problem of the housing industry, and when housing is down timber is down. And to the extent that I can do anything about it, I am not going to allow housing to be sacrificed on the altar of some other method of capital formation or some other industry.

Senator Danforth.

Senator DANFORTH. Following your admonition, Mr. Chairman, I will offer my statement for the record.

[The prepared statements of Senator John Danforth and Lawrence J. Brady, Assistant Secretary of Commerce, follow:]

STATEMENT OF SENATOR DANFORTH

Mr. Chairman, the joint hearing we have scheduled today pertains to yet another aspect of U.S. trade relations with Canada, which have so often been in the news of late. The softwood lumber industry, which relies so heavily on a vigorous housing industry for its own health, is indeed suffering dramatically at the present time. Some statistics I have seen suggest that we have not had such industry plight in 35 years. It seems apparent that the slight improvement demonstrated in the latter part of last year has collapsed in the face of continued high interest rates that have depressed the housing markets severely. In this period of falling consumption, rapidly increasing imports of Canadian softwood lumber are of particular concern.

Trade in but one important aspect of the multitude of factors comprising the United States' close relationship with our northern neighbor. It is a mutually beneficial relationship; trade between the two countries exceeded $77 billion in 1980. Seventy percent of Canada's international trade is with the United States, while its share of our trade exceeds 18 percent of the U.S. total. In considering the many trade issues that have arisen recently between our nations, particularly with regard to Canadian energy and investment policies, it is well to keep in mind that both countries have much at stake in seeking mutually agreeable solutions to these notes of discord in our trading partnership.

I thus applaud the approach suggested by Senator Packwood to this particular issue of lumber trade. It seems to me that requesting the International Trade Commission to conduct a study under section 332 of the Tariff Act is the most appropriate way to analyze the causes and effects of the current state of the U.S. softwood lumber industry. There is evidence that Canadian exporters enjoy advantages in the U.S. markets gained through unfair Government-sponsored pricing practices at home. If the pricing practices of the Canadian Government or its firms figure importantly in the reverses currently being suffered by our firms, then we will have an informed basis on which to act. If not, the study should point us to any other causes and remedies we might wish to consider. I am confident that both the U.S. industry and our Canadian friends will cooperate to produce an enlightening report by the ITC. I hope our witnesses today will agree that an ITC study is an appropriate way to proceed at this time.

This hearing also will focus on certain tax problems that concern the timber industry. In particular, we will hear testimony on S. 1824, a bill introduced by Senator Packwood which would expand the reforestation tax incentives approved by the 96th Congress and signed into law last year. Under S. 1824, the annual limit on qualifying amortizable reforestation expenditures would be raised from $10,000 to $25,000. In addition, reforestation expenses could be carried over for three years, and the Reforestation Trust Fund would be funded by cutting fees from Federal timber sales, rather than from tariffs on forest products as is now the case.

I look forward to hearing the testimony on the proposal by Senator Packwood, and on the use of timber as a tax shelter, which has also been listed as an item for discussion this morning. Tax code changes that can improve the management of our timber resources certainly merit our attention, and I hope this hearing will establish a good record to guide our future policy decisions in this area.

Testimony of Lawrence J. Brady, Assistant Secretary of Commerce for Trade Administration

Mr. Chairman, it is an honor and a pleasure to appear before this Committee to comment on the impact of United States-Canadian trade policies on our timber industry. There is no question that the American timber industry, especially in the Pacific Northwest, is faced with a problem of crisis proportions. I agree with your analysis in your recent floor statement that continued high interest rates are an important cause of the timber industry's depression.

The high interest rates have resulted from an inflation, fueled by excessive government spending , that we inherited from the past Administration. The President's economic recovery program will eventually bring the interest rates down. Indeed, they are declining significantly now. In the meantime, however, we must pay particular concern to our industries which are more vulnerable to the unfair trade practices of foreign governments because of the high interest rates. I would add that I am a resident of New Hampshire, which borders Canada, and I am well aware of the plight of many border industries, not only in your region of the country but also in mine.

Secretary Baldrige and Under Secretary Olmer have promised you and the Congress that they will vigorously enforce the countervailing duty and antidumping statutes. I assured this Committee that I will carry out that promise. We are actively working with our businessmen to determine if they are being injured by unfair trade practices. I believe you will find a significantly different attitude in this regard among me and my counterparts as compared to some previous Administrations.

UNITED STATES-CANADA TRADE

United States-Canada trade is the most extensive of any two countries in the world. In 1980, our two-way trade exceeded $77 billion, accounting for over 18 percent of U.S. world trade and 70 percent of Canadian world trade.

Much of our economic interdependence with Canada is helpful to us politically and economically. The United States and Canadian governments must, however, be cautious about how our two-way trade affects our respective border industries. In border trade, there are no geographical barriers that provide a natural advantage to domestic industries. In addition, government policies in support of their exporters have a more immediate impact on bordering countries.

In this regard, we are very concerned by Canada's increasing government intervention in its economy. For example, Canada is vigorously pursuing policies of export expansion and import substitution. The United States Government has discussed these concerns with Canada in high-level bilateral talks. If these talks are not successful, however, we have laws to protect our industries which may be adversely affected if these Canadian policies are translated into unfair trade practices. Recent trends in the lumber market have focussed our attention particularly on the applicability of those laws to imports from Canada.

The Canadian market share of softwood lumber has grown from 19 percent in 1975 to a current level of 32 percent. This alarming increase seems to be caused in part by the method Canada uses for pricing its timber. As you have noted, the United States uses competitive bidding to price its timber for sale to lumber companies. The Canadians, through their stumpage pricing system, seem to set prices at their own discretion. This price is now significantly below our market price.

Increasing Canadian lumber imports also seem to be tied in part to their lower rail transportation costs. Because stumpage and freight are major cost factors in the sale of lumber, the lower prices associated with them have given Canadian producers a considerable competitive advantage in the world market. Whether or not the provision of these goods and services constitutes a countervailable subsidy has been the subject of considerable research by my staff. If there is such a subsidy, we will not hesitate to make the appropriate determination under the 1979 Trade Agreements Act.

My staff has met with representatives of one of the Northwest lumber industry's trade associations, and we intend to continue to work with the industry to ascertain if Canada's stumpage pricing system and rail rates are counteravailable subsidies. It is my understanding that several of the industry groups have begun to collect data which will help us understand the Canadian system.

A counteravailable subsidy in this context exists where different purchasers in the exporting country are charged different, preferential prices. The fact that a country provides goods or services at a fee lower than the world market price or U.S. price, does not mean it has conferred a countervailable benefit.

Low prices or price ceilings placed on a natural resource, such as stumpage, do not necessarily constitute a subsidy under U.S. law. This is because a natural resource may be considered a free good. The government need not be concerned with prices if it incurs no costs which must then be recovered. For example, we have insisted that the European Community not regard our natural gas price controls as a countervailable subsidy. Each country may utilize its natural resources to give it a comparative advantage in the market for certain products, in order to maximize benefits to the general development of the economy of that country.

With respect to stumpage, countervailable preferential pricing would result from a refusal to sell stumpage to a given type of firm which otherwise meets reasonable requirements such as minimum capitalization and/or production levels, and the clearing of debris and other forms of land recovery. For example, allocating only to firms on the basis of export performance or allocating on better terms to one industry than to another.

Even if most firms do export, it would be an export subsidy only if the system were specifically designed to increase exports, even in a time of high domestic demand.

In the case of low rail rates, we could find a countervailable subsidy if lumber products receive preferential rates over other industries, if exporters receive preferential rates over non-exporters, or if the railroad fails to cover its operating costs. We do not yet have evidence that such a situation exists in Canada.

New evidence has recently been provided to my staff on the Canadian timber situation. It will be carefully reviewed and screened for any indication of discriminatory pricing or any other subsidy feature. We will continue to closely monitor the situation.

We are also in contact with the Cedar Shake and Shingle producers. We reviewed and commented on a draft antidumping petition submitted by shake and shingle producers earlier this year. They requested that we send someone to assist them in reformulating their petition and we were pleased to be able to help them. A member of my staff spoke to the Board of Directors of the U.S. Shake and Shingle Manufacturing Association in Seattle last July and answered questions concerning their petition for relief from import competition. During our most recent contact with the Association, they indicated that they were prepared to formally file a petition. When their petition is filed, I can assure you that it will be very carefully considered.

In closing, Mr. Chairman, we are alert to the problems of the timber industry in the Pacific Northwest. If we identify, from the information we are still gathering, an unfair Canadian trade practice, we will act. My door is always open to our businessmen and workers to assist them in identifying any unfair trade practices.

We fully support, in the meantime, your proposed resolution to request the International Trade Commission to investigate Canadian lumber imports in accordance with 19 U.S.C. 1332. We stand ready to cooperate with them in every way that we can.

Thank you for the opportunity to testify.

Senator PACKWOOD. And Senator Mitchell, from Maine.

Senator MITCHELL. Thank you, Mr. Chairman. I commend you for these hearings. I heard just the end of what you said, but if the rest of it is as good, why, you are to be commended for that.

I will also insert my statement for the record.

I do want to say that I look forward to hearing from my colleague, Senator Cohen, who has already done much work in this area and has expressed great interest in the problems which affect our principal areas.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT ON UNITED STATES-CANADIAN LUMBER TRADE BY SENATOR GEORGE J. MITCHELL

I am pleased that Senator Packwood and Senator Danforth have scheduled this hearing today. The plight of the forest products industry is serious, and I hope that today's hearing will shed light on some actions that we can take to aid the industry.

While most of the witnesses today will focus on the conditions in the Northwest, the economic forces creating the depressed state of the industry are at work in the Northeast. The record, high interest rates and the depression in the housing industry are resulting in cutbacks and layoffs in mills throughout the country. Social and economic hardships are also being felt in those firms and communities that depend on a thriving lumber industry.

A recent survey by the New England Lumber Manufacturers Association highlights the condition of the forest products firms in my part of the country. Of their members responding to the survey, the Association reports a 25 percent layoff rate over the last 12 months. The New England mills have had to reduce their average operating time from 58 hours to 44 hours per week, a cut of 24 percent. Sixty percent of the reporting firms realized a decline in sales, averaging 31 percent lower than last year. Prospects for improvement in the near future appear dim, as over 90 percent of the mills expect no improvement or further curtailment in operations over the next year.

When the mill owners were asked the causes of the decline in their sector, the large number of respondents citing the high level of interest rates and low level of housing starts was no surprise. Yet the Lumber Manufacturers Association found several mill owners attributing their financial troubles to Canadian lumber imports. Thus, today's hearing addresses a problem that is of great concern to New England mill owners.

Although current exchange rates also benefit the Canadians, a number of special subsidies apparently are available to Canadian mills that give them an additional advantage over U.S. mills. Stumpage prices in Canada are not set by private markets, as in the U.S., but by the government. Relatively lower stumpage prices are an important element of the Canadian plan to encourage lumber production for export. Subsidized rail transportation costs is another significant subsidy. This allows lumber from British Columbia to be sold at a lower price than U.S. lumber in many eastern U.S. markets. The federal and provincial governments in Canada also offer an array of construction and operating subsidies to their sawmills.

Because of the vagueness and lack of information surrounding the allegations of Canadian subsidies, I strongly support Senator Packwood's call for an ITC investigation of the subsidies and their effects on U.S. manufacturers. This study should aid the U.S. industry as they seek appropriate forms of import relief.

I believe that today's hearing also serves a broader purpose. The forest products industry is one of several industries in the states bordering Canada that are feeling the effects of an aggressive subsidization campaign by the federal and provincial governments in Canada. Hearings held last week by my colleague from Maine, Senator Cohen, documented this very well. I look forward to hearing Senator Cohen's observations on this issue.

My hope is that today's hearing will lead to further inquiry into Canada's trading practices and their effects on U.S. producers. The problems faced by Maine's potato growers and fishermen are very similar to those confronting the lumber manufacturers.

Senator PACKWOOD. Thank you, George.

We will start this morning with Senator William Cohen from Maine.

Good morning, Bill.

STATEMENT OF HON. WILLIAM S. COHEN, A U.S. SENATOR FROM THE STATE OF MAINE

Senator COHEN. Good morning, Mr. Chairman. I can assure you I will stay within the 5-minute allotment. I want to thank you for providing me with this opportunity to address you on this issue.

We have had serious unemployment problems in the State of Maine, particularly as it affects the timber industry, with unemployment in millwork doubling between October of 1979 and 1980. Like the State of Oregon, we have got a severe slump in our housing industry. And I think that you pointed out in your opening remarks there is one principal factor involved, and that is high interest rates. But I don't think we should look only to the high interest rates. There are many diverse reasons for this: we have got a depression in the housing starts, we have got log exports which boost domestic stumpage prices, and there is a surge in Canadian exports into the United States. And this is what I would like to focus on just briefly this morning.

We have held hearings in the Senate Governmental Affairs Committee, the Oversight Committee on Government Management, which I chair, on United States-Canadian trade policies on small, border State industries, trying to find out how we can regress the unfair import competition that our local industries currently face. We examined a number of different industries: the horticultural industries, fishing industry, wood product industry, and we found several distinct problems with our trade policies, with the administration of our domestic trade remedies, I think which deserve some attention.

First, the rising Canadian exports to the United States in a number of sectors threaten the domestic industries, and these exports are the product of long-term development policies on the part of the Canadian Government. Now, I have no quarrel with our Canadian neighbors, and I don't question the wisdom or propriety of what they seek to achieve. In fact, I share many of their own concerns; mainly, we should be doing more to help specific industries in this country.

But the difference is that, while we rely on a free market or free enterprise theory, the Canadians have employed subsidies, preferential tax treatments, loans, loan guarantees, grants, training programs, and the like, as primary vehicles of public involvement in private development. And their use is extensive, and their success is extraordinary.

Now second, we have seen a direct causal connection between this kind of aggressive subsidization policy on the part of the U.S. Government, which has resulted in direct loss of sales, increased unemployment, and a severe slump in U.S. industries.

The third point I would like to stress is that our trade policy, the administration of our trade policy, has evolved in such a fashion as to effectively bar our own industries from seeking redress. The remedies that were designed to promote free trade and respond to unfair competition, in accordance with the multitrade agreements negotiated at Tokyo round, effectively preclude small industries from getting any relief. They are complex; they are in many cases even inconsistent; the burden of proof is extraordinary in some cases, with the burden of proof not even being clearly understood by those who are required to enforce these laws, as to whether there must be, for example, a proof, a burden of proof, as to whether a causal connection exists between subsidy and the resulting loss of business on the part of the domestic industry. Even that is unclear on the part of many of our own people.

During the course of the hearings I asked many of the witnesses who came before us from the ITC, from the trade representatives offices, and so forth, the commerce committee, as to what is a subsidy. How do you classify something, as a subsidy or a long-term government program in Canada? There was general confusion on that subject matter, particularly as it affects the fishing industry.

I have a document which I will at least offer you. Whether you choose to put it in the record is a matter of your choice, Mr. Chairman, but it shows the kind of programs made available by the Canadian Government and the maritime provinces to their fishing industry, 9 to 10 pages of programs which effectively provide a subsidy for their fishing industry.

And then you have a document that comes out of our own State Department which reveals and concludes that without these programs they could not effectively compete against our own fishermen. Now the ironic thing is that we now import nearly two-thirds of all the fish that are caught off our own waters from Canada.

So I would offer to you this as at least a tangential issue to be considered by this committee.

The second thing I would ask you to look at is the ABC's of Canada, Assistance to Business in Canada. This is another little booklet that our own representatives in our own agencies were unaware of. It has now been submitted to them for their own review.

But what you see in addition to the interest rate problem, as you pointed out, is a rather calculated long-term aggressive subsidization program on the part of the Canadian Government, which I don't disagree with. What I disagree with is our Government's indifference and turning either a blind eye or a deaf ear to what is going on across the border and how it affects those local industries.

The remedies that we currently have are simply too complex. They are too costly, and you will find from some of the witnesses to come before you it costs a minimum of $100,000 to seek legal counsel here in Washington to file, for example, a countervailing duty petition. It takes at least 6 months and probably longer, during which time the problem will only worsen. And then, ultimately, you will find a very thin record of anyone prevailing on the imposition of countervailing duties, which are usually waived for foreign policy considerations. And they are waived with a statement that, well, the Canadian Government has terminated that subsidy program.

Well, if you have, for example, a loan program or a construction program for fishing vessels, and those vessels have a lifetime of 20 or 25 years, even though the program is terminated the effects of that program extend well into the future. So you still have an advantage on the part of a competitor.

So I would suggest to you that our current remedies are complex; they are overlapping and in some cases contradictory; they are time consuming, costly, and ultimately they are illusory. There is no effective remedy available to small businesses in this country who are, in fact, impacted adversely by unfair competition.

So, while I salute the committee in pursuing these particular hearings, I would like to also call your attention, Mr. Chairman, to looking at the interest rate problem. That is something that is not going to resolve, that you suggested.

I would also ask you to look at the testimony that will come before you which shows that States like Washington, Oregon suffer a 12 to 1 disparity in the price of stumpage in British Columbia. That is something that, in addition to the interest rates, they have to compete with the Canadian Government selling timber at 12 times a lower price.

So these are incremental burdens that our industries have to face. We can say, well, it is the interest rate problem, and that is your difficulty, U.S. company; but it is all of the things on top of the interest rate which, I think, are contributing to the decimation of the fabric in your State and mine.

With that, Mr. Chairman, I will terminate my remarks and ask that my full statement be included in the record.

Senator PACKWOOD. Your whole statement, as all of the statements, will be placed in the record. I may have a question or two, but Senator Baucus has an opening statement, first.

[The prepared statement follows:]

OPENING STATEMENT OF

SENATOR WILLIAM S. COHEN

FOREST PRODUCTS INDUSTRY ISSUES

A Joint Hearing Before The

SUBCOMMITTEE ON INTERNATIONAL TRADE

AND THE

SUBCOMMITTEE ON TAXATION & DEBT MANAGEMENT

SENATE COMMITTEE ON FINANCE

November 24, 1981

Mr. Chairman, I want to thank you for the opportunity to express my concerns for the very serious problems confronting the timber industry in our country today. Mill slowdowns and mill shutdowns, affecting over one-third of the industry in the Northwest and Northeast, have caused sharp rises in unemployment and regional depressions in those geographic areas most dependent on the forest products industry. For example, in my own state of Maine, the number of unemployed mill workers doubled between October 1979 and October 1980, and mills across the state are curtailing production, laying off workers, or shutting their doors altogether. Foreclosures and repossessions continue to increase. The industry, in short, is in a severe slump, and I applaud your decision to look into the causes of this slump and the possible actions that we can take to rectify it.

The factors affecting this downturn are diverse: record-high interest rates, a depression in housing starts, log exports which boost domestic stumpage prices, and a surge in Canadian exports into the U.S. lumber market. It is on this latter point that I wish to focus my remarks.

One week ago, the Senate Governmental Affairs Subcommittee on Oversight of Government Management, of which I am chairman, held hearings on the impact of U.S.-Canadian trade policies on small border state industries to investigate the adequacy of our domestic trade remedies to redress injuries caused by unfair import competition. We examined a number of industries, including border state horticultural industries, the fishing industry, and wood products.

We found several distinct problems with our trade policy and with the administration of our domestic trade remedies which deserve mention.

First, rising Canadian exports to the U.S. in a number of sectors threaten our own domestic industries. These exports are the product of long-term development strategies of the Canadian federal and provincial governments in order to expand Canadian commerce and boost regional employment. I have no quarrel with our Canadian neighbors, nor do I question the wisdom or propriety of their development policies. In fact, I share many similar concerns for the economic well-being of our own regional industries. However, our strategies for promoting our own domestic well-being differ markedly. While we rely more fully on the free market, the

Canadians have employed subsidies, preferential tax treatment, loans, loan guarantees, grants, training programs and the like as primary vehicles of public involvement in private development. Their use is extensive, and their successes, in many cases, noteworthy. Our hearing record documents their scope.

Second, many of our border state industries have suffered lost sales, decreased employment, decreased profits, and under-utilization as a consequence. The wood products industry is one such example of this.

Third, the administration of our trade laws has evolved in such a fashion as to effectively bar many of our own industries from seeking redress. These remedies were designed to promote free trade and respond to unfair import competition, in accordance with the multilateral trade agreements negotiated at the Tokyo Round. Close examination of these trade remedies reveals that what they were designed to do differs from what they, in fact, do. The administrative complexities of countervailing duty and antidumping provisions ensure that access to them is barred to those smaller border state industries that may suffer the most serious consequences of import competition. High costs -- our records indicate average legal costs per case exceed $100,000 -- and the requirement that petitioners "prove" extraordinarily complex factual matters discourage those who have meritorious claims and disappoint those who try. Lack of data, disputes over what constitutes a subsidy, and convoluted, overly technical tests for injury all characterize the procedures.

When compared with how our other trading partners administer similar provisions in their own domestic laws, our proceedings are complex and unresponsive.

Viewed from a realistic perspective, the ability of small industries to secure relief from the escape clause provisions (Section 201) or through enforcement of U.S. rights under Section 301 is compromised by the highly complicated nature of those proceedings. Both trigger the complex review process of the Trade Policy Committee, requiring high-level, wide-ranging Administration support before any action is taken. Within the framework of overall trade policy and with the linkage that inevitably occurs, the chances for a small border state industry to secure relief are minimized.

I believe in fair trade, and I believe that our industries deserve the opportunity to compete on a fair basis. But I do not believe that our government should require its regional industries to compete with the treasuries in Ottawa and the provinces. A case in point is the wood products industry, now ravaged by a number of factors including subsidized Canadian exports into the U.S. lumber market. When we look at the remedies that might be available to those smaller independent mills and manufacturers, we find a litany of problems facing them. How will they define their "industry?" Is the sale of below-market stumpage in British Columbia a "subsidy?" Can they prove material injury in a national market? And, is the necessary causal link broken by interest rates? And, finally, can they afford to go the route at all?

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In Maine and New England, our mills and wood products industries are suffering a similar slump. Scheduled mill expansions are postponed, existing mills are shut down or slowed down, and unemployment is increasing significantly in a region that can ill afford it. Because of this, and because of the serious problems which I believe inhere in the ability of our smaller industries to secure relief from Canadian exports, I support these hearings you have called today, and hope that they are able to generate solutions to the problems which plague our wood products industries. I thank you for the opportunity to participate.

FROM "THE SCHAFFER REPORT," DEPARTMENT OF FISHERIES + OCEANS, OTTAWA SEPT. 1981

Table A.1

Government Financial Assistance Programs Available to Fishermen in the Atlantic Groundfish Industry.

PROGRAM	PURPOSE	FUNDED BY:
Fishing Vessel Construction Assistance Program * (35% or less)	to assist fishermen meet high capital costs of constructing, converting or modifying vessels up to 75 feet in length.	D.F.O.-federal
Fishing Vessel Insurance Program	to provide low cost insurance for fishing vessels	D.F.O.-federal
Fisheries Improvement Loans Program	to increase availability of credit	D.F.O.-federal
Fisheries Prices Support Board	to protect fishermen against sharp declines in prices and loss of income through deficiency payments	D.F.O.-federal
Newfoundland Bait Services	to ensure adequate bait supply for inshore fishermen	D.F.O.-federal
Shipbuilding Industry Assistance Program *	to provide financial assistant to shipyards for construction of vessels over 100 feet and to ensure the viability of a Canadian ship building industry	I.T.C.-federal
* Unemployment Insurance Benefits	to provide income support for unemployed people including seasonal fishermen	C.E.I.C.-federal
Canada Manpower Training Program	upgrade workers skills to meet employers' changing requirements through training courses up to 52 weeks long	C.E.I.C.
Fisheries Loan Program *	low interest loans to fishermen 8%	Nfld.

Table A.1 (cont'd)

PROGRAM	PURPOSE	FUNDED BY:
Fisheries Development Program	cost-sharing of development programs with the provincial governments	D.F.O.-federal
Canadian Salt Fish Co.	salt fish industry development	Crown Corporation - federal
Indian Economic Development Fund	loan assistance for businesses run by or primarily for the benefit of Indians	D.I.A.N.D. federal
Eskimo Loan Fund	loan assistance for businesses run by or primarily for the benefit of Eskimos	D.I.A.N.D. federal
Environment Management Service	to provide advance weather forecasting to fishermen	Ocean Science Environment Canada
Hydrographic Services	to make hydrographic charts available to fishermen	Survey's Branch Environment Canada

Table A.1 (cont'd)

PROGRAM	PURPOSE	FUNDED BY:
Fishing Ships Bounty Program	to assist fishermen to meet the capital costs of vessels	Nfld.
Small Fishing Boat Bounty Program	to assist fishermen to purchase vessels	Nfld.
Vessel Building and Repair Bounty Program	to assist fishermen in repairing vessels	Nfld.
Inshore Fishing Gear Program	to defray costs of fishing gear	Nfld.
Loan Interest Subsidy Program	defrays interest costs of vessel construction and repair	P.Q.
Maritime Fishery Credit Program	loans to assist in construction and repair of vessels and equipment	P.Q.
Small Boat Subsidy Program	subsidies on vessel construction	P.Q.
Gear Subsidy Program	subsidizes gear costs	P.Q.
Engine Subsidy Program	subsidizes cost of new engines	P.Q.
Insurance Premium Subsidy Plan	covers 100% of insurance costs of fishermen and vessels	P.Q.

Table A.1 (cont'd)

PROGRAM	PURPOSE	FUNDED BY:
Fisherman's Loan Board	provide low cost loans for vessel and related equipment construction	N.S.
Vessel Subsidy Plan	a grant for 25% of vessel cost	N.S.
Ice Making, Bait Freezing, Water Installation Program	details not available	N.S.
Fisheries Development Board	low cost loans to fishermen	N.B.
Insurance Premium Prepayment Program	defray costs of fishermen vessel and equipment insurance	N.B.
Prince Edward Island Landing Authority	to provide low cost financing for fishermen for the purchase of vessels and vessel construction	P.E.I.
Vessel Subsidy Program	15% vessel subsidy	P.E.I.
Fisherman's Holding Unit Program	to assist fishermen with grants to cover material costs to build holding units	P.E.I.
Light and Power Charge Assistance	to defray user costs of light and power	P.E.I.
Loan Deficiency Guarantee Program	provincial government guarantees on private sector loans to fishermen and processors	Nfld.

Table A.1 (cont'd)

Source:

Most of the information concerning federal and Newfoundland provincial programs is taken from Gerry M. Crawford-Dawe, "Inventory of Financial Assistance Programs to the Fishing Industry, D.F.O., Nfld. Region, November 1979, discussions with D.F.O. and is supplemented by:

Governement du Quebec, Ministere de l'Agriculture, des Pecheries et de l'Alimentation, "Strategie Quinquennale D'Allocation des Resources pour les Peches Maritimes du Quebec, 1980-1984", July, 1980;

D.F.O., Program Planning and Co-ordination Branch, Maritime Region, "Maritime Region Fisheries Manager's Handbook", Halifax, N.S.;

T.F. Peart, "Structure, Conduct and Performance of Atlantic Fishing Enterprises and Financing Institutions (1968-77), together with Government Policy Options for Fleet Financing Assistance Over Period 1978-85", D.F.O., October, 1978;

Government of Newfoundland and Labrador, "White Paper on Strategies and Programs for Fisheries Development to 1985", St. Johns, November, 1978;

Government of Newfoundland and Labrador, "Managing All Our Resources", St. Johns, 1980;

Province of Nova Scotia, "Fifteenth Annual Report", Department of Fisheries, March, 1979;

Province of Prince Edward Island, "Annual Report", Department of Fisheries, March, 1979;

Province of New Brunswick, "Annual Report", Department of Fisheries, March, 1979.

Table A.2

Government Assistance Programs Available to the Atlantic Groundfish Processors

PROGRAM	PURPOSE	FUNDED BY:
Promotional Projects Program	to provide businessmen with access to export markets by financing costs of trade promotion, trade visits, trade missions, etc.	I.T.C. federal
Machinery Program	remission of import duty on machinery not produced in Canada	I.T.C. federal
Enterprise Development Program	assists firms with grants up to 75% of total cost to identify new products, for product development, to study productivity improvement projects - also insures loans from private lenders	I.T.C. federal
Small Business Loans Program	guarantee loans up to $100,000 from private lenders for purchase of equipment, premises or land.	I.T.C. federal
Export Market Development Program	grants up to 50% of costs (repayable if export sales result) of entering new markets or expanding existing markets by undertaking foreign capital projects, visiting trade fairs, etc.	I.T.C. federal
Canada Manpower - Industrial Training Program	develops worker skills through employer centered training and on the job training - covers up to 85% of wages and 100% of training cost	C.E.I.C. federal
Regional Development Incentives Program	to provide incentives for the creation, expansion and modernization of facilities in areas of low economic growth and high unemployment	D.R.E.E. federal

Table A.2 (cont'd)

PROGRAM	PURPOSE	FUNDED BY:
Manpower Mobility Program	grants to workers who have to relocate to obtain employment	C.E.I.C. federal
Secondary Processing Equipment Loans Program	financial support for the expansion and modernization of the processing sector	Nfld.
Production Machinery and Processing Technology Program	financial and technical assistance for design of plant layout and development and acquisition of machinery	Nfld.
Rural Development Loans Program	loans for the purchase of machinery and equipment	Nfld.
Market and Product Development Program	provides market and product development assistance	Nfld.
Federal Business Development Bank	financial assistance, loans, loan guarantees and equity financing to small businesses	Federal
Export Development Corporation	covers 90% of risk of loss in export transactions	Federal
Newfoundland and Labrador Development Corporation Loans Program	low cost loans if financing unavailable anywhere else	Federal/ Provincial
Newfoundland and Labrador Development Corporation Equity Program	shares of a company are purchased to provide capital - advisory assistance as well	Federal/ Provincial
Fish Transport Subsidy Program	a per pound subsidy to defray the costs of transporting fish to the plant	Quebec

Table A.2 (cont'd)

PROGRAM	PURPOSE	FUNDED BY:
Economic Stimulation and Employment Maintenance	financial assistance for the modernization of processing plants	Quebec
Processing Plant Worker Subsidization Program	subsidizes wages to plant workers when plants cannot operate at sufficient capacity	Quebec
Gutting Machine Program	an experimental program for a limited number of machines	N.S.
Plant Development Program	cost sharing for plant development	N.S.
Cool and Cold Storage	to improve capacity and equipment through grants	N.S.
Ice Making and Storage	to provide sufficient ice making machinery through grants	N.S.
Aid to Fishing Associations	provides financial assistance to eleven fishing associations	N.B.
Fish Chilling Program	province funds 25% of cost of ice or fish chilling facilities	N.B.
Winterization of Fish Plants	contribute financial assistance to winterize fish plants	N.B.
Fish Chilling Program	grant of 25% of cost of chilling facilities	P.E.I.
Fish Box Pool	provides industry with fish boxes at cost plus 5% interest over 5 years	P.E.I.

Table A.3

Government Financial Assistance Available to Develop Fishing Community Infrastructure

PROGRAM	PURPOSE	FUNDED BY:
Inshore Fish Handling Systems Program	to improve fish quality by installing fish handling systems in Newfoundland ports	D.F.O. federal
Small Craft Harbours Program	to provide harbour facilities for the commercial fishery	D.F.O. federal
Canada Employment Program	to provide short-term employment to benefit local communities	C.E.I.C., D.F.O., D.R.E.E. federal
Fish Handling Facilities	to provide community stages at various locations around Newfoundland	Nfld.
Federal-Provincial Assistance to Development	provide financial assistance to development associations	Federal/ province
General Development Agreement Program	federal-provincial agreements to share costs of development programs in specific economic sectors	Federal D.R.E.E./ provinces
Incentive Grants for Unloading/Conveying	to improve productivity and unloading efficiency	N.S.
Incentive Grants for Wharves, Slipways/ Haulouts	to improve infrastructure and harbour facilities	N.S.
Unloading Derrick, Weather Shelter, Fish Box Pull-Out, Oyster Storage and Grading Facili-ies, Haulouts, Slipways	to improve infrastructure and harbout facilities	P.E.I.
Funding for Harbour Facilities	to improve harbours	N.B.

Source: See Table A.1

Table A.4

Government Tax Exemptions Available to Fisherman and Processors

PROGRAM	PURPOSE	Government Issuing Exemption
Machinery Program	provides remission of import-duty on machinery not available from Canadian manufacturers	Federal-I.T.C.
Federal Gasoline Sales Tax Refund	fuel refund of sales tax on gasolines purchases for commercial use	Federal-Revenue Canada
Federal Sales Tax Exemption	permits fishermen and processors exemption on tax payable on machinery and equipment	Federal-Revenue Canada
Fuel Tax and Fishing Gear Retail Tax	removes Nfld. sales tax from fishing gear and fuel purchases	Nfld.
Income Tax Act	5 year income average privilege integration of fishery incomes with non-fishing incomes for independent operators capital cost allowance provision to enable a 3 year Capital Cost Allowance on a straight line basis for fishing vessels	Revenue Canada
Federal Excise Tax on Diesel Fuel Refund	refund on federal excise tax on diesel fuel purchases available only to offshore vessels	Revenue Canada Federal

Source: See Table A.1

ii) Processors:- Financial assistance to processors is designed to help new firms enter the industry in areas of high unemployment and slow economic growth (through federal programs, such as, D.R.E.E.'s R.D.I.A. grants and provincial programs, such as Newfoundland's Secondary Development Incentives Program) and to assist existing firms to modernize and expand. An array of programs exist to defray the costs of introducing new machinery and processing techniques, training new employees, developing new products and marketing techniques. Although the programs listed in Table A.2 are not all inclusive, they illustrate assistance available to processors.

(b) Infrastructure Improvements:

Another function that government has undertaken in the Atlantic region is to develop programs to improve the industrial infrastructure for the benefit of the local users and communities. These programs can range from funding for small craft harbour improvements to programs designed to increase local employment. Table A.3 provides a listing of some of the major programs available.

(c) Tax Assistance:

The federal government has made some tax exemptions available to the fishing industry. These include exemption on gasoline, federal sales tax and custom duty. As well, the Newfoundland provincial government also exempts fishermen from provincial sales tax on fuel and fishing gear. Tax assistance including income tax benefits is outlined in Table A.4.

(d) Direct Involvement:

In some instances, the federal and/or provincial government have become involved in direct operations in the groundfish industry, particularly during periods of depressed fish markets.

A notable example of this involvement is the Canadian Salt Fish Corporation (C.S.F.C.) which operates in Newfoundland and the Côte Nord of Quebec. The C.S.F.C. has exclusive marketing rights for all salt product within its charter's operating area. The C.S.F.C. announces its offer price for salt fish at the beginning of each season and then hires agents (processors) to package salt fish under its label. The Corporation advances its agents working capital as well as the required supplies to produce cured fish, e.g., salt. Funds to make infrastructural improvements and investments are made available to agents usually as part payment for product. As well, if an agent loses money over a season, the C.S.F.C.

makes up 50 per cent of the loss. U.I.C. premiums are paid by the C.S.F.C.[1] on behalf of the fishermen.

Although the C.S.F.C. has been a source of some controversy as to its marketing role, particularly since salt product markets have improved, it should be noted that this Corporation's charter allows it to operate only with the approval of the federal and provincial governments. The provincial governments could revoke the C.S.F.C. charter if they chose to.

Other notable examples of direct government involvement include the operation of two processing plants in Labrador at Nain and Makkovik by the Newfoundland and Labrador government. In Quebec, the federal Department of Indian Affairs helps to manage a processing plant in the Côte Nord area at Mingan.

4. Conclusion

Although the above listing of governments' involvement in the Atlantic fishery is not exhaustive, it does indicate governments' extensive participation in stock management, licensing, financial and tax assistance. The role of government itself is a most important structural characteristic of the industry.

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(1) "Inventory of Financial Assistance Programs to the Fishing Industry", op. cit.

TO: EUR/CAN - Bill Newlin
FROM: EMB CANADA - Peter Lande

In a 1981 official Provincial Commission Report on the P.E.I. fishery it is stated that:

> *"It appears that on the basis of 1978 figures, total government assistance including administration, and Unemployment Insurance payments, amounted to at least half the value of landings of all types of fish. If fishermen and processors were to bear the full cost of these services, they would not be able to catch or to process fish."*
>
> *("Report on Commission of Enquiry into the P.E.I. Fishery, January 16, 1981, p III-3)*

Assuming this official estimate for P.E.I. were generally applicable to the other Maritime Provinces and to Newfoundland, one should expect a conclusion that government assistance in Eastern Canada would significantly affect the export price of fish sold to the United States, a principal Eastern Canadian fish export market.

Senator BAUCUS. Thank you, Mr. Chairman. I appreciate your courtesy, due to another markup which I must attend in another 15 or 20 minutes.

Mr. Chairman, today's hearing could not be more timely. Sky-high interest rates have produced plummeting housing starts. The impact on the forest products industry can be seen in shutdown mills and unemployment lines from Missoula, Mont., to Tillamook, Oreg., or most areas to the west. The problems are mounting throughout the Nation. For example, 1981 will be the third time in a decade that softwood production will have dropped below 27 billion board feet, compared to a typical 30 to 32 billion board feet level.

In looking for a way out of these economic doldrums this hearing will consider the problems resulting from importation of Canadian forest products. Our imported hardwood is only a small part of the market; the reverse is true for Canadian softwood. In fact, over the last 25 years, imports have risen from 3 billion board feet to almost 12 billion. That's a 400-percent increase.

This kind of competition is not a theoretical matter. Imports of this magnitude directly displace domestic producers. The situation has been clearly outlined in a letter which I recently received from Mr. Royce Satterlee of Stoltz Lumber Co. in Columbia Falls, Mont.

In part, Mr. Satterlee states, "Increasing Canadian lumber imports are having a devastating effect on Montana lumber producers, particularly those of us who are primarily producers of whitewood dimensioned lumber. There are numerous facets of this problem which will come out at the November 24 hearing, but basically it comes down to a situation where the Canadian Government has an official policy of pricing timber in such a manner that Canadian lumber producers can at all times remain competitive in world lumber markets."

I would ask, Mr. Chairman, that the balance of that letter be included in the record.

Senator PACKWOOD. The entire letter will appear in the record.

[The letter follows:]

F. H. STOLTZE LAND & LUMBER CO.

Lumber Manufacturers

Box 490 COLUMBIA FALLS, MONTANA 59912

November 19, 1981

The Honorable Max Baucus
United States Senate
1107 Dirksen Senate Office Bldg.
Washington, D.C. 20510

Dear Senator Baucus:

I am contacting you today to urge that you attend Oregon Senator Bob Packwood's hearing on November 24 concerning Canadian Lumber Imports and their effect on domestic production. Increasing Canadian lumber imports are having a devastating effect on Montana lumber producers particularly those of us who are primarily producers of whitewood dimension lumber.

There are numerous facets to this problem which will come out at the November 24 hearing but basically it comes down to a situation where the Canadian Government has an official policy of pricing timber in such a manner that Canadian lumber producers, can at all times, remain competitive in world lumber markets. This is accomplished by allocating timber to producers at appraised prices which virtually amounts to a giveaway. In addition, when competitive circumstances change, the Canadian government arbitrarily changes stumpage prices to allow the producer to beat competition. This in effect is a subsidy which we; Montana producers, cannot economically compete against.

Canadian rail rates on government-owned railroads are also kept at a low rate which allows them to tap our markets even if they are much farther away.

As an example, Canadian lumber producers in the British Columbia Interior can ship lumber to Detroit for about the same price or slightly lower than we can from Columbia Falls, Montana. This is also true into the Twin City area of Minneapolis and St. Paul. This mid-western area has traditionally been the principal marketing area for Montana lumber producers.

When Canadian producers have to ship any distance on U.S. railroads, this advantage rapidly disappears. An example, again, is that freight on U.S. lumber from Columbia Falls, Montana, to Denver, Colorado, is $25/M cheaper than freight from the British Columbia Interior.

Our methods of competitively selling timber to get the highest price for the government is the best method and I am not advocating any change; but, I do feel that U.S. lumber producers are facing unfair competition at this time.

I have visited many Canadian mills and generally find them to be good mills but not as good or efficient as our U.S. mills. Where the raw material is cheap, as in Canada, they have not been forced to get the recovery from each log that we in the U.S. must get in order to compete domestically for a log supply.

I would urge that a Congressional study be started immediately concerning Canadian lumber imports into the U.S. as to whether they are competing fairly with U.S. producers; and, if the charges are found to be true, that a countervailing duty on Canadian lumber imported into the U.S. be established to effectively equalize conditions between U.S. and Canadian producers.

Sincerely,

Royce Satterlee
Vice President and
General Manager

RS/bls

Senator BAUCUS. After the testimony of today's hearing has been received and evaluated, I will be willing to review our options as a member of the International Trade Subcommittee; moreover, an International Trade Commission investigation, in my view, cannot be ruled out.

The other matter being heard today, S. 1824, is also of interest to me. Particularly, section 2 of this measure is of interest because of its parallel provisions for a bill which I introduced earlier this year, S. 1141. This measure has also been referred to the committee.

Last year, as you will recall, Mr. Chairman, the Congress enacted a bill introduced by you which created a fund derived from unencumbered tariff revenues on lumber. This fund was designed to encourage deforestation of the leftover Federal forest funds.

As I understand it, S. 1824 will seek to modify this legislation by directing 65 percent of all national forest revenues and all Interior Department revenues to the sale of timber to this reforestation fund. The obligation of tariff revenues is repealed.

S. 1824 is similar to the bill of mine, because mine also creates a special fund—that is, S. 1142—which assigns national forest net revenues from all sources to a national forest investment fund. This fund would be available to the Committee on Appropriations to finance all of the multiple use investments needed for forest and grange land in the national forests. This investment in the future would fund the necessary improvements for roads watersheds, grazing, wildlife, reforestation and recreation. In effect, S. 1141 allocates 75 percent of gross revenues, since 25 percent goes now to the counties in shared revenues. This 10 percent now appropriated for roads, in my bill, would be merged to the large, multipurpose investment fund.

My bill did not seek to fashion the same authority for the range lands and forest lands administered by the Department of Interior because of numerous allocations that are already in the law. For example, 95 percent of timber revenues from public lands under the Interior Department now go to the reclamation fund; 4 percent go to States, 1 percent to the general fund.

Also there are several special acts relating to mineral leasing that assign these revenues to the States, to reclamation fund. Thus, it seems to me that including interior lands might lead to considerable debate.

My bill seems to enhance the capabilities of the Congress and the Executive to focus on long-term resource needs while adhering carefully to the context of a sound budget. It seeks the help of the Committee on Appropriations to plan the appropriate level of funds both for operations and investments.

The problems of the timber industry today underscores the needs for an economic planning process that looks to the future. The budget process must recognize that the basic strength of our Nation rests upon a productive natural resource base. High quality water supplies, sustained timber yield, abundant recreational opportunities and rich grazing lands have one thing in common: they can all be produced by our national forests, but only with timely investments.

During the weeks ahead I look forward to working with other members of the committee to develop a more effective way of financing the investments needed for our public and private forests. We must insure this adequate resource base for the future for our domestic economy.

Again, Mr. Chairman, I would like to commend you for scheduling the hearings. The forest products industry is in desperate straits. Help is needed now, not at the end of a questionable curve on an economist's chart. I believe that this committee can now take an important step in that direction.

Thank you, Mr. Chairman.

Senator PACKWOOD. Senator Baucus, thank you.

Bill, I wanted to ask you a question, since you mentioned the difficulties in determining artificial subsidies.

I recall when I first ran into this problem in this committee. To this date, it was one of the most difficult determinations to make. It involved the sales in this country of Polish golf carts. I know that almost sounds like the lead-in to a joke, but indeed it is not. First you have a Communist economy, not a market economy, and you are trying to determine what their costs are.

Second, in order to be in violation of dumping, they have got to be selling it at less than they sell it for, assuming you can figure their cost, in their home territory. Except they don't have any golf courses, and they don't sell any golf carts in Poland.

So the question became: What is the golf cart worth when you have no market to base it on?

Now the question I want to ask you is this. We sell our public timber in this country under a different philosophy than Canada sells theirs. We sell ours on a highest-bid basis and we maximize the revenue to the Federal Government. Canada does not sell theirs on a bid basis, for whatever policy reasons they may choose.

In your estimation, is that a violation of our law against dumping or, if they are choosing to do it because they want to keep their lumber deliberately low-priced and do not sell it in our economy any lower than they sell it in their economy, is it a violation of our law?

Senator COHEN. It is questionable. If you have a long-term policy on the part of Canada to have a low price, a deliberately set lower price, does that constitute dumping? That is one of the difficulties we have with our antidumping action.

There are three tests that you have got to satisfy on that. Export prices are lower than home market prices? Well, if they sell the same in Canada as here, then clearly you haven't met that test. Lower than export prices to a third country market, or lower than the Canadian cost of production? To the extent that it is owned by the Federal Government of Canada as such, then that would be hard to prove. So there is a case in which they clearly are pursuing a policy which is deliberately undercutting our own domestic industry, and yet it would be hard to satisfy an antidumping action under those criteria, which is one of the reasons why it is difficult to go that route.

Now, you might try and pursue the countervailing duty route, but that also implies or casts a tremendous burden upon a small U.S. firm. You go from there to import relief action, then on to section 301 actions, and it goes on and on and on. And what you find out is that you get bounced around. This is what the testimony would reveal in our own committee hearings, that a small industry will go into one door and they say, "Sorry, that is not an antidumping action; you had better go over and file your petition for countervailing duty." You get to countervailing duty and they say, "Well, perhaps you should try section 201 of the Trade Act of 1974." And then they tell him to go to 301.

What we had was a woman from Presque Isle, Dotty Kelly—Senator Mitchell is quite familiar with her—saying that she had been bounced around from one agency to the other, and finally they said, "Here, go file your countervailing duty petition." It cost her $120,000. There is very little likelihood of any relief.

What we did get out of those hearings, Mr. Chairman, was a commitment on the part of this administration to open its doors to get at least some sort of an affirmative action program, as such, to affirmatively assist small industries to try to find the right remedy, to try to simplify what we have got and provide relief.

In addition to the interest rate problem, let me just mention one other thing. There is a 17-percent monetary exchange rate differential. That is also nonnegotiable as far as the Canadian Government is concerned. So if you take 17 cents on the dollar, plus the interest rates in this country, plus these programs, it is little wonder why we are in trouble. Little wonder.

Now, I think the difficulty is how do you reconcile two essentially contradictory philosophies about our governments? Ours is free trade; theirs is not. It is a controlled-type of economy of targeting industries.

I think you will find in the record, if you look over those multitrade agreements, you will find there is—and Senator Mitchell and I have talked about this on many occasions about a Frost Belt Sun Belt dichotomy in this country. It also is true with respect to the items that were negotiated during the Tokyo round and others. You will find that we made concessions on those items which most severely impact so-called Frost Belt States, potatoes and other types of industries, and held up on the citrus fruit and other items which are principally grown in the Sun Belt and which you have a substantial need of in Canada, which they don't produce themselves.

And I think you will find that the impact is more severe upon the Frost Belt States than it is upon the Sun Belt States. That is just another item, I think, which deserves some consideration; although I suspect it cannot be addressed by this committee during the course of these hearings.

Senator PACKWOOD. I am not ashamed to say that "the" or perhaps at least "a" major goal of this Government ought to be affordable housing for the bulk of the population in this country. Affordable housing is no longer available, and it certainly does not appear to be a policy of the Government at the moment. And if that is going to be a policy, then perhaps we should move to pricing Federal timber the way Canada prices theirs, and indeed try to bring down the cost of timber and the cost of housing. That is not a policy anybody has to apologize for. But at the moment it certainly isn't the policy in this country.

Senator COHEN. Let me suggest, Mr. Chairman, if we have a case where you have a policy of pricing timber at a 12 to 1 differential, that ought to be some sort of presumptive evidence on the part of this Government that, whether you call it an antidumping action or whether you call it a deliberate policy of undercutting of our own domestic industry, whatever it might be classified, there ought to be some sort of presumptive evidence taken into account and either offset in some fashion by our Government or taken into account in proving their case that they are entitled to a countervailing duty to be imposed. That is not the case today.

Senator PACKWOOD. Senator Danforth.

Senator DANFORTH. No questions.

Senator PACKWOOD. Senator Mitchell.

Senator MITCHELL. Thank you, Mr. Chairman.

I want to commend Senator Cohen for his very forceful statement. As I indicated earlier, he has long been a leader in this area, deeply concerned, obviously because of the impact on our State. And I think it is important to bear in mind the principal point he made, and that is that as important and significant and critical as the housing and lumber industries are, it is but one example. It is just the tip of the iceberg. What is happening in that industry is happening also in the fishing industry and in the potato industry and in many other industries.

We are facing a severe crisis in terms of our relations with our Canadian neighbors as they develop programs specifically to encourage exports to this country. That is the purpose behind their programs, that is the objective, and our producers in various areas are simply not able to compete.

I truly commend the Senator for a very forceful statement, and I hope that as we develop a possible proposal to deal with the problems in the lumber industry we will also bear in mind that there are other industries suffering in the same way.

Thank you, Mr. Chairman, and thank you, Senator Cohen.

Senator PACKWOOD. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman. I would like to follow up a little more on that same basic point to see how to pursue it.

We have this problem not only with, as Senator Mitchell pointed out, the forest products industry but with lots of other industries. We also have the same problem with other countries, in fact with most of the countries that we deal with in any meaningful comparative basis with. And most of those countries don't have free competition, a free market philosophy, like we do in ours. And in many areas we are really beat—most areas, I would say.

My question, therefore, is what do we do about it? To what degree should we modify our economy, and to what degree do we encourage other countries to modify their action, the ways that they deal with us? How do you solve it?

Senator COHEN. Well, I think you have to have an attitude on the part of our Government which has not existed for some time. We have been committed in theory and in philosophy to a particular economic program; that is, free and open trade, with the belief that more competition will produce a better product at the lowest price.

Now, the difficulty is we have been asking our producers, whatever industry, whether it is the auto industry or whatever industry—timber, fishing—to compete, but starting 40 yards behind in a hundred-yard dash. And that is the difficulty that we have to resolve.

It seems to me we cannot maintain it's an open, 300 competition, when in fact there is no competition, that we will have to take a look at our laws to see what factors must be taken into account to put us in a more competitive position so that we start at the zero-yard line and run the 100-yard dash, but we start even or as close to even as is reasonably possible.

Right now I think we are being ravaged by our own philosophy, that other nations are subsidizing their industries, importing almost without restriction in this country, and then crying foul when moves developed in this Congress to start raising import restrictions and barriers. I think what it is going to take is an attitudinal change on the part of our own Government to say that "We want to compete. We are not competing on a fair basis now, and we are going to revise our current laws to take those programs which you currently have into account so that we simplify."

I have been watching television the past few days about our budgetary process. And I think there is some analogy to be made here, that it is so complex, so confusing, that very few people in the Congress know what is going on between continuing resolutions, reconciliations, budget outlays, authority, and the appropriations process. I would submit to you we are caught between the complexities of our own programs, where no one simply knows where to go and how to deal with the problems. So simplification would be one thing I would recommend, but an attitudinal change on the part of our own Government, saying we are not going to turn a blind eye to the problem, we are going to deal with it as effectively as we can.

Senator BAUCUS. Well, it's a big problem. Obviously, simplification is going to help, but I think it is going to be a problem that we are going to be addressing, or at least attempt to address it, more and more frequently. And certainly this hearing is part of it.

Senator COHEN. As I recommended to the chairman, for example, taking into account when you have something as glaring as a 12 to 1 disparity in pricing on timber that is essentially contiguous to our own States, that ought to be given some weight as far as its evidentiary value, as to whether or not that is an unfair competitive advantage if in fact it is a deliberate policy. So there are things that can be done.

I would only add one thing, and then I will get out of here, Mr. Chairman, with the witnesses. What is important about these hearings is that you are at least providing a forum for a civil discussion of these issues.

We have seen evidence, I don't know about your State, but in the State of Maine, when the people of our respective States fail to see their elected leaders listening to them with any degree of sensitivity, they may start to take the law into their own hands. And we have had the blockade of orders in Maine.

Senator BAUCUS. We don't have that problem in Montana.

Senator COHEN. Well, we do, and it's serious. And unless we do something constructive and more than simply talk about it, I think you are going to see a repeat of it in the future.

Senator BAUCUS. Thank you.

Senator PACKWOOD. Are there any other questions?

[No response.]

Senator PACKWOOD. Bill, thank you very much.

Our next witness will be the Governor of Oregon, Vic Atiyeh. Governor.

STATEMENT OF HON. VICTOR ATIYEH, GOVERNOR OF THE STATE OF OREGON

Governor ATIYEH. Senator Packwood, Senator Danforth, and members of the subcommittee.

I deeply appreciate Senator Packwood's quick and positive response to my request for a hearing, and I am equally pleased that Senator Danforth and his subcommittee will make this a joint venture.

You are here to examine the cause of a severe recession in this Nation's forest products industry. It is a recession that imperils not just the economic welfare of America's timber-producing States, but a vital and irreplacable part of America itself.

The testimony you will hear from me and others today will not be pleasant. I think we sometimes shield ourselves from reality by codifying human misery in cold, dispassionate statistics. I do not represent statistics. I represent Oregonians, and there are 17,000 men and women in Oregon who are victims—and there is no better way to describe them—victims of a system they steadfastly have supported and which they thought supported them. The system they supported assured them that housing was a high-priority national goal. Americans need housing, we were told. Homeownership is an American birthright. In Oregon we believed in the system. We worked and invested and managed our forest resources to become this Nation's most prolific supplier of lumber, plywood, and wood products.

We built an industry that once employed 90,000 persons, more than a third of the State's manufacturing work force. We geared to help achieve a national goal of decent and affordable housing for everyone. We believed in the system.

Now a different Federal fiscal policy dictates that virtually no one can afford to build or buy a new home. Home mortgage interest rates of 17, 18, 19 percent have trampeled a vibrant and healthy homebuilding industry and left it maimed, perhaps never fully to recover.

An Oregon adage holds that a recession triggered by runaway interest rates hurts us in Oregon first and worst. When homebuilding stops, Oregon's timber products industry faces immediate, complex, and devastating consequences. A crisis in our timber products industry cannot be contained to that sector alone. The livelihoods of nearly one of every two Oregonians are directly or indirectly dependent upon forest products. Half our mills have shut down or curtailed work.

Since 1979, 22,000 logging and sawmill jobs have disappeared. Nearly one in five forest products workers is on a layoff or a part-time status. Unemployment in Oregon is 10.6 percent, projected to go to 12½ percent. In some Oregon communities the unemployment rate exceeds 18 percent. Nearly 3,000 workers have long since exhausted unemployment benefits, including all extended benefits. Those are statistics of human despair.

Revenue from timber sales traditionally has been one of the few reliable budget cornerstones for counties, school districts, and State government. Those entities anticipated sharing more than $256 million from Oregon timber sales in 1982; as much as $100 million of that may not be forthcoming.

The implications are staggering, more so because the victims: Jobless workers and their families, employers, school districts, counties, and even the Governor, cannot attack the root cause of an economic dissolution of this magnitude.

In early September I asked Senator Packwood to conduct hearings to determine the extent to which Canadian lumber exports to this country have damaged our own forest products industry. The influx of low-priced Canadian imports have claimed a sizable share of our domestic market at a time when we can least afford it. That may be pushing our good-neighbor policy a bit too far.

I and the Oregonians consider themselves close to the citizens of British Columbia, and it may very well be that Canada has a problem they are trying to solve. As the Governor of Oregon, however, I am more concerned about unemployed Oregonians, and I'm going to fight as hard as I can for their jobs.

The question of Canadian exports must be examined. If necessary, appropriate action must be taken to preserve American jobs. I have every confidence that your subcommittees will keep that thought focused in your mind as you gather evidence and draw sensible conclusions from that evidence.

There is no question, unequivocally, Oregon has lost business to Canadian exports. The chaos in this Nation's homebuilding and forest products industry was not brought about by international and interregional competition in the marketplace. A lethal combination of three elements went into the making of an economic neutron bomb. The buildings still stand, but they are vacant. Those three lethal elements are: a Federal fiscal policy that places a higher priority on industrial capitalization than housing; different speculators, including those in the industry itself, who overbid both State and Federal timber sales, catapulting stumpage prices far beyond their appraised values, and who are now up against the wall in a depressed market; and last, a unilateral decision by the U.S. Forest Service to grant 2-year contract extensions and extensions of extensions. It is not likely that much timber will be cut and paid for during those extensions. Moreover, the Forest Service did not fully consider the devastating consequences for school districts, counties, and other public agencies which rely on a consistent flow of timber sale revenues for vital public services.

What did the Forest Service decision to extend contracts really achieve? A reprieve for speculators who can tie up that timber for another 2 years and hope for a windfall when market conditions improve.

This line that I am about to read, Senator, says that I'm not a good poker player. Senator Packwood knows that very well. [Laughter.]

He's not, either. [Laughter.]

But if I were a good poker player——

Senator DANFORTH. Where are you all playing this morning?

Governor ATIYEH. You wouldn't want to play his game.

However, if I were a good poker player, I would like to find a game that lets you play for a $100,000 pot on a 10-cent ante and let you draw 12 cards to fill a flush. That's the game timber speculators have played. If my guess is right, they will continue to play it under the Forest Service contract extension policies.

It is common for hearings like this to host a parade of witnesses that demand Congress do this or do that to solve one problem or another. And I, too, am going to ask your help in restoring the crippled forest products industry. But, first, I want to tell you what I am prepared to do and what I will do to help the State of Oregon help itself.

In October I appointed a Governor's Special Panel on Timber Strategy to determine what short-term and long-term actions are available to me and to the legislature to ease the impact of the timber products recession in Oregon. The panel, comprised of representatives of the timber industry, homebuilders, financial institutions, labor, local government, and the public worked almost around the clock to investigate and analyze our problems.

Let me say this: these people all worked for nothing—no per diem, no expenses. They did it all on their own.

The panel has concluded its investigation and submitted its report of recommendations to me. Copies will be available to you, and I sincerely hope that you will read the report carefully.

I would like to briefly quote some of the panel's observations.

The Governor asked for both short-term and long-term recommendations. Short-term actions ease the crisis now, put workers back on the job in the woods and mills to avoid disastrous impacts on vital public services that are financed by timber sales revenues.

Longer range remedies will help preserve economic stability and employment in the industry to assure reliable flows of timber sales revenues to State and local government, to restore the homebuilding industry and Oregon's share of markets, and will guard against the systemic flaws which are detrimental to the industry and the public interest.

And the closing panel remarks are:

Governor Atiyeh is fully aware of what he cannot do to stem the tide of recession in Oregon's timber products industry. He cannot summarily lower interest rates; he alone cannot persuade Congress to invest profitably in intensive forest management programs or to insist on literal interpretations of Federal multiple-use management legislation.

In all candor, we have documented that which Governor Atiyeh and we already knew: There is no quick fix, no easy solution, no immediate and total cure.

The Oregon Board of Forestry manages only 3 percent of the State's timber-producing land. Ninety-seven percent is owned and managed by Federal agencies and private landowners. The Governor and the State legislature have limited powers and authority.

The panel believes, however, that within those powers and authorities some effective action can be taken.

The panel's suggestions are sensible and they are doable. I have already given direction for actions on their short-term recommendations.

A moment ago I criticized the U.S. Forest Service for granting contract extension based on market conditions. It may be unseemly, then, that I have asked my board of forestry to consider market conditions in contract extensions for State timber sales. There will, however, be significant differences between the conditions for contract extensions offered by the Forest Service and the conditions I will recommend to the State board of forestry.

Our conditions for 1-year extensions, not 2 years but 1, will include full payment on the contract in order to maintain revenue flows. Timber must be harvested during the 1982 season to provide logging employment and revenue and larger downpayments to discourage speculation. This latter one will require legislation.

In short, there will be no giveaways. I do not at this time support no-penalty defaults on any public timber sales. Our timber industry wants a hand, not a handout. I have directed the State department of forestry to work with the U.S. Forest Service and the Bureau of Land Management to design and administer timber sales that will require continuous harvesting. These will be short-term sales of 3 years or less with requirements for a harvest of priority timber units or of specified volumes during each logging season.

Such sales of State-owned timber will not require costly project work and will be tailored to a local market. And I urge Federal agencies to follow our lead. I also, parenthetically, add that Oregon has been in the timber producing and harvesting business for most of its life as a State, and if there is any State that understands the timber industry it is Oregon. Our single aim is to survive the crisis. To that end I will formally declare a State of disaster in Oregon's timber products industry when I return to Salem. That will make mill operators and others eligible for low-interest Federal-assisted loans, and in many cases such help will be the difference between staying afloat and going under.

These, Senators, are the actions the Governor of Oregon will take to stave off the economic collapse of his State's breadwinner. And now I need your help.

Publicly owned timber, whether it be on Federal lands or State lands, is not a prize in a lottery; it is publicly owned, and its stewardship should be such that the public interest is served if that timber is sold. Speculative overbidding is a prime factor for this stillness in our logging industry. The virtually conditionless contract extensions granted by the U.S. Forest Service are irresistibly tempting to speculators.

The Forest Service defends its actions as a means to avoid contract default. I can only refer you to our 25-year history of timber sales on State-owned lands. From 1955 through 1980 only 28 defaults have occurred.

With respect to recent Forest Service extensions, the damage has been done; but I strongly urge Congress to reconsider the made-for-profiteering contract extension policies of the Forest Service. There must be some provision for timber harvesting during those extensions.

Second, all public timber management agencies should withhold hasty judgments on allowing no-penalty contract defaults. What is good for General Motors is not necessarily good for the country.

Third, if there are appropriate and reasonable actions that should be taken to protect the U.S. timber industry's share of U.S. markets, Congress should not hesitate to take those actions.

Finally, let me ask you these questions. What has happened to our national goal of affordable housing for American families? This hearing will attempt to diagnose the ills of a rapidly failing industry. Will the next hearing be a postmortem? Have we sacrificed too much by abandoning a longstanding priority in order to achieve another priority? There are 17,000 people in my State who think we have. I ask you to think about it, too.

And again, let me thank you.

Senator PACKWOOD. Governor, thank you very much. I note that you are accompanied by Les Anderson.

Les, why don't you come up to the table. Do you have a statement to add to the Governor's?

Mr. ANDERSON. Yes, I do, sir.

Senator PACKWOOD. All right. Why don't you go ahead now, before we question the two of you.

Mr. ANDERSON. It will only take about 5 minutes.

Senator PACKWOOD. Thank you.

I might ask if we could run the timer, henceforth, on the witnesses, and when the yellow light goes on, you will have 1 minute to finish.

Mr. ANDERSON. Senator Packwood and members of the subcommittee.

Senator PACKWOOD. Let me interrupt you for just 1 second. I want to place in the record a Statement of Steve Symms. He wanted to stay for this hearing. He knew he would be able to come back, but he had to go to a hearing on the Clean Air Act. The hearing is now, and the markup on the bill is now. He has several amendments that he says he is quite sure many of the people in this room would be interested in, also. If he gets his amendments passed, or if he gets them overwhelmingly defeated, in either event he would be back. For the moment he is going up there to fight for them.

Senator MITCHELL. Senator Baucus and I are going to have to go to that same hearing very shortly and see that the latter results. [Laughter.]

Senator PACKWOOD. Go ahead, Les.

[The prepared statement follows:]

VICTOR ATIYEH
GOVERNOR

OFFICE OF THE GOVERNOR
STATE CAPITOL
SALEM, OREGON 97310

Testimony

Victor Atiyeh
Governor Of Oregon

Before The
U.S. Senate Subcommittee on Taxation and Debt Management
And The
U.S. Senate Subcommittee on International Trade

November 24, 1981
9:30 a.m.
Room 221, Dirksen Senate Office Building
Washington, D. C.

Senator Packwood, Senator Danforth, members of the subcommittees.

I deeply appreciate Senator Packwood's quick and positive response to my request for this hearing. I am equally pleased that Senator Danforth and his subcommittee will make this a joint venture.

You are here to examine the causes of a severe recession in this nation's forest products industry. It is a recession that imperils not just the economic welfare of America's timber-producing states, but a vital and irreplaceable part of America itself.

Senators, the testimony you will hear from me and others today will not be pleasant.

I think we sometimes shield ourselves from reality by quantifying human misery in cold, dispassionate statistics.

I do not represent statistics. I represent Oregonians. And, there are 17,000 men and women in Oregon today who are victims -- and there is no better word to describe them -- victims of a system they steadfastly have supported and which they thought supported them.

The system they supported assured them that housing was a high priority national goal. America needs housing, we were told. Home ownership is an America birthright.

In Oregon, we believed in the system. We worked and invested and managed our forest resources to become this nation's most prolific supplier of lumber, plywood and wood products.

We built an industry that once employed 90,000 persons -- more than a third of the state's manufacturing workforce. We geared up to help achieve a national goal of decent and affordable housing for everyone.

We believed in the system.

But now, a different federal fiscal policy dictates that virtually no one can afford to build or buy a new home. Home mortgage interest rates of 17, 18 and 19 percent have trampled a vibrant and healthy homebuilding industry and left it maimed -- perhaps never fully to recover.

An Oregon adage holds that a recession triggered by runaway interest rates hurts us first and worst. When homebuilding stops, Oregon's timber products industry faces immediate, complex and devastating consequences.

A crisis in our timber products industry cannot be contained to that sector alone. The livelihoods of nearly one of every two Oregonians are directly or indirectly dependent upon forest products.

Half our mills have shut down or curtailed work. Since 1979, 22,000 logging and sawmill jobs have disappeared. Nearly one in five forest products workers is on lay-off or part-time status. Unemployment statewide is near 10 percent. In some Oregon communities, the unemployment rate exceeds 18 percent.

Nearly 3,000 workers have long since exhausted unemployment benefits, including all extended benefits.

Those are the statistics of human despair. But there is more.

Revenue from timber sales traditionally has been one of the few reliable budget cornerstones for counties, school districts and State government. Those entities anticipated sharing more than $264 million from Oregon timber sales in 1982.

As much as $100 million of that may not be forthcoming.

The implications are staggering. Moreso because the victims -- jobless workers and their families, employers, school districts, counties and -- yes, even the Governor -- cannot attack the root causes of an economic dissolution of this magnitude.

In early September, I asked Senator Packwood to conduct hearings to determine the extent to which Canadian lumber exports to this country have damaged our own forest products industry.

The influx of low-priced Canadian imports has claimed a sizeable share of our domestic market at a time when we least can afford it. That may be pushing our "good neighbor" policy a bit too far.

The question of Canadian exports must be examined. If necessary, appropriate actions must be taken to preserve American jobs. I have every confidence that your subcommittees will keep that thought foremost in mind as you gather evidence and draw sensible conclusions from the evidence.

Oregon has lost business to Canadian exports. We have also lost business to lower-cost lumber products from the U.S. South.

But, the chaos in this nation's homebuilding and forest products industries was not brought about by international and inter-regional competition in the marketplace.

A lethal combination of three elements went into the making of an economic neutron bomb -- a bomb that kills industries and jobs, but leaves unemployment lines.

Those lethal three elements are:

- A federal fiscal policy that places a higher priority on industrial capitalization than on housing

- Hit-and-run speculators -- including those among the industry itself -- who overbid both state and federal timber sales, catapulted stumpage prices far beyond their appraised values...and who now are up against the wall in a depressed market. And, last,

- A unilaterial decision by the U.S. Forest Service to grant two-year contract extensions -- and extensions <u>of</u> extensions. It is not likely that much timber will be cut and paid for during these extensions. Moreover, the Forest Service did not fully consider the devastating consequences for school districts, counties and other public agencies which rely on a consistent flow of timber sale revenues for vital public services.

And what did the Forest Service decision to extend contracts really achieve A reprieve for speculators who can tie up that timber for another two years and hope for a windfall profit when market conditions improve.

Senators, I am not a poker player. But, if I was, I would like to find a game that lets you play for a hundred-thousand dollar pot on a 10-cent ante...and lets you draw 12 cards to fill a flush.

That's the game timber speculators have played. And, if my guess is right, they will continue to play it under the Forest Service contract extension policies.

It is common for hearings like this to host a parade of witnesses who demand that Congress do this or do that to solve one problem or another.

I too am going to ask your help in restoring the crippled forest products industry.

But first, I want to tell you what I am prepared to do -- and what I <u>will</u> do -- to help the State of Oregon help itself.

In October, I appointed a Governor's Special Panel on Timber Strategy to determine what short term and long term actions are available to me and to the Legislature to ease the impact of the timber products recession in Oregon.

The Panel, comprising representatives of the timber industry, homebuilders, financial institutions, labor, local government and the public, worked almost around-the-clock to investigate and analyze our problems.

The Panel has concluded its investigation and has submitted its report and recommendations to me. Copies will be available to you and I hope you will study the report carefully.

I would like briefly to quote some of the Panel's observations.

"The Governor," the report states, "asked for both short and long term recommendations. Short term actions ease the crisis <u>now</u> -- to put workers back on the job in the woods and mills and to avoid disastrous impacts on vital public services that are financed by timber sales revenues.

"Longer range remedies will help preserve economic stability and employment in the industry, assure reliable flows of timber sales revenues to state and local government, restore the homebuilding industry and Oregon's share of markets, and will guard against systemic flaws which are detrimental to the industry and to the public interest."

Senators, it is worth noting the Panel's closing remarks:

Again, I quote. "Governor Atiyeh is fully aware of what he cannot do to stem the tide of recession in Oregon's timber products industry.

"He cannot summarily lower interest rates. He alone cannot persuade Congress to invest profitably in intensive forest management programs, or to insist on literal interpretations of federal multiple-use forest management legislation.

"In all candor, we have documented that which Governor Atiyeh and we already knew: there is no quick fix, no easy solution, no immediate and total cure.

"The Oregon Board of Forestry manages only 3 percent of the state's timber-producing land. Ninety-seven percent is owned and managed by federal agencies and private landholders. The Governor and the State Legislature have limited powers and authority. The Panel believes, however, that within those powers and authority, some effective action can be taken."

I believe the Panel's suggestions are sensible and do-able. I have already given directions for action on their recommendations.

A moment ago, I criticized the U.S. Forest Service for granting contract extensions based on "market conditions". It may be unseemly, then, that I have asked my Board of Forestry to consider market conditions in contract extensions for state timber sales.

There will be, however, significant differences between the conditions for extensions offered by the Forest Service and the conditions I will recommend to the State Board of Forestry.

Our conditions for one-year extensions -- not two years, but one -- will include:

-Full payment on the contract in order to maintain revenue flows

-Timber must be harvested during the 1982 season to provide logging employment and revenue, and,

-Larger down payments to discourage speculation. This will require legislation and I will ask for it.

In short, there will be no "give-aways". I do not at this time support no-penalty defaults on any public timber sales. Our timber industry wants a hand -- not a hand-out.

I have directed the State Department of Forestry to work with the U.S. Forest Service and the Bureau of Land Management to design and administer timber sales that will require continuous harvesting.

These will be short term sales of three years or less, with requirements for harvest of priority timber units or of specified volumes during each logging season.

Such sales of state-owned timber will not require costly project work and will be tailored to a local market. I have urged federal agencies to follow our lead.

Our single aim is to survive the crisis. To that end, I will formally declare a State of Disaster in Oregon's timber products industry when I return to Salem.

That will make mill operators and others eligible for low-interest federal assistance loans. In many cases, such help will be the difference between staying afloat and going under.

These actions, and others recommended by the Timber Strategy Panel, are what the Governor of Oregon will take to stave off the economic collapse of his state's breadwinner.

Now, I need <u>your</u> help.

Publicly-owned timber -- whether it be on federal lands or state lands -- is not a prize in a lottery. It is <u>publicly</u>-owned and its stewardship should be such that the public interest is served when that timber is sold.

Speculative overbidding is a prime reason for the stillness in our logging industry. The virtually conditionless contract extensions granted by the U.S. Forest Service are irresistibly tempting to speculator

The Forest Service defends its action as a means to avoid contract defaults. I can only refer you to our 25-year history of timber sales on state-owned lands. From 1955 through 1980, only 28 defaults have occurred.

With respect to recent Forest Service extensions, the damage has been done. But, I strongly urge Congress to reconsider the made-for-profiteering contract extension policies of the Forest Service. There must be some provision for timber harvesting during those extensions.

Second, all public timber management agencies should withhold hasty judgments on allowing "no-penalty" contract defaults. What is good for General Motors is not necessarily good for the country.

Third, if there are appropriate and reasonable actions that should be taken to protect the U.S. timber industry's share of U.S. markets, Congress should not hesitate to take those actions.

And, finally, Senators, let me ask you these questions:

What has happened to our national goal of affordable housing for all American families?

This hearing will attempt to diagnose the ills of a rapidly-failing industry. Will the next hearing be a post-mortem?

Have we sacrificed too much by abandoning a long-standing priority in order to try to achieve another goal? There are 17,000 people in my state who think we may have.

I ask you to think about it, too.

Thank you.

STATEMENT OF LESTER ANDERSON, REPRESENTING THE OREGON TIMBER STRATEGY PANEL

Mr. ANDERSON. Thank you, Senator, and members of the subcommittee. I think Governor Atiyeh has stated very accurately the devastating effect that the current situation is having on our local economy and local government revenues.

I was a member of the timber strategy panel which Governor Atiyeh appointed to seek some short- and long-term relief and improvements in the timber sales procedures. The panel considered Canadian exports, which, of course, is the concern of this committee and, as it was often cited, is one of our major problems.

The committee, I think rightfully, examined the situation in perspective, recognizing that both regions have vast timber resources, heavy concentration of manufacturing units and long-standing free trade policies.

Until 1960, Canadian imports had a relatively small contribution to U.S. markets; however, with the advent of increased housing needs in the 1970's and 1980's and predictions of 2 million housing starts over several decades, even the President's Panel on Housing and Environment in 1972 sought increasing supply roles from Canada to supply the lumber necessary for our housing needs.

Then there was the Jones Act, and this ultimately gave Canada an exclusive on water-borne intercoastal markets. Up to 1 billion feet has been shipped in one year. For the United States it has been nil.

These are two significant examples, one direct and one indirect, which I think invited Canada to participate in the U.S. markets.

The panel also examined differences in production of forest products between the two countries. First, timber sales policies. Canada, particularly through its provincial government in British Columbia, has made available an assured supply to producers, with prices indexed to product market fluctuations. On the other hand, in the United States we have an allowable cut which is not always fully funded and subject to the competitive or speculative urges on the part of the producers.

Labor and productivity.

Canada has higher labor costs, less productivity, because of logging conditions and less sophistication in its production. This is offset in the United States by lower labor and higher productivity.

Transportation.

Canada has a government regulated agreed charge system, while in the United States we are moving toward deregulation with incentive rates, and this causes considerable imbalances in our transportation rates as Canadian and United States lumber is shipped into U.S. domestic markets.

In log exports, Canada limits log exports. On the other hand, they have a vigorous, aggressive government policy to promote the export of lumber. In the last year it approached almost 3 billion feet. Surprisingly, this is about the same amount that we are shipping to Japan in log exports, and Canada has developed, as I say, a very aggressive program in shipping lumber.

And there are other differences, involving species and grade composition and stumpage appraisal systems. Many of these differences offset each other and are comparatively minor, except in one very significant item, and that's the cost of timber. It is higher in the United States, has been estimated at anywhere from 8 to 12 times higher because competitive bidding as we know it has become highly speculative. It has been based on projected inflation, high housing demand forecasts and excessive long-term contracts which allow betting on the con, and finally, and I think most importantly, uncertainties and fear of restriction on timber supply.

It is the base cost of raw material which, along with our self-imposed actions and procedures, has given the competitive edge to Canada, enabling a growing penetration into U.S. domestic markets at the expense of products from Pacific Northwest producing region.

Thus, any problems, I feel, resulting from increasing Canadian exports have not necessarily been the cause but to a large extent are the effect of many of our own actions and policies, or in some cases inaction.

It is such actions and policies, particularly applied to the sale and distribution of public timber, that Governor Atiyeh's panel specifically addressed. He mentioned several recommendations; we just finished our last meeting yesterday, and a number of others have been added. But briefly, here are just a few:

Reduce the speculative effects of competitive bidding by a prequalification of bidders. In other words, require production facilities or some insurance that those logs which are bought on contract will result in the production of forest products.

Shorten the length of the harvesting period. In some cases the harvesting period now allows up to 6 and 7 years.

Make changes in the deposit and payment schedules on the timber contracts.

And finally, again, most important, to provide a stable timber base, an allowable cut that is backed by full funding for sales management.

The Governor mentioned short-term sales to replace long-term contracts for operators with low inventories and to bring down the average cost to current market conditions.

And contract extensions, these to be also added by the BLM and the State.

And to reduce the costly regulatory requirements on many a nonessential project, so it's go with timber sales.

Another item that the panel asked for is a moratorium on any sales that extend over 3 years, until the bidding and contract provisions have been modified.

Another is a review of transportation rates, to offset some of the effects of the Jones Act.

And to increase our efforts to expand into international markets.

And finally, and I think this is most significant, in the event that it appears that these recommendations would not avert further deterioration of the forest products industry in the Pacific Northwest, agencies should plan to modify existing sale contracts to achieve downward stumpage adjustments.

The final draft of our report will be available within a day or so and will be put on the record of this committee. And we hope for prompt action, because the success depends on it if we are to retain our raw material base and our manufacturing capabilities and to maintain our position in U.S. markets on the long term and to retain the economic vitality of one of our Nation's most vital natural resources.

[The final draft follows:]

REPORT BY

GOVERNOR'S TIMBER STRATEGY PANEL

November 25, 1981

Honorable Victor Atiyeh
Governor of Oregon
Salem, OR

Dear Governor Atiyeh:

We, the Panel, received our instructions on October 18, 1981. Your instructions to this panel were clear: investigate every element of a complex process in which the Governor and State agencies have authority and influence, and determine what action can be taken to help the forest products industry and Oregon survive one of the most critical periods in our history.

You asked for both short term and long term recommendations. Short-term actions ease the crisis now -- to put workers back on the jobs in the woods and mills and to avoid disastrous impacts on vital public services that are financed by timber sale revenues. Longer-range remedies will help preserve economic stability and employment in the industry, assure reliable flows of timber sale revenues to State and local government, restore the home-building industry and Oregon's share of markets, and will guard against systemic flaws which are detrimental to the industry and public interest.

We conducted six public hearings in October and November -- in Salem, Bend, Medford, Eugene and Coos Bay. More than 200 persons attended those hearings and 100 offered testimony. In subsequent work sessions, the Panel screened more than 60 specific concerns expressed at hearings and a variety of suggested actions.

We have concluded our investigation.[1] In all candor, we have documented that which you, Governor, and we already knew: there is no quick fix, no easy solution, no immediate and total cure. The State Board of Forestry manages only 3 percent of Oregon's timber-producing land. Ninety-seven percent is owned and managed by federal agencies and private landholders. The Governor and the State Legislature have limited powers and authority. The Panel believes, however, that within those powers and authority, some effective action can be taken.

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[1]Specific issues regarding log exports, substitution and Canadian imports were presented in each of the public sessions. However, the Panel has elected to defer these complicated issues to the Joint Legislative Interim Committee on Trade and Economic Development and the Oregon Congressional delegation. Relevant testimony from the hearings will be available for Legislative and Congressional consideration.

We applaud your insistence that what can be done will be done. And we share your absolute confidence that Oregon will recover.

We believe the short-term recommendations in this report will help us toward recovery. Our recommendations for the longer term will help us maintain that recovery.

Respectfully submitted,

Kenneth W. Self

Kenneth W. Self
Chairman, Timber Strategy Panel

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INTRODUCTION

The information received during the Timber Strategy Panel hearings indicates that the severe recession has all but crippled Oregon's forest products industry. It now threatens not only the welfare of timber-dependent communities, but the very fabric of the state's social and economic stability.

It is of the utmost urgency for the economy of the State and the welfare of its citizenry to reduce the adverse economic impacts of the current recession upon Oregon and the Northwest.

Our present situation can be summarized by three general statements. First: A combination of factors has caused the Northwest's timber industry to be significantly less competitive in the market place. The most significant factors include high raw material costs; uncertainty of the long-term availability of timber, largely due to federal and State restrictions on the land base; the Canadian government's policy to reduce raw material costs to maintain their industry; governmental sales policies that do not adequately consider the changing market; taxing policies and governmental restrictions on all levels that increase cost both to the producer and consumer without a significant benefit. In short, we are pricing ourselves out of much of our markets.

Second: There has been a drastic reduction in our customary markets. The most notable change has been in the number and sizes of housing starts. Current projections are around one million new starts for this year and next year, 300,000 less than used in the State's recent draft economic forecast. Past optimistic projects of housing starts were double the current projection and significantly contributed to the high bidding for public timber.

America is a nation of homeowners. The U.S. ratio of owner-occupied homes to rentals is the highest in the world. Nearly all buyers finance homes with mortgage loans. In this decade, more than 40 million Americans will be ready to buy homes -- more than ever before in history.

But at current interest rates, only 2 percent of prospective buyers can afford mortgage financing even if new housing were available. New housing starts in 1981 plummeted to a 15-year low. In 1977, Oregon's home-building industry built 40,200 new homes. In 1981, new housing starts trickled off to fewer than 13,000. Oregon's homebuilder bankruptcies averaged fewer than five per month in mid-1980. A year later, the rate was 35 to 45 bankruptcies per month.

In 1982, only 12,400 new homes will be built in Oregon, unless the State Department of Veterans Affairs home loan program manages to sell several bond issues at favorable interest rates.

Current projections become even more dynamic when you consider that the size and composition of these starts will require fewer wood products and that similar reductions are occurring internationally.

Changes in national monetary and fiscal policies that have caused the individual purchasers of housing to compete for capital at the going interest rate is the most direct cause for this decrease in housing starts.

The first clear signals of trouble came a year ago. Home mortgage interest rates have topped 13 percent. By April 1981, the average effective mortgage interest rate was 14.15 percent. Then, in July, 14.72 percent. By September, home loan interest rates averaged a record 17.71 percent. The prime lending rate of the nation's banks soared from a low of 7 percent in early 1979 to more than 21 percent this year.

Without changes to the national monetary and fiscal policies or reduction of interest rates for housing, there does not appear to be a reasonable opportunity for future significant improvement in housing starts and a subsequent increased market for our forest products.

Increased deficit spending which creates large governmental demand for new capital is the most direct cause of high interest rates. Simply stated, the federal monetary and fiscal policies do not recognize housing as a national priority and high interest rates place a disproportionate burden upon the timber economy of Oregon and other markets that require long-term capital.

Third: Oregon's forest industries are primarily producers of raw material and are very subject to market fluctuations. There has not been enough emphasis on secondary manufacturing of wood products and the development of specialized wood product markets. We have adequate and efficient capacity to produce the basic raw materials but have not aggressively developed specialized markets or facilities for secondary products. Employment in the forest products industry may not return to its past strength.

The current situation indicates that:

A. Local governments face potential loss of revenue from forest revenues of disastrous proportions. While detailed projections are not available, it appears that as much as 40-60 percent of National Forest and Bureau of Land Management revenue could be lost to counties and school districts and a somewhat smaller percentage loss of State forest revenues. In addition, the revenue to the school districts from the severance tax may be reduced by 30-40 percent due to lower stumpage prices.

B. Employment resulting from direct and indirect benefits of the lumber industry creates about 46 percent of Oregon's employment. Presently we have about 50 percent of past direct employment. Stated another way, we may have 23 percent less total opportunity for employment in Oregon unless there is a significant improvement.

C. Many of our small and medium size timber producers are in precarious financial condition and even with considerable help some will not remain viable firms.

It is with this information in mind that the Panel presents the following findings and recommendations for your consideration.

FINDINGS

Based upon testimony taken at public hearings, upon our own investigations and research, the Panel makes these findings:

1. Oregon's forest products economy is imperiled by construction slowdowns and a depressed economy caused by high interest rates.

2. The Federal government no longer ranks housing as a top national priority.

3. Despite a very recent decline in interest rates, the forest products industry may not fully resume operations. Important shares of Oregon's markets have been lost to Canada and the U.S. South. Full recovery depends on regaining those markets. The major causes of Oregon's loss of market share are:

   a. Canadian government subsidies to that nation's forest products industry. This support, coupled with the favorable exchange rate, give Canadian exports a substantial competitive advantage in the U.S. market.

   b. Federal, state and local government policies restrict the land available for timber production. These governments have failed to establish a reliable and definite timber base.

   c. Transportation policies negatively affect the Pacific Northwest's ability to compete with lower-cost Canadian and Southern lumber and wood products, in many portions of the U.S. domestic market.

4. The forest products industry relied on past government projections of a continued strong housing demand. That reliance, coupled with past administrations' high priority for national housing goals, led to industry projections of the need for increased timber harvesting and production.

5. Strong housing demand projections, continued inflation, and the declining commercial land base signaled the industry to the risk of inadequate supplies of raw materials. That implication stimulated highly speculative overbidding for public timber sales.

6. When the housing and construction industry slumped, speculative prices paid for stumpage could not be recovered in a depressed market. That further compounded the industry's inability to compete with Canadian and Southern products.

7. Dramatically fewer housing and construction starts obliged the industry to stockpile unsold inventories. Logging and mill shutdowns and layoffs were unavoidable. The cumulative effect has been the deterioration of Oregon's fundamental economic base.

8. Due to developments in world markets and increased competition, attempts to increase exports have been of limited success.

9. Federal deregulation of the savings industry helped push home mortgage interest rates to record highs. Savings and loan institutions and mutual savings banks lost deposits to more attractive money market instruments.

10. Even if the prospects for lower interest rates and affordable housing were to improve, considerable damage will have been done to the nation's homebuilding and lumber manufacturing capacity. A lengthy recession will put contractors out of business and the industry's supply of skilled labor will be dispersed.

SHORT-TERM RECOMMENDATIONS

Recommendation 1: The State Board of Forestry (SBF) and the federal Bureau of Land Management (BLM) temporarily should permit contract extensions because of market conditions.

To the extent possible, terms and conditions for granting extensions should be compatible with U.S. Forest Service (UFSF) policies to avoid inequities among purchasers. Contract terms can be modified by SBF and BLM to allow the market to catch up with bid prices. Both SBF and BLM need to modify policies to permit contract extensions to mitigate market conditions.

Extension conditions should consider potential negative impacts on county revenues and the ability of administering agencies to continue management of public forest lands. Implementation of this recommendation will not necessarily curtail speculative overbidding on future sales. The Panel cautions that contract extensions and attendant overbidding could result in more delays in harvesting if market conditions do not improve. The effect would be more industry layoffs and diminished revenues to counties, school districts and administering agencies.

Conditions for granting extensions should consider the need for continuing cash flows to counties and administering agencies.

The success of this recommendation relies heavily on improved market conditions. If, however, markets do not improve, some purchasers may find relief by melding their high-cost stumpage with lower-cost stumpage from new offerings.

Recommendation 2: To the extent practical, USFS, BLM and SBF should adjust sales schedules so that timber will be harvested during contract extension periods.

Short-term sales, (three years or less) when there is a local market and when sale and harvesting conditions are suitable, may enhance revenue flow to local governments, school districts and administering agencies to stabilize local economics. It may also stabilize the economic base of local communities.

Short-term sales may allow operators with low inventories to purchase stumpage and continue operations. Some buyers of previously obtained high-cost stumpage may be able to cut losses by buying lower-cost stumpage in short-term sales and selling at current market prices.

Recommendation 3: Within statutory authority, USFS, BLM and SBF should reduce regulatory requirements and standards for costly, non-essential projects in timber sale contracts. This will reduce logging costs and encourage continuous harvesting.

During sale design and contract preparation, administering agencies can defer costly project work that delays harvesting. Agencies should make every reasonable effort to develop and administer contracts that encourage continuous harvesting and provide employment and revenue during these critical market conditions.

Recommendation 4: Agencies should not set sales with terms longer than three operating years until bidding procedures and contract provisions are modified to discourage speculative overbidding.

Under current conditions, speculative overbidding likely will continue on sales with terms longer than three years. A moratorium on longer term sales will encourage a priority on relatively short-term sales. The moratorium will give administering agencies an opportunity to develop and refine procedures that will make speculative overbidding prohibitive.

Recommendation 5: Agencies should expedite modification of bidding procedures and contract revisions to discourage speculative overbidding.

Agencies are working now to strengthen important contract areas such as bidding qualifications, bonding, deposits, payment schedules, default procedures, and extension terms. These provisions will be critical to maintaining a competitive and healthy forest products industry.

Recommendation 6: The federal government actively should pursue a fiscal policy to balance the federal budget and to reduce inflation and high interest rates that discourage homebuilding.

The depressed forest products industry is a direct casualty of federal fiscal policies of the past few years. Efforts by the Reagan Administration to balance the federal budget and curb inflation have worsened -- not eased -- the problems in the forest products industry.

LONG TERM RECOMMENDATIONS

Recommendation 1: In the event the recommendations aforementioned do not avert further economic deterioration of the forest products industry, the USFS, BLM and SFB should undertake immediately the development of plans which modify existing timber sale contracts to achieve downward stumpage price adjustments.

Economic conditions may worsen. Short-term solutions may not be effective. Purchasers of extended contracts may find it even more unprofitable to harvest during the contract extension period. If extended contract stumpage still cannot compete in the market toward the end of the extension period, more drastic relief measures -- no-penalty defaults, for example -- may be considered by the Legislature and the Congress.

Recommendation 2: The Federal government should restore affordable housing to a national priority. Private sector financial institutions must be allowed to provide a reliable, affordable and consistent flow of mortgage funding without specific action to counteract deregulation of lending institutions.

Safe, decent and affordable housing has been afforded priority in national policy since World War II. That no longer is true. Today, the most modest starter home in Oregon costs more than $60,000. To meet the debt obligations on a $60,000 mortgage for 30 years, a family must earn at least $45,000 annually and be willing to spend 30 percent of that on housing.

Recommendation 3: Federal and State regulatory agencies should give high priority to reducing production costs when regulations are developed and implemented.

Costs of timber production and harvesting have increased significantly, in large part because of government laws and regulations for environmental protection, land use planning, and other requirements.

If, before implementation, the impacts of regulations on the economy, jobs and other social values were considered more fully, it appears likely that alternative solutions might be sought. Typically, the need for regulations is emphasized without adequate consideration of the negative consequences.

Recommendation 4: Transportation rates should be reviewed to make West Coast timber competitive in U.S. markets.

Transportation costs have reduced the ability of Oregon producers to compete in domestic markets, including those within the region. More favorable transportation rates could offset cost disadvantages in the Jones Act and in Canadian rates to U.S. markets.

Recommendation 5: Amend building codes that discourage use of wood products.

Building codes that discriminate against use of wood contribute to higher costs of housing and commercial construction. Unnecessarily restrictive building codes have put forest products at a marketing disadvantage. Alternative construction materials, including plastics and metals, have been substituted for wood in many construction applications. A revitalized marketing effort demonstrating the construction advantages of wood will be necessary to recapture this market.

Recommendation 6: The State of Oregon must play a larger and more active role in BLM and USFS planning processes.

BLM and USFS land use planning decisions decrease productivity and reduce the timber production base. Set-asides, rehabilitation of non-stocked lands, and policies for non-declining even-flow are among the primary factors impacting timber supply. Only a few state agencies have funds and staff to provide an adequate review of federal plans. Those few often find their responses are in conflict because of different statutory missions and different policies.

The Forest Resources Program for Oregon recommends a process to identify and resolve these conflicts. The process can provide the level of coordination in State and Federal planning that is essential to maintain Oregon's timber supply and to achieve other forest resource objectives.

Recommendation 7: Actively support the objectives of the Forestry Program For Oregon to maintain timber production at a high sustained yield.

The Forestry Program For Oregon is the primary timber supply policy statement by the Oregon Board of Forestry. It contains the basic policies and programs necessary to maintain or slightly increase Oregon's timber harvests through intensive management and policy changes. It is based on the most up-to-date timber inventory data available and is now under revision to reflect post-1976 changes in inventory, harvesting schedules and other resources and policy changes.

Recommendation 8: Urge the development of federal legislation that will maintain a stable timber supply base adequate to meet state and regional timber production goals on federal lands.

Federal legislation emphasizes multiple-use forest management. But some management policies preserve forest lands for a variety of uses that exclude timber harvesting. There is no assurance that an adequate federal forest land base will be maintained to meet timber production demand. Timber supply management practices should be directed toward increasing the economic stability of local communities.

Recommendation 9: The Oregon Legislature and the Oregon Congressional Delegation should support adequate funding for all intensive forest management practices on all public forest lands.

The USFS is dependent upon Congressional appropriations for intensive management programs. The SFB and the BLM rely on revenue from timber harvesting and other activities that generate revenue. More revenue is the product of high sustained yields. But, funding historically has been less than necessary to achieve optimum yields, although favorable returns on investments can be demonstrated.

Recommendation 10: Oregon's Statewide Comprehensive Land Use Planning Goals should be interpreted to accommodate an economically productive timber base.

Interpretation of statewide land use goals and local comprehensive land use plans conflict with timber production and processing. Interpretations of statewide goals for comprehensive land use planning made by the Department of Land Conservation and Development (DLCD) and the Land Conservation and Development Commission (LCDC) have resulted in uncertainties about the future of Oregon's private forest land use base.

Oregon's Forest Land Goal (Goal 4) and Open Space Goal (Goal 5) accommodate an economically productive timber base.

The Forest Land Goal (Goal 4) was intended to consider productivity of forest land during the planning process. But, the goal has been interpreted to provide equal status for all forest uses without regard to the Economic Goal (Goal 9). The interpretation of the Open Space Goal (Goal 5) is an additional level of uncertainty about whether timber land in the production base will remain there or will be zoned for an alternative forest use or a non-forest use.

Goal 8 (Recreational Needs), Goal 15 (Willamette Greenway), Goal 16 (Estuarine Resources) and Goal 17 (Coastal Shorelands) all have interpretations that could imply a reduction in Oregon's timber production base.

Goal 5 requires an assessment of economic, social, environmental and energy consequences when Goal 5 resource uses conflict with existing uses. Interpretation by DLDC staff requires specific language and policies to preserve Goal 5 resources, although many are already adequately protected and can be managed in conjunction with existing forest uses and require no additional protection.

Goal 9 (Economy of the State) requires that plans and policies shall contribute to a stable and healthy economy for all regions of Oregon. Application of Goal 9 has been limited. Goal 9 has not adequately been considered in plan development and acknowledgment processes.

DLCD staff and LSDC interpretations frequently do not satisfy local planning needs and objectives. A closer liaison with local jurisdictions and more direct local control of final recommendations must be established.

Recommendation 11: Domestic and international marketing efforts for processed wood products should be increased.

Oregon's share of domestic and international markets has declined because of competition from other regions, imports, restrictive trade barriers and bidding practices that escalated stumpage prices far beyond appraised and market value.

Innovative marketing techniques to stimulate demand for affordable secondary and custom wood products (doors, windows, cabinets, laminated beams, etc.,) should be developed further. The development and marketing of secondary wood products has fallen behind competitive products in some areas. While the primary market opportunities are still in the lumber and plywood areas, secondary product manufacturing and marketing plays an important role in the economy and contributes to market stability through diversification.

Senator PACKWOOD. Les, thank you. Senator Mitchell has a question before he goes out to do battle with Senator Symms.

Senator MITCHELL. I have more of a comment, followed by a general question, Mr. Chairman.

I think the Governor's testimony was truly eloquent about the national policy which has existed in this country for at least four decades regarding an affordable home for every American. And you, Mr. Chairman, commented earlier that there is no housing policy by this Government now. I think this is the first administration in four decades that has not had a housing policy, culminating in what I regard as the truly incredible spectacle of the Secretary of Housing and Urban Development appearing last Friday before the National Convention of Realtors, telling them that the only suggestion the administration had was for realtors to go out and buy homes themselves because it is a good long-term investment, at a time when 75,000 realtors have gone out of business this year. I think we need a national housing policy.

The Governor and Mr. Anderson have obviously approached the lumber problem with great care and thoughtfulness and have come up with some very specific recommendations. In the absence of any policy by the administration, I think it is incumbent on the Congress to develop and present a housing policy. And I would ask both of them, especially you, Governor—I don't expect you to to give me an answer today—to give some thought to what you think, what elements ought to comprise a national housing policy at this time to achieve the goal that you so eloquently spoke of, and perhaps give it to us in writing at the earliest possible time.

I think we should be doing something. I don't know what the answer is. I think the administration's abdication makes it incumbent on us in Congress to do something. I would like to have you and the other witnesses today at the earliest possible time tell us what we ought to be doing, what kind of a policy ought we to have to make that home affordable again for every American.

Governor ATIYEH. Senator, there are two large elements, as I understand, at the present time that would be favored for the capital that's available. One, it would be industry to create jobs. Now I think the Senator would know, and I do, as well, that there has been very little capital formation in the development of new jobs in the United States for several years. We have been going downhill in that. I think that's very productive.

The other element remains, and one that is soaking up the rest of the capital money. It is the Federal debt. What I see is the administration saying "We must produce jobs; therefore, housing is going to get crowded out," but nothing has been said directly, that is, that there needs to be less borrowing by the Federal Government. The Federal Government is going to borrow about 50 percent of the available capital out there, and they have been doing it for some time.

So I am giving you my opinion, and I have thought about it a great deal. The target of borrowing less—we talk about spending less at the Federal level; I am thinking about borrowing less at the

Federal level—is a good policy. And the reduction of inflation is a good policy. And the reduction of interest rates which will follow all of that. Young people cannot afford to buy an increasingly expensive house at a higher interest rate.

Now, specifically, what Congress should say: We believe in housing, and we are going to work toward that end. It is a major part of our policy in the United States for housing. Just articulate it along with the actions you are presently taking, which I applaud.

Senator MITCHELL. Thank you, Mr. Chairman.

Senator PACKWOOD. Thank you, George.

Governor, do you think we ought to continue to sell timber off the public lands to the highest bidder, or should we change that policy?

Governor ATIYEH. I would say to you we should sell it to the highest bidder, but one of the recommendations the panel has made is that they would have shorter contracts. You bet on the con for a shorter period of time. I think that's a valuable thing.

I would say, also, along your own initiative, Senator, to do a better job in the management of our forest land, to reharvest, so that the operators that are there know there is timber out there. If they don't want to bid this time or don't need to bid this time, they won't enter that market, only when they need it, because they know there is going to be a supply. I am trying to remove some of the pressures that have created this speculative bidding.

We haven't discussed this at all in the view of the panel or with any of my staff, but I really think that it would be important in the process of bidding that someone have an established sawmill in order to bid, to make sure that we do not have just sheer speculators out there.

Senator PACKWOOD. I know Les Anderson made reference to that. He called it prequalification, whether that be owning a mill or not. I am not sure I would want to jump into that immediately. There may be legitimate people buying timber who are legitimate middlemen, who are selling it to mills, and who are not speculators. I speak of speculation in the sense that we now find timber being used as a tax shelter. A lot of timber is deliberately being used for that purpose. It is long-term contracts that give them that opportunity.

Let me ask you this, because I don't want to get blind-sided, so I am going to let you take the blame. If we adopt a variety of Federal policies, whether it be bidding or short terms or higher down payment's, whatever causes the price of Federal timber to go down, who should bear the burden of the loss to the counties in Oregon that are depending on that revenue and would, of course, complain bitterly if we had deliberate Federal policies that drove the cost down?

Governor ATIYEH. Senator, I think what you need to look at is the conditions under which we presently exist is one that is under the open bidding, and everything else that is going on. I am saying to you that we have a loss now. We have a loss under the present policy.

I would say that counties, and I am not directly speaking for them, would applaud something on which they could depend; not a feast or famine, but something that they can depend on routinely.

And I would think that they would prefer to get a lower amount rather consistently than to starve or overeat.

Senator PACKWOOD. Go ahead, Les.

Mr. ANDERSON. As it applies to one other item which concerns what the Governor was referring to and your question, one of the recommendations of the panel will also be to consider the possibility of indexing. In other words, after a bid has been awarded, to provide some means for the actual harvesting cost, or the cost at the time of harvest, to reflect the existing market conditions rather than having to bid at a time when the market conditions have to be forecast 5 or 6 years ahead.

Senator PACKWOOD. Part of that might be alleviated if you had relatively short periods to cut, and you could not bid 2, 3, 4 years down the road.

Governor, let me ask you this. I agreed with your statement that this administration has tilted toward industrial capitalization rather than housing. Unless there is a change in this administration's policy, if we continue to pursue the road we are on, and if President Reagan gets every budget cut that he has asked for so far, spending cut, we are still faced—and, Harry, you correct me if I am wrong—we are still faced with approximately $80 to 100 billion deficit in fiscal year 1982 and any place between $100 and $150 billion deficit in each of the 2 following years.

I think that is simply going to blow interest rates out of the water. If we think they are high now, when we have an accumulation of somewhere between from $250 and $400 billion in deficits, over the next 3 years they will be incredibly high. If that happens, would you favor some kind of additional incentive? It may be a further deduction for mortgage interest or some other incentive, some additional incentive to insure that houses will be built?

Governor ATIYEH. Senator, as a legislator I introduced legislation that would allow tax-free a certain amount of interest, which recently Congress has taken some action. Those things, however, are short-term measures which you use to kind of tide you over. It's the sort of thing we are asking, for example, of you, now, on the short term of the timber problem and the Canadian problem.

I am going to say this to you, and understand this is not an economist talking and, as you know, a little old rug man who now is Governor of the State, I am fully supportive of the Reagan policy. I want to make sure that is clear. And, as the Governor of Oregon, that is a little difficult with the high unemployment we have.

I, however, believe that inflation and high interest rates are the thing that is really killing us. And as a legislator, you and I, and as a Governor, I have been trying to fight the effects of inflation and the effects of high interest. What I am going to say to you is that I think it's a better policy that the President of the United States who is urging a tax cut—and I agree with it; I agree with the philosophy—and a budget cut—and I agree with that, as well—would separate the timing of those two; that we would in fact have the budget cuts, and the President would ask for a tax cut a year and a half or 2 years from now, so that it would go into effect, so that we could get a hold of this deficit.

The theory of the tax cut is to put money out there for us to invest it to create jobs. However, it is my opinion, this little old rug man, that with high interest rates they are not going to invest it in capitalization, formation of capital, formation of jobs. They are going to put it in whatever high interest rate paper there is out there. And so we are not going to get the effect that we want.

We need to get hold of the budget, I think. And then the market will understand we are going to work at inflation; and then interest rates will begin to come down. And then you give me my tax credit, and then I'll invest it in building a building or building a home or building a factory.

And now what I am getting at is, rather than answer yours in saying let's kind of repair it right now, I am suggesting a longer term solution.

Senator PACKWOOD. Senator Byrd.

Senator BYRD. Thank you, Mr. Chairman.

Governor, you developed what I think is a very important point when you mentioned the public debt and the degree to which the Federal Government is going into the money markets. That is bound to be one, if not the major, cause of the tremendous, devastating interest rates facing our Nation today.

Incidentally, in the current budget the figure for interest charge on the national debt is $100 billion. A hundred billion dollars just to pay the interest on the debt. It is no wonder we are in the very severe situation we are in in regard to interest rates.

I was so pleased to hear your comments in regard to the public debt.

I have just one question, and it touches on Senator Packwood's question a moment ago. You say one of the lethal elements, disadvantageous to the housing interest, is a Federal fiscal policy that places a higher priority on industrial capitalization than on housing. Would you amplify on that?

Governor ATIYEH. Pretty much as I have observed it, Senator, there is, and I think appropriately, a high priority for the creation of capital investment to develop jobs. We haven't really done that in this Nation. We haven't done very much of it.

However, I should say, if I hadn't expanded on it further in my nonprepared testimony in which I'm saying we have industry as a high priority into the capital market, we have Government into the capital market, and we crowded the home buyer out of that capital market. And I'm suggesting that it's important that we develop jobs. And I believe that to be the case.

I am suggesting that the Government get out of the borrowing market and allow a little room for the homeowner to get into it.

Senator BYRD. I like that approach. I might say that there is a question that has been bandied around Washington recently that Congress change the tax laws to either prevent or minimize the deduction for income tax purposes of the interest on home mortgages. Now, if that's done, it seems to me that not only will the American dream of everyone having a home go down the drain, but the housing industry would be shut down as well. I can't imagine anything more devastating to our Nation than to change the tax laws in that way. I wonder if you have a view on it.

Governor ATIYEH. Change the tax laws quite how, Senator? I didn't quite understand you.

Senator BYRD. Change the tax laws to prevent a homeowner from deducting from his income taxes any interest paid on his home mortgage. If you do that, it seems to me that you are just not going to have any home sales.

Governor ATIYEH. Well, I'll tell you what I'll do, Senator. I'll make a trade. If you can arrange with a stroke of a brush to reduce both inflation and high interest rates, then I'll make a trade with you and support the elimination of the interest. However, we need every advantage we can get right now. That, I don't think, is even enough today to have someone move into the housing market, but we've got to give them every break we can today. I agree with you; we shouldn't work against ourselves.

I want to say one other thing. I suppose it is more personal than I ought to be, but I have a daughter who is married, who does not own a home, and I'm worried about her having that opportunity. I genuinely am. And when I say that, now, I'm not now talking just about my daughter; I am saying I understand personally those young people who want a home and are foreclosed from so doing. It's a bad social policy, beside that. One thing I learned as a youngster myself is if I bought a home I was in fact forced saving. I was creating some capital of my own, some equity of my own.

For these young people—they may have rented an apartment—they will never be able to put aside anything for an equity, and one of these days they will retire and they won't have anything. I will at least have my home that I can sell. So there is a lot at stake in the fundamental economic strength of this Nation in what we are talking about, much beyond our conversation right here.

Senator BYRD. You are so right. For the average young person today, there is no way that that person can buy a home under these devastating circumstances.

Thank you, sir.

Mr. ANDERSON. Thank you.

Senator PACKWOOD. Governor, for a little old rug merchant you are very eloquent. [Laughter.]

Governor ATIYEH. Thank you, Senators.

Senator PACKWOOD. Thank you very much, Les, also.

Governor ATIYEH. I'll play poker with you again sometime.

Senator PACKWOOD. If the economy gets into a worse fix, we'll have nothing else to do.

I am going to ask, henceforth, that the statements do not be read. I have to terminate this hearing about 1:00. It will be in the record, so please abbreviate your statement and watch that yellow light. You will have about a minute to finish when the yellow light goes on.

We will next hear from David R. Macdonald, the Deputy U.S. Trade Representative.

Go right ahead.

STATEMENT OF HON. DAVID R. MACDONALD, DEPUTY U.S. TRADE REPRESENTATIVE, WASHINGTON, D.C.

Mr. MACDONALD. Thank you, Mr. Chairman. I do have a prepared statement which, with your consent and the consent of the committee, will be filed.

Essentially, we have used the sad state of the housing industry. It relates back to the forest products industry and its dependence on the housing industry, then it goes into the pathetic state of the lumber mills in the Northwest, and in Canada, for that matter. Then it recites a visit to our offices at the U.S. Trade Representative's office of a group of small Northwest lumber producers who called on us to explain to us the very serious economic conditions in which they find themselves.

The problems that they enumerated were the pricing policies for stumpage sold from U.S. Federal lands in the Northwest, upon which they relied, the slowdown in lumber exports, and the continued high level of import penetration from Canadian forest products.

These people were uniformly small mill owners from an association of 30 members in Washington State.

We then in the statement go to analyze the causes, some of the possible causes, of their decline and of the decline of the industry in the Northwest. And, in particular, we review in the statement the question of the method of calculation of stumpage prices, which has been addressed by the prior speakers; the problem of the falloff of exports of logs to Japan, which is going through its own housing downturn, and this has had an adverse effect on our own lumber industry; and then it goes into the Canadian export competition and reviews the steady rise in Canadian exports. Four reasons, really, are attributed to that. One is the low value of the Canadian dollar, relative to the U.S. dollar; second is a ban on Canadian log exports, which holds down Canadian competition, and the price for Canadian stumpage, and this is partly provincial and partly federal in Canada; the fact that British Columbian stumpage prices are adjusted every 3 months, which renders their prices much more sensitive to cyclical conditions and helps insulate Canadian producers against adverse marketing conditions, a situation that does not prevail in the particular region of the United States that we are interested in; and, finally, the method of appraisement used by the British Columbian provincial government in determining the price of their stumpage, a method of appraisal as opposed to a method of competitive bidding.

The Canadians also came in to see us and disputed a number of comparisons that had been drawn by the people in the Pacific Northwest. They point to such things as the fact that when they sell their stumpage, they sell it with a lot less services, that the timber cutter has to actually go in and perform a lot of things that our Government officials in the Agriculture Department does in this country, things like that.

We have not finally determined the facts of this case, and we would like very much to await the outcome of what we believe is an excellent initiative on your part, Mr. Chairman, which is the mandate that you have given to the International Trade Commission to get down and determine the actual cause of the competitive conditions and what is transpiring in the Northwest.

Beyond that, I would just like to say that we in the U.S. Trade Representative's office stand ready, willing and able to help these producers and others similarly situated. The situation argues for action and a thorough study of the facts, so that we can start from that point and negotiate from there, if negotiation needs to be done with the Canadians. That is the appropriate place to start.

So, from that, I will stop and await questions.

[The prepared statement follows:]

OPENING STATEMENT OF
DAVID R. MACDONALD
DEPUTY U.S. TRADE REPRESENTATIVE
FOR THE TAXATION AND DEBT MANAGEMENT SUBCOMMITTEE
AND INTERNATIONAL TRADE SUBCOMMITTEE

NOVEMBER 24, 1981

I AM PLEASED TO HAVE BEEN ASKED TO APPEAR TODAY TO DISCUSS THE CURRENT CONDITION OF THE NORTHWEST LUMBER INDUSTRY AND THE FACTORS RESPONSIBLE FOR THE VERY SERIOUS ECONOMIC MALAISE THE INDUSTRY IS EXPERIENCING.

I AM CERTAIN EVERY PERSON HERE IS AWARE THAT THE U.S. HOUSING INDUSTRY HAS BEEN IN A DEEP SLUMP FOR MONTHS NOW. HOUSING STARTS IN OCTOBER WERE AS LOW AS AT ANY TIME SINCE 1966 WITH TOTAL STARTS AT AN ANNUAL RATE OF 857,000 UNITS. I AM ALSO CERTAIN THAT ALL ARE AWARE OF THE REASONS UNDERLYING THIS EXCEPTIONAL AND SERIOUS DOWNTURN: THE TWIN EFFECTS OF HIGH INFLATION AND A RECESSION HAVE COMBINED TO SQUEEZE THE LIFE BLOOD FROM THIS ALREADY HARD-PRESSED INDUSTRY.

WHAT MAY NOT BE FULLY UNDERSTOOD BY THOSE PRESENT IS THE VERY CLOSE RELATIONSHIP BETWEEN THE HEALTH OF THE HOUSING INDUSTRY AND THE VITALITY OF THE LUMBER AND OTHER PORTIONS OF THE FOREST PRODUCTS INDUSTRY. RESIDENTIAL CONSTRUCTION IS THE SINGLE LARGEST USER OF LUMBER AND IS THE KEY DETERMINANT OF LUMBER PRODUCTIVITY AND DEMAND. THUS, THE MALAISE IN THE HOUSING INDUSTRY HAS LED VERY DIRECTLY TO THE 65-70

PERCENT LEVELS OF CAPACITY UTILIZATION BEING EXPERIENCED BY NORTHWESTERN MILLS, THE ACROSS-THE-BOARD FINANCIAL LOSSES, THE CLOSINGS, THE BANKRUPTSIES, FURLOUGHS AND FIRINGS. NOR IS IT LIKELY TO BE WELL KNOWN THAT SIMILAR CONDITIONS EXIST FOR OUR NEIGHBORS TO THE NORTH: THEIR RATE OF RESIDENTIAL CONSTRUCTION IS DOWN, THEIR LUMBER MILLS ARE OPERATING AT A 70 PERCENT CAPACITY UTILIZATION RATE, THEY ALSO ARE SUFFERING PLANT CLOSINGS AND FURLOUGHS.

MR. CHAIRMAN, ALMOST TWO MONTHS AGO, A GROUP OF SMALL NORTHWEST LUMBER PRODUCERS VISITED OUR OFFICES, AS I BELIEVE THEY DID YOURS. THEY CALLED TO ALERT US TO THE VERY SERIOUS ECONOMIC CONDITIONS IN WHICH THEY FIND THEMSELVES, TO EXPLAIN TO US THE RANGE OF FACTORS, IN ADDITION TO THE DEPRESSED HOUSING MARKET, TO WHICH THEY ATTRIBUTE THEIR CURRENT SERIOUS ECONOMIC PROBLEMS. AT A RISK OF MISREPRESENTING THEM, I WOULD CATEGORIZE THE PROBLEMS THEY INNUMERATED AS FOLLOWS:

-- THE PRICING POLICIES FOR STUMPAGE SOLD FROM U.S. FEDERAL LANDS IN THE NORTHWEST;
-- THE SLOWDOWN IN LUMBER EXPORTS; AND
-- THE CONTINUED HIGH LEVEL OF IMPORT PENETRATION OF CANADIAN FOREST PRODUCTS.

I WOULD LIKE TO REVIEW EACH OF THESE FACTORS WITH YOU:

THE FOREST PRODUCTS REPRESENTATIVES WHO VISITED THE OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE WERE UNIFORMLY SMALL MILL OWNERS FROM AN ASSOCIATION OF 30 MEMBERS IN WASHINGTON STATE. THE MEMBERS OF THIS ASSOCIATION MANUFACTURE BUILDING MATERIALS PRIMARILY FROM NATIONAL FORESTS AND STATE-OWNED TIMBER, IN CONTRAST TO THE LARGE INTEGRATED LUMBER PRODUCERS WHO SUPPLEMENT PUBLIC LAND PURCHASES WITH EXTENSIVE FEE SIMPLE HOLDINGS.

THESE PRODUCERS BELIEVE THAT THE SMALL LUMBER PRODUCERS ARE SUFFERING DISPROPORTIONATELY FROM THE ECONOMIC DECLINE. ONE REASON FOR THIS IS THAT THE FOREST SERVICE DOES NOT HAVE PRICE DE-ESCALATION CLAUSES IN THE NORTHWEST FORESTS CONTRACTS AS THEY DO IN OTHER REGIONS. IN THE NORTHWEST, THE RIGHTS TO HARVEST STUMPAGE FROM FEDERAL LANDS ARE SOLD AT AUCTION FOR FIXED PRICES FOR AVERAGE THREE-YEAR PERIODS. SINCE THE PRICES ARE FIXED, NORTHWESTERN MANUFACTURERS BENEFIT SUBSTANTIALLY FROM RISING MARKETS BUT PAY HEAVILY IN FALLING ONES. LARGER PRODUCERS WITH PRIVATE HOLDINGS ARE MORE IMMUNE TO THE VICISSITUDES OF THE MARKET SINCE THEY CAN SHIFT PRODUCTION FROM PUBLIC TO PRIVATE HOLDINGS DEPENDING ON THE ECONOMIC CLIMATE. ALTERNATIVELY, WHEN THEIR LUMBER PRICES DECLINE BELOW THEIR FIXED COSTS, SMALLER PRODUCERS HAVE NO RECOURSE BUT TO SHUT DOWN.

INFORMATION FROM THE FOREST SERVICE HIGHLIGHTS THIS PROBLEM. BIDS FOR STUMPAGE ROSE TO $267 A THOUSAND BOARD FEET OF TIMBER IN 1980 FROM $104 IN 1975. MEANWHILE THE BENCHMARK PRICE OF LUMBER, WHICH WAS $140 A THOUSAND BOARD FEET IN 1975, PEAKED AT $260 IN 1979 AND DROPPED TO $205 LAST YEAR. IT IS CURRENTLY ABOUT $150. OBVIOUSLY, LUMBER PRICES HAVE NOT KEPT UP WITH STUMPAGE PRICES AND MANY SMALL PRODUCERS ARE OPERATING BELOW THEIR BREAK-EVEN POINTS.

THE INDEPENDENT MANUFACTURERS ALSO CALLED TO OUR ATTENTION THAT THE PROBLEM OF LOG EXPORTS HAS EASED SOMEWHAT OWING TO THE FALL-OFF IN DEMAND IN THE JAPANESE MARKET; BUT IN LINE WITH THE DECLINE IN LOG EXPORTS HAS BEEN A SLOWDOWN IN EXPORT LUMBER SALES, AS WELL. SINCE LUMBER EXPORTS HAVE BEEN ONE OF THE BRIGHTER SPOTS IN THE MARKET FOR LUMBER IN 1980 AND EARLY 1981, THE FALL-OFF IS VIEWED SERIOUSLY.

NORTHWEST INDEPENDENT PRODUCERS ALSO POINT THE FINGER OF BLAME AT CANADIAN EXPORTS (AND PARTICULARLY EXPORTS FROM BRITISH COLUMBIA) AS THE OTHER MAJOR FACTOR RESPONSIBLE FOR THEIR CURRENT ECONOMIC DIFFICULTIES.

AN EXAMINATION OF LUMBER IMPORT STATISTICS REVEALS THAT THEIR CONCERN ABOUT CANADIAN IMPORTS IS NOT EXAGGERATED. AS THE TABLE BELOW SHOWS, FROM 1971 THROUGH 1976, CANADIAN

IMPORTS ACCOUNTED FOR BETWEEN 18 AND 22 PERCENT OF THE TOTAL U.S. MARKET, RISING AND FALLING WITH THE CYCLICAL CONDITIONS OF THE U.S. ECONOMY. IN 1977, HOWEVER, IMPORTS SURPASSED THE PREVIOUS HIGH EXPERIENCED IN THE 1973 BOOM, AND THEIR SHARE HAS CONTINUED TO INCREASE IN EACH SUBSEQUENT YEAR, REGARDLESS OF THE CONDITION OF THE U.S. MARKET. IN THE FIRST HALF OF 1981, CANADIAN IMPORTS CAPTURED A 32 PERCENT MARKET SHARE.

CANADIAN EXPORTS OF LUMBER TO U.S.

1971	19.8	Percent
1972	22.5	"
1973	23.2	"
1974	20.9	"
1975	18.7	"
1976	22.2	"
1977	25.8	"
1978	27.9	"
1979	28.4	"
1980	29.4	"
1981(1st half)	32.0	"

IN 1981, WE PREDICT THAT CANADIAN IMPORTS WILL BE ROUGHLY THE SAME LEVEL AS IN 1980, WHILE U.S. PRODUCTION IS EXPECTED TO DECLINE FROM LOW 1980 LEVELS.

THE INDEPENDENT PRODUCERS ATTRIBUTE THE CONTINUED GROWTH IN CANADIAN EXPORTS TO THE GREATER COST COMPETITIVENESS OF CANADIAN PRODUCTS OWING TO:

-- THE LOW VALUE OF THE CANADIAN DOLLAR RELATIVE TO THE U.S. DOLLAR;

-- THE VIRTUAL BAN ON CANADIAN LOG EXPORTS, WHICH HOLDS DOWN CANADIAN COMPETITION AND THE PRICE FOR THEIR STUMPAGE;

-- THE FACT THAT BRITISH COLUMBIAN STUMPAGE PRICES ARE ADJUSTED EVERY THREE MONTHS. THIS RENDERS PRICES MUCH MORE SENSITIVE TO CYCLICAL CONDITIONS AND HELPS INSULATE CANADIAN PRODUCERS AGAINST ADVERSE MARKETS CONDITIONS, ALTHOUGH IT REDUCES THEIR PROFIT LEVELS IN GOOD TIMES AS WELL; AND

-- THE METHOD OF APPRAISEMENT USED BY THE BRITISH COLUMBIAN PROVINCIAL GOVERNMENT.

NORTHWEST INDEPENDENT PRODUCERS BELIEVE THAT THIS APPRAISAL SYSTEM IS DELIBERATELY DESIGNED TO HOLD DOWN THE PRICE OF STUMPAGE AND POINT OUT THAT EVEN GIVEN THE DIFFERENCES U.S. AND CANADIAN SPECIES, STUMPAGE, QUALITY, LOGGING COSTS AND TAX TREATMENT, THE CANADIAN SYSTEM RESULTS IN A 25 PERCENT PRICE ADVANTAGE ON FINISHED TIMBER.

OF COURSE THESE ESTIMATES ARE STRONGLY DISPUTED BY BOTH BRITISH COLUMBIANS AND BY THE LARGE INTEGRATED U.S. PRODUCERS. THEY HAVE PROVIDED US WITH EQUALLY CONVINCING DATA WHICH CALLS INTO QUESTION THE INDEPENDENT'S CONTENTIONS, OR AT LEAST SO IT SEEMS TO THOSE OF US WITH ONLY A LAYMEN'S KNOWLEDGE OF THE INDUSTRY. WE HAVE ASKED THE INDEPENDENT PRODUCERS TO HELP US ACCOUNT FOR THE DIFFERENCES.

MY OFFICE HAS HELD LENGTHY DISCUSSIONS WITH THE INDEPENDENT PRODUCERS. WE BELIEVE WE UNDERSTAND THE NATURE OF THEIR PROBLEMS AND WE CERTAINLY ARE WILLING TO DO WHAT WE CAN TO HELP. WE HAVE EXPLORED THE VARIOUS AVENUES OF IMPORT RELIEF WHICH ARE AVAILABLE TO AID U.S. INDUSTRIES IMPACTED BY IMPORT COMPETITION, WHETHER FROM FAIR OR UNFAIR REASONS. WE HAVE REVIEWED FRANKLY WITH THEM THE MERITS AND DEMERITS OF EACH APPROACH, AND HAVE EXPRESSED OUR WILLINGNESS TO CONTINUE TO ADVISE THEM FURTHER. RATHER THAN REVIEW THE INDIVIDUAL TRADE LAWS AT THIS TIME, THE LIST OF IMPORT REMEDIES HAS BEEN ATTACHED TO MY STATEMENT. UNFORTUNATELY, BECAUSE OF THEIR FINANCIAL CONSTRAINTS THE NORTHWEST INDEPENDENT PRODUCERS HAVE NOT YET HIRED LEGAL COUNSEL TO HELP THEM PREPARE AN ADEQUATE CASE. ADDITIONALLY, THEY ARE FACED WITH THE DIFFICULTY OF DEVELOPING AN INDUSTRY DEFINITION WHICH SEPARATES OUT THEIR SMALL SEGMENT OF THE LUMBER INDUSTRY FROM THE WHOLE

WHICH OPPOSES ANY PETITION FOR RELIEF. THESE FACTORS HAVE MADE THEIR DECISION TO PURSUE ONE OF THE TRADITIONAL IMPORT RELIEF APPROACHES VERY DIFFICULT.

THE SITUATION CERTAINLY ARGUES FOR ACTION, HOWEVER, AND THE INITIATION OF AN INDEPENDENT, OBJECTIVE, THOROUGH-GOING STUDY OF THE PROBLEM SEEMS A VERY REASONABLE PLACE TO START. FOR THESE REASONS, MY OFFICE FULLY SUPPORTS SENATOR PACKWOOD'S RESOLUTION REQUESTING THE U.S. INTERNATIONAL TRADE COMMISSION TO INVESTIGATE THE FACTORS UNDERLYING THE IMPORTATION OF CANADIAN SOFTWOOD LUMBER INTO THE U.S. ONCE THIS INFORMATION IS DEVELOPED, IT IS HOPED THAT WE WILL THEN ALL HAVE A BETTER IDEA OF HOW NEXT TO PROCEED.

I THANK YOU FOR YOUR ATTENTION. I AM PREPARED TO ANSWER ANY QUESTIONS.

89-494 O - 82 - 7

SUMMARY OF REMEDIES

ANTIDUMPING ACTION (Sec. 731, Tariff Act of 1930, as amended)

Conditions to Satisfy:
1) Export prices are lower than home market prices; or
2) Lower than export prices to third-country market; or
3) Lower than Canadian cost of production.

and

4) U.S. "industry" must be materially injured or threatened with material injury by reason of above.

Remedy: Antidumping duties imposed in amount equal to margin by which imports from Canada are priced below home market prices, third-country prices or cost of production

or

Agreement is reached to eliminate dumping margin or eliminate exports to U.S. of dumped products.

COUNTERVAILING DUTY ACTION (Sec. 701, Tariff Act of 1930, as amended)

Conditions to Satisfy: Products imported into U.S. must benefit from a subsidy

and

U.S. "industry" must be materially injured or threatened with material injury by reason of above.

Remedy: Countervailing duties imposed in amount equal to margin of subsidization

or

Agreement is reached to eliminate subsidy margin or eliminate exports to U.S. of subsidized products.

IMPORT RELIEF ACTION (Section 201, Trade Act of 1974)

Conditions to Satisfy: Imports must be increasing (in actual or relative terms)

and

Increased imports must be a substantial cause of serious injury to the U.S. "industry"

and

The President must proclaim relief from increased imports.

* Should the President take no action or action which differs from the recommendation of the International Trade Commission, his decision is subject to legislative override.

SECTION 301 ACTION (Section 301 of the Trade Act of 1974, as amended)

Conditions to Satisfy:

Canadian practice affecting exports of products to the U.S. or third-country markets or adversely affect sales of U.S. products into Canada must be shown to be:

1) Inconsistent with the provisions of, or otherwise denies benefits to the United States under any trade agreement

<u>or</u>

2) Unjustifiable, unreasonable, or discriminatory and burdens or restricts U.S. commerce

<u>and</u>

The President must take action to affect relief from such practice.

Senator PACKWOOD. I know the arguments pro and con of whether the way Canada sells timber is, indeed, less expensive than the way we sell it. The argument will be made in Canada that their producer has to build bridges; it sounds like they write a litany of social services that would be equal to Japan. And our timber people are saying we've got to build super highways in the forests, and all they build are rut roads up there.

If, indeed, for whatever internal purposes, Canada subsidizes its production of timber, cutting of timber, transporation of timber—and there may be perfectly legitimate reasons from the standpoint of their housing industry—if they do that, what should be the United States' response?

Mr. MACDONALD. Well, one appropriate response is a countervailing duty petition by the industry. But to do that, you have got to face your with-injury is a violation of our countervailing duty laws.

Senator PACKWOOD. I'm curious. Is it a subsidy if they choose not to sell their stumpage on a bid basis to the highest bidder, but sell it on some other basis?

Mr. MACDONALD. I don't think that fact, alone, shows subsidy. I think other facts that we are not aware of could show subsidy. The Commerce Department, of course, administers that law, and I understand we have a Commerce witness who might be able to shed a little more light on that.

Senator PACKWOOD. The Commerce Department has indicated they cannot be here today. They will submit a full statement, but they will not be here. But that is one of the questions I have asked them to address themselves to.

Mr. MACDONALD. Well, I used to administer that law when it was over in the Treasury Department, and a year of price depression in the past has not been held to be a subsidy in this country; that is to say, price controls. This is somewhat analagous to that. I don't want to say that it is the same thing, but that is the one thing that occurred to me when I saw that situation and began to search around for a solution.

There is a much broader remedy which I think Senator Cohen mentioned, and that's 301. Section 301 is an international remedy which we could request the Canadians to cooperate in. It is much more general in its operation, and it is not as fast and sure as the application of the countervailing duty laws. So when there is subsidization of products to the United States, normally countervailing duty petitions are appropriate. When there is subsidization to a third market in which we are also competing with our own exports, a section 301 complaint is.

Senator PACKWOOD. One of the keys on subsidization, though, is are they selling it at less than they sell it in their own market, domestically?

Mr. MACDONALD. That would be dumping, Mr. Chairman. And, as I understand it, there is no particular evidence of dumping.

Senator PACKWOOD. There has been no allegation of dumping. There is of heavy subsidy, but not to the extent of selling it in this market at less than they sell it in the Canadian market.

Mr. MACDONALD. That's right. Subsidization, though, could be present even though they sold it at the same price in Canada as they sold it in the United States, and that petition could be maintained without any showing of a sale at less value than they sell it in their home.

Senator PACKWOOD. Were you involved in Treasury when we had that Polish golf cart case?

Mr. MACDONALD. Yes, I was.

Senator PACKWOOD. We tried to figure out what the market would have been in Poland, had they had golf courses for which they sold golf carts.

Mr. MACDONALD. As a matter of fact, the Treasury Department applied a Canadian golf cart manufacturer's cost in order to determine what the appropriate price from the Polish manufacturers should be.

Senator PACKWOOD. Thank you very much. I have no other questions. I appreciate your taking the time to come.

Next we will hear from Assistant Secretary Chapoton, who faces this committee about every 2 weeks.

Do you have a prepared statement?

Secretary CHAPOTON. Yes, we do have a statement.

Senator PACKWOOD. Again, it will be in the record, and I would appreciate it if you would abbreviate it.

Assistant Secretary CHAPOTON. Yes, sir. I will summarize it very briefly.

STATEMENT OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Secretary CHAPOTON. We will just address the tax issues before the committee this morning, specifically S. 1824, which among other things, would amend section 194 of the Internal Revenue Code.

To provide a little background, I know the chairman is familiar with this, but to set the provisions in context: Before 1981 the amounts spent for reforestation were required to be capitalized and recovered as cost depletion when the timber was harvested. At the end of 1980, Section 194 was added to the Code, applicable to 1981 and later years, to provide incentives for reforestation of lands privately held by small owners. The provision allows reforestation expenditures with respect to qualified timber property to be amortized, that is, to be deducted ratably, over a 7-year period, and also provides a 10-percent investment tax credit for such expenditures.

The section 194, as currently in the law, does have limits. Only $10,000 a year of expenditures may be taken into account, and there is no carryover of the $10,000 limit if less than that amount is spent in any one year.

S. 1824 would make two changes in section 194 of the Code: It would increase the $10,000 limit to $25,000, and it would provide a carryover of the excess of $25,000 over the amount actually spent for qualifying reforestation expenditures in any year. Thus, if in the preceding 3 years the taxpayer had no such expenditures, $100,000 could qualify for amortization and for the investment tax credit in the taxable year.

Mr. Chairman, we must oppose S. 1824 on the grounds, principally, that timber is already one of the most tax-favored of domestic industries in four specific respects: First, a taxpayer may elect to treat the cutting of timber as the sale or exchange of a capital asset, whereas most manufacturers and producers are, of course, required to treat their income as ordinary income; second, the cost of producing inventory for resale for most manufacturers and producers may not be deducted currently but must be reflected in income as an offset against the selling price of the goods in the year of sale. But in the case of the timber industry, costs incurred in connection with growing and carrying timber after reforestation may be currently deducted against ordinary income. Our figures show that these costs represent about three-fourths of the cost of raising timber.

These two tax benefits combine to allow deferral of current ordinary income (when the timber company deducts against other ordinary income the cost of carrying the timber and raising the timber) and the conversion of ordinary income into capital gain (when the income from the sale of the timber is realized in the year the timber is cut).

The fourth area in which timber is benefited is the preferential minimum tax treatment. In 1976, when the minimum tax rate was increased from 10 to 15 percent and the carryover of regular taxes was no longer allowed as an offset, timber was exempted from these changes, so that the increases in the minimum tax was not applicable to timber.

Therefore, on the grounds that the industry already enjoys significant tax benefits, when added to the 1980 legislation which does allow a limited deduction and credit for reforestation expenditures, we would not support an increase in those benefits.

We would also point out, Mr. Chairman, that the timber industry will enjoy benefits under the Economic Recovery Tax Act of 1981. The capital gains rate for individuals, as you know, was dropped from 28 to 20 percent. And, of course, machinery and equipment used in the cutting of timber will be allowed a faster writeoff; 5 years as opposed to 7 years under current law, retaining the full 10-percent investment tax credit.

We recognize the problems that the timber industry is experiencing, but we think it is inappropriate to single out this industry for special tax relief.

We would also point out that tax relief probably does not fit the ills besetting the industry now. If there is a cyclical problem here, it does not seem appropriate to provide incentives for timber growing. We also think the incentives of the market, when the market turns around, should provide the incentives for reforestation and not tax incentives at this time.

Section 2 of S. 1824 would change the source of funding for the Reforestation Trust Fund. Basically, the 1980 legislation also established the trust fund and requires receipts from tariffs to be put in that fund for reforestation of Federal lands. Section 2 of S. 1824 would instead require that amounts from the sale of trees and forest products from Federal lands to be put in the trust fund.

Senator Packwood. Mr. Secretary, let me interrupt you there and ask a question. It is fair to say that this Treasury Department, or most treasury departments, do not like trust funds generally. Isn't that true? Your criticism is not aimed at this particular trust fund.

Secretary CHAPOTON. I would agree, Mr. Chairman. Let me just say we do not like limited trust funds or earmarking of receipts. And that's our sole objection to this trust fund.

Senator PACKWOOD. Let me ask you this, however: As between the two, if you have a trust fund for the purpose of reforestation, would you rather have it funded from tariffs or from cutting receipts?

Secretary CHAPOTON. Mr. Chairman, I am not sure I'm prepared to answer that. I think it is a very legitimate question, and I would be happy to respond in a letter. We haven't analyzed it that way. We don't want the additional funding that would come in. And we assumed, and I think correctly, that additional funds would be provided when you change the funding.

Senator PACKWOOD. Well, not yet, because I am keeping the $30 million cap; although I would be less than frank to tell you I didn't have some future intention of lifting the cap.

Assistant Secretary CHAPOTON. That's right. The cap is retained. But as the tariffs go down, and they may well go down, we would see additional funding coming this way.

I would be happy, if you would like, to respond to that, though; which of the lesser of two evils from our viewpoint, we would prefer.

Senator PACKWOOD. I don't mind if you do that, so long as I have the right to characterize your descriptions in the letter that you send.

Secretary CHAPOTON. Yes, sir.

[The information follows:]

[This provision was passed by the Senate as part of H.R. 4717 December 16, .1981, and, at this time, is scheduled for conference. During the markup, Mr. Chapoton indicated that, while Treasury opposes trust funds generally, it has no position regarding whether receipts from timber sales are preferrable to tariff receipts as a funding source].

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

DEC 24 1981

Dear Senator Packwood:

At the November 24, 1981 hearing on timber issues (conducted by the Taxation and Debt Management and International Trade Subcommittees of the Senate Finance Committee), one of the issues raised was the emergence of a tax shelter involving the use of public timber cutting contracts. In my testimony before that hearing, I indicated that, having only recently learned of the arrangement, we did not have the opportunity to study it closely and therefore did not believe it appropriate to pass judgment on it at that time. I added, however, that we would continue to study this transaction. In your letter to me of November 24, you indicated that you would appreciate our promptly completing our review.

In conjunction with the Internal Revenue Service, we have examined this tax shelter arrangement in more detail. We understand the facts in these cases to be generally as follows: A timber company successfully bids for the right to cut timber on Forest Service lands, being obligated to pay for the timber as it is cut. The timber company then assigns the cutting rights and payment obligations to a tax shelter promoter (the company, however, remaining responsible for its obligations under the contract). The obligations of the promoter generally equal the contract price owed the Forest Service by the timber company plus some override payment to the timber company. The promoter in turn "sells" the right to cut the timber to a limited partnership. The "sale" takes the form of an installment purchase with the purchase price being substantially below the timber company's bid and the promoter's obligations. However, the total payments to the promoter -- repayment of "principal" and "interest" on the purchase obligation -- generally equal the promoter's obligations under the assigned contract. The promoter may also be paid management and syndication fees. Additionally, the timber company may perform or supervise the actual logging and other similar operations as "agent" for the limited partnership.

The partners claim deductions on their individual tax returns for their allocable shares of the losses of the partnership (subject to other generally applicable rules) flowing largely from the interest deduction. Further, the difference between the "purchase price" and the fair market value of the timber is reported as long-term capital gain under section 631 of the Internal Revenue Code when the timber is cut.

In our judgment, this tax shelter arrangement is abusive. It attempts to convert what is economically a part of the timber purchase price into an interest deduction to the partnership and therefore to the partners. We have opened a project to determine whether, under existing law, this conversion is allowable. If we conclude that it is not, a revenue ruling will be issued so holding. Should we conclude that existing law permits this arrangement, we will be pleased to work with the Congress in fashioning legislation to change this result. Since we regard tax shelter arrangements such as these as seriously injurious to our self-assessment system, we have assigned a high priority to this project.

Additionally, we have furnished materials on this arrangement to the Assistant Commissioner (Compliance) of the Internal Revenue Service. As you may know, the Internal Revenue Service has established a Tax Shelter Program to identify and examine schemes of this type. As part of this program, the Western Region has identified two promoters of this arrangement. While currently we do not know the number of investors involved in the two promotions, efforts will continue to identify and examine promoters and investors involved in this type of transaction.

Thank you very much for your interest in this matter. As our work on this project proceeds, we will, of course, continue to keep you informed of our conclusions and of other developments.

Sincerely,

John E. Chapoton
Assistant Secretary
(Tax Policy)

The Honorable
Bob Packwood
United States Senate
Washington, D.C. 20510

cc: Roscoe L. Egger, Jr.
Commissioner of Internal Revenue

Secretary CHAPOTON. Well, finally, let me just mention that the committee has brought to our attention the use of public timber as a tax shelter. Basically, as described by other witnesses, the tax shelter arrangement, as we understand it, is this: Under a public cutting contract, a timber company obtains the right to cut timber in the future for a specific amount, most of which is payable on the future date when the timber is cut.

These tax shelter arrangements involve the acquisition of the cutting rights by a promoter, who turns around and sells these rights to a limited partnership at a lower price. The promotor also charges interest on the lower price, which interest is designed, evidently, to bring the total amount paid by the investors, interest and principal, up to the cost of the cutting rights, plus I am sure, some profit to both the promoter and the company that originally had these rights.

It does appear that this is a recharacterization of the purchase price partially as interest, and, therefore, deductible to the investor. We do see a problem in this arrangement, but I would have to say, Mr. Chairman, we are still trying ~~to~~ obtain more information. We have asked the Internal Revenue Service to look into this. If there is a problem here we will attempt to deal with it. And if necessary, we will seek legislation to deal with it.

Senator PACKWOOD. This is one that I want to work with you very quickly on. It has come to our attention in the industry only in the last 6 months. I think you have characterized the facts accurately. I'm not going to ask you to prejudge them, but I would hope we could expedite your consideration of it, because it was never intended by me or any of the rest of us who are involved in attempting to encourage timber production that it would be used in that particular fashion, and obviously for two reasons: One, I think it is taking unfair advantage, and, two, I have often seen an abuse like this lead to overkill and lead to changes of all kinds of what I regard as justifiable tax treatment of timber. And they all get wiped out at once because people generalize from that kind of an abuse. I want to shut it off before it grows very far.

Secretary CHAPOTON. We will act quickly. Certainly, it well could jeopardize the treatment. We have the classics of a tax shelter, that is, deferral by use of the deductions against ordinary income in the early years, and then capital gains when the income is later realized. So we will look at that quickly.

Senator PACKWOOD. It is a shelter trick which you and I are both familiar with, and it's not limited to timber. And every time we find it, we try to close it if we can, but it seems the ingenuity of those who read the tax law is slightly ahead of the ingenuity of those who draw it. We never quite catch them all.

Secretary CHAPOTON. That concludes the description of our position, Mr. Chairman.

Senator PACKWOOD. Mr. Secretary, I have no other questions. Thank you very much. I appreciate it.

[The prepared statement follows:]

Time limitations have not permitted the
Office of Management and Budget to advise
as to the relationship of this statement
to the President's program.

For Release Upon Delivery
Expected at 9:30 a.m. EST

STATEMENT OF THE HONORABLE JOHN E. CHAPOTON
ASSISTANT SECRETARY FOR TAX POLICY
DEPARTMENT OF THE TREASURY
BEFORE THE SUBCOMMITTEES ON
TAXATION AND DEBT MANAGEMENT
AND
INTERNATIONAL TRADE
OF THE SENATE FINANCE COMMITTEE
NOVEMBER 24, 1981

Messrs. Chairmen and Members of the Subcommittees:

I am pleased to have the opportunity to appear at this joint hearing to present the views of the Treasury Department on issues of concern to the forest products industry. Specifically, I will address the issues raised by S. 1824 relating to the tax treatment of reforestation expenditures and the financing of the Reforestation Trust Fund, and will comment briefly on a tax shelter involving the use of public timber which has recently come to our attention.

The Treasury opposes the provisions of S. 1824. We recognize that the timber industry is experiencing significant problems because of, among other things, high interest rates, the reduction in home building, and the economic downturn in general. However, we believe it inappropriate to single out that industry for special treatment. Rather, we believe that the timber industry, as other industries, will share in the growth of the economy resulting from the Administration's economic program.

With respect to the tax shelter issue, prior to our passing judgment, further study of the details of this arrangement is necessary.

S. 1824

Reforestation Expenditures

To put into perspective the provisions of S. 1824 relating to the tax treatment of reforestation expenditures, a brief exploration of the recent history in this area would be helpful.

Under the law prior to 1981, amounts spent for reforestation were required to be capitalized and recovered as cost depletion when the timber was harvested. However, to provide incentives for reforestation of lands privately held by small owners, the Congress last October enacted a series of provisions modifying the law in this area. Specifically, a new section (section 194) was added to the Internal Revenue Code which allows, upon the election of the taxpayer, reforestation expenditures with respect to qualified timber property to be amortized -- that is deducted ratably from ordinary income -- over a period of 7 years.* The Act also provided a 10 percent investment tax credit applicable to these expenditures (new Code section 48(a)(1)(F)). The expenditures for which amortization and the credit are allowed generally include the direct costs incurred in planting or seeding including the cost of preparing the site, the amount spent for seeds or seedlings, and the costs of labor and tools.

The 1980 Act, however, contained a limitation on the annual amount of expenditures eligible for amortization and the investment tax credit. Generally, only $10,000 of yearly expenditures can be taken into account ($5,000 in the case of a married individual filing a separate return). If more than $10,000 is spent in the taxable year, the $10,000 amount is

* The 1980 legislation also provided that recapture of the expenses would not be required if the property were held for more than 10 years.

allocated among the qualified timber properties, and no carryover of the excess to other years is allowable. Similarly, if less than $10,000 is spent, the limitation in other years is not affected.

S. 1824 would amend the 1980 legislation in two significant respects. First, for expenditures made after 1981, the annual limitation for purposes of both 7-year amortization and the investment tax credit would be increased from $10,000 to $25,000. In addition, for taxable years beginning after 1979, the taxpayer could carry over for three years the difference between the otherwise applicable limitation and the yearly expenditure. The limitation in the carryover year (for purposes of both amortization and the credit) would then be increased by the amount of the carryover.

The Treasury opposes this portion of S. 1824.

Timber is already one of the most tax-favored of domestic industries. For example, under the tax laws, amounts received by manufacturers and producers for the sale of their products are generally taxed as ordinary income. However, a taxpayer may elect to treat the cutting of timber as the sale or exchange of a capital asset, with the result being that receipts from timber sales are generally taxed at the preferential capital gains rates. Taxation at capital gains rates reduced the taxes of the timber industry by an estimated $350 million in 1978.

Similarly, a basic principle of the tax laws is that an expenditure may not be currently deducted if it is related to the purchase or production of an asset that will generate income beyond the year in which the expenditure is made. Thus, the cost of producing inventory for resale is not currently deducted but is reflected in income as an offset against the selling price of the goods in the year of sale. However, for the timber industry, there is a significant exception in that costs incurred in connection with growing and carrying timber after the reforestation period are currently deducted against ordinary income. These costs represent approximately three-fourths of the costs of raising timber. The amortization of reforestation expenditures is another exception to the basic tax principle. In theory, the expenses incurred in the reforestation period and beyond should be capitalized and recovered against the income to which they relate in the later years when the timber is cut or sold.

The combination of the two benefits described above results in the conversion of ordinary income into capital gains. The costs of growing and carrying timber are currently deducted against other ordinary income of the timber company, while the income produced by those expenses is taxed at the capital gains rates.

In addition, timber growing receives special treatment under the corporate minimum tax provisions of the Code. In 1976, the Congress increased the minimum tax rate from 10 to 15 percent and eliminated both the carryover of regular taxes as an offset and the $30,000 exemption. Timber, however, was not subject to these changes.

These four items -- capital gains treatment of income, mismatching of income and expense, conversion of ordinary income into capital gains, and the special minimum tax provisions -- give the timber growing industry a substantial tax subsidy. *

Accordingly, in light of the substantial benefits already provided for the timber industry, the Treasury opposed the 1980 legislation,** on the grounds that further assistance in the form of current deductions for reforestation expenditures could not be justified. A fortiori, we believe that an increase in those benefits would be inappropriate.

Moreover, developments subsequent to the 1980 legislation argue even further against the increase provided by S. 1824. The Economic Recovery Tax Act of 1981 provides significant tax benefits to all taxpayers and to all industries. Specifically, with respect to timber, the reduction in individual tax rates, with the concurrent reduction in the capital gains rates, will significantly reduce the taxation of timber income. Indeed, for sales and exchanges by noncorporate taxpayers occurring after June 9, 1981, the top capital gains rate is reduced from 28 to 20 percent -- a 29 percent reduction. Additionally, for all taxpayers, the Accelerated Cost Recovery System provides more

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* A study completed by the Treasury's Office of Tax Analysis in 1979 estimated that, even before the enactment of the 1980 legislation providing special tax benefits for reforestation expenditures by small owners, these special tax preferences are equivalent to a direct cash subsidy of 35 to 43 percent of the value of standing timber.

** See Statement of Deputy Assistant Secretary of the Treasury (Tax Legislation) Daniel I. Halperin on S. 100, May 18, 1979.

generous cost recovery deductions and investment tax credits than under prior law for machinery and equipment used for the cutting of timber. Whereas under the ADR system, a taxpayer could select a recovery period of 7 years for such property with a 10 percent investment tax credit (or a recovery period of 5 or 6 years with a 6 2/3 percent credit), under ACRS the taxpayer is entitled to a 5-year recovery period and a 10 percent credit.

We recognize that the timber industry is experiencing significant problems because of the economic downturn. We also appreciate the necessity of maintaining a secure long-term timber supply. However, we believe it inappropriate to single out this industry for special relief. The timber industry, as other industries, will share in the growth of the economy resulting from the Administration's economic program. Special relief, separate and apart for that program, simply cannot be justified. Further, the relief provided does not seem to fit the ills described. If timber cutting is cyclically depressed it does not seem appropriate to provide incentives for timber growing. Moreover, we believe the economics of the market, not special tax incentives, should operate to provide the necessary reforestation of privately-owned lands.

Reforestation Trust Fund

Section two of S. 1824 would change the source of funding for the Reforestation Trust Fund. The Treasury also opposes this amendment. Again, I believe that a few words of background may be useful.

In addition to providing incentives for reforestation of privately-owned lands, the 1980 legislation also provided for the reforestation of national forests. Thus, to assure an adequate source of funding to eliminate the backlog in reforestation and timber stand improvement on these public lands, the legislation established within the Treasury a separate Reforestation Trust Fund. Transfers to the Fund of up to $30 million a year are required for fiscal years 1980 through 1985 from tariffs received on the import of wood and wood-related products. For each of the fiscal years 1981 through 1985, appropriations are authorized from the Fund to the Secretary of Agriculture to pay the direct and allocable administrative costs of reforestation and related programs to the extent the amounts appropriated out of general revenues are insufficient for this purpose.

S. 1824 would change the source of funding for the Trust Fund from tariff receipts to amounts received from the sale of trees and forest products from Federal lands. Thus, beginning in 1982, the Secretary of the Treasury would be required to transfer yearly to the Fund, subject to the $30 million limitation, 65 percent of the amount received by the Secretary of Agriculture from sales from the National Forest System and all amounts received by the Secretary of the Interior from sales from other Federal lands (other than lands held in trust for Indian tribes).

While financing the Trust Fund through tariff receipts is objectionable to the Treasury, financing it through receipts from timber sales also suffers serious defects. These receipts, derived from the sale of a national resource held by the Federal Government beneficially for all citizens, should be available for all Governmental and public purposes. Earmarking those funds for the Trust Fund has the result of providing a preference for reforestation over other Governmental functions. We think it is more appropriate for these monies to be included in general revenues and subject to all competing interests in the appropriations process.

Use of Public Timber as a Tax Shelter

~~The~~ Treasury has very recently become aware of the emergence of a tax shelter involving the use of public timber cutting contracts and limited partnerships. Under a public cutting contract, a taxpayer can obtain the right to cut timber for a specified dollar amount which is not payable until the timber is actually cut. Additionally, no interest is charged in the interim. While we have not yet been provided with the details of the tax shelter arrangement, as we understand it the transaction involves the conversion of a portion of the contract price of the successful bidder to an interest charge to the limited partners. The interest accrues during the period between the bid and the time the timber is cut (which may be a number of years). Additionally, the partners' basis in the contract is lowered by this amount of interest. As a result, the partners have a current deduction against ordinary income until the timber is cut, at which time the correllative reduction in basis is recaptured at capital gains rates. As so described, the shelter would have the features of deferral of tax and conversion of ordinary income into capital gain.

Since, as I have noted, we have only recently learned of this arrangement and, therefore, have not had the opportunity to study it closely, I do not believe it appropriate for me to pass judgment on it at this time. However, as it has been described to me, the transaction appears to attempt to exploit the absence of an interest charge in the contract. At first glance, it would

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seem abusive for this unstated charge to be passed on to the limited partners (with the benefits to them of deferral and conversion), since the transformation of a portion of the contract price into interest would not seem to be a bona fide transaction. In other words, either the price charged the partnership by the bidder for the contract is inappropriate, or the "interest" charges should be recharacterized as capital items and thereby included in the purchase price.

We do, however, want to study this transaction more closely, and to this end we have requested the appropriate materials from the Committee Staff and the Internal Revenue Service. To our knowledge, the shelter is not currently of widespread use. If the transaction is truly abusive, we will, of course, examine the available administrative remedies and, if insufficient, propose appropriate legislative measures.

I would be pleased to answer any questions you may have.

Senator PACKWOOD. Now we will move on to a panel consisting of Arnie Ewing of the Northwest Timber Association, Roland Caron, and Eley Frazer.

While Mr. Ewing is coming up, again, gentlemen, I would admonish you about our time limits. Your entire statements will be in the record. If you could abbreviate them within those time limits, I would appreciate it.

Mr. Ewing.

STATEMENT OF ARNOLD EWING, NORTHWEST TIMBER ASSOCIATION, EUGENE, OREG.

Mr. EWING. Thank you, Senator. I will shorten my testimony considerably so that I can recognize your short time.

I am Arnold Ewing, executive vice president of the Northwest Timber Association, Eugene, Oreg. We are a trade association comprised of independent lumber and plywood manufacturers, all of whom are classified as small business and all are dependent on Federal timber for the raw materials supply.

I was very pleased to testify before these subcommittees on the issues that are of vital importance to our members as independent lumbermen in western Oregon.

We have found ourselves in this declining market not competing with individual manufacturing plants or complexes, but with a foreign government. The British Columbian government, through subsidization, has created an uneven balance in competition for American markets. In the last few years Canadian mills have gone from an almost static 20 percent share of the American market to in excess of 30 percent and are still growing.

We have no interest in completely isolating the British Columbian mills from their traditional American markets, but we do feel some type of parity must be achieved if we are to keep the American mill worker employed. It is one thing to suffer a recession or depression in the American forest products market, but it is something else to do it while allowing a situation to continue that allows a foreign government the ability to maintain its economic stability at the expense of ours.

We strongly urge the U.S. International Trade Commission to investigate the importation of Canadian softwood lumber into the United States. We have learned that the Pacific Northwest Range and Experiment Station of the U.S. Forest Service has begun to assemble facts and figures as to the impact of Canadian lumber shipments to this country. We hope that you would encourage this research in the assembling of facts and figures, and that the ITC utilize their expertise in arriving at some conclusions on your reforestation bill.

The future of the forest products industry anywhere is based solely on its ability to reforest areas after harvest or environmental catastrophies such as fires. The intent of Senate bill 100 would make a definite impact on the Federal reforestation effort. Reforestation is an investment in the future that has to be made and should not be subject to political whims or treated like a bouncing football, going one direction one year and another the next.

The ability to amortize reforestation expenditures is a necessary incentive to promote reforestation by individual independent forestland owners. It is right that this dollar amount be increased from the $10,000 and that a carryover be allowed for 3 subsequent years.

Although reforestation costs vary, not only from one area of the country to another but in fact from one slope to another in the same area, $25,000 in the West should reforest between 100 and 125 acres per year. As you can see, the $25,000 is helpful, but greater increase is needed. This bill could have a positive and significant impact on the availability of future wood fiber for our Nation's needs with the proper increases.

The last item I want to discuss in this hearing deals with limited partnerships. We are aware that limited partnerships have often been used in generating capital for major construction or industrialization projects. Under these situations it appears it is an effective tool to finance such operations and has a place in our financial structure. I have grave concerns that the use of such financing procedures has a legitimate place in the purchasing of Federal timber.

There are several limited partnerships presently operating in Oregon on Federal timber, and it appears by several other operator's purchasing pattern that more are in the offing. I consider the limited partnership purchasing of Federal timber the greatest threat to the survival of small business, more than any item we have experienced in the past 20 years.

We as an industry in the Northwest are presently in real financial jeopardy from extreme stumpage prices. Limited partnerships can pay whatever price it takes to purchase the timber, profit being no motive, and force us all out of business. The use of tax gimmicks that allow bidding prices absolutely unrelated to the real worth must be challenged in Federal timber purchasing. If the Federal agencies cannot handle or will not handle the major misuse of capital gain, then legislation should be considered to stop this monster before we cripple our industry permanently.

Thank you, Senator.

Senator PACKWOOD. Thank you, Arnie.

[The prepared statement follows:]

NORTH WEST TIMBER ASSOCIATION

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STATEMENT OF ARNOLD EWING
BEFORE SENATOR BOB PACKWOOD
OF THE
TAXATION AND TRADE SUBCOMMITTEES
OF THE
SENATE FINANCE COMMITTEE

November 24, 1981 - Washington, DC

Senator Packwood, my name is Arnold Ewing and I am Executive Vice President of North West Timber Association, Eugene, Oregon. We are a trade association comprised of independent lumber and plywood manufacturers all of whom are classified as small business, and all are dependent on federal timber for their raw material supply.

I was very pleased to be asked to testify before these subcommittees on issues that are of vital importance to our members as independent lumbermen in western Oregon. I will not try to fill my testimony with statistics and numbers because there are others here who are more qualified to do so. However, I would like to speak to the impact on our members, the small business independent lumber and plywood manufacturer. Our mills, on the whole, are the most cost efficient and productive in the world. The independent lumberman in western Oregon has long been in the forefront of innovation and modernization. We are no longer the backwoods, small, one-horse sawmill or the old "thick and thin" veneer plants. We are by most any yardstick the best there is, and everything else being equal, we could compete with any mill.

We have found ourselves in this declining market not competing with individual manufacturing plants or complexes, but with a foreign government. The British Columbian government, through subsidization, has created an uneven balance in competition for American markets. In the last few years Canadian mills have gone from an almost static 20 percent share of the American market to in excess of 30 percent and are still growing.

We have no interest in completely isolating the British Columbian mills from their traditional American markets, but we do feel some type of parity must be achieved if we are to keep the American mill worker employed. It is one thing to suffer a recession or depression in the American forest products market, but it is something else to do it while allowing a situation to continue that allows a foreign government the ability to maintain its economic stability at the expense of ours.

We strongly encourage your proposal that the U. S. International Trade Commssion (ITC) investigate the importation of Canadian softwood lumber into the United States. We have learned that the Pacific Northwest Range and Experiment Station of the United States Forest Service has begun to assemble facts and figures as to the impact of Canaaian lumber shipments into this country. We hope that you would encourage this research in the assembling of facts and figures, and that the ITC utilize their expertise in arriving at their conclusions.

The future of the forest products industry anywhere is based solely in its ability to reforest areas after harvest or environmental catastrophy. The intent of Senate Bill 100 would have made a definite impact on the federal reforestation effort. Your proposed amendment that would change the basis for funding in the reforestation trust fund has merit if, in fact, it ensures that the money will be available to the Secretaries of Agriculture and Interior to reforest their lands. Reforestation is an investment in the future that has to be made, and should not be the subject of political whims or treated like a bouncing football--going one direction one year and another the next.

Reforestation is a major expenditure, but its net benefit even on private lands contributes to the national good. The ability to amortize reforestation expenditures is a necessary incentive to promote reforestation by individual independent forestland owners. It is right that this dollar amount be increased from the $10,000 originally establised to $25,000 and that a carryover be allowed for three subsequent years. One problem that has been evident is that many of the small woodlot owners do not realize the tax incentive programs that have been available to them. We would hope that along with this increase an information program would also be developed to get the word out to these independent forestland owners.

Although reforestation costs vary, not only from one area of the country to another, but in fact from slope to slope in the same area, $25,000 in the West should reforest between 100 to 125 acres per year. If all of the private forestland owners take advantage of this tax incentive it doesn't take much of a mathematician to see that this would have a positive and significant impact on the availability of future wood fiber for our nation's needs.

The last item I want to discuss in this hearing deals with limited partnerships. We are aware that limited partnerships have often been used in generating capital for major construction or industrialization projects. Under these situations it appears it is an effective tool to finance such operations and has a place in our financial structure. I have grave concerns that the use of such financing procedures has a legitimate place in the purchasing of federal timber.

We have experienced many schemes whereby speculators have purchased vast amount of timber in an attempt to get a stranglehold on the public timber supply. Thank goodness to this point all such efforts have failed, but the side effects of such efforts has been disastrous by creating extreme speculative bid prices unrealistic to any known market.

There are several limited partnerships presently operating in Oregon and on federal timber, and it appears by several operator's purchasing pattern more are in the offing. I consider the limited partnership purchasing of federal timber the greatest threat to the survival of small business, than any item we have experienced in the past 20 years.

We as an industry in the Northwest are presently in real financial jeopardy from extreme stumpage prices. Limited partnerships can pay whatever price it takes to purchase the timber--profit being no motive--and force us all out of business. The use of tax gimicks that allow bidding prices absolutely unrelated to the real worth must be challenged in purchasing federal timber. If the federal agencies cannot handle or will not handle the major misuse of capital gain then legislation should be considered to stop this monster before we permanently cripple our industry.

We have appreciated testifying before you today on these individual, yet important, items. We hope that you will avail yourself of any additional information that we might have. We are more than willing to work with you to try and solve the many problems that face our industry today.

Senator PACKWOOD. I believe that Senator Mitchell wants to say a few words about our next witness.

Senator MITCHELL. Thank you, Mr. Chairman. I merely wanted to introduce Mr. Roland Caron, who is the director of personnel of J. Paul Levesque & Sons, Inc., of Ashland, Maine. Mr. Caron is here representing not only his company but also to talk about the problems that affect the entire industry in our part of the country, where we face the same problems that exist in the Western part of the country that is the focus of much of this hearing.

So I am pleased to welcome Mr. Caron, and I look forward to hearing from him.

Senator PACKWOOD. Mr. Caron.

STATEMENT OF ROLAND CARON, J. PAUL LEVESQUE & SONS LUMBER CO., ASHLAND, MAINE

Mr. CARON. Thank you, Mr. Mitchell. Thank you, Mr. Packwood for allowing us to be here to represent that part of the country which I believe has had little representation up to this point in the hearing.

In an attempt not to be redundant and overemphasize some of the points that have already been mentioned this morning, I think I would like to take this time to talk about a couple of things that haven't been mentioned, one of which is we believe that Canadian exports are providing a very, very unfair trade advantage to manufacturers in the United States, and we believe that if the reverse situation was existing, Canada would not allow this to happen, invoking their antidumping tribunal.

The other point which we would like to make is the fact that Canadian Mills are setting the price for lumber and are forcing us to compete with their prices. We have had some argument against this, but, unfortunately, they are setting the price. The wholesalers who are buying lumber today are buying at their prices, and those of us in the United States who want to sell any lumber at all must meet the Canadian price in order to move our lumber.

The major problem that is providing for us is the fact that, due to forest subsidiary agreements and Canadian aid to industry in Canada, they are able to undersell us as far as prices are concerned, primarily because they are able to cut their costs.

There are over 300 programs in Canada that contribute to the growth and development of their industry. They expend billions of dollars each year. These programs range from Federal-Provincial development agreements, which provide various business assistance program aides, grants, interest rebates, loans, and even forgiveable loans.

Other costs that the American industry must bear in an attempt to compete with this Canadian market are: a percentage of reforestation; we must build and maintain our own road systems; we must handle whatever timber salvage that is alloted us each year; not only by forest fires but in the Northeast we are presently burdened with the spruce budworm, which is virtually destroying a lot of our spruce species. We have to handle this problem and try to gain whatever monetary help we can in harvesting this timber, which is virtually nil.

For your perusal and with your agreement, I would like to submit for the record a partial listing of incentive programs offered to businesses in Canada. These contribute to this unfair trade advantage that now exists.

We believe that the Canadian lumber industry is getting more than its fair share of subsidy from its own government. Why should the United States further subsidize it while allowing lumber to be dumped into this country, only to be crippling its own forest products industry?

Help us put our industry back onto the road to recovery by limiting or restricting the Canadian export of lumber into this country. Help put your people back to work.

Thank you, Senator.

Senator PACKWOOD. Mr. Caron, thank you very much.

Mr. Frazer.

[The prepared statement follows:]

NOVEMBER 24, 1981
JOINT HEARINGS ON: FOREST PRODUCTS INDUSTRY ISSUES
TESTIMONY OF ROLAND K. CARON, J. PAUL LEVESQUE & SONS INC.,ASHLAND, MAINE

YES, THIS INDUSTRY IS IN A DEPRESSION. UNEMPLOYMENT IN OUR INDUSTRY IS NEAR 17% WITH THE PROGNOSIS FOR RECOVERY VERY BLEAK.

MANY PEOPLE BELIEVE THE MAJOR CAUSE OF THE SITUATION TO BE HIGH INTEREST RATES. HOWEVER, WE IN THE INDUSTRY BELIEVE THIS TO BE ONE OF TWO MAJOR PROBLEMS THAT MUST BE DEALT WITH IN ORDER TO PUT OUR INDUSTRY BACK ON THE ROAD TO RECOVERY.

WE PERCEIVE THE OTHER MAJOR PROBLEM TO BE THE CANADIAN EXPORT OF LUMBER INTO THIS COUNTRY. THUS THEY ARE FLOODING THE MARKET WITH CHEAPER LUMBER AND CONSEQUENTLY ESTABLISHING THE PRICES IN OUR INDUSTRY. AN ATTEMPT MUST BE MADE TO CURTAIL THIS SITUATION.

DO YOU THINK FOR ONE MINUTE THE CANADIANS WOULD ALLOW US TO RUIN THEIR MARKET WITH OUR EXPORTS? THIS WOULD NEVER HAPPEN. THEY WOULD ENFORCE THEIR "ANTI-DUMPING TRIBUNAL" WHICH WOULD IMPOSE A DUTY SURCHARGE ON THOSE GOODS DUMPED INTO THEIR ECONOMY.

WE MUST TAKE SOME ACTION TO END THIS FOSTERING OF THE CANADIAN LUMBER INDUSTRY, WHILE AT THE SAME TIME WE ARE ALLOWING OUR INDUSTRY TO BE PUT TO A SLOW DEATH.

WE ARE CURRENTLY AT A POINT WHERE WE MUST RE-EMPHASIZE THE FACT THAT THE CANADIAN MILLS ARE RESPONSIBLE FOR SETTING THE PRICE OF LUMBER, WHICH IS AN OBVIOUS INJUSTICE TO OUR INDUSTRIES. THEY ARE IN A POSITION TO UNDERSELL ALL AMERICAN COMPETITION ONLY BECAUSE OF THEIR GOVERNMENT SUPPORT. THUS FORCING US TO SELL AT THEIR PRICES JUST TO TURN OVER A DOLLAR.

MOST PEOPLE ARE BLIND AS TO THE REASON WHY THE CANADIANS ARE ABLE TO ACCOMPLISH THIS WHOLE SALE OF LUMBER WELL BELOW OUR COST OF PRODUCTION. YOU MUST UNDERSTAND THAT THE ECONOMIC RATIONAL IS VERY SIMPLE ONCE YOU HAVE THE FEW FACTS THAT UNDERLINE THIS UNFAIR TRADE ADVANTAGE.

CANADA HAS OVER 300 PROGRAMS THAT CONTRIBUTE TO THE GROWTH AND DEVELOPMENT OF THEIR INDUSTRY, WITH EXPENDITURES OF BILLIONS OF DOLLARS. AMONG THESE PROGRAMS INCLUDE THE FEDERAL-PROVINCIAL DEVELOPMENT AGREEMENTS WHICH PROVIDE VARIOUS BUSINESS ASSISTANCE PROGRAM AIDES, INCLUDING GRANTS, INTEREST REBATES, LOANS AND FORGIVEABLE LOANS. FORESTRY SUBSIDIARY AGREEMENTS ALONE INVOLVE OVER $40 MILLION A YEAR.

A COMPARISON OF BOTH THE U.S. STUMPAGE RATES AND THE CANADIAN STUMPAGE RATES WOULD YIELD FIGURES THAT WOULD SHOW THAT THE U.S. RATES ARE 75% HIGHER THAN THE CANADIAN RATES, FOR THEIR STUMPAGE IS GOVERNMENT SUBSIDIZED UNDER A FEDERAL-PROVINCIAL AGREEMENT.

OTHER COSTS THAT THE AMERICAN INDUSTRY MUST BEAR INCLUDE:

(1) REFORESTATION
(2) ROAD BUILDING AND MAINTENANCE
(3) TIMBER SALVAGE
(4) UPDATE OUR PRODUCTION MECHANISMS AND FACILITIES
(5) SEEK AND PROCURE NEW MARKETS

ALL THE ABOVE ARE SUBSIDIZED BY THE CANADIAN GOVERNMENT. IN ADDITION TO THESE SUBSIDIES YOU FIND THAT THE CANADIAN GOVERNMENT ALSO SUBSIDIZES EXPORTS.

THESE FACTORS CIVE CANADIAN MILLS A DEFINITE UNFAIR TRADE ADVANTAGE. THIS ALLOWS THE CANADIANS TO UNDERSELL OUR LUMBER MARKET BY ANYWHERES FROM 20-40%.

HOPEFULLY YOU ARE AWARE THAT WE IN THE INDUSTRY BELIEVE THAT UNDER NORMAL ECONOMIC CONDITIONS OUR PRODUCTS ARE DIRECTLY COMPETITIVE TO THOSE OF CANADA; BUT THEIRS REPRESENT A BETTER BUY WHEN THEY ARE SETTING THE PRICES.

WE BELIEVE THAT THE CANADIAN LUMBER INDUSTRY IS GETTING MORE THAN ITS SHARE OF SUBSIDY FROM ITS OWN GOVERNMENT. WHY SHOULD THE UNITED STATES FURTHER SUBSIDIZE IT WHILE ALLOWING LUMBER TO BE DUMPED INTO THIS COUNTRY ONLY TO BE CRIPPLING ITS OWN FOREST PRODUCTS INDUSTRY?

HELP US PUT OUR INDUSTRY ON THE ROAD TO RECOVERY BY LIMITING, OR RESTRICTING THE CANADIAN EXPORT OF LUMBER INTO THIS COUNTRY.

HELP PUT YOUR PEOPLE BACK TO WORK.

ENCLOSED FOR YOUR REVIEW IS A PARTIAL LISTING OF THE INCENTIVE PROGRAMS OFFERED TO BUSINESSES IN CANADA THAT CONTRIBUTE TO THIS UNFAIR TRADE ADVANTAGE THAT NOW EXISTS.

RESPECTFULLY SUBMITTED
ROLAND K. CARON
DIRECTOR OF PERSONNEL
J. PAUL LEVESQUE & SONS INC.
ASHLAND, MAINE 04732

PARTIAL LISTING OF THE INCENTIVE PROGRAMS OFFERED TO BUSINESSES IN CANADA

Regional Development Incentive Program:(RDIP)

The purpose of this program is to encourage growth and development of industry in slow growth regions. Assistance is provided with both grants and loan guarantees. Incentive grants are 20% of approved capitol cost of plant construction, modernization, or expansion; and 25% of the approved capitol cost plus $5,000 per direct job created, for new development. Loan Guarantees may be authorized for any industry with an anticipated capitol cost guarantee of over $100,000. Such guarantees are for 90% of the principal.

Investment Tax Credit:

Different regions throughout Canada draw a higher rate of investment tax credit for eligible industries which include the manufacturing and processing of lumber, farming and logging. This credit is deducted against the federal income on the tax return forms.

Employment Tax Credit:

Tax credits are available to firms throughout Canada, particularly in areas of high unemployment. RDIP applicants may also qualify for higher rates available in designated regions. This credit is also deducted from the federal income tax on the forms.

Federal-Provincial Development Agreements:

The purpose of these programs is to encourage the economic growth and development of industry through joint federal-provincial subsidiary agreements which establish various business assistance programs, including grants, interest rebates, loans and forgivable loans.

Enterprise Development Program: (EDP)

This program provides financial assistance packages and insures loans for companies seeking to adjust to changing markets. Loan guarantees are provided for mergers, working capitol or acquisition, construction or conversion of plant and equipment. Grants are also available up to 75% of the cost of productivity improvement, innovation and market feasibility.

Federal Business Development Bank:(FBDB)

A program to provide financial assistance to firms experiencing financial difficulty. Assistance is provided through direct loans, loan quarantees and equity financing.

Accelerated Capital Cost Allowances:

This program assists with a rapid write off of the cost of machinery and equipment purchases for manufacturing improvements and processing.

Export Development Corporation: (EDC)

The purpose of this program is to provide financial assistance to promote export sales through loans, loan guarantees, insurance and surety guarantees. Examples include: Credit Insurance, which provides insurance of up to 90% of the losses resulting from non-payment of a buyer. Thus making the export market a virtually non-risk venture. Also, loans and loan-guarantees provide the purchaser of Canadian exports a financing source when commercial financing is not available.

Export Market Development:

A program designed to guarantee 50% of the cost of breaking into a new market area.

STATEMENT OF ELEY C. FRAZER III, F & W FORESTRY SERVICE, INC., ALBANY, GA.

Mr. FRAZER. Senator, my name is Eley Frazer. I have with me Bill Condrell, who is with the Industries Committee on Timber Valuation and Taxation. I am a consulting forester out of Georgia. I work in the States of Georgia, Florida, Alabama, and South Carolina, and we have a few trees in Georgia and the rest of the Southeast, too.

I represent primarily the non-industrial landowner. My consulting business was built on this basis, and for 20 years that has been the basis of my business. I will be brief, and I will summarize what I have to say. The rest of it can go in the record.

I would like to take this opportunity, though, to thank you from the bottom of my heart and from the bottom of my landowners' hearts for the present law, Senate bill 1824. There is only one problem with that thing, and I alluded to that at my last testimony here. It was that there was too little, and, with site preparation and planting costs in excess of $200 an acre now, we need to up this $10,000 limit, maximum, to at least $25,000, and we need to make a carryover possibility for this for at least 3 years.

And I would suggest that we cut the 7-year bid back to 5 years, so that it will parallel the present cost recovery system that is in the tax law.

I also believe that trusts should be eligible for the same treatment, the same tax treatment, as the rest of the landowners are. Many of our forests are held by trusts that people left with banks, and so forth, and it is vital for the production of timber that this be done. And it is my understanding that it is not a matter of philosophy, it is just a matter of how do you do it without having abuses.

Senator PACKWOOD. Frankly, the thought never occurred to us at the time we were drawing the bill. It was purely an oversight, and nobody mentioned it. We just barely got that bill passed, by the hair of our chinny-chin chin. It was touch and go, and I was happy to get anything we could at the time. We will build on that. But there was no intention to discriminate against trusts; we just didn't think about it.

Mr. FRAZER. Well, as you can see from my statement, I am happy, too. But I would be happier if we could get these other changes made, and I think it will be beneficial to our Nation as a whole.

I would like to point out that capital gains was the bill of a lifetime, and maybe still is the most important legislation for timber growers that ever came along. Until the time the capital gains was passed we were losing timber inventory every year in our Nation. Since the capital gains was passed we have increased our inventory. And the problem is now that our inventory is beginning to be depleted once again, and we need other things to help us do this job of getting trees in the ground. And any legislation that is supportive of this through a tax method, which in my opinion is the most efficient method of doing it, would be welcome. But I don't think myself or any member of the committee that I am here representing today has any intention that we create a system whereby tax avoidance rather than business concern is the main program that we follow.

However, let me say one thing. It is certain in many cases that the limited partnerships can be a benefit if they are properly used, and they are in instances in our State. But we are not supporting tax avoidance.

I would like to close by saying that we need more trees. The building of a forest is a low-return, high-risk business. We contend that the passage of S. 1824 is a great plus for the production of timber and should be improved by making the $25,000 cap with a carryover of 3 years and the inclusion of the trusts.

We urge the adoption of the new bill as the best method for increased production at the least cost. And remember this, that any year that we have lost production from our forests, we will never make up, because a tree not planted today cannot be planted until some time in the future, and that year's growth, that land is lying fallow.

We need more timber for our home building; we need more timber for fuel, and many plants are converting to wood fuel; and the pulp and paper industry continues to increase. The proposed tax changes that are set forth here and with this committee are, in my opinion, the cheapest way to achieve forest production which we need so badly.

I would like to submit these statements and the attachment for the record, please.

Senator PACKWOOD. Your entire statement will be in the record.

[The prepared statement follows:]

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STATEMENT OF ELEY C. FRAZER III, PRESIDENT, F & W FORESTRY SERVICES, INC.,

We appreciate the opportunity to appear before you this morning.

I am Eley Frazer, President of F & W Forestry Services, Inc., Albany, Georgia, a consulting forester. Next to me is Bill Condrell, General Counsel of the Forest Industries Committee on Timber Valuation and Taxation, which consists of over 5,000 timberland owners, representing the more than 5,000,000 timberland owners in our nation. Our testimony will concern itself primarily with reforestation tax incentives.

At the outset, we commend the efforts of Chairman Packwood and the other members of this Committee for the work they have done in obtaining landmark legislation to provide reforestation tax incentives.

As a result of these efforts, in 1980, a new provision was added to the Internal Revenue Code. This was the most important legislation dealing specifically with timber taxation since 1944 when capital gains treatment for timber was first adopted. Under this new provision, up to $10,000 per year of reforestation expenses are eligible to be amortized over seven years and to be taken into account for purposes of the investment tax credit.

We believe that this provision will prove to be important to our nation and its timber growers in ensuring an adequate supply of timber for future years.

In preparing for this hearing, we attempted to ascertain just how well these new incentives are working. We spoke with representatives of the U.S. Forest Service, the Internal Revenue Service, the timber trade associations and a variety of consulting foresters. We believe that this provision is being used to ensure the availability of our nation's future timber stock.

In furtherance of the objective of adequate reforestation, Senator Packwood has now introduced S. 1824, a measure which would revise these reforestation incentives in two significant respects. First, it would expand to $25,000 the amount of reforestation expenditures that could be taken into account in any year for purposes of the amortization deductions and tax credit. Second, it enables a taxpayer who incurs less than $25,000 in reforestation expenditures in any year to carry over the unused amount to each of the three succeeding years.

We agree with the bill's recognition that the $10,000 limitation is inappropriate to achieve the job that must be done.

As an indication of this, one needs only to consider how far the current limitation will go. If it costs approximately $200 to reforest one acre, the current $10,000 limitation provides incentive to reforest merely 50 acres per year. This incentive is inadequate as it covers only a small portion of our nation's acreage in need of reforestation.

Nationally, for every 9 acres of private non-industrial woodland harvested, only one acre is being purposefully regenerated. Moreover, the investment requirements to improve our timber supply are substantial. It has been estimated that they amount to more than $10.3 billion on the 139 million acres of forestland which have been identified as presenting economically feasible opportunities for improved growth.1/

An increase in the limitation to $25,000 would represent a substantial improvement. Through its more appropriate and logical limitation, as well as its carryover feature, S. 1824 will provide timber farmers with more realistic incentives and flexibility in planning their replantings. Moreover, the costs of providing these changes will be ultimately recouped many times over in future years when the trees are cut.

S. 1824 might, however, be improved in one respect. Under present law, which was enacted prior to the recently adopted Accelerated Cost Recovery System ("ACRS"), reforestation expenditures may be amortized over a 7-year period.

1/ Forest Industries Council, National Forest Products Association, Forest Productivity Report 45 (1980).

However, under ACRS, property which had a class life of from more than 4 years to 12.5 years is now considered 5-year property, and may be depreciated over 5 years. To parallel ACRS, we would urge that S. 1824 be amended to provide this same 5-year period for amortization of reforestation expenditures. Apart from its conceptual justification, this change is warranted as it would provide increased benefits to the sector of forest owners who need them most.

Nevertheless, we recognize that these changes will involve a current revenue expenditure, albeit a small one. Therefore, we strongly support the enactment of S. 1824 whenever the Congress determines the timing to be right.

However, there is one feature of the reforestation incentives that should be changed immediately as it would involve virtually no revenue impact: These incentives should be made applicable to trusts, the only taxpayers not now eligible to use them.

It is our understanding that trusts were not excluded for any policy reasons. Rather, they were excluded solely as a result of what were believed to be technical problems in the manner in which these incentives would apply to trusts and their beneficiaries.

We have studied these technical difficulties, and believe that they can be overcome. We have attached to our testimony an outline for a proposal which would make trusts eligible for the reforestation incentives (Attachment A).

This proposal is consistent with the underying policies behind the provisions of the Internal Revenue Code relating to the taxation of trusts and their beneficiaries, as well as with the objectives of the reforestation incentives. We hope that it will be considered in the next Technical Corrections Act.

While discussing reforestation incentives we should mention the most significant incentive for reforestation -- timber capital gains. Our almost 40 years experience with timber capital gains has proven its effectiveness in stimulating timber growing. It clearly represents the most significant and essential step taken by Congress to achieve that result.

We have attached to our testimony a statement explaining the special need for timber capital gains (Attachment B), which I will briefly summarize.

The economics of growing timber are unattractive absent capital gains treatment. This results first from the inherent substantial front-end investments in land and planting costs, the carrying costs, and the 15 to 100 year growing cycle for timber. The effect of these factors is to tie up investments for extended periods without any current returns. Second, the return which is generated is substantially lower than the return for other types of investments. Third, substantial risks, such as fire, insects and disease, and windstorms, exist with respect to timber. The long-term growing cycle of timber results in an increased exposure to these risks far beyond that of other types of investments.

Even with capital gains treatment, the return from investment in timber is marginal.

It also should be pointed out that the current level of land withdrawal for uses other than timber heightens the need for increased investment on the remaining private timberlands. In this regard, it is important to recognize that tree growth lost because trees were not planted will be permanently lost. Although other planting may occur later, the lost growth cannot be recouped by future planting of other trees.

Our nation is already struggling to meet its timber needs. According to the Forest Service in its most recent assessment of future timber demand, the United States has severe timber supply problems, and these problems will continue into the future.

If housing is to be obtained by future homeowners at reasonable prices and if our other essential fiber needs are to be met, it is vital that timber capital gains treatment be retained and improved. (Attached to our statement is a paper entitled "America's Renewable Resource" which provides general background on the importance of timber).

In this connection, at the earliest feasible time, the Congress should restore parity between the corporate and individual capital gains rate by reducing the alternative corporate capital gains rate to 20 percent. Never, until the most recent tax act, have corporate capital gains rates been higher than individual capital gains rates. (See Attachment C). Attached to our testimony is a brief statement indicating the justification for a corporate capital gains reduction (Attachment D).

Finally, there have been suggestions that some limited partnerships involving public timber are entered into solely for tax purposes--and are tax shelters. We have not examined these new arrangements in any detail. Nonetheless, we believe that any business arrangement which is motivated by tax avoidance, rather than business considerations, should be discouraged.

Mr. Chairman, we support your efforts to increase the limitation on the reforestation incentives to $25,000, and to provide for a three year carryover. This concludes our testimony. We would appreciate your including the materials we are submitting today in the record, and will be pleased to answer any questions that you may have.

ATTACHMENT A

PROPOSAL TO MAKE TRUSTS ELIGIBLE FOR SECTION 194 REFORESTATION AMORTIZATION DEDUCTIONS AND TAX CREDIT

I. General Considerations

A. The $10,000 limit shall apply both at the trust level and at the beneficiary level.

B. Except as provided by paragraph K, a trust may not use the amortization deductions and tax credit in determining its own tax liability.

C. Reforestation expenditures made by a trust will be deemed to have been made first from current income to the extent not distributed, next from accumulated income, and finally from corpus.

D. To the extent reforestation expenditures are deemed made from corpus, pass through of the amortization deductions and tax credit would be allowed to current income beneficiaries without any requirement for a deemed distribution.

E. To the extent reforestation expenditures are deemed made from current income and/or accumulated income, pass through of the amortization deductions and tax credit would be allowed to current income beneficiary only to the extent that such beneficiary elects to be deemed to have received such current income and/or accumulated income.

F. The trust shall reduce its taxable income to the extent of deemed distributions from distributable net income; it shall reduce its undistributed net income to the extent of deemed distributions made therefrom.

G. To the extent an income beneficiary is deemed to have received a distribution of current income, he will be subject to the rules in Subpart C; to the extent that he is deemed to have received a distribution of accumulated income, he will be subject to the rules in Subpart D.

H. The trust will reduce its basis in the timber to the extent that its beneficiaries are permitted to claim the benefits of the reforestation incentives.

I. The proposal comports with the scheme underlying Subchapter J which embodies a modified conduit theory: The reforestation expenditures, regardless of how treated under the trust instrument and local law, are deemed to be made first from distributable net income, next from undistributed net income, and next from corpus. The benefits of such expenditures are received tax-free only to the extent made from corpus.

J. Pass through of the amortization deductions and tax credit would be allowed only with respect to those trusts using a calendar year as their taxable year.

K. A § 2503(c) trust may apply the amortization deductions and tax credit to reduce its tax liability for years in which income is accumulated for a beneficiary who is a minor. Under § 665(b), distribution of income accumulated for a beneficiary while he is a minor is exempt from the "throwback rules". In view of this fact, and the purpose of a § 2503(c) trust, such trusts should be allowed to utilize the amortization deductions and tax credit. However, to take into account the possibility of multiple trusts for the benefit of any beneficiary, as a condition for claiming the amortization deductions and tax credit the trust first must obtain the consent of the parents or legal guardian of the minor-beneficiary, which consent may be given to only one trust and only if the minor does not claim any such deductions or credit on his own return.

II. Allocation Formula.

A. Tentative allocation. The "tentative allocation of reforestation expenditures" means, for a current income beneficiary, that portion of reforestation expenditures (up to $10,000) which,

1. in the case of a trust with one or more current income beneficiaries with defined income interests and no discretionary allocation or accumulation powers, bears the same ratio as each beneficiary's share of trust income bears to total trust income; and

2. in the case of all other trusts, is equal to a per capita allocation of such reforestation expenditures (up to $10,000) among income beneficiaries to whom income could be distributed currently.

B. Tentative allocation percentage. The "tentative allocation percentage" for any beneficiary is an amount equal to the amount of such beneficiary's tentative allocation of reforestaton expenditures over the total reforestation expenditures (up to $10,000) made by the trust.

III. Amortization Deductions and Tax Credit.

A. Reforestation Expenditures Made from Corpus. If the actual distributions made exceed the sum of the trust's distributable net income and undistributed net income for all prior years, each current income beneficiary would be entitled to the amortization deductions and tax credit on the reforestation expenditures as tentatively allocated.

B. Reforestation Expenditures Made from Current Income and/or Accumulated Income. If the sum of the trust's distributable net income and undistributed net income for all prior years exceeds the actual distributions made, and if the amount of such excess equals or exceeds the amount of reforestation expenditures (up to $10,000) made, each current income beneficiary would be entitled to amortization deductions and a tax credit on an amount equal to the reforestation expenditures tentatively allocated to him if he elects to be deemed to have received a distribution from the trust in a amount equal to the reforestation expenditures tentatively allocated to him.

C. Reforestation Expenditures Made from Corpus and from Current Income and/or Accumulated Income. If the sum of the trust's distributable net income and undistributed net income for all prior years exceeds the actual distributions made, and if the amount of such excess is less than the amount of reforestaton expenditures (up to $10,000) made, each current income beneficiary would be entitled to amortization deductions and a tax credit as follows:

1. <u>Reforestation Expenditures Made from Corpus</u>. On an amount equal to the product of such beneficiary's tentative allocation percentage and the excess of (a) the reforestation expenditures (up to $10,000) over (b) the difference between (i) the sum of the trust's distributable net income and undistributed net income for all prior years over (ii) the actual distributions made.

2. <u>Reforestation Expenditures Made from Current Income and/or Accumulated Income</u>. In addition to the deductions and credit provided by subparagraph 1, on an amount equal to the excess of the reforestation expenditures tentatively allocated to him over the amount on which he might claim amortization deductions and a tax credit under subparagraph 1, if he elects to be deemed to have received a

distribution from the trust in the amount of the product of such beneficiary's tentative allocation percentage and the excess of (a) the sum of the trust's distributable net income plus undistributed net income plus undistributed net income for all prior years and (b) the amount distributed to all beneficiaries.

ATTACHMENT B

THE NEED FOR TIMBER CAPITAL GAINS

This memorandum provides background information regarding the history of, and continued need for, timber capital gains.

The tax treatment of timber prior to 1944 provided no financial incentive for timber owners to manage their timberlands for continuous production.[1/] Rather, it created strong pressures for timber owners to liquidate their timber holdings, since this was the only way in which capital gains treatment might be achieved. The consequences were low levels of forest management and severe damage to American forests.

The 1944 changes (which provided timber capital gains treatment) promoted conservation and reproduction of timber. The favorable impact of timber capital gains has been evidenced over the last 37 years by a dramatic increase in reforestation, thus reversing the serious decline of the

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1/ Capital gains treatment for timber is provided by Sections 631(a) and (b) of the Internal Revenue Code. The predecessors of these sections were enacted in 1944 to eliminate the discrimination against timber owners who managed their timber properties, and who cut timber for use in their business or sold their timber under cutting contracts. Prior to the enactment of these provisions, the Internal Revenue Service had treated gain arising from such transactions as ordinary income. On the other hand, the gain arising upon an outright sale of timber was generally treated as capital gain. The 1944 changes provided for equal treatment of these types of transactions.

nation's timber supply. Since 1944 over 26 million acres have been planted and growing stock which was declining has shown a remarkable resurgence.

These reasons for enacting timber capital gains in 1944 are even more valid today.

The economics of growing timber continue to be unattractive absent capital gains treatment. This results first from the inherent substantial front-end investments in land and planting costs, the carrying costs, and the 15 to 100 year growing cycle for timber. The effect of these factors is to tie up investments for extended periods without any current returns. Second, the return which is generated is substantially lower than the return for other types of investments. Third, substantial risks, such as fire, insects and disease, and windstorms, exist with respect to timber. The long-term growing cycle of timber results in an increased exposure to these risks far beyond that of other types of investments.

Even with capital gains treatment, the return from investment in timber is marginal. Federal Trade Commission reports indicate the return on equity from paper and allied products for the period 1960-1979 to be 11.1%, compared with a return of 12.5% from all durable and nondurable goods produced. Although separate numbers for timber and wood products were not maintained by the Federal Trade Commission

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later than 1973, the comparable figures for 1960-1973 show a similar pattern.

It should also be pointed out that the current level of land withdrawal for uses other than timber heightens even further the need for increased investment on the remaining private timberlands. The U.S. Forest Service's current forecast[2/] of land withdrawals shows a reduction in available commercial forest land area in excess of 10% for the period through 2030. Thus, one way of stating our problem is that we must get increasingly more timber from less land.

In this connection, it is important to recognize that tree growth lost because trees were not planted will be permanently lost. Although other planting may occur later, the lost growth cannot be recouped by future planting of other trees.

Our nation is already struggling to meet its timber needs. According to the Forest Service in its most recent assessment of future timber demand,[3/] the United States has severe timber supply problems, and these problems will continue into the future.

Forest Service figures show that while the consumption of timber will increase 50 percent over recent levels by

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2/ U.S. Department of Agriculture, An Analysis of the Timber Situation in the United States (1980).

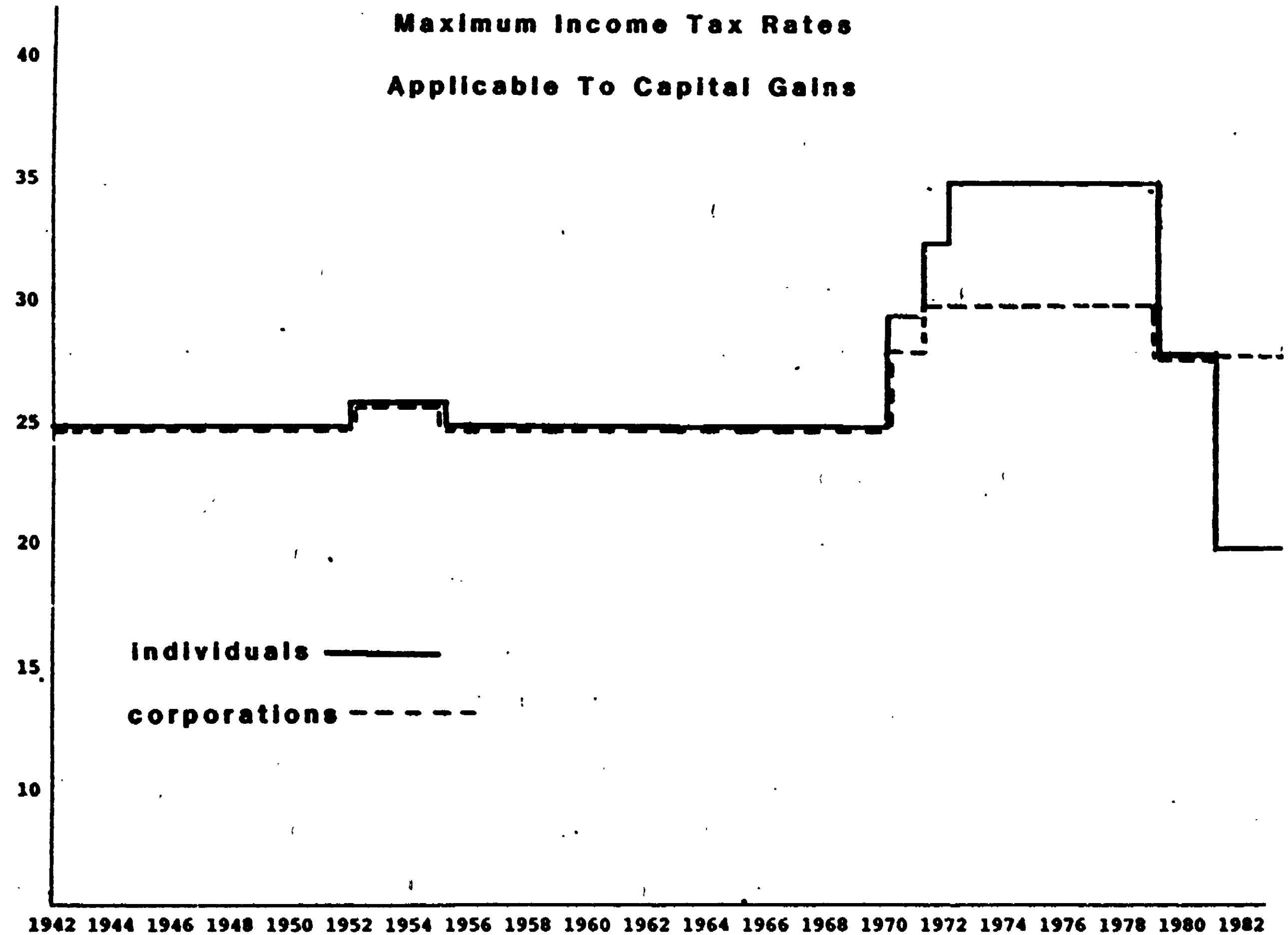
3/ Id.

the year 2030, at present levels of investment, inventory levels are forecast to fall significantly and relative prices to consumers are predicted to rise dramatically. This price increase is above and beyond the inflation that affects the economy generally. And, present prospects of reduced investment would make this forecast even worse.

The need for adequate husbanding of this vital resource is further illustrated by the monies being spent annually by federal and state governments to protect, promote and provide technical assistance to support forestry on private lands. Thus it is clear there is widespread recognition of the unique status of timber growing as a vital activity in the U.S. economy.

If housing is to be obtained by future homeowners at reasonable prices and if our other essential fiber needs are to be met, it is vital that timber capital gains treatment be retained and improved.

ATTACHMENT C



ATTACHMENT D

THE NEED TO REDUCE THE
ALTERNATIVE CORPORATE CAPITAL GAINS TAX RATE

As a result of the Economic Recovery Tax Act of 1981, the maximum tax rate on individual capital gains was reduced to 20%, while the maximum tax on corporate capital gains is unchanged at 28%. This is the first time ever[1/] that the alternative corporate capital gains tax results in a higher rate than is applicable to individual capital gains. There was a nine year period beginning in 1969 during which the maximum capital gains tax on corporations was lower than the maximum capital gains tax on individuals. However, the maximum tax for corporations was equal to that for individuals for most of its life: It was a flat 25% or 26% from 1942 to 1969, and 28% from 1978 to 1981.

The venture capital industry will be perhaps hardest hit by the disparity between the maximum corporate capital gains rate and the maximum individual capital gain rate. It has been estimated by Stanley Pratt, editor of Venture Capital Journal, that the professional venture capital industry currently manages $4.9 billion of assets, over 60% of which is organized and managed in corporate form. If the present rate differential between individual capital gains rates and the corporate capital gains rates is allowed to continue, there

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1/ The alternative corporate capital gains tax was adopted in 1942.

will be natural pressure on venture capitalists to reorganize their activities into individual or partnership forms. Those corporations unable to make the switch will be prompted to move their assets out of venture capital situations into other investments.

Additionally, industrial corporations, using internal corporate capital as opposed to pension funds, in 1980 became the second leading source of capital for venture capital investments. In that year, corporations committed 18 percent of total funds raised for private independent venture capital firms. New technological breakthroughs agree critical to the productivity increases needed by the American economy. A lower corporate capital gains tax rate will play an important role in encouraging corporations to finance innovation, new ideas, and the growth sectors of our economy.

Further, a number of basic U.S. industries, such as timber, coal and iron, and agricultural sectors, utilize the corporate capital gains tax rate. This serves to encourage investment by these industries, thus helping to insure an adequate supply of their products at competitive prices. Corporations, like individuals, run the risk of possible loss of an investment in an asset that does not measure up to expectations or if there is an economic downturn. Inflation, too, has a corrosive impact on corporate investment. A substantial portion of corporate capital gains represents inflation and the higher replacement cost of the asset.

During the Finance Committee markup of the Economic Recovery Act of 1981, an amendment was offered to maintain the historic parity between individual and corporate capital gains tax rates. The amendment would have lowered the corporate capital gains tax rate from 28 to 20 percent in conjunction with the reduction in the maximum individual capital gains tax rate. At that time, the Treasury Department opposed the amendment, not on philosophic or tax policy grounds, but solely because of its apparent revenue impact projections--estimates we now have cause to believe are substantially overstated.

The historic parity between corporate and individual capital gains tax rates should be restored at the first opportunity for both sound tax policy and economic considerations. Specifically, a reduction in the corporate capital gains tax rate from 28 to 20 percent, should be included in the next tax package.

Senator PACKWOOD. You know, when we passed that bill—you and I are on exactly the same wavelength—what we wanted to do was grow more timber.

Mr. FRAZER. That's right.

Senator PACKWOOD. I don't care if it is grown by Weyerhaeuser or family trusts or small woodlot owners or elves. If they will plant the trees, they will get the credit. The day is going to come—we don't see it now because of the depression of the housing industry—but the day is going to come again where the major problem we face in this country is timber supply. And that is a problem we have faced most of my Senate career. It has only been recently, with the tremendous depression of building, that another issue is the principal immediate issue. The principal long-range issue is going to be supply; that is, if interest rates ever come down where people can build. And to the extent that there is an advantage to be taken, we might as well take advantage at the moment of the fact we are not cutting as much timber as we are to plant as much as we can, because Lord knows we'll need it as we round this century and head into the next.

Mr. FRAZER. Senator, at the end of the last 10 years in the area of Southwest Georgia where I live, which is the heart of farm land and timber land and probably some of the best timber land in the United States, we lost 280,000 acres to agriculture, the irrigated agriculture, in that area. We are losing land at a rapid rate. We have got to grow more timber on the acreage we have just to make up for those acres we are losing, sir.

Senator PACKWOOD. You are losing that because the agricultural land has been lost to a shopping center. They are moving down to your timber lands.

Mr. Caron, let me ask you this question: You referred to dumping. That term as usually used in international trade means a foreign country selling below what they sell for in their country. Does Canada actually sell, at least in your market area, their timber for a lower price than they would sell it just across the border in their own country?

Mr. CARON. No, sir. I do not believe so. However, because of the government supports they are able to produce their lumber at a much cheaper price than we are able to.

Senator PACKWOOD. I understand that. And it gets into the issue of subsidies. I wanted to make sure there is no allegation of dumping. They just have an incredible array of subsidies that allow them to sell timber at a lower price than we sell it.

Now, Mr. Ewing, let me ask you a question. Assuming that Canada continues its practices, and it does not constitute dumping because they sell it in their market at the same price they sell it here, should we be considering moving from a highest-bid basis on the sale of timber off of public land to some other basis, and, if so, what other basis?

Mr. EWING. I believe in competitive bidding procedures. It is part of the American free enterprise system. There needs to be stronger contract requirements that discourages extreme speculative bidding.

Now specifically, when the economic market in the United States is at extreme lows, there needs to be some sort of mechanism that reduces the stumpage to provide American mills the ability to retain their fair share of the reduced market. In economic crises as we are presently experiencing, the Canadians are able to take a much bigger slice of the market at the expense of American mills, worker receipts to counties, et cetera.

Senator PACKWOOD. Senator Mitchell.

Senator MITCHELL. No questions, Mr. Chairman.

Senator PACKWOOD. Gentlemen, I have no further questions. Thank you very much.

Next we will move on to a panel of Aaron Jones, Tom Westbrook, Paul Ehinger, and Mike Burrill.

Again, gentlemen, I would encourage as I have the previous witnesses to emphasize the major points of your testimony orally. Your entire statement will be in the record, but as you can see from the witness list there are a good many people coming after you.

Mr. Jones, why don't you go right ahead?

Mr. JONES. It's all right with me. I think that Paul wants to. I'm the cleanup man.

Mr. EHINGER. Mr. Westbrook is going to lead off.

Senator PACKWOOD. He's going to lead off. All right. Mr. Westbrook, you go right ahead.

Mr. WESTBROOK. I suppose that's from my superior speed in hitting.

STATEMENT OF TOM WESTBROOK, CASCADE WEST FOREST PRODUCTS, INC., TUMWATER, WASH.

Mr. WESTBROOK. Mr. Chairman, my name is Tom Westbrook. I am the president of Cascade West Forest Products of Olympia, Wash., and also today representing the Northwest Independent Forest Manufacturers of Tacoma, Wash., as their president.

I would like to take this opportunity to thank you, Mr. Chairman, and members of the committee, for allowing us this opportunity to make you more familiar with the Canadian lumber import situation, and specifically for your interest in this area.

Briefly, Northwest Independent Forest Manufacturers is an association of approximately 30 members in Washington State, operating about 40 sawmills, plywood plants, veneer plants, and shake and shingle mills, of which our company is one of the sawmill members.

I have provided written testimony to the committee, but I will come off of that somewhat and speak in a more informal manner today and try to summarize that testimony as much as possible. I would, however, ask you to look very strongly at our attachments to my testimony showing some of the technical data involving the levels of Canadian imports and what has happened to our market share.

As you no doubt are aware, as I guess everyone in this room is by now, the forest products industry nationally is in a severe crisis, the most severe that we have seen in the past 50 years. We have been victims of a severely depressed housing market which has been brought on substantially by a restrictive monetary policy and basic changes in the structure of the monetary delivery system.

And later today Dan Goldie, an economist with WFIA, will be testifying specifically about what is happening in that monetary delivery system.

One of the problems we see with the competition of funds, from the Federal Government needing massive funds in connection with the current administration's industrial revitalization program that we will see in the next few years, and with other financial needs in the private sector, not only is there very little money available for housing, but in fact we don't see any time in the near term where there will be the levels of money available to meet the demographic demand for housing.

We expect rates to remain high, certainly higher than to what we were accustomed. Whether they are going to stay at today's level or not is certainly conjecture. But the problem, also, with money availability is, even if it is available, often people can't qualify. And so it's really one of the deals: Who really cares if money is available, if rates are so high you can't qualify?

I want to impress upon the Congress that this is not a normal cycle that we are experiencing that we haven't experienced in the past. I am sure you have heard that before, today. And what is compounding the problem today is continued increase in Canadian lumber imports. They are taking over a larger and larger percent of our nation's lumber market. This continued erosion of our industry's marketplace of Canadian producers has made what would otherwise have been an untenable situation into an unmitigated disaster. We have got 57 percent of our work force unemployed or working fewer hours, approximately 25 percent of those unemployed—and this is in the western part of the States—and 33 percent, approximately, on some curtailed basis. What that really means is only 43 percent are working on full employment.

I would like to point out that in 1970 our Nation consumed 31.6 billion board feet of lumber; in 1975, 30.2 billion board feet of lumber. And those were the two previous market bottoms. In 1980 we consumed 32.3 billion, and in 1981 we estimate 30 billion. Now, these are levels very similar to levels in the past. So the question, I guess, is: Why is our industry being so severely depressed? And that's because we bought 4 billion board feet of our market share to Canadian producers.

Senator PACKWOOD. Mr. Westbrook, I've got to draw your testimony to a close and put it all in the record. We will not finish this hearing if I don't hold each of the witnesses to 5 minutes. I'm sorry. We cannot make it with the number of witnesses that are still to go. Your entire statement will be in the record. If you could summarize—and I want to say to the rest of the witnesses who are here, I don't want to be harsh with you, but I want to finish and let everybody get on. We will not make it otherwise.

Can you summarize, Mr. Westbrook?

Mr. WESTBROOK. In summary, I guess all I can say is that the huge differential in what allows the Canadian lumber imports to impact our markets so severely is the ability or the way within which they sell their raw materials on an allocated, noncompetitive basis that allows them the availability of timber at very low prices; whereas our timber is sold on a competitive price and a competitive situation and has created very high stumpage prices. With their ability to get the raw material as cheaply as they can, they can move into any market they desire. And, quite frankly, we don't have that ability. We feel that we would like this committee to do as you have suggested, to ask the ITC under section 332 to begin an investigation of this situation and see what we can do to alleviate this problem.

Thank you, Mr. Chairman.

Senator PACKWOOD. Thank you.

Now, is it Mr. Burrill or Mr. Ehinger? Is Mr. Burrill going to go next? OK.

[The prepared statement follows:]

STATEMENT OF THOMAS J. WESTBROOK
CASCADE WEST FOREST PRODUCTS, INC.
NORTHWEST INDEPENDENT FOREST MANUFACTURERS
HEARING REGARDING CANADIAN LUMBER IMPORTS
SENATE FINANCE COMMITTEE
JOINT HEARING OF SUBCOMMITTEES ON INTERNATIONAL TRADE
AND TAXATION AND DEBT MANAGEMENT
Washington, D. C.
November 24, 1981

Mr. Chairman and Members of the Committee:

My name is Thomas J. Westbrook. I am before this Committee today on the behalf of my Company, Cascade West Forest Products, Inc., Olympia, Washington, as its President, and, also, as President of the Northwest Independent Forest Manufacturers (NIFM), Tacoma, Washington. NIFM is a forest products association with thirty members in Washington State, who operate approximately forty sawmills, plywood plants, veneer plants, and shake and shingle mills, of which our company is one of the sawmill members. NIFM members manufacture building materials primarily out of the timber from National and State forests, those materials being for sale primarily in the United States market. All of the NIFM members are manufacturers in what we consider the small and medium size class, and are independently owned and operated, that is, they are owned primarily be the people who manage and run the mills. Nearly all NIFM members are small business companies in that they have fewer than five hundred employees. My company, Cascade West Forest Products, Inc., is a relatively small, independently operated sawmill, employing approximately fifty employees on a one-shift basis.

I am pleased and very much appreciate this opportunity to acquaint members of the Congress, and, particularly, members of this Senate Subcommittee with the every increasing problem of Canadian lumber imports. These imports have displaced many United States sawmills through continued market penetration already, and are threatening the survival of many more today.

As you are no doubt aware, the Forest Products Industry, nationally, is suffering the most severe crisis in the past fifty years as a primary result of a housing market, which has been severely crushed by restrictive monetary policy. I doubt that it is any surprise to you that our Industry is very sensitive to high interest rates.

We have faced difficult times in our Industry many times before, most recently in 1970, when United States lumber consumption fell to 31.6 billion board feet, and in 1975, when it plummeted to 30.2 billion board feet. Lumber consumption in 1980 was 32.3 billion board feet, somewhat above the 1970 and 1975 levels, yet the impact upon the Forest Products Industry is more severe than the previous down turns. Now, in 1981, United States lumber consumption is estimated to be at 30 billion board feet and our Industry is being devastated (a lumber consumption level nearly identical to that in 1975). According to the Western Wood Products Association (WWPA) figures, 57% of our Industries work force in the Western United States is either unemployed or working fewer hours. Of that 57% affected, approximately 25% of the workers are unemployed and approximately 33% are working in some curtailed basis. That means that only 43% of the work force is maintaining full employment. Our Industry has not had such tremendous employment disruption since the Depression.

The question then becomes, why is the situation so much more severe in 1981 than in 1975, where lumber consumption levels are so similar. Without question, this difference between previous market bottoms and the current situation, is the dramatic increase in Canadian lumber imports over the past six years. Canadian lumber imports have increased nearly 4 billion board feet from the 1975 level, while United States sawmills have decreased by that same amount (see Attachment #1). The Canadian market share of United States consumption has increased from 18.7% in 1975, to 31.6% in 1981. Small and medium size mills in Washington State, particularly those who are not diversified and who are dependent on public timber for their raw material supply, have been the most severely impacted by this staggering increase of imported lumber, primarily from British Columbia. The loss of 4 billion board feet in lumber market share during the past six years, translates into approximately forty thousand logging and sawmilling jobs that are history, lost to the United States labor force. We estimate that 4,500 have been lost in Washington State alone in logging and milling. For each direct job, economists estimated between two and three indirect jobs are generated in service, supply, trade and other secondary employment. Thus, we are talking about an employment impact of some 13,500 jobs, or more, in Washington State alone, and approximately 120,000 jobs nationally.

Our company has one of the most modern and efficient mills in the Pacific Northwest, and we have not been able to come anywhere close to a break-even operation this year. I have talked with many other independent owners and can tell you without fear of contradiction that there are not any profits this year in the Lumber Industry, and in several cases, the loses over the past two years are approaching the net asset value of the company. Previous years retained earnings have been wiped out, which will severely curtail future plant modernization and investment. Some very well managed, efficient operations will not survive another year similar to this one.

Certainly, most diversified timber owning companies will survive, yet not unscathed. However, many of the faces in the Industry will be gone and the important mix in size of operations could be lost, jeopardizing the competitive posture of this Industry.

How then, you might ask, can the Canadian Forest Products Industry continue to operate to advantage in the same market place? As an example, British Columbia, the Province in Canada with which I am most familiar, exports well over 75% of the lumber and other wood products in Canada. In British Columbia, 90% of the timber harvested comes from lands owned and managed by the Province. In an effort to maintain full employment, the Province of British Columbia has eliminated competitive timber sales and provides timber to mills in British Columbia at far below the true value of that timber on an allocation basis.

In 1980, Professor David Haley, of the University of British Columbia, published a report entitled, "A Regional Comparison of Stumpage Values* in British Columbia and the United States Pacific Northwest". This study shows that public timber sold in Oregon and Washington for eight and one half (8.5) times the average price paid in British Columbia in 1978. Mr. Haley concluded, "There is little doubt that the principal reason for higher stumpage in the Pacific Northwest is that all public agencies involved in timber production encourage competitive bidding for standing timber, whereas in British Columbia competitive sales of public timber have been virtually eliminated". He went on to conclude, "There is good reason to believe that if public timber in British Columbia were to be sold competitively, stumpages, in many cases, would be bid well above their appraised level and direct Crown revenues would be substantially increased". We believe this governmentally contrived and controlled marketing of timber constitutes a subsidy to the British Columbia sawmills to allow them to impact any market they desire.

We have taken the Haley study, analyzed the procedures used and confirmed his accuracy up through 1978, which is the latest data that was available at that time. We have also gone beyond that to update the report to include timber sold in 1979 and 1980. The differences have become even greater in the past two years. The average price paid for standing timber sold on timber sales and harvesting licences in British Columbia during 1980 was $24 per thousand board feet, compared with $286 per thousand board feet from National Forest lands in Washington and Oregon. That is a 12 to 1 price difference. Now there are some considerations to be given to the British Columbia operators. It is generally accepted that road building costs and some general logging costs are higher in British Columbia than in the Pacific Northwest, and that also the quality in British Columbia is somewhat poorer than the timber in the Pacific Northwest in general. The studies also show that the

*price paid for standing timber

average British Columbia sawmill will pay approximately 50% more in corporate taxes than its Pacific Northwest counterpart. Yet, when these factors, as well as monetary exchange differentials, are considered, our studies tells us that there is a real cost advantage to the British Columbia mills of somewhere between $60 to $90 per thousand board feet. Considering the fact that the price for standing timber is about one third (1/3) the total cost of manufactured lumber, f.o.b. mill, you can understand how British Columbia mills have a significant price advantage, which simply cannot be overcome by better management or newer more efficient equipment. Further, once the timber has been allocated at a price, that price moves up or down based upon United States market price fluctuations.

In addition to this obvious raw material advantage, British Columbia mills also enjoy an advantage in lower energy costs, cheaper transcontinental rail costs and cheaper water-borne shipping to the United States Atlantic Coast. The latter being a result of the Jones Act. In fact, as a result of the Jones Act restrictions, British Columbia now enjoys 98% of the water-borne market to the Atlantic Coast, which no longer than twenty years ago was dominated by West Coast mills in the United States. You can see from this, that if these practices are allowed to continue, we lumber manufacturers in the Pacific Northwest, and much of the rest of the Western United States will be residual producers in our own market. We cannot operate only at the peaks of the housing cycle, on a boom and bust basis.

It is not only the Western producers that are feeling this impact, I have talked to producers in the South, the Mountain States and the Lake States, they have the same situation. Canadian lumber is finding its way into every area in the market place, much the same as water flowing into the cracks in an aquifer. A very good friend of mine, who operates a large lumber wholesaling company in Oregon, told me that today over 50% of his sales all over the Nation are imported Canadian lumber, where previously, they were predominatedly dealing in the United States lumber.

It is important to recognize that this is not a problem that has occurred just in the past two years when the lumber market has been depressed. Canadians have gradually increased their market share every year since 1975. This is not a problem that is going to go away when and if the United States housing market gains viability. As producers nationally, we lost an additional 13% of our 1975 market during some of the best years our Industry has ever experienced; 1976 to 1979.

In an effort to illustrate the margin differences the British Columbia sawmills enjoy over an modern and efficient sawmill, such as ours, let me tell you that we could currently be increasing our monthly revenue by $62,000, if our raw material costs were the same as those in British Columbia. That would provide us with a profitable position, when in actuality we are suffering substantial monthly losses.

I have computed this margin differential based on simply reducing the cost of our raw material by $60 per thousand board feet, the minimum differential in the adjusted stumpage advantage the British Columbia mills enjoy. If the difference is actually $90 per thousand board feet, as we suspect, than our company's monthly revenues would be increased by $93,000; that means $1,116,000 per year. To give you a perspective, that would amount to 24% of our total annual sales, and would put us in a very comfortable profit position.

In reaction to the NIFM effort to inform people of the cost advantages the British Columbia Forest Products Industry has over our Industry, spokesmen for the British Columbia Industry have attempted to maintain that they have no such advantage. They have stated that their Industry is being impacted as severely as ours. This is simply not true. When comparing 1980 and 1981 to 1978 and 1979, statistics prove that the Untied States Industry has shipped 22% less lumber in the past two years, while the British Columbia mills shipments have fallen by only 12%. That means that the decline in United States shipments is 83% deeper than the decline in British Columbia shipments. If the British Columbia mills are suffering at all, it is certainly not because of timber prices, but more likely due to relative plant inefficiencies. If the situation is as difficult for British Columbia mills as they would have you believe, why then do they continue to make significant market penetrations in the United States lumber market.

What can be done to offset this tremendous disparity in raw material costs between Canadian producers and United States producers in our Industry? How do we achieve some degree of parity? We have many legal tools available. We could initiate countervailing duty or anti-dumping actions, and we have, in fact, met on several occasions with the Department of Commerce and the International Trade Commission personnel regarding this. However, to accumulate all the needed financial information from our Industry in total, as is required in filing those petitions, our small association does not have the staff or financing to accomplish such a large undertaking. Also, during such acute financial times, it is very difficult to ralley the forces of industry to spend money they do not have.

Another possibility that we are investigating is assistance from the United States Small Business Administration. I recently read a statement by the new General Council for Advocacy in the Small Business Administration, where he stated that they would provide assistance to small business in trade related matters. I am not sure what kind of assistance this might be at this point, however, we are pursuing it.

From what I have been able to determine at this point, it seems that the most direct assistance that could be provided by the United States Senate would be for the Senate Finance Committee to request the International Trade Commission to initiate an investigation under Section 332 of the Tariff Act of 1930 on the effect of subsidized softwood lumber imports from Canada on the United States industry. This action could greatly reduce the expense we might have in pursuing the filing of a countervailing duty petition and would greatly enhance the appreciation and understanding of this problem to the agencies involved.

Again, I would like to thank you for the opportunity to appear before this Committee and for your concern for our problem. I would be pleased to answer any questions you might have.

TJW:cjw

attachments

ATTACHMENT #1

CANADIAN SOFTWOOD LUMBER IMPORTS
AS A PERCENTAGE OF TOTAL U.S. CONSUMPTION
(In million board feet)

Year	U.S. Mills	Canadian Imports	Other Imports	Total U.S. Consumption	Canadian % of U.S. Consumption
1/ 1975	24,569	5,666	45	30,380	18.7
1/ 1976	27,608	7,905	45	35,558	22.1
1/ 1977	29,668	10,344	42	40,054	25.8
1/ 1978	29,623	11,764	77	41,464	28.4
1/ 1979	27,791	11,068	50	38,909	28.4
1/ 1980	22,831	9,514	25	32,370	29.4
2/ 1st 8 months 1981	14,860	6,561	17	21,438	30.6
3/ Est. Total 1981	20,425	9,500	25	30,000	31.6
3/ Est. 1975-81	-4,144	+3,834	-20	+380	12.9

Source:
1/ Western Wood Products Association
Statistical Yearbook of Western Lumber Industry, 1975-80
2/ National Forest Products Assn. - Fingertip Facts, August, 1981
3/ NIFM estimate based on current market conditions

Prepared by: Northwest Independent Forest Manufacturers.

11/81

ATTACHMENT #2

BRITISH COLUMBIA LUMBER EXPORTS INTO REGIONS OF THE UNITED STATES BY METHOD OF TRANSPORTATION
(in Million Board Feet)

Year	Shipped By	NE	NC	SE	S	WEST	TOTAL
1975	Truck	3.3	9.3	1.9	2.2	145.1	161.8
	Rail	619.6	1,425.7	723.4	537.1	230.2	3,536.0
	Water	403.8	0.0	195.3	3.6	38.1	640.8
	Total	1,026.7	1.435,0	920.6	542.9	413.4	4,338.6
1976	Truck	8.1	15.3	3.3	2.8	257.7	287.2
	Rail	732.0	2.093.6	901.3	813.6	416.4	4,956.9
	Water	621.8	0.0	261.7	0.0	116.7	1,000.2
	Total	1,361.9	2,108.9	1,166.3	816.4	790.8	6,244.3
1977	Truck	2.5	15.5	2.8	3.5	449.1	473.4
	Rail	575.9	3.148.0	962.3	897.0	546.2	6,129.4
	Water	771.7	0.0	364.0	29.8	223.9	1,389.4
	Total	1,350.1	3,163.5	1,329.1	930.3	1,210.2	7,992.2
1978	Truck	5.5	28.4	7.1	9.7	568.7	619.4
	Rail	580.4	2.531.3	1,297.1	1,284.1	717.0	6,410.5
	Water	683.4	0.0	415.7	48.8	258.5	1,406.4
	Total	1,269.3	2.559.6	1,719.8	1,342.7	1,544.7	8,436.1
1979	Truck	8.5	50.2	11.6	11.6	581.0	663.5
	Rail	539.2	2.178.4	1,205.0	1.207.7	624.0	5.546.1
	Water	588.8	0.0	345.0	50.2	225.5	1,216.4
	Total	1,136.5	2,228.6	1,053.4	1.275.5	1,432.3	7.726.3
1980	Truck	4.8	38.1	3.8	15.6	515.0	575.2
	Rail	450.1	1.645.6	1,272.1	1,093.1	456.0	4,947.8
	Water	355.9	0.0	199.3	15.6	220.2	800.0
	Total	810.8	1,683.7	1,475.2	1,124.3	1.232.0	6,326.0
1981	1st Qtr.	N.A.	N.A.	N.A.	N.A.	N.A.	1,560.0

Source: British Columbia Council of Forest Industries

6/81

ATTACHMENT #3

A COMPARISON OF AVERAGE STUMPAGE BID PRICES OF TIMBER SOLD IN BRITISH COLUMBIA
BY TIMBER SALE HARVESTING LICENSES AND TIMBER SALES
COMPARED TO TIMBER SOLD IN OREGON & WASHINGTON
FROM NATIONAL FOREST LANDS, DURING 1970-80

(In U.S. $/Thousand board feet, scribner scale)

Year	Coastal D. Fir			Interior D. Fir			Hemlock			Cedar			All Species		
	FS	BC	Diff	FS	BC	Diff	FS	BC	Diff	FS	BC	Diff	FS	BC	Diff
1970	42	25	17	8	10	-2	20	8	12	15	6	9	27	8	19
1971	49	17	32	4	14	-10	21	6	15	17	5	12	30	7	23
1972	72	21	51	16	26	-10	49	7	42	68	7	61	53	14	39
1973	138	33	105	60	49	11	99	16	83	147	24	123	~~103~~	29	74
1974	202	32	170	68	29	39	111	12	99	217	12	205	142	16	126
1975	170	13	157	34	3	31	68	6	62	119	3	116	102	4	98
1976	176	16	160	39	4	35	78	3	75	160	6	154	113	4	109
1977	226	21	205	71	11	60	89	6	83	150	21	129	154	7	147
1978	250	18	232	98	39	59	112	6	106	207	46	161	185	21	164
1979	394	47	347	82	55	27	197	14	183	329	75	254	270	34	236
1980	432	76	356	71	28	43	208	27	181	301	27	274	286	24	262

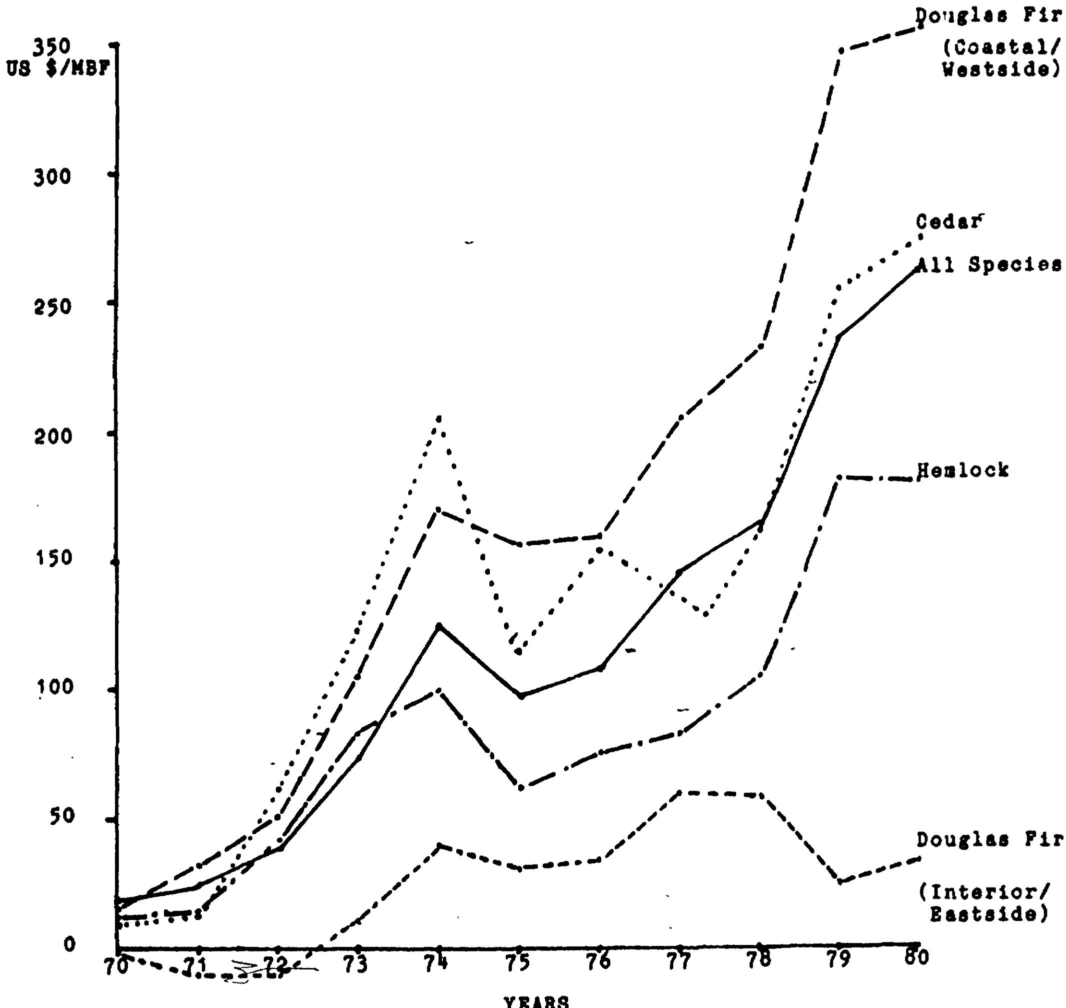
Note: The following conversions were used: Canadian to U.S. $ 1970-.958; 71-.990; 72-1.009; 73-1.000; 74-1.022; 75-.931; 76-1.014; 77-.941; 78-.877; 79-.850; 1980-.850. $/cunit to $/thousand board feet multiply by 1.85; $/cubic meter to $/thousand board feet multiply by 5.24

Source: B. C. Forest Service Annual Reports 1975-80
USDA Forest Service, Production, Prices, Employment & Trade in Northwest Forest Industries, first Quarter 1981

Prepared by: Northwest Independent Forest Manufacturers 11/81

DIFFERENCE IN STUMPAGE BID PRICES OF TIMBER SALES SOLD FROM PROVINCIAL LANDS IN BRITISH COLUMBIA & FROM NATIONAL FOREST LANDS IN OREGON & WASHINGTON, DURING 1970-80

(In U.S. $ per thousand board feet, Scribner)



Prepared by: NIFM 11/81

COMPARISON OF SOFTWOOD LUMBER SHIPMENT DECLINE
IN WESTERN U.S. -vs- BRITISH COLUMBIA
(in million board feet)

Year	Western U.S. (Coast & Inland Regions)		British Columbia (Coast & Interior)
High Market Period			
1978	18,975		12,601
1979	18,108		12,318
Total	37,083		24,919
Average monthly ÷ 24 =	1,545	÷ 24 =	1,038
Depressed Market Period			
1980	14,628		11,708
1981 (1st 9 mos.)	10,746		7,443
Total	25,374		19,151
Average monthly ÷ 21 =	1,208	÷ 21 =	912
Decline in Production			
'78 & '79 vs. '80 & 9 mos. '81	22%		12%

Decline in Western U.S. softwood lumber shipments is 83% deeper than decline in British Columbia softwood lumber shipments.

Source: Western Lumber Facts - Western Wood Products Association

Prepared by: Northwest Independent Forest Manufacturers 11/81

STATEMENT OF MICHAEL BURRILL, EUGENE F. BURRILL LUMBER CO., MEDFORD, OREG.

Mr. BURRILL. Mr. Chairman, my name is Mike Burrill. I am the president of the Eugene F. Burrill Lumber Co. and also president of the Northwest Timber Association, Burrill Lumber being located in Medford, Oreg.; the Northwest Timber Association being located in Eugene, Oreg. Because of the time constraints I am going to cut my testimony very, very short to allow some of my colleagues more time to present more detail.

As I have listened to some of the discussion this morning, I have heard the term used that we are having a problem in our industry, and I want to assure you that we are not having a problem in our industry. We are having a recession that is approaching the actual description of a depression.

Many of the oldtimers that I talk to in the industry tell me that they are comparing it back to the mid- and early-thirties, as to the real impact that we are having. Our company, as well as many others that are members of our association, are small business companies that were founded by individuals many years ago. And we have fought and built a company over a period of years that we feel is very, very efficient; we feel that we do a good job of managing our company, and yet it is extremely frustrating to watch everything that we have worked for over a 30- to 40-year period being taken away from us in the form of high interest rates, high stumpage payments, and in the form of having our markets taken away where we cannot even sell our products.

It's to the point now that, if we don't have changes, and this particular thought is shared by many others in the industry, within the next year you could see as much as 50 percent of the independent production taken off the market in terms of business failures in the Northwest. I don't really think that's what our Government wants.

I want to assure you that most of us support the President's program in trying to bring the budget under control. And I want to assure you that we all realize that there has to be some suffering by all of us. But it is very difficult for us to sit back and find out that the suffering that we are asked to suffer is really to go out of business and lose a 30-year investment.

Thank you.

Senator PACKWOOD. Mr. Jones.

[The prepared statement follows:]

STATEMENT OF
MICHAEL E. BURRILL, PRESIDENT
EUGENE F. BURRILL LUMBER COMPANY
MEDFORD, OREGON

BEFORE THE U.S. SENATE FINANCE SUBCOMMITTEES
ON
TAXATION AND DEBT MANAGEMENT,
AND
INTERNATIONAL TRADE

November 24, 1981

INTRODUCTION

Mr. Chairman, I am Michael E. Burrill, President of Eugene F. Burrill Lumber Company, Medford, Oregon and also President of the North West Timber Association, headquartered in Eugene, Oregon.

Burrill Lumber Company is a small family owned and operated company that produces high quality 2x4 studs for use in framing of homes. We have been in business for over 35 years and have developed a very efficient production facility that relies totally on U.S.F.S. and BLM for our timber supply. Markets for our product cover nearly the entire continental U.S. with major emphasis in the North East and Great Lakes states, Texas and California.

North West Timber Association has a membership of approximately 35 small business sawmills, plywood plants and veneer plants, membership is restricted to the west side of Oregon and the Southwest part of Washington.

We appreciate the opportunity to share with you some of the problems we are currently facing and some of the contributing factors. Inasmuch as the main focus of my input will deal with the Canadians exporting lumber into the U.S. and the effect of limited partnerships using federal timber as tax shelters, my input will be for my own company and the membership of North West Timber Association. I have refrained from including tables and graphs and would urge you to analyze that information presented by my colleagues.

INDUSTRY FACTS:

1. Approximately 80% of the lumber currently moving into the Los Angeles markets is imported from Canada.

2. Approximately 32% of the total U.S. consumption of lumber is currently imported from Canada.

3. Canadian share of U.S. market has doubled since 1971.

4. 54% of the employees involved in lumber production in the Northwest are curtailed by layoff or reduced hours.

5. NWTA membership production is off in excess of 35%.

6. 55,000 employees are affected at this date by curtailments.

IMPACT:

The forest products industry in the Northwest is in a depression that is being compared to the state of the industry in the early 1930's. Mill failures are occurring with increasing frequency and estimates floating around the industry are that if changes don't occur we will see nearly 50% of the production capacity in the Northwest in bankruptcy within the next year.

Strong, well-managed firms are watching their capital disappear and are unable to find any way to stabilize their position.

The problems we face are narrowed into two areas, the first being the high cost of timber brought on by an artificial shortage of timber due to the constant reductions in allowable cut, timber actually sold and the continuing threat of further reductions. The conditions we have dealt with over the past decade have forced us into a position of having to continually gamble our total survival on expensive timber or to have suspended operations.

This problem is compounded by the use of limited partnerships which are buying government timber and through tax benefits receive a bidding advantage over the producers. The limited partnerships also gain by pushing timber prices to the maximum and attempt to minimize any down side risk.

The second problem is that of no market for our products. This problem has been brought on by high interest rates, inflation and the efforts of our government to control inflation. We all recognize the need to control inflation and also realize that we all must suffer some pain to win the battle. The problem in our industry is that we are not only suffering but are being slowly and totally wiped out. It seems to us that to destroy a major part of our economy in an effort to control inflation is not in the best interest of our country. The impact from these actions are greatly compounded by the importing of large amounts of Canadian lumber at extremely low prices.

CANADIAN IMPORTS IMPACT:

The Canadian lumber coming into the United States is being priced at values far below the break-even point of U.S. mills. While we are paying $300 per thousand for timber, they are paying $10.00. The Canadian Government has even stated that they would pay the mills to take the stumpage in order to keep them working. Canadian mills also enjoy a freight advantage that is nearly 25% lower than ours. The freight advantage extends not only to subsidized rail rates but also to subsidized shipping by water. The Canadian Government in subsidizing both stumpage and freight is giving the Canadian producers an edge over us that we cannot meet. Our only option, in many cases, is to curtail or suspend operations and give up our markets.

LIMITED PARTNERSHIP IMPACT:

In our area a limited partnership is bidding nearly every timber sale in an attempt to not only purchase timber but to keep the underlying price high and climbing. They enjoy, due to the special tax treatment, nearly a 10% bidding advantage over legitimate operators. What they end up doing is to keep timber out of production as well, thus pushing up the demand side for mills that need timber. A close analysis by the Treasury Department would uncover an unbelievable, but legal, maze that brings about the tax benefit to the partnerships.

CONCLUSION:

I would again like to thank you for the opportunity to share these problems with you and would urge that you bring about some sort of action that will hopefully solve at least some of our problems.

STATEMENT OF AARON JONES, SENECA SAWMILL CO., EUGENE, OREG.

Mr. JONES. Well, to dispense with the amenities, other than thank you very much, Senator, for allowing us to be here, approximately 20 years ago I did a study for this Government on the ramifications of our log and lumber exports from the west coast. This study took several months of which one month was spent in Japan.

While in Japan, the head of one of the largest trading companies told me an interesting story. In his words, the Japanese Government and trading companies study our laws and regulations in order to develop a method to turn these laws and regulations to their advantage. I was told that because of the Jones Act, Japanese interests owned or controlled 94 percent of the wood producing industry in Alaska.

Because the Canadians would not export logs and the United States would, Japan would purchase lumber from Canada, but only logs from the United States.

Since British Columbia sold 80 percent of its softwood lumber production to the United States, and since the Canadian Government guaranteed protection of this market through its timber allocation and pricing program, Japan believed that the Canadians effectively controlled the price of lumber in the United States. Thus, Japan would never purchase so much lumber from Canada as to upset this balance. As a consequence, the Japanese would always be able to outbid the American mills for a log volume of up to 6 billion board feet a year.

As you know, log exports were stopped from Federal timber lands and the State of Oregon, but not from Washington. The Japanese still buy up to 3.2 billion feet of logs per year from private and State of Washington lands.

An attempt was made to no avail in 1962 or 1963 to create equity with Canada on lumber imports to the United States. With some changes in percentages, the story of 20 years ago is still just as true today.

The problem today, brought about by the continued influx of Canadian lumber into the United States, has caused a great deal of concern. But as of this time we have no laws or regulations that promise any meaningful relief now or in the near future. There have been discussions of embargoes, countervailing duties, Presidential action under the 201 or 301 provisions, and possible general trade sanctions. The obvious problem with all of these is that they take significant amounts of time and effort, with no guarantees of success.

The objective which we must seek is to work internally to improve our competitive position with Canadian imports from this side of the border. Our goal is to retain as much of our own market as possible under depressed conditions and to be positioned to capture our markets as rapidly as possible when the economy turns around.

Because of our method of selling public timber, the mill dependent on this timber in the Pacific Northwest is the first one to lose his market in a downturn and the last to regain it in an upturn. And, Senator Packwood, I would like to point out a fact of life today. As of last week, by the Canadian's own admission, the Douglas fir region in Canada was operating at 75 percent. The interior of Canada, by their own admission, was operating at 69 percent. The Douglas fir region in western Oregon is operating at 39 percent, and our unemployment is running at about 80 percent. If you take the private timber out of this, we are down to about 15 percent.

My suggestion is that in a time of depression, and I will read:

> The permanent method to cope with a recession must provide a triggering device for each Region or Sub-Region that will permit the stumpage price on all timber sales being operated to be reduced to a parity with the imported forest products. This reduced level of stumpage would apply only to logs removed from timber sales.
>
> Once such a stumpage price level was established, it would move on a parity, both up and down, with imported products until such time as the recession or emergency was concluded. At that time, all stumpage would return to the original contract price levels and a return to normal would have been accomplished.

I'll quit right there, since the bell rang.

[The prepared statement follows:]

STATEMENT OF AARON U. JONES, PRESIDENT
SENECA SAWMILL COMPANY, EUGENE, OREGON, AND
PRESIDENT, WESTERN RESOURCE ALLIANCE, EUGENE, OREGON
BEFORE THE U.S. SENATE FINANCE SUBCOMMITTEES ON
TAXATION AND DEBT MANAGEMENT, AND INTERNATIONAL TRADE
NOVEMBER 24, 1981

INTRODUCTION

Mr. Chairman, I am Aaron U. Jones, President of Seneca Sawmill Company, Eugene, Oregon. I am also testifying as President of Western Resource Alliance, headquartered in Eugene, Oregon, which is an association of independent sawmill and plywood mill operators who are principally dependent on federal timber for their source of raw material.

Approximately twenty years ago, I did a study for this government on the ramification of our log and lumber exports from the West Coast. This study took several months of which one month was spent in Japan.

While in Japan the head of one of the largest trading companies told me an interesting story.

The Japanese government and trading companies study our laws and regulations in order to develop a method to turn these laws and regulations to their advantage.

I was told that because of the Jones Act, Japanese interests owned or controlled 94% of the wood producing industry in Alaska.

Because the Canadians would not export logs and the United States would, Japan would purchase lumber from Canada, but only logs from the United States.

Since British Columbia sold 80% of its softwood lumber production to the United States and since the Canadian government guaranteed protection of this market through its timber allocation and pricing program, Japan believed the Canadians effectively controlled the price of lumber in the United States. Thus Japan would never purchase so much lumber from Canada as to upset this balance. As a consequence, the Japanese would always be able to outbid the American mills for a log volume of up to 6 billion feet a year.

As you know, log exports were stopped from federal timber land and State of Oregon lands. The Japanese still buy up to 3.2 billion feet of logs per year from private and State of Washington lands.

An attempt was made to no avail in 1962 or 1963 to create equity with Canada on lumber imports to the United States.

With some changes in percentages, the story of twenty years ago is still just as true today.

The problem today, brought about by the continued influx of Canadian lumber into the United States, has caused a great deal of concern. But as of this time we have no laws or regulations that promise any meaningful relief now or in the near future.

There has been discussions of embargos, countervailing duties, Presidential action under the 201 or 301 provisions, and possible general trade sanctions. The obvious problem with all of these is that they take significant amounts of time and effort, with no guarantee of success.

The objective which we must seek is to work internally to improve our competitive position with Canadian imports from this side of the border. Our objective is to retain as much of our own markets as possible under depressed conditions and to be positioned to capture our markets as rapidly as possible when the economy turns around.

Because of our method of selling public timber, the mill dependent on this timber in the Pacific Northwest is the first one to lose his market in a downturn and the last to regain it in an upturn.

The ensuing loss of employment, government revenues, and community vitality are all negative byproducts of our present system which places the independent operator in this unfavorable position.

The answer, while not simple, has to be found in the way we price and sell our government timber. We are currently addressing ourselves to the issues of timber sale contract extension, timber sale contract termination, and more stringent contract terms which might tend to dampen some of the speculation fever that helped intensify the problems in this present recession.

These are all necessary Band-Aids. But they do not address the issue of lower cost timber during recession, which will enable the industry to establish some degree of parity with its Canadian competitor so as to be on as close to an equal footing in the marketplace as possible.

The permanent method to cope with a recession must provide a triggering device for each Region or Sub-Region that will permit the stumpage price on all timber sales being operated to be reduced to a parity with the imported forest products. This reduced level of stumpage would apply only to logs removed from any timber sale.

Once such a stumpage price level was established, it would move on parity both up or down with imported products until such time as the recession emergency was concluded. At that time, all stumpage would return to the original contract price levels and a return to normal would have been accomplished.

The development of such a system would guarantee no magic in the marketplace where there is no consumer demand. It would, however, protect established markets and the opportunity to penetrate the markets available. It would create the maximum employment possible and give the various levels of government some revenues that would otherwise not be available.

This thought merits serious consideration in trying to minimize future disasters such as we are involved in now.

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SUMMARY OF STATEMENT

The Japanese recognized 20 years ago that Canadians, through their exports, effectively control the price of lumber in the United States.

This is as true today, when the continuing influx of Canadian lumber is causing a great deal of concern.

International trade law remedies take significant time to pursue, with no guarantee of success.

Our objective should be to work internally to improve our competitive position with Canadian imports. The situation is most critical for mills dependent on public timber.

A permanent method to cope with a recession must be developed that will permit the stumpage price on operating timber sales to be reduced to a parity with imported forest products during the recession.

Such a method could not produce consumer demand where there is none, but it would protect established markets, maximize possible employment and protect government revenues as much as possible.

STATEMENT OF PAUL F. EHINGER, WESTERN RESOURCE ALLIANCE, EUGENE, OREG.

Senator PACKWOOD. Mr. Ehinger.

Mr. EHINGER. Thank you, Senator Packwood.

There has been very ample testimony and documentation with figures that were probably more than anybody can consume on the Canadian issue. I would just like to say that with regards to the whole issue that surrounds the industry today, we have to be concerned and evaluate the magnitude of what is going on, and I think this is where everyone is failing.

The Canadian situation, for instance, in the first 8 months of this year they have exported more lumber into the United States than any year prior to 1970, and at the end of the year this will be their fourth highest year of exports into the United States if they follow the present trends. Ours, the American production, and consumption of American production, will be the lowest since prior to World War II. These are dramatic figures.

The Canadians have tried to justify this by a response to the Governors panel on their position, claiming that they do not have an advantage. However, I submit to you, if that response becomes a part of the record of this hearing, that it is extremely inaccurate, filled with the kind of political rhetoric which I would use if I were on their side, but really does not address the facts as we know them. I would just leave that at that point.

What I would like to talk about just briefly, again looking at the problems we are talking about, is how do we arrive at a solution to the problem that confronts us, including the Canadian?

To begin with, we have to analyze and understand what led us here. First, we have the high interest rates which destroyed our primary market. Second, constant budgetary restrictions and other legislative and administrative restrictions on allowable cut and withdrawals of commercial forest land that followed it. We used to hear regular testimony by the chief of the Forest Service that a potential of 20 billion feet annual cut could be developed as the eventual net output of the National Forest system. Now we scream, scrape and holler, and we are lucky if we get 11.9 billion feet to maintain the existing level of cut. It's a different ballgame.

Third, we have the inflation, which created the monstrosity of bidding which we have now. People learned quickly that, if you didn't bid the inflationary factor out of your timber supply of 3 or 4 years, whatever the length of the sale was, you didn't buy. Somebody else did. Particularly it was an advantage to the operator who had no mill facility. He could wait and harvest in the last year. So it soon became a reality that either you followed the speculator and bought some timber or you went out of business. It was that simple. I have been involved in both sides of that. I was involved in a mill that went out of business because we didn't believe in that type of inflation.

Fourth, we then have the increased advantage of the Canadian mills, the increased penetration to our marketplace, which has been amply demonstrated here. These four items, themselves, are the rules of the ballgame which the independent mills dependent on public timber are forced to play by. They didn't make the rules.

They are in the ballpark, and that's what they have to play with. Their only contribution was perhaps, in several cases, purely speculative bidding through the competitive bidding process that was probably unnecessary but yet borne out of the situation which I have described.

Western Resource Alliance tried to search for equity in the resolution of the issues, and we found out there is no such thing as equity, but we came up with a solution or rather a proposal which addressed first the local communities, it addressed the local governments, and it addressed the operator's needs, whether he had timber under contract at too high a price, too little or too much, and tried to come up with a proposal that balanced this diverse situation.

I have to mention the fact that the local governments and all the governments cheered when the competitive bidding was going on. The eyes on the dollars were glassy-eyed, and they could plan for what they thought was a very rich harvest in dollars, which now is not materializing. They are still under the naive impression that we can force harvests when there is no market to preserve their flow of revenue.

I submit to you, Senator, if I put 10 million feet out in the town square in Eugene, Oreg., and said come and get it, at the end of a month 5 million would still be there. There is no market, and we have to understand that.

Shortening terms of contracts and termination of contracts at the present time will not put people to work; it will not place anything in the marketplace; but it will allow the earliest possible return to the market as conditions gradually improve.

The WRA proposal consists of three parts: Extensions, which the Forest Service has granted and they should not be castigated for what they did. They didn't do it exactly as we wanted, but they responded responsibly to a need.

The second part is redoing certain terms of the contract which we are working on currently with the Forest Service. This will try to avoid the kinds of situations that help create speculation. We can't avoid the disaster today.

Senator PACKWOOD. Paul, I have got to close you down. Make your third point.

Mr. EHINGER. The third point is termination of contracts. And if you look at the stumpage figures, and you look at the dollars, you know that somewhere ahead a consideration of termination of a large number of contracts has to be considered if this industry is to survive.

I thank you.

[The prepared statement follows:]

RESOURCE
WESTERN ALLIANCE

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STATEMENT OF PAUL F. EHINGER, EXECUTIVE VICE PRESIDENT,
WESTERN RESOURCE ALLIANCE, EUGENE, OREGON
BEFORE THE U.S. SENATE FINANCE SUBCOMMITTEES ON
TAXATION AND DEBT MANAGEMENT, AND INTERNATIONAL TRADE
NOVEMBER 24, 1981

INTRODUCTION

Mr. Chairman, I am Paul F. Ehinger, Executive Vice President of Western Resource Alliance, headquartered in Eugene, Oregon. WRA is an association of independent sawmill and plywood mill operators who are principally dependent on federal timber for their source of raw material. We appreciate the opportunity to share our views and information today on certain problems of the forest products industry in the Pacific Northwest.

The timber industry in the Northwest is in a state of collapse. We do not know how long the collapse will last. We do not know how many companies will survive. We cannot accurately project the long term effects on Oregon and nearby states of this disaster in a major segment of the regional economy.

Your hearing today is concerned in part with the contribution that lumber imports from Canada make to this crisis. Our association and others are also concerned. We are exploring the Canadian impact on our business, the nature of certain advantages the Canadians enjoy, and the possible remedies that may be available to us through various provisions of U.S. trade law.

We endorse Senator Packwood's proposed resolution of the Finance Committee. The resolution would request the U.S.

International Trade Commission to investigate the importation of Canadian softwood lumber into the United States. Information on the eight points listed in the proposed resolution will importantly help the industry determine the best route to pursue to obtain equitable treatment vis-a-vis the imports from Canada. In addition to information on injury to our industry which the ITC will develop, we are pursuing both data and legal advice concerning the nature and extent of subsidies provided by Canadian national or provincial governments to Canadian lumber manufacturers. As you know, if industry seeks a countervailing duty against these imports, it will be up to the Department of Commerce's International Trade Administration to determine if a government subsidy exists, and will be up to the International Trade Commission to determine if our industry is being injured.

Since those determinations will be made in a forum other than this hearing, I will not take up your time with our views of what those determinations ought to be.

INDUSTRY DATA

Rather, I want to present you with as much data as I can to portray the industry's collapse and its impact. Tables illustrating my points are in the appendix following my statement.

A. Production.

Lumber and plywood manufacturing is a cyclical industry. Table 1 lists annual production since 1960. Note that the drops in production which occur periodically typically last for about one year before production again returns to normal levels. The present downturn, however, now is nearly two years old. It is the longest trough since the depression of the 1930s.

Lumber and plywood, of course, are products which are very costly to inventory because of their bulk. As a result, production levels are extremely sensitive to immediate demand. It is neither economically feasible nor physically possible to continually produce at a consistent level and let inventory increase or decrease with demand. Table 1 clearly shows these cyclical variations over the last two decades.

Because the industry is known to be cyclical, operators are readily prepared for a periodic one-year slump. When a downturn runs as long as this one, however, operators begin to run out of capital and methods to ride out the storm. Thus, while operators could survive present low levels of production for a year or more, many are now to the point where the mere continuation of these levels, much less a worsening, is about to drive them from business.

B. Prices.

Lumber and plywood prices are extremely volatile, again because demand fluctuates both seasonally and cyclically, and because builders and other product users cannot afford to stockpile these products any more than the mills can.

Table 2 shows prices for several typical product categories for the past decade. Note that as with production, the present lows are lasting for a significantly longer period than previous downturns.

C. Mill Closures and Unemployment.

The latest figures on curtailment and closures of mill operations and the effect on employees are shown in Table 3. They portray a clear picture of an economic disaster.

D. Market Share.

Table 4 shows the percentage share of the U.S. softwood lumber market that the Canadians have had for the past 20 years. The increasing rate of penetration has continued during the present downturn. Table 5 shows the actual volume relationship between U.S. and Canadian production and Canadian exports to the U.S.

Note that in a contracting market as at present, the market share supplied by U.S. mills declines much more sharply than if the drop in demand were spread uniformly. Note the dramatically increased share going to Canadian lumber. Note that the volume of Canadian imports has remained much closer to the peak demand years, despite a drop in U.S. consumption of more than 20 per cent.

E. Raw Material Prices.

Tables 6-10 show trends in prices bid and paid for timber on the stump in national forests of Oregon and Washington as compared with the price paid in British Columbia.

Note that although prices for finished products have declined markedly, we have no such corresponding decrease in stumpage prices paid in the Northwest. There is still a certain amount of speculative bidding which appears to be attributable to uncertainty of future federal timber supply, the increasing length and size of timber sale contracts proffered by the Forest Service, and a continuing hesitation by some bidders to believe that future inflation rates will be significantly lower than during the latter 1970s. Note that prices paid for timber actually harvested continue to increase despite the decline in finished product prices; prices presently being paid reflect bids made mostly in the mid and later 1970s, a time of extreme inflation psychology.

While stumpage prices in the Pacific Northwest have increased, prices charged by the province of British Columbia to its mills have stayed low and steady, and declined in 1980. Table 6 shows price differentials between all species of timber in B.C. and the same type of timber in the U.S. Pacific Northwest. Tables 7-10 show the differences in price between B.C. and Forest Service timber for various species. The B.C. government owns more than 95 per cent of the timber in that province, and B.C. in turn produces about two-thirds of all Canadian timber.

F. Community Impact.

Attached to my testimony in the appendix are a number of articles from Oregon newspapers showing the tremendous impact that these closings have on the local communities. More often than not, the mill is the economic base of the community and the major employer as well as the largest taxpayer. The economic havoc is substantial and demands serious attention.

CONCLUSION

As this information makes clear, the condition of our industry is a debacle for its employees, their communities, mill owners and, indeed, the entire Northwest. We applaud the Committee's interest in this crisis and Senator Packwood's determination to pursue particularly the issue of the extent to which imports from Canada are causing our difficulties. We appreciate the opportunity to testify and stand prepared to assist in whatever further way we can to develop information you seek.

APPENDIX
TO
STATEMENT OF PAUL F. EHINGER, EXECUTIVE VICE PRESIDENT
WESTERN RESOURCE ALLIANCE, EUGENE, OREGON
BEFORE THE U.S. SENATE FINANCE SUBCOMMITTEES ON
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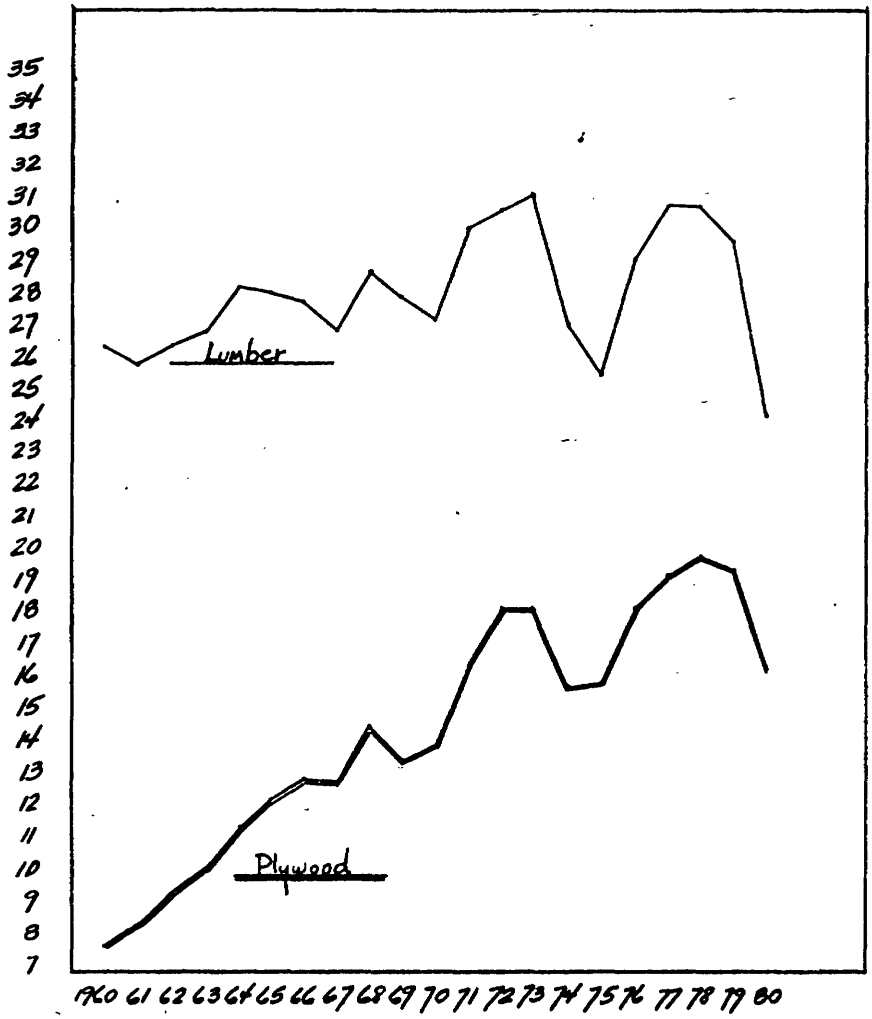
NOVEMBER 24, 1981

Annual U.S. Production table-1

Softwood Lumber and Plywood

Lumber - Billion Feet Board Measure
Plywood - Billions of Feet 3/8" Basis



Key: —— Lumber
▬▬ Plywood

Source Data: Lumber - W.W.P.A. Year book
Plywood - A.P.A. Report E 31

Compiled by: W.R.A. 11/81

TABLE 1a

U.S. PRODUCTION

SOFTWOOD LUMBER AND PLYWOOD

Lumber - Million Feet Board Measure
Plywood - Millions of Feet--3/8" Basis

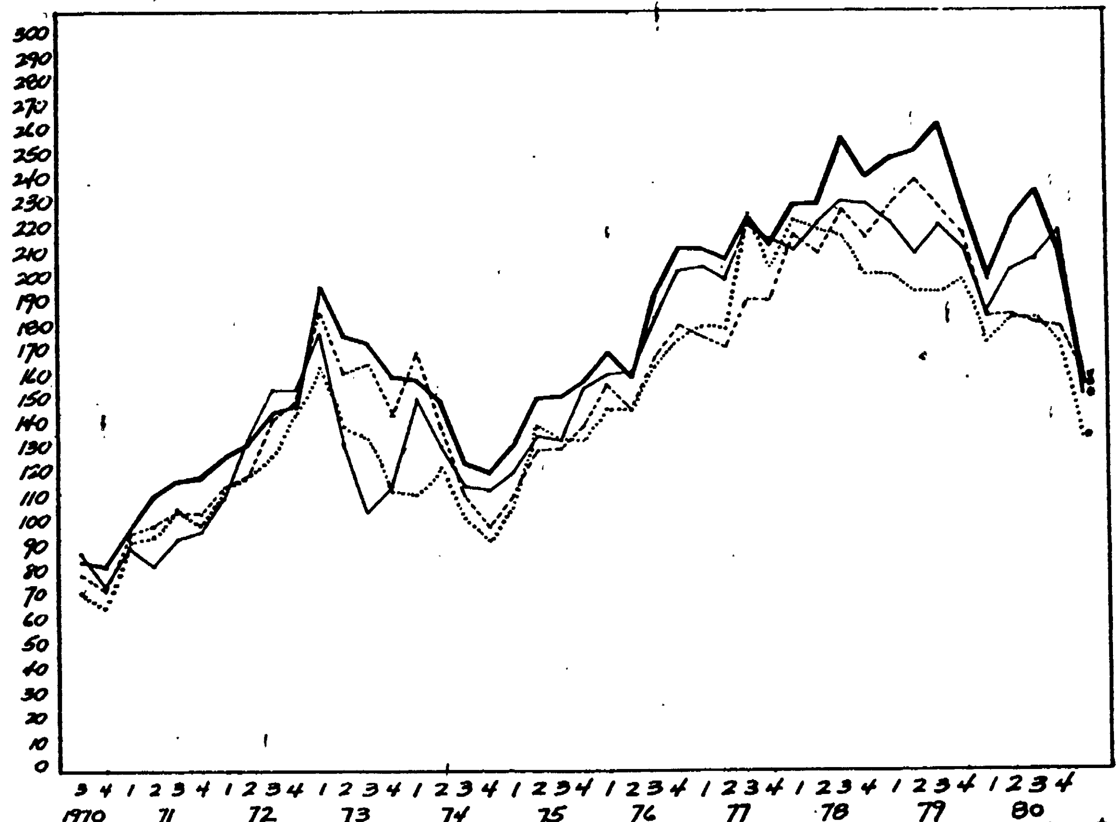
Year	Softwood Production Lumber	Softwood Production Plywood
1960	26,672	7,816
1961	26,066	8,577
1962	26,754	9,513
1963	27,017	10,216
1964	28,458	11,679
1965	28,230	12,447
1966	27,973	13,056
1967	27,069	12,958
1968	28,936	14,695
1969	28,133	13,694
1970	27,439	14,340
1971	29,432	16,635
1972	30,873	18,324
1973	31,289	18,305
1974	27,193	15,878
1975	25,711	16,050
1976	29,343	18,440
1977	30,987	19,376
1978	30,899	19,964
1979	29,878	19,653
1980	24,335	16,468

Source Data: Lumber--W.W.P.A. Yearbook
Plywood--A.P.A. Report E 31

Compiled By: Western Resource Alliance
11/81

Quarterly Average Prices U.S. table-2

Douglas Fir - Std. & Btr. 2x4 K.D., Studs K.D., ½" Plywood Ext. (4/5 Ply)
Hem-Fir - Std & Btr 2x4 K.D.
(Prices Net f.o.b. Mill, $/Thousand Board Feet or 3/8" Basis)



Compiled by: W.R.A. 11/81 • 1981 Tentative Sales Amounts

Key: ——— ½ Ply Std Ext (4/5 Ply)
- - - - Hem-Fir, KD - 2x4" Std Btr 8/20'
——— Douglas Fir 2x4 KD, Std Btr.
.... Douglas Fir 2x4 - 8' PET, KD Studs

Source Data: Yearbook Random Lengths

TABLE 2a

QUARTERLY AVERAGE PRICES - U.S.

$/Thousand Board Feet or 3/8" Basis
Prices Net f.o.b. Mill

Year	Quarter	1/2" Plywood Std. Ext.	Hemlock Fir K.D., 2x4	Douglas Fir K.D., 2x4	Douglas Fir K.D., Studs
1970	3	89	80	88	73
	4	76	74	84	68
1971	1	91	90	98	92
	2	84	100	111	97
	3	96	106	118	108
	4	98	105	119	100
1972	1	111	116	127	114
	2	136	120	134	120
	3	156	142	144	128
	4	156	150	149	146
1973	1	179	187	198	164
	2	133	161	177	140
	3	107	166	175	136
	4	116	145	160	106
1974	1	151	170	159	112
	2	132	139	150	123
	3	116	112	125	102
	4	115	99	121	94
1975	1	121	112	131	108
	2	137	130	151	140
	3	135	131	152	140
	4	156	140	159	134
1976	1	161	158	170	148
	2	163	148	160	148
	3	185	169	193	166
	4	204	181	213	175
1977	1	206	177	212	180
	2	200	172	199	180
	3	222	191	226	227
	4	217	191	214	205
1978	1	212	218	230	226
	2	223	211	230	220
	3	231	228	257	218
	4	230	217	241	202
1979	1	223	230	249	202
	2	210	240	252	195
	3	222	272	263	195
	4	203	219	229	200
1980	1	186	185	201	174
	2	204	186	223	184
	3	208	182	236	185
	4	219	170	210	175

Source Data: Random Lengths Yearbooks
Compiled By: Western Resource Alliance, 11/81

TABLE 3

PRESENT CONDITION OF TIMBER INDUSTRY

WESTERN LUMBER INDUSTRY - WEEK ENDING 11/14/81

Western Mills Closed	212
Western Mills Curtailed	267
Closed or Curtailed	479
Total Western Mills	756
Employees Affected	55,344
Total Western Lumber Industry Employees	102,000

U.S. PLYWOOD INDUSTRY - WEEK ENDING 11/14/81

Western U.S.	
Mills Closed	34
Mills Curtailed	37
Closed or Curtailed	71
Total Mills in West	108
Employees Affected	6,834
Southern U.S.	
Mills Closed	11
Mills Curtailed	24
Closed or Curtailed	35
Total Mills in South	68
Employees Affected	3,601
Total U.S. Plywood	
Total Mills Curtailed or Closed	106
Total Mills	176
Total Employees Affected	10,435
Total Plywood Industry Employees	38,000

There is a further deterioration of all major lumber and plywood markets. As a result, these figures are increasing with no apparent sign of any early relief. The situation exceeds the "depression" years of the 1930's.

Continued..........

TABLE 3 -- Continued

SUMMARY BY STATE OF WESTERN LUMBER MILL CLOSURES AND CURTAILMENTS

WEEK ENDING 11/14/81

	OREGON	WASH.	CALIF.	IDAHO	MONTANA	ROCKY MTN.*	TOTAL
Mills Closed	59	48	33	21	16	35	212
Mills Curtailed	74	60	41	26	20	46	267
Total	133	108	74	47	36	81	479
Total Mills	210	170	116	74	56	130	756
Employees Affected	16,812	10,938	12,930	5,086	2,921	6,657	55,344
Total Employees	31,076	20,218	23,900	9,400	5,400	12,305	102,299

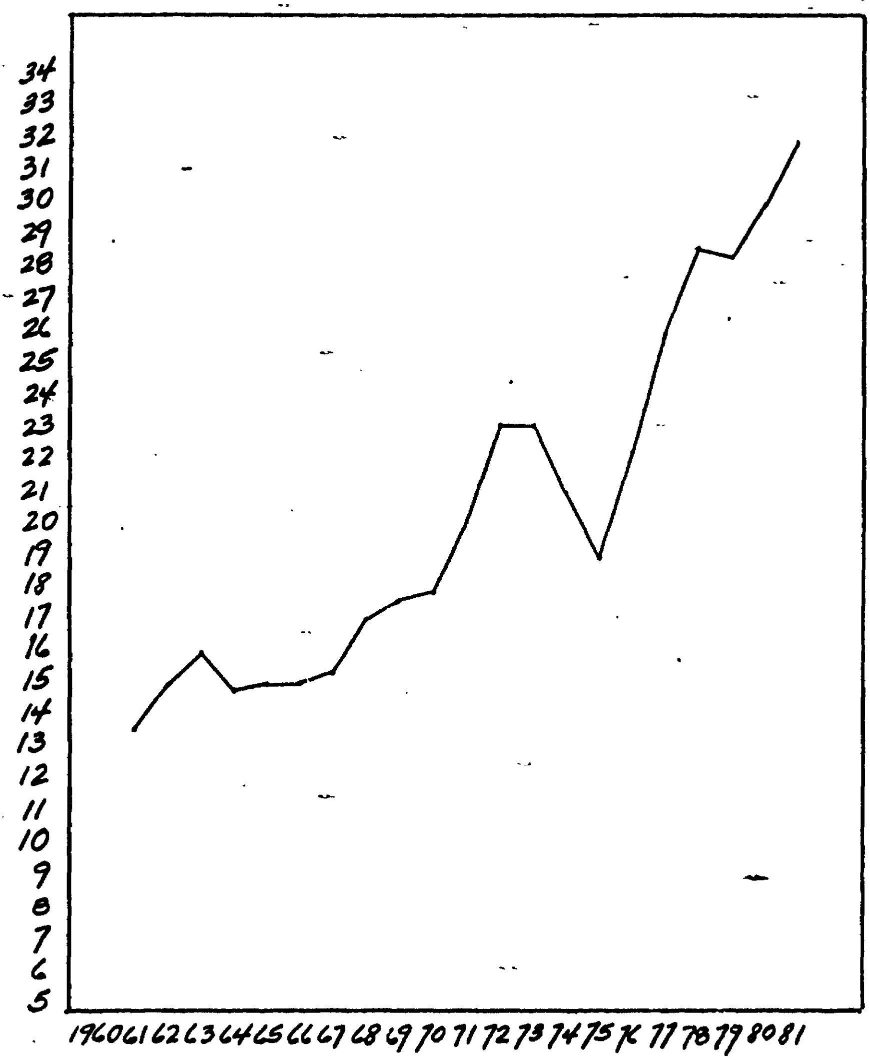
*Includes Wyoming, Colorado, South Dakota, Utah, Arizona, Nevada and New Mexico.

Source Data: W.W.P.A., Portland, OR
A.P.A., Tacoma, WA

Compiled By: Western Resource Alliance
11/20/81

Softwood Lumber table-4

Percentage of Canadian Exports to United States - Based on U.S. Consumption



Compiled by W.R.A. 11/81
Source Data: W.W.P.A. Statiscal Yearbook
N.F.P.A. Fingertip Facts

TABLE 4a

SOFTWOOD LUMBER
CANADIAN EXPORTS TO U.S.
AS A PERCENTAGE OF TOTAL U.S. CONSUMPTION

Million Feet Board Measure

Year	Soft-wood	Exports Total	Canada Exports to U.S.	Total U.S. Consumption	Canadian % of U.S. Consumption
1960	26,672				-
1961	26,066	(599)	4,040	29,507	13.7
1962	26,754	(626)	4,634	30,762	15.1
1963	27,017	(742)	5,028	31,303	16.1
1964	28,458	(811)	4,884	32,531	15.0
1965	28,230	(779)	4,895	32,346	15.1
1966	27,973	(864)	4,805	31,914	15.1
1967	27,069	(960)	4,804	30,913	15.5
1968	28,936	(1,044)	5,800	33,692	17.2
1969	28,133	(1,019)	5,879	32,993	17.8
1970	27,439	(1,155)	5,785	32,069	18.0
1971	29,432	(933)	7,239	35,738	20.3
1972	30,873	(1,187)	9,029	38,715	23.3
1973	31,289	(1,749)	8,996	38,536	23.3
1974	27,193	(1,536)	6,851	32,508	21.1
1975	25,711	(1,401)	5,739	30,049	19.1
1976	29,343	(1,599)	7,996	35,740	22.4
1977	30,987	(1,437)	10,433	39,983	26.1
1978	30,899	(1,374)	11,873	41,398	28.7
1979	29,878	(1,781)	11,184	39,281	28.5
1980	24,335	(1,976)	9,618	31,977	30.1
1981	21,800	N/A	10,300	32,100	32.0

Source Data: W.W.P.A. Statistical Yearbook
N.F.P.A. Fingertip Facts

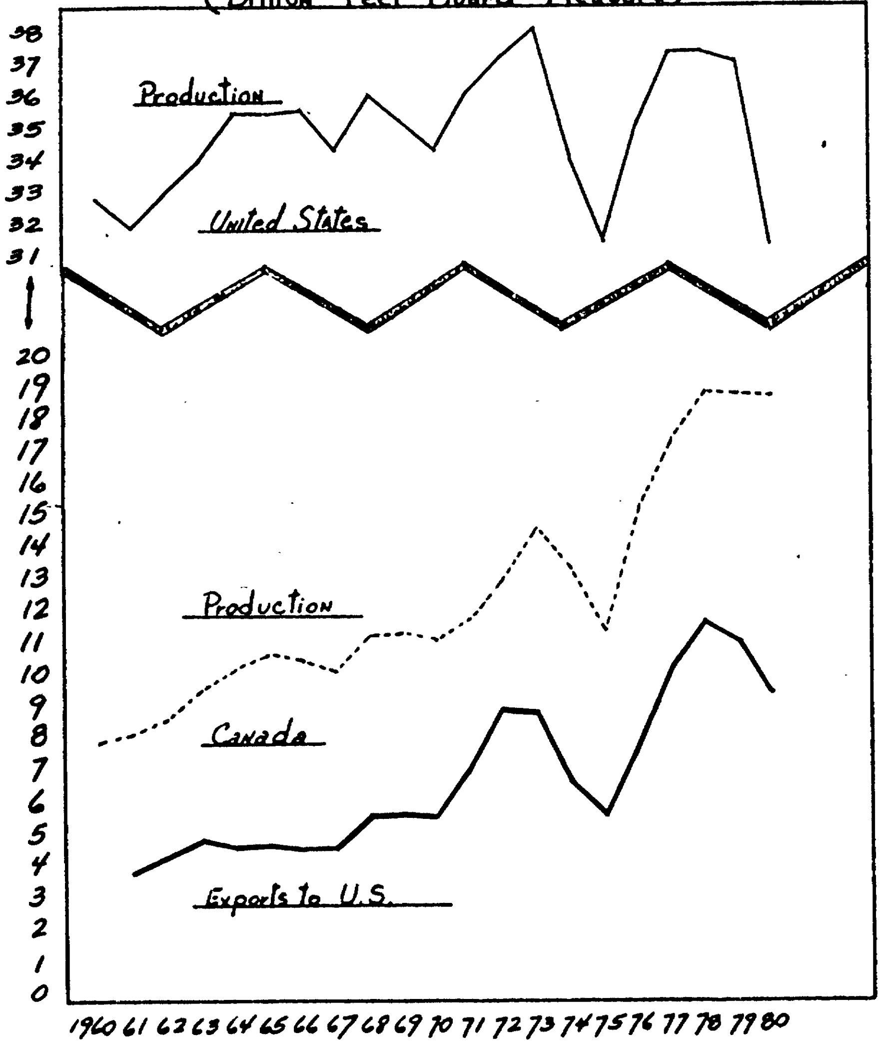
Compiled By: Western Resource Alliance
11/81

Annual Production U.S. and Canada table - 5

Exports to U.S.

Softwood and Hardwood Lumber Combined

(Billion Feet Board Measure)



Key: ——— U.S. Production
------- Canada Production
▬▬▬ Canadian Exports to U.S.

Compiled by W.R.A. 11/81
Source Data: W.W.P.A. Yearbook
U.S.D.A. FRR 20, Timber 1952-2030

TABLE 5a

LUMBER PRODUCTION
U.S. AND CANADA

CANADIAN EXPORTS TO U.S.

Million Feet Board Measure

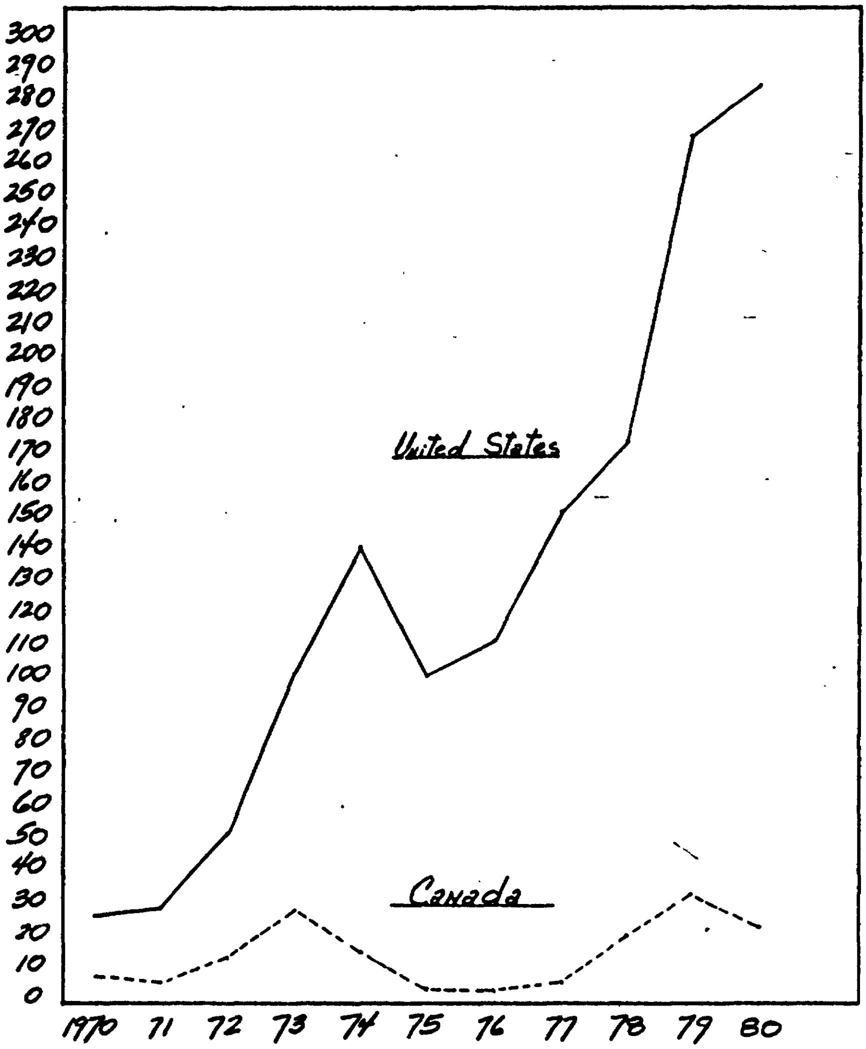
Year	U.S. Production Soft-wood	Hard-wood	Total	Canada Production Soft-wood	Hard-wood	Total	Canadian Exports to U.S.
1960	26,672	6,254	32,926	7,600	400	8,000	
1961	26,066	5,953	32,019	7,800	400	8,200	4,040
1962	26,754	6,359	33,113	8,400	400	8,800	4,634
1963	27,017	7,154	34,171	9,400	400	9,800	5,028
1964	28,458	7,275	35,733	9,800	500	10,300	4,884
1965	28,230	7,467	35,697	10,300	500	10,800	4,895
1966	27,973	7,737	35,710	10,000	600	10,600	4,805
1967	27,069	7,430	34,499	9,700	600	10,300	4,804
1968	28,936	7,188	36,124	10,800	600	11,400	5,800
1969	28,133	7,316	35,449	11,000	500	11,500	5,879
1970	27,439	7,023	34,462	10,800	500	11,300	5,785
1971	29,432	6,949	36,381	11,600	400	12,000	7,239
1972	30,873	6,770	37,643	12,800	500	13,300	9,029
1973	31,289	7,008	38,297	14,200	600	14,800	8,996
1974	27,193	6,904	34,097	13,000	600	13,600	6,851
1975	25,711	5,872	31,583	11,200	400	11,600	5,739
1976	29,343	6,417	35,760	14,900	500	15,400	7,996
1977	30,987	6,680	37,667	17,167	500*	17,667	10,433
1978	30,899	6,758	37,657	18,377	600*	18,977	11,873
1979	29,878	7,300	37,178	18,389	600*	18,989	11,184
1980	24,335	7,304	31,639	18,184	600*	18,784	9,618

*Estimate

Source Data: W.W.P.A. Yearbook
U.S.D.A. FRR 20, Timber 1952-2030

Compiled By: Western Resource Alliance, 11/81

Comparison of Average Stumpage table-6
British Columbia - Oregon and Washington
All Species



(In U.S. $ / Thousand board feet, Scribner Scale)
Source Data: U.S. F.S. and Council of Forest Industries of British Columbia

TABLE 6a

A COMPARISON OF AVERAGE STUMPAGE BID PRICES OF TIMBER SOLD IN BRITISH COLUMBIA
BY TIMBER SALE HARVESTING LICENSES AND TIMBER SALES
COMPARED TO TIMBER SOLD IN OREGON & WASHINGTON
FROM NATIONAL FOREST LANDS, DURING 1970-80

(In U.S. $/Thousand board feet, scribner scale)

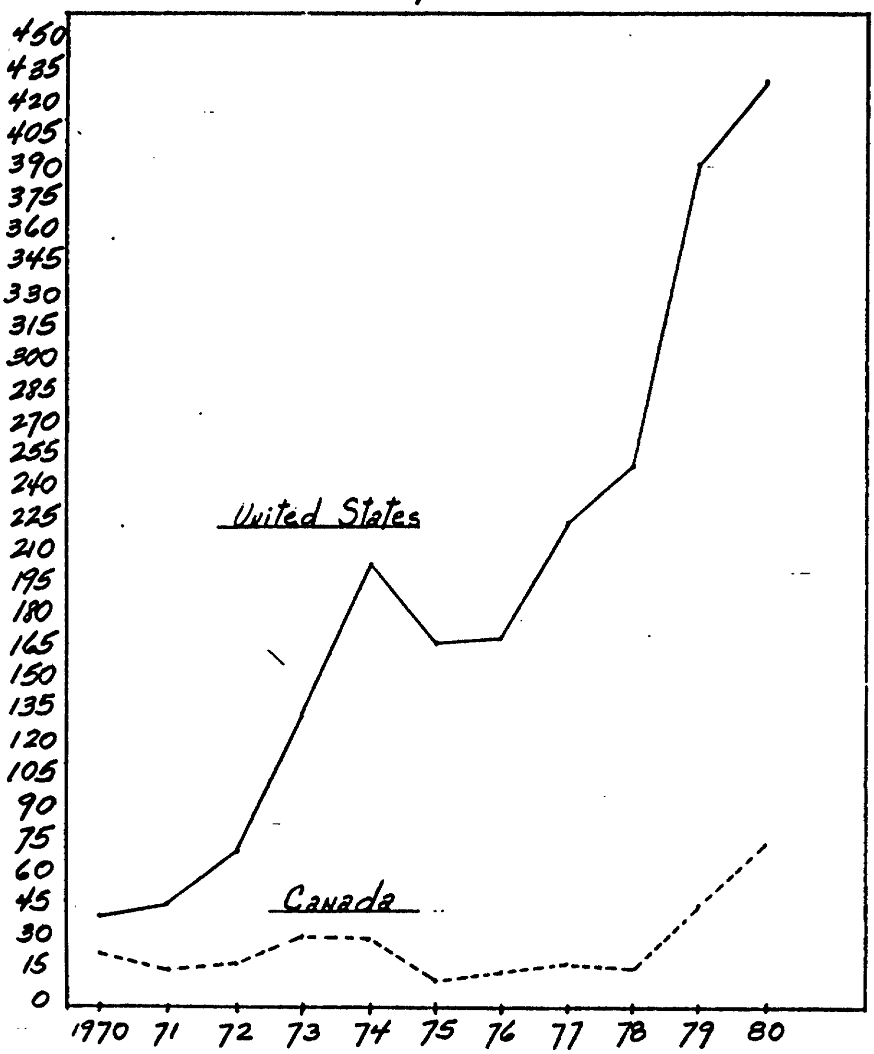
Year	Coastal D. Fir			Interior D. Fir			Hemlock			Cedar			All Species		
	FS	BC	Diff	FS	BC	Diff	FS	BC	Diff	FS	BC	Diff	FS	BC	Diff
1970	42	25	17	8	10	-2	20	8	12	15	6	9	27	8	19
1971	49	17	32	4	14	-10	21	6	15	17	5	12	30	7	23
1972	72	21	51	16	26	-10	49	7	42	68	7	61	53	14	39
1973	138	33	105	60	49	11	99	16	83	147	24	123	103	29	74
1974	202	32	170	68	29	39	111	12	99	217	12	205	142	16	126
1975	170	13	157	34	3	31	68	6	62	119	3	116	102	4	98
1976	176	16	160	39	4	35	78	3	75	160	6	154	113	4	109
1977	226	21	205	71	11	60	89	6	83	150	21	129	154	7	147
1978	250	18	232	98	39	59	112	6	106	207	46	161	185	21	164
1979	394	47	347	82	55	27	197	14	183	329	75	254	270	34	236
1980	432	76	356	71	28	43	208	27	181	301	27	274	286	24	262

Note: The following conversions were used: Canadian to U.S. $ 1970-.958; 71-.990; 72-1.009; 73-1.000; 74-1.022; 75-.931; 76-1.014; 77-.941; 78-.877; 79-.850; 1980-.850. $/cunit to $/thousand board feet multiply by 1.85; $/cubic meter to $/thousand board feet multiply by 5.24

Source: B. C. Forest Service Annual Reports 1975-80
USDA Forest Service, Production, Prices, Employment & Trade in Northwest Forest Industries, first Quarter 1981

Prepared by: Northwest Independent Forest Manufacturers 11/81

Comparison of Average Stumpage table - 7
British Columbia - Oregon and Washington
Coastal Douglas Fir

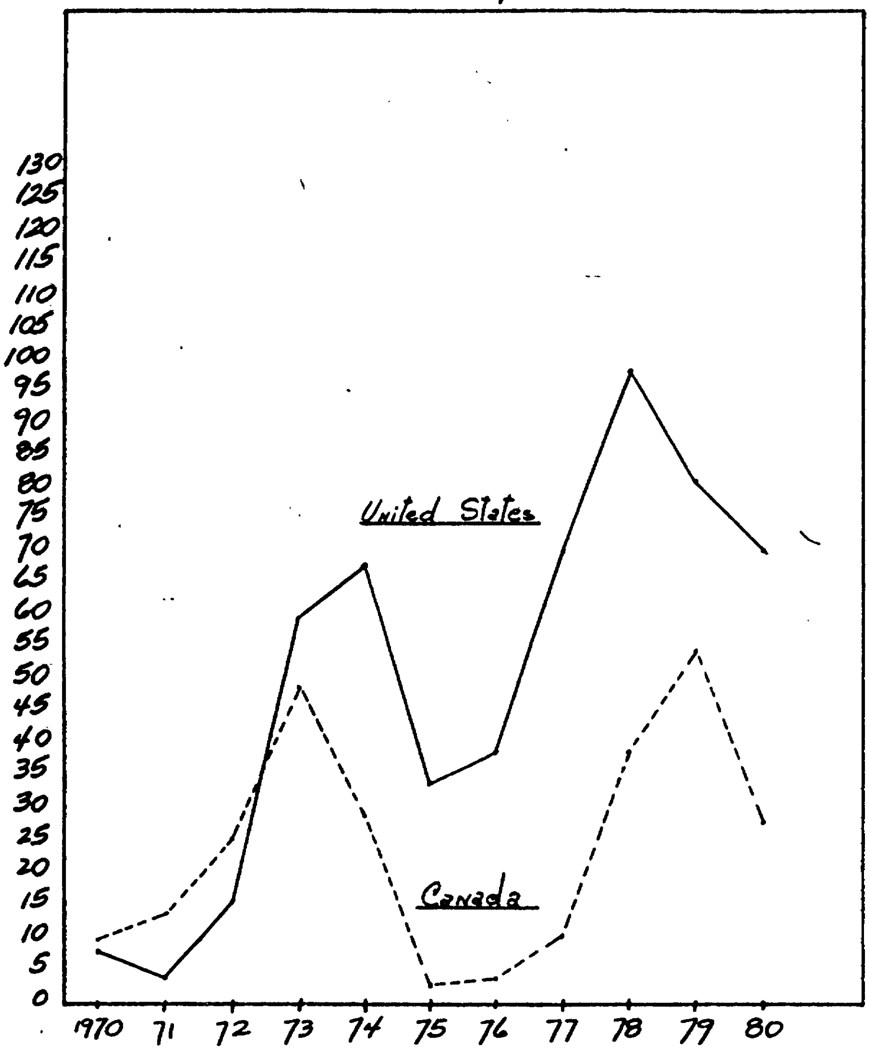


(In U.S. $/Thousand board feet, Scribner Scale)
Source Data: U.S.F.S. and Council of Forest Industries of Britsh Columbia

Comparison of Average Stumpage table-8

British Columbia - Oregon and Washington

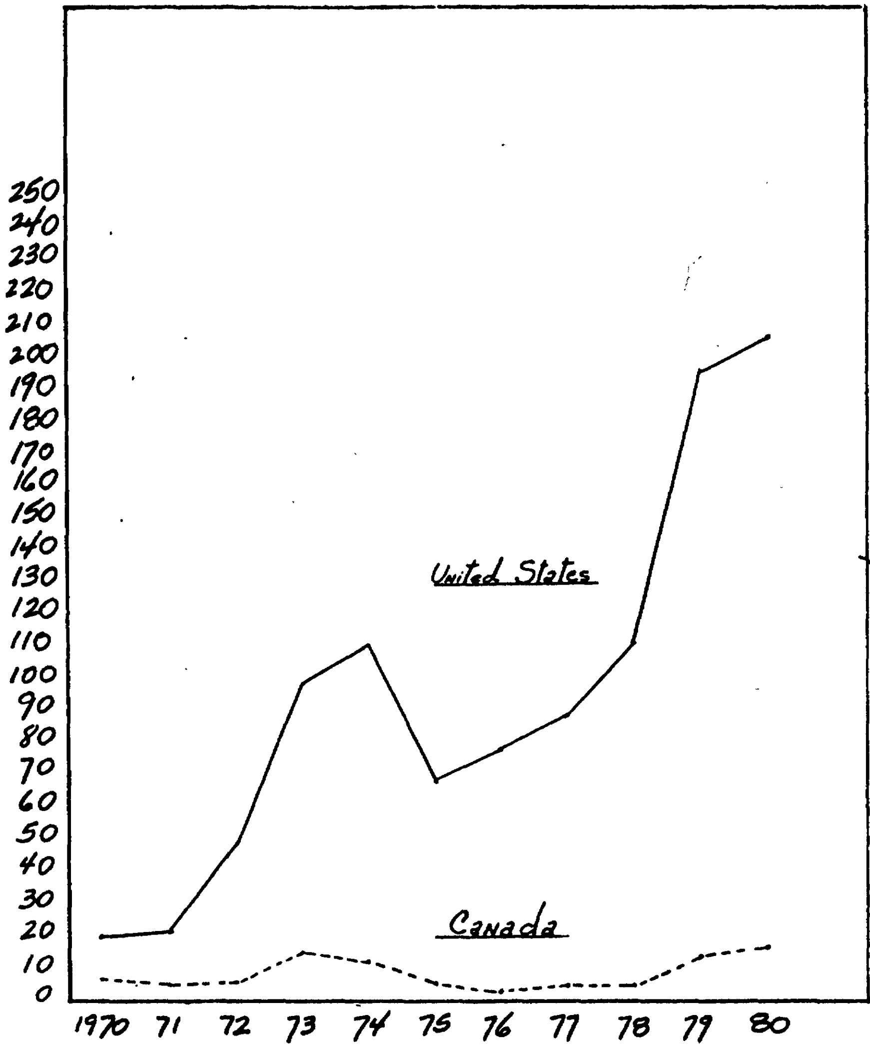
Interior Douglas Fir



(In U.S. $/Thousand board feet, Scribner Scale)

Source Data: U.S.F.S and Council of Forest Industries of British Columbia

Comparison of Average Stumpage table 9
British Columbia - Oregon and Washington
Hemlock

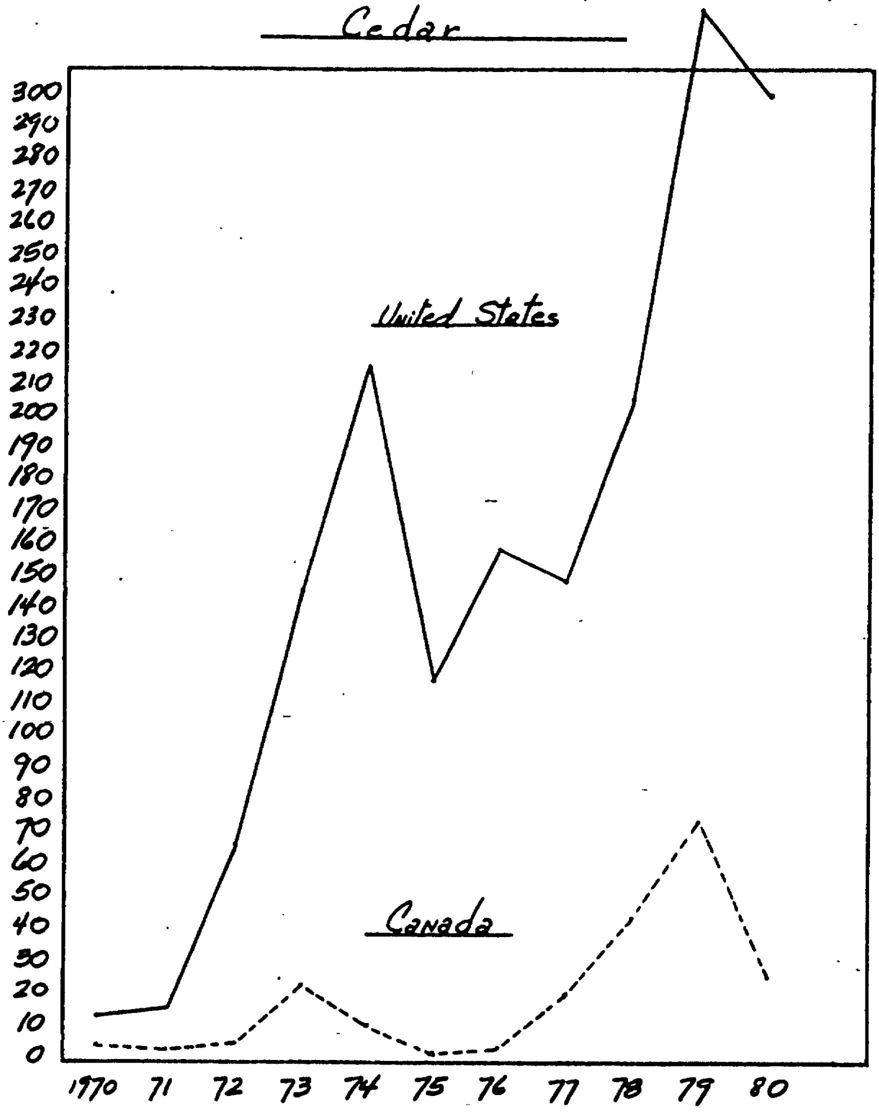


(In U.S. $ / Thousand board feet, Scribner Scale)
Source Data: U.S.F.S. and Council of Forest Industries of British Columbia

Comparison of Average Stumpage table-10

British Columbia - Oregon and Washington

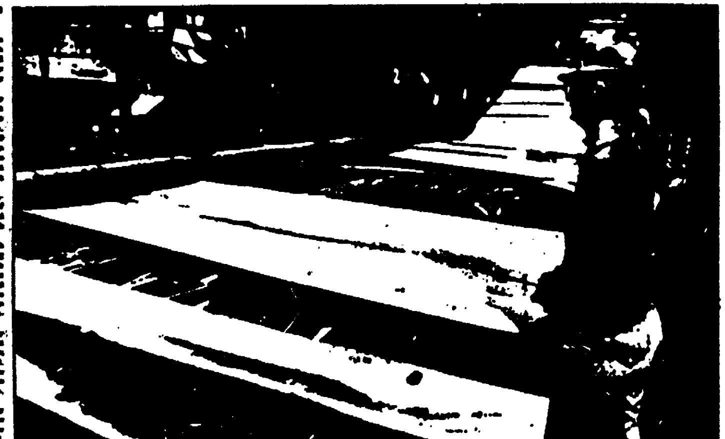
Cedar



(In U.S. \$/ Thousand board feet, Scribner Scale)
Source Data: U.S.F.S. and Council of Forest Industries of British Columbia

County wood products industry hits all-time low

11/1/81



Week shifts reduced

11/7/81

Weyerhaeuser announces cuts

Lumber mill cuts hours to half-time

10/21/81

Toledo sawmill closing Friday; 110 to be idled

SECTION B

Eugene Register-Guard

Area News

Regional

19,600 without jobs in lumber mill crisis

Mills

11/11/81

G-P shuts down logging activity until next year

Compiled by W.R.A. 11/81

200

Eugene Register-Guard

Area News TV, Theaters

More lumber mills to grind to a halt

Market to blame

Warrenton mill idled indefinitely

Millersburg plywood plant

Boise-Cascade mill to close, idling 111

RG

Lumber company increases layoffs

Three mills close

Plywood-mill closes

RG

One mill closes, another lays off its swing shift

RG

GP closes mill for time being; 40 to be laid off

RG

Weyerhaeuser will cut 27 jobs at Cottage Gr[ove]

Mapleton plant to be shut down

RG

Plywood mill closes

Two mills to lay off another 150 workers

Mills

Compiled by W.R.A
11/81

Section B

Eugene Register-Guard

Area News

TV, Stocks

Mill closure casts pall over Oakridge

RG 10/30/81

Drain mill shut down, idling 190

Closure indefinite, Bohemia Inc. says

Mill

Closure

Firm plans mill shutdowns

RG

CG 11/4/81

Mill closures affect 54% in wood jobs

It had reopened earlier

RG 11/1/81

Bohemia ply mill shuts down today

RG 10/31/81

Oakridge mill, veneer plant to shut down

Brookings mill closes, idling 230 employees

RG 10/1/81

Oregonian 10/30/81

300 jobs hit by cutbacks

Compiled by
W.R.A.
11/81

SUMMARY OF STATEMENT

The timber industry in the Northwest is in a state of collapse. We are exploring the impact of imports from Canada and possible remedies available through U.S. trade law.

Adoption of the resolution proposed by Sen. Packwood would aid the industry in developing its information and deciding what route to pursue.

The present downturn is the longest since the 1930s. Usually, industry recessions last only about a year, a period which operators are accustomed to riding out. Now, however, many operators are to the point where they are about to be driven from business.

Nearly two-thirds of all mills are closed or on curtailed production. More than half of industry employees are laid off or on short work schedules. The impact is severe on dependent communities.

The Canadian share of the U.S. market has increased during this downturn.

While stumpage prices have soared in the Northwest due to inflation psychology and the uncertainty of future federal timber supply, stumpage prices in British Columbia have stayed low and steady.

Senator PACKWOOD. I have some questions for each of you.

Aaron, explain to me how this system works, where you provide a triggering device for each region or subregion that will provide stumpage prices on all timber sales being operated to be reduced to a parity with imported forest products. Now, does that mean this: You are bidding in a cutting circle around Eugene, and you can bid $2,000 a thousand because you know that when the time comes to cut the competitive imports are going to be $200 a thousand, and therefore, it doesn't matter what you bid. Would your purchase price be brought down to that?

Mr. JONES. No, that isn't true, Senator. Both your office and Senator Hatfield has asked us to come up with some remedy, if we can, to the Canadian problem. We have not tried to come up with a remedy under this proposal in the time of normal times. We think that perhaps the Canadians and the Americans can live together in the same marketplace during normal times, but we are talking about recession or depressions.

What we are talking about is the fact that the Canadian lumber, which we can show you by our figures—Canadian stumpage in the Douglas fir region of British Columbia is selling about close to $300 a thousand less than it is in the Douglas fir region of Oregon. We are saying in a time of recession, when this value of Canadian stumpage goes down to a point and ours is still up here, a triggering device would be triggered which would bring our stumpage down on a parity with Canada. Then at that time, forget timber sales and think about logs. Any logs removed from the land would stay on a parity with Canada under that triggering program. That would entail us to theoretically keep 50 percent of the market. We would go down with Canada and back up until we hit the triggering point on the way up, and we would detrigger and go back to our competitive contract.

Senator PACKWOOD. All right. I understand.

Now, Mike, let me ask you a question. On page 3 you refer to the artificial shortage of timber due to the constant reductions in allowable cut, timber actually sold, and the continuing threat of future reductions.

When I came to the Senate, we could produce enough timber in this country, private and public, to build about 1.8 million homes. If we went beyond that, we had to import. And so in those days we welcomed some of the Canadian imports. We needed them.

I don't know how much the base has been reduced with set-asides, reassessments of allowable cuts, and what not, but just as a top-of-the-head guess I would say we could build maybe 1.5 million homes a year, or 1.4 or 1.6, out of our domestic resources. Beyond that we would have to import. It has been a long time since we have been able to test that theory, because we have been so far off in building that many homes for so long.

What I want to make sure as we go through this exercise is that we are not going to put into effect restrictions, tariff barriers, rules, or whatever else, that are simply going to keep more mills in business than the market will justify, even assuming we cut off the imports.

And so my question is this: First, are you in the Northwest facing increased competition from timber in the Southeast that you didn't face 10 years ago, 5 years ago, 15 years ago?

Mr. BURRILL. "From the Southeast," you are talking about the Southeastern United States?

Mr. PACKWOOD. Yes.

Mr. BURRILL. Yes; the markets that our company have enjoyed have been primarily in the Northeast and the Great Lakes States. We used to ship 70 to 75 percent of our production into those areas, and we are down now, probably, into the area of 50 percent. A big part of that is coming from the Southeastern part of the United States, and a big part of it is coming in from Canada; so we are getting the pressure from both sides.

Senator PACKWOOD. But you are not asking for any particular barrier against Southeast competition, American competition?

Mr. BURRILL. No.

Senator PACKWOOD. All right.

We will be lucky, I think, in any year in the next three to five to have 1.5 million starts a year. If that is true, and if the production is increasing in the Southeast, do we at the moment have more mill capacity than we would use, than we need, to produce the timber for 1.5 million homes?

Mr. BURRILL. I think I would answer in the affirmative on that. My concern, though, is that going through the recession that we are going through, and we've all talked in the past with people in the industry that at some point there is going to be a weeding out and there is going to be a certain number of us that are going to have to go out of business. And we accept that. Of course, each one of us doesn't want it to be us.

But the recession that we are going through right now, in my opinion, is going to take out much more of the production than is necessary under this normal weeding-out process. As I stated before, if it took us down to 50 percent of the production capacity that we have had before, I would shudder to think what is going to happen if we get an economy where we turn around and go the other way. We are going to see lumber prices that are going to be doubling and tripling from where they are now.

Senator PACKWOOD. I agree, because you are not going to find people to put in millions of dollars on 3 months notice to have workers working 24 hours a day to build a mill for a market that suddenly shows up. Those that have managed somehow to weather it are going to be in a bonanza position, because half of their competitors will have died on the vine. And then you are going to have exorbitantly high timber prices because of limited mill capacity. So we still won't have solved the problem as to how to provide the average homeowner in this country with reasonably priced timber at reasonable interest rates.

I want to say again what I said at the start of this hearing: I do not agree with this administration's policy about interest rates. And I'm not blaming the Federal Reserve Board; I'm more inclined to blame Congress over the past years than I am the Federal Reserve Board. I hate to think what interest would be in this country if Congress had control of the money supply in addition to the spending. Because if our record in the past on spending is any indi-

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cation, I can see what we would have done to solve the problem. We simply would have inflated the money supply beyond belief. And we would have paid off the national debt in worthless dollars, and you would have seen inflation more typical of third world developing countries than we have seen in the past.

But, that aside, this administration is determined to turn its capital formation to building factories rather than building homes. And I think that is a philosophical mistake. If what you want to insure in this country is a conservative, stable population, nothing is more likely to insure that than homebuilding and homeownership. And the fact that you have got to paint your own fence and mow your own lawn probably is a greater inducement against revolution than any other single thing that you can do. The policies of this country are going in the wrong direction as far as housing is concerned. I don't throw that out for a comment; it's just an aggravation I find. It's going to be ironic if we are going to pass all kinds of business incentives so that you can modernize your mills at the very time when there will be no product which your mills can turn out.

Mr. BURRILL. Two thoughts that I had while you were just talking: one of them is the fact that it doesn't make any difference what types of incentives the Government gives us that are tax incentives; if we don't have profits, we can't use any of those.

Another one refers back to your thoughts a little bit ago about the Government deficit reaching the $1 trillion and being possibly up to $1.3 trillion in 3 years. It's so easy for us to lose perspective. It took 200 years to get to $1 trillion and in 3 years we will be at $1.3. It wasn't very many years ago that 14 percent interest rates were considered to be extremely high, and we worried about them. Now we would love to see them.

Senator PACKWOOD. Isn't it ironic? When you and I purchased homes, we probably complained of interest rates up to 9 percent. We thought that was absolutely horrendous. And now we think if they get down to 12 percent, that would be incredibly low. And that's all in a 5-year period, for all practical purposes.

Gentlemen, I don't think I have any other questions. Thank you very much.

Next we will have Bradley Witt, representing the Western Council of the Lumber and Production Workers.

Good morning.

Mr. WITT. Good morning.

Senator PACKWOOD. You have been very patient in waiting out there. I appreciate it.

STATEMENT OF BRADLEY WITT, WESTERN COUNCIL, LUMBER PRODUCTION AND INDUSTRIAL WORKERS, PORTLAND, OREG.

Mr. WITT. Chairman Packwood, my name is Bradley Witt. I am the researcher for the Western Council of Lumber Production and Industrial Workers. We are an industrial union that represent workers in the forest products industry throughout the West.

Among our membership we have over 39,000 workers, among whom over half are either unemployed or working reduced work shifts.

Let me begin my comments today with a brief overview of the plight of the forest products industry. Since 1979 there has been a 25-percent decrease in employment in the forest products industry in Oregon. This has been 20 percent for Washington and Idaho. Sixty-seven percent of the sawmills and 71 percent of the plywood plants in the entire Western United States are either completely down or working curtailed shifts.

In 1980, timber revenues dropped a record $1.5 billion in Oregon and Washington as a result of the record drops in lumber and plywood production. And, unfortunately, year-end 1981 figures are going to be worse yet.

We are presently in a recession in the Northwest and heading for a depression.

Let me recount some of the social consequences of this major problem. The social consequences extend far beyond the immediately perceptible bankruptcies, foreclosures and human want. Indeed, the social fabric of the Pacific Northwest is threatened. Drug and alcohol abuse, hypertension, depression, child and spouse abuse, crime, divorce and suicide have all been documented as rising with the increasing unemployment in Pacific Northwest. And at some point, Senator Packwood, we are going to reach the breaking point, and people are going to react. I don't know how they are going to react, but I can assure you that they will.

Let me identify some of the problems that we are facing so that immediate corrective action can be taken. The major problem that is encumbering our industry today is high interest rates. It has in fact reduced demand. There is none left for housing and new construction. Housing accounts for 40 percent of the demand for lumber and wood products. When you include all new construction, that is 60 percent of the demand for those products.

There have also been cuts in the Federal housing program which have further reduced the demand for wood products. There is simply no demand out there. Our people don't work if the products are not being used.

Stumpage inflation is also a problem, as you very well know. There have been requests for extensions and, in fact, termination of timber sales and contracts. The problem here is the system of those sales.

What we have to do, what Members of Congress should do, is consider two alternatives: one, revamping the present system—patching it up, if you will. We list the course of action that the Senate should decide to pursue. And I would suggest that contract terms be shortened to 2 years; that there should be significant downpayments made on the sales; we should increase the bonding performance requirements; and enforce the duration of these contracts.

Now, one word of caution here. By increasing the downpayment on sales, we may in fact contribute to increasing market concentration within our industry, which is already a very significant problem. From 1967 to 1977 the 50 leading firms in the forest products industry increased their market concentration rates from 28 to 46 percent. We have to consider the impacts that downpayments would have in this area, as well.

Should we decide to try and restructure our system of timber sales? I would suggest that we take a look at the supermarket approach, which has been referred to within the industry. Under this system the timber harvesting is subcontracted to private firms. Then the Government sells logs that have been harvested, on demand, at fair market appraisals, by species and grade, from coal decks. This system would in fact eliminate speculation that leads and encourages stumpage inflation.

Another very serious problem confronting our industry is log exports. This is a significant detriment to our industry in terms of both production opportunities as well as employment opportunities, and it has a very negative impact upon our Nation's balance of trade. And I must emphasize that the export of soft wood logs is, in fact, a subsidy to the foreign trading ventures of private corporations that avail themselves of the public's timber.

I would suggest that a comprehensive log export ban would exclude all log exports, would do away with grandfather clauses in appropriations riders that provide loopholes for those people that were exporting the timber back in the early 1970's. It would also exclude third-party substitution of log exports and also would close the Kant loophole, which allows firms to export timber simply by surfacing three sides of the log.

And finally, our tax codes should be restructured. And I have particular reference here to DISC. This is all outlined in my testimony. They should be restructured so that they encourage the export of finish wood products to the exclusion of round logs.

The pernicious complement to log exports are lumber imports, particularly cheap lumber imports from Canada. One-third of our domestic market is currently being served by Canadian-processed lumber. There are several reasons for this: a cheaper Canadian dollar, lower freight rates in Canada, lower energy costs, license to ship on foreign bottoms, smaller logs due to their climatic conditions, and, again, the Canadian system of timber sales. Under this system the Canadian companies are allotted or are leased timber sales, noncompetitively, on the basis of their productive capacities.

Now, the cost to the companies, what the Crown charges these companies, this cost only reflects the administrative and management costs that are incurred by the Crown; as well as it also reflects a conviction by the Crown that the cost of this timber need only pay for itself, because the system pays as it goes.

And finally, these costs are adjusted immediately preceding a sale and reflect the market conditions at the time of sale. What this leads to is a hundred dollar cheaper timber for the Canadian mills at the time that that log reaches the mill, when it does in the Pacific Northwest. This is called the millpond cost of logs and makes it possible to compare more accurately the cost of Canadian timber and American timber. Because of the system, stumpage prices are not a good comparison. Millpond prices are. A hundred dollars difference.

Our union believes that this is in fact a subsidy for Canadian timber, that our members have been forced to suffer economic hardship as a result, our industry has lost production opportunities, and we therefore request that under a general agreement on tariffs and trade that the countervailing duties be enacted.

Now, very briefly——

Senator PACKWOOD. Bradley, you have to make it brief, because I have got to make you sum up now.

Mr. WITT. OK.

Very briefly, we would also encourage increased funding for silvacultural programing, research, and outreach efforts by the Government for small private woodland owners. We also look very favorably upon your reforestation bill. There needs to be increased outlays for the control of insects, diseases, fire, and theft. There are over 2½ million board feet in Oregon that are lost in Oregon alone every year, due to these losses. We would also encourage that the nondeclining evenflow policy be changed, that we can still meet sustained yield by increasing the harvest on old-growth timber and reforestation efforts. And I would emphasize that all of these are going to require increased appropriations.

[The prepared statement follows:]

Statement by Bradley Witt, Researcher
for
WESTERN COUNCIL LPIW

Before: The United States Senate Finance Subcommittees on Taxation and International Trade

November 24, 1981

Chairmen Packwood and Danforth and members of the Joint Senate Subcommittees on Taxation and International Trade, my name is Bradley Witt. I am the researcher for the Western Council of Lumber, Production and Industrial Workers, an industrial union that represents workers in the forest products industry throughout the western United States.

Among our membership we count over 39 thousand workers; over half of whom are now either unemployed or working reduced shifts. I also want to point out that there are an additional 12 thousand men and women who have contributed a great deal to our union in the recent past but who are now suffering the burdens of permanent plant closures. Since 1975 about 2 thousand of our members have lost their jobs in this fashion every year.

The LPIW appreciates the opportunity to appear before the Joint Senate Subcommittees on Taxation and International Trade in order to make known the very serious problems confronting our industry, the origins of these problems and to ask your help in correcting them.

As is evidenced by the disastrous levels of unemployment, capacity utilization, production and revenues, our industry is in the throws of an economic catastrophe. A total of 35 thousand lumber and wood products jobs have been eliminated in Oregon, Washington and Idaho since August 1979. This registers a 23% employment decline in lumber and wood products jobs in Oregon and a 20% drop in both Idaho and Washington.[1] Furthermore 67% of the sawmills and 71% of the plywood plants in Oregon, Washington, California, Idaho and Montana are presently closed or working curtailed shifts.[2]

It is significant to note that the highest levels of employment in the forest products industry are normally recorded during the month of September. However, in Oregon, which is the nation's leading producer of lumber and plywood, September 1981 marked the highest level of unemployment to that date. And the figures are increasingly ominous every week, if not in fact, every day. Messrs. Chairmen, the forest products industry of the Pacific Northwest is heading into the winter off-season with already record levels of unemployment and diminished capacity utilization. Our industry is facing the worst retraction in the Post War Era. This winter may qualify as a veritable depression.

In Oregon and Washington, timber revenues dropped a record $1.5 billion in 1980 with lumber production having dropped 1.5 billion board feet in Oregon and 680 million board feet in Washington. Plywood production dropped a record 1.75 billion square feet in Oregon and 250 million square feet in Washington.[3] And year-end figures for 1981 promise even further declines.

Messrs. Chairmen at this point I would like to cast an editorial presage. There are many people in the Northwest who have concluded that the Potomac pundits of tight monetary policy have become, at least ostensibly, anesthesized to the very personal tragedies that encompass the growth in unemployment. A reasonable person can only assume that were our economic programs designed with an element of human concern, that those in a position of power would never have let our industry and region fall to the present depths of perdition. Furthermore this sentiment holds that these same pundits have decided quite cavalierly to right our nation's economic ills on the backs of our industry, its workers and our region. I have two points to make. First, and please excuse the colloquialism, you can only kick a dog just so many times before it bites back. Secondly our unemployment crisis extends far beyond the immediately perceptible bankruptcies, foreclosures, deficits and human want. Our region's social fabric is threatened as well. I hasten to point out Senators that drug and alcohol abuse, hypertension, depression, child and spouse abuse, crime, divorce and suicide have all been documented as rising in tandem with the growing unemployment.

Having summarized our industry's woes, Messrs. Chairmen, it is now appropriate to identify some of the problem areas so that corrective action can be promptly undertaken. The overwhelmingly pernicious and salient factor encumbering our industry today is high interest rates. If the forest products industry is ever to return to some semblance of normal capacity, interest rates are going to have to come down. Housing construction accounts for about 40% of the demand for lumber and plywood with total new construction accounting for about 60% of the demand for these products.[4] However because of today's high interest rates, the housing and construction markets have been garrotted. In point of fact, the current rate of housing starts is less than half of normal demand. (See Appendix) Current mortgage interest rates are simply beyond the financial means of 95% of America's families.[5]

Messrs. Chairmen tight monetary policies have wreaked havoc with the construction industry (the unemployment rate is 18% and subcontractors are bankrupting at 120% of 1980 levels[6]), have subsequently ravaged our industry, have dashed the hopes of homeownership for an entire generation of Americans (which has in turn reduced rental vacancies and forced families to double-up) and have plunged our nation into yet another recession with the likelihood of a depression not improbable - especially in our region.

Before we are forced to suffer even greater economic and financial hardships, before the backbone of our nation's forest products industry is broken, before the unemployed and impoverished in this country begin burning the Trojan Horse as they did in England last summer and before our nation's budget deficit is allowed to approach the projected levels of $150 billion, the LPIW beseeches these Joint Subcommittees to do everything in your powers to see to it that high interest rates are eliminated.

Even with a reduction in interest rates our industry's recovery may be prolonged by the Reagan Administration's penchant for cutting federally assisted housing programs. It should be remembered that the White House's involvement in housing was crucial to the economic recovery of the mid-1970's. However, in FY 1981, Section VIII housing starts, which comprise HUD's primary housing program, declined 55% to 60,429 units.[7] In addition the Administration's

FY 1982 budget cuts that were passed earlier this year, reduce the number of new apartments by about 60 thousand units. Projected cuts for FY 1983 will eliminate another 10 thousand units.[8] In light of the need for housing in this country and the need to rekindle our construction and forest products industries, the LPIW recommends Congressional approval of a housing program similar to the one appended.

There has been a lot of discussion lately concerning extensions to timber contract sales on both USFS and BLM lands. With all the debate surrounding the issue, the LPIW feels that the disease has been overlooked in light of the prominence of the current symptoms. Many of these contracts have been placed in jeopardy as a consequence of unbridled speculation on the part of those timber companies that have sufficient market power to influence prices and who persist in propelling stumpage prices ever higher in order to be able to recoup profits from previous rounds of speculative bidding.

Now we can all point a finger at these companies and blame them for digging their own graves----and we are certainly right in doing so. And depending upon our inclination we could either grant them extensions or tell them to take their own licks. Yet we will have solved nothing because the scenario will only repeat itself again and again. The LPIW recommends that these Joint Subcommittees, in cooperation with the various other Committees of the Congress that have province in the distribution of the public's timber, examine how the present sales system allows, and even encourages, speculative bidding.

It can be anticipated that such an investigation will move Congress to enact remedial legislation. This will necessarily mean that Congress will have to decide whether to revamp the existing system or to abandon it in favor of an altogether different method of timber allocation. I suggest that motivations to adopt the former course of action would include a desire to maximize the public's financial return on our nation's natural resources. It would be necessary in this case, in order to realize the greatest success from your legislative efforts, to shorten the length of contracts to a maximum of two years, to rigidly enforce contract durations, to increase bonding requirements and perhaps require significant downpayments on timber sales. (It should be noted here that this last proposal might exacerbate an already serious problem of market concentration in our industry. Between 1967 and 1977, the 50 largest U. S. forest products firms increased their share of the lumber market from 28 to 46 percent.)[9] While these reforms would help to curb speculative bidding, they will not eliminate it. Purchasers will simply have two years to bet-on-the-come instead of five.

Should the Congress decide to eliminate the bid system altogether, with the intention of ending speculative bidding and thereby also providing our finished forest products with a more competitive position in both the domestic and international markets, then the "supermarket approach" warrants consideration. Under this method of timber allocation the USFS and the BLM would subcontract timber harvesting. The federal government would then sell the logs on demand at fair market appraisals by species and grade from cold decks.

Another problem area that is of significant detriment to our industry as well as the nation's balance of trade is log exports on the one hand and lumber imports on the other. It may surprise some members of the Senate that the LPIW should be concerned with the export of federal timber. Congress has attempted to ban log exports by means of a rider to the annual Appropriations Bill. Herein lies part of the problem. There exists the very real threat that in any given year, the rider will fail to pass and federal timber will be made available for export. Therefore the LPIW strongly urges that Congress adopt legislation to ban log exports.

Each year some 83 million board feet of federal timber are exported from Washington with another 11 million board feet from Oregon by means of the direct substitution provisions contained in the rider. A grandfather clause enables firms that export their inventories to replace them with federal timber up to an annual volume of 110 percent of their average annual harvest on federal lands for the base years 1971 to 1973. I must emphasize that this is public timber that is being used to supplement the foreign trading ventures of private firms. Legislation must be adopted by the Congress to end this practice.

Additional timber is made available for export by means of a loophole in the rider which allows third-party substitution. Companies are free to substitute federal timber for exported logs simply by arranging purchase agreements through a third party. In 1980 this loophole was responsible for the export of 200 million board feet of logs from the Pacific Northwest.[10] Legislation must be adopted by the Congress to end this practice as well.

Federal restrictions on log exports only address round logs. This creates yet another loophole whereby firms can surface only three sides of a log and then export it. It is estimated that 40 million board feet of softwood logs are exported in this fashion from just Oregon alone, every year.[11] A comprehensive log export ban such as the LPIW requested Congress to enact must mandate that finished wood products are exclusively available for export.

It is essential that members of Congress understand the damage that log exports do to our industry. They not only cause a significant net reduction in the job carrying capacity of our nation's forests, they also deny raw materials to our mills. In terms of employment, log exports generate a mere 4.7 worker hours per thousand board feet, whereas lumber and plywood manufacturing generate 12.6 and 19.5 worker hours respectively. The devastating impact that log exports exert on the job market becomes ever more indubitable when one considers that domestic timber manufacturing generates 2.5 jobs in ancillary sectors for every job in the wood products industry.[12] In light of the unemployment rate in our industry Mr. Chairman, it is an abomination that the public's timber is exported, or substituted for export.

The quality of our region's finished wood products is also adversely impacted by log exports. (It should be noted here that virtually all of our nation's softwood timber that is exported as logs is grown in the Pacific Northwest.)[13] The best grades of lumber and plywood are produced, ceteris paribus, from old growth timber. Yet two-thirds of the timber exported from the Northwest are old growth logs.[14] Furthermore fully one-third of all the timber harvested in Oregon and Washington in 1980 was exported.[15] This depletion of our region's old growth inventories is particularly troublesome for those plywood mills whose operations are dependent upon this specific grade of raw material. Without access to old growth logs, many plywood plants are faced with the prospects of permanent plant closures.

Log exports also deny our domestic mills an opportunity to process the public's timber for consumption in our domestic markets. Most obvious in this regard are the 9 billion board feet of softwood lumber that is imported from Canada annually. This volume is triple our nation's total average volume of softwood log exports.[16] It is a hyperbolic understatement to characterize this as a poor allocation of resources.

Log exports also contribute to stumpage inflation. The Japanese, who consume 90% of the log exports originating on Oregon and Washington lands,[17] have demonstrated an inexorable willingness to continually outbid domestic buyers of the region's timber. This has led to higher raw materials costs for our domestic mills and in turn higher finished products prices (40% of the price of lumber and 17% of the price of plywood is attributable to stumpage pric~~es)~~[13] ~~and~~ ultimately higher costs for housing and all other construction and manufacturing that utilize wood materials. Furthermore the higher stumpage prices climb, the greater becomes the number of small mills that are forced to close due to raw materials costs. The end result is higher unemployment, reductions in productive capacity and increased market concentration.

The LPIW wishes to emphasize that a comprehensive ban on log exports will not eliminate international markets for finished wood products. It will in fact cultivate such trade. Witness the fact that the Canadians maintain a ban on log exports and the international markets for their finished wood products have grown over time throughout the world.

Cheap lumber imports, especially softwood lumber from Canada, comprise a ruinous complement to log exports. Approximately one-third of all lumber consumed in the United States is now manufactured in Canada; up from 20% as recently as 1975.[19] There are a variety of reasons why Canadian lumber enjoys a considerable price advantage in our domestic markets. Among them are a cheaper Canadian dollar, lower Canadian freight rates, lower energy costs, license to ship lumber on foreign flag vessels, smaller diameter logs due to climatic conditions and last but certainly not least, the Canadian system of timber sales.

In Canada, stumpage inflation is held to a minimum in the absence of the bid system. Instead, forest products companies are allotted timber noncompetitively on the basis of their productive capacities. The Crown leases tracks of land to these companies for periods ranging between 10 and 25 years. During this time the companies assume all management, development and administrative costs on their respective leases. It is important to note that these costs are not reflected in Crown stumpage prices. Thus comparisons are difficult to make between U. S. and Canadian stumpage prices.

Nevertheless "the price of Canadian logs delivered at the mill is about $255 per thousand board feet, or about $100 less than the cost of logs arriving at U. S. mills in the Pacific Northwest."[20] This "mill pond" price is particularly suited to making comparisons between Canadian and U. S. West Coast raw materials costs. It also elucidates Canada's competitive advantage in U. S. lumber markets. Canadian lumber is cheaper than U. S. lumber ceteris paribus, because the Crown sets noncompetitive timber prices immediately preceding harvest. These prices reflect Provincial administrative and management costs as well as a Crown conviction that revenues only need to make the system pay for itself. In addition the administered price reflects market conditions at the time of sale. This in essence is a Crown subsidy of Canada's forest products industry because the companies' raw materials costs do not reflect what the market would otherwise bear.

As a direct consequence of subsidized Canadian lumber capturing one-third of the U. S. market, LPIW members and our industry have been caused to suffer reduced employment and production opportunities. In keeping with the General Agreement on Tariffs and Trade (GATT) the LPIW hereby petitions the United States Senate to implement countervailing duties on Canadian softwood lumber imports. GATT provides that "if an industry suffers material injury, or the threat of injury from the import of subsidized goods, then the importing country may levy countervailing duties to offset the trade effects of such subsidies."[21]

The LPIW would like to focus the Taxation Subcommittee's attention on a particular aspect of the federal tax codes that encourages log exports. Under provisions of the Domestic International Sales Corporation, log export firms are encouraged to channel their profits through fabricated subsidiaries. Companies are thereby excused from paying taxes on as much as half of their profits[22] (which are only subject to a 46% rate to begin with). The LPIW requests that the Subcommittee pursue tax legislation that will promote the export of finished wood products at the exclusion of unprocessed logs.

To this point, I have been addressing industry issues that are primarily economic in nature. I would now like to turn the Subcommittees' attention to issues connected with forest management. By virtue of the fact that the adequacy of our nation's forest management programming is in large part determined by the federal budget, the remainder of my testimony will continue to reflect the LPIW's economic and financial concerns.

The United States faces an extremely severe timber shortage in the coming decades. Our present market anomaly excluded, the USFS projects that U. S. demand for wood products will expend between 1.5% and 3.0% per year through 1990. However over the same time period domestic supply is predicted to expand by only 0.5%[23] if we do not significantly expand our commitments to commercial forest management.

Much of the shortfall in the Northwest is attributable to the historically inadequate levels of timber production and harvesting on federal and non-industrial private forests. For example, while this latter group owns 16% of Oregon's commercial forest land, only 20% of these holdings are managed for timber production.[24] Similarly while 47% of Oregon's timber inventory is growing on federal lands, these forests contribute to only 30% of Oregon's total harvest.[25]

In a protracted effort to meet demand, the industry's response has been to harvest its own timber at rates which currently consign much of their inventory to immature growth stages. As a result, these stocks will not be ready for harvest in Oregon until the turn of the century. During the interim period the shortfall in available supply can only be compensated for by increasing the harvest volume on the region's federal forests and small private woodlands.

To achieve the necessary increases in harvest levels, the United States must intensify its forestry research and technical outreach efforts. This will enable the various ownership types to implement intensive forest management on their lands. Optimally all of the nation's forests should have complete and coordinated silvercultural applications as warranted. These methods include site preparation, rehabilitation and conversion and improvements in reforestation, fertilization, thinning (both precommercial and commercial) and better protection from fire, insects, diseases, animals and theft. (See Appendix.)

Forests located throughout the country need management programs. Yet the pending Appropriations Bill will necessitate a 300 million board foot reduction in FY 1982 harvest levels on our national forests alone. Our federal priorities have indeed set a poor example for the other forest owners. How can one justify asking the small woodlot owners to increase their investments and harvest levels while the federal government abandons similar responsibilities? Forest planning is conducted on the basis of 10 year leads. In 1990, when projected demand indicates that harvests from our national forests should approximate 17 billion board feet, what will be the magnitude of the supply gap as a consequence of our present budget austerity? What are the implications regarding inflation and housing shortages?

Throughout the country there are countless opportunities begging for forest management. Assistant Secretary of Agriculture, John Crowell has disclosed that annual timber harvests could be tripled on our national forests if they were intensively managed.[26] Oregon has about 570 thousand acres of prime forest lands located in the Coastal Mountain Range that are underproductive due to extreme brush competition. If this area was rehabilitated under an intensive Douglas fir management scheme, yields on a 60 year rotation could realistically be increased by over 30 billion board feet.[27] Similarly the reforestation, thinning and fertilization of deprived lands in eastern Oregon could increase total annual yields by up to 70%.[28]

As I indicated earlier, small woodlot owners will play a central role in efforts to increase our country's harvestable timber supplies. In Oregon, for example, this ownership category could conceivably double its annual harvest by means of comprehensive forest management.[29] However many small woodlot owners are financially prohibited from making sizeable investments and then having to wait 60 years until the timber is harvested in order to recover their costs. Therefore the LPIW recommends that our federal tax codes be restructured to enable small woodlot owners to expense silvercultural applications rather than having to capitalize them.

In the same vein, the LPIW urges adoption of Senator Packwood's reforestation tax credit. This legislation would augment our nation's timber inventories by raising the cap on reforestation tax incentives from $10,000 to $25,000. The LPIW wants to emphasize that these tax incentives should accrue to small landowners only. We reject the notion of providing further tax subsidies for the large corporations.

The forest products industry is denied the opportunity to harvest and process significant volumes of timber due to an array of natural and administrative inventory leakages. For example, losses caused by insects, diseases and old age amount to 2 billion board feet in Oregon every year. Nearly half of this waste occurs on westside national forests.[30] In northeastern Oregon, mountain pine beetles have already killed 1.5 times more timber than was killed by the eruption of Mount St. Helens and 3 to 4 times more timber is threatened.[31] Once again it must be pointed out that these losses cannot be prevented without adequate funding.

Federal policies designed to manage wilderness areas and old growth timber inhibit the amplification of timber inventories. Throughout the West Coast, commercial timberland is forecast to drop 8.7 million acres by the year 2030. Of this total, nearly 7 million acres will be withdrawn from commercial production because of wilderness set asides. The remainder will be lost to various land conversions including agriculture, industrial parks, housing construction, roads, power lines, reservoirs and recreational development.[32]

Reductions in our forested land base of this magnitude point out the need to increase our commitments to intensive forest management on remaining lands.

The LPIW cautions the Senate against sanctioning excessive wilderness designations. These areas not only lock-up vital resources and reduce employment opportunities, they also serve as breeding grounds for timber diseases and pest infestations as well as wildfires. These afflictions often spread to adjoining forests, thus making their control difficult and eradication impossible.

The LPIW urges members of Congress to review public policy governing timber harvests on federal lands. These forests are managed by a philosophy that attempts to maintain sustained yields in perpetuity. This particular aspect of the public policy is commendable. However serious problems arise when the USFS and BLM implement inappropriate means to accomplish the intended goal. My specific reference here is to non-declining, even-flow management which is derived from a myopic and grossly over-simplistic analysis of the components of sustained yield management.

The LPIW suggests that harvest levels of old growth timber can be increased on public lands in conjunction with intensive silvercultural schemes like the ones I discussed earlier and still meet or exceed sustained yield targets. It is significant to note in this regard that the harvest of old growth timber and subsequent reforestation account for over 70% of the net annual growth opportunities on national forest lands located in western Oregon.[33] It should also be noted that over-mature trees are characterized by extremely slow rates of growth and high levels of susceptibility to disease and pest infestations.

Prudent changes in non-declining, even-flow policy would increase net annual growth rates on federal forests. This in turn would increase the employment carrying capacities on the public's land and help to curb stumpage inflation. While departures from current policy are warranted, the problem again is one of federal budgeting. As the Chief Forester for Region VI has explained, "The big danger I foresee in opting for a major departure from even-flow is one of funding intensive forest activities."[34]

Animal damage and theft further reduce our timber inventories. A study published in 1979 reported that conifer growth rates and yields in the Northwest are reduced by up to 13% due to animal damage.[35] It is difficult to accurately assess total lossage due to theft. Estimates by the FBI indicate that up to 10% of our federal timber stocks may be lost to thieves and vandals. While this estimate may appear excessive, it nonetheless indicates the gravity of the problem. Again it is going to require significant budget outlays in order to bring these losses under control.

Messrs. Chairmen, throughout the latter portion of my testimony which has dealt with timber management, I have made repeated mention of the need to appropriate adequate funds to help correct the many problems that are limiting our nation's supply of timber. I want to make one final point. It makes sense and cents to adequately fund forest management. For every dollar the government invests in forest management in the Pacific Northwest, $2.40 is returned to the Treasury.[36]

Thank you Messrs. Chairmen. That concludes my prepared testimony. I would now be happy to try and answer any questions that you might have.

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RECOMMENDED HOUSING PROGRAM

(1) For fiscal year 1982:

Enact additional budgetary and contract authority to support 50,000 new construction units under the public housing and Section 8 low-income rental housing programs, with authority for 10,000 Section 8 units to be reserved for the Section 202 program of housing for the elderly and the handicapped.

Enact additional budgetary and contract authority to permit support for 50,000 new units under the HUD Section 235 low- and moderate-income homeownership assistance program.

Enact authorization for the purchase of 100,000 middle-income new home mortgages at below-market interest rates, pursuant to the Emergency Housing Act of 1974, as amended.

(2) For fiscal year 1983:

Authorize budgetary obligations and contract authority to support a total of 300,000 units under the Public Housing and Section 8 low-rent public housing limits, of which two-thirds are to be reserved for new construction.

Authorize budgetary obligations and contract authority for 75,000 low- and moderate-income Section 235 homeownership assistance units, of which two-thirds shall be new construction.

Enact authorization for the purchase of 75,000 middle-income new home mortgages at below-market interest rates, pursuant to the Emergency Housing Act of 1974, as amended.

(3) Make permanent the Credit Control Act of 1969, presently due to expire June 30, 1982, and implement it temporarily to help bring mortgage interest rates below double-digit levels.

Source: Office of Housing and Monetary Policy, AFL-CIO

APPENDIX A-1

Total Private Housing Starts, Annually
1978-1981; Monthly at Seasonally
Adjusted Annual Rates 1981

Year or Month	Housing Starts (in thousands of units)
1978	2,020
1979	1,745
1980	1,292
1981*	1,178
1981	
Jan.	1,660
Feb.	1,215
Mar.	1,297
April	1,332
May	1,158
June	1,039
July	1,049
Aug.	934
Sept.	918

*Average of seasonally adjusted rates, January-September, 1981

Sources: National Association of Home Builders;
U.S. Bureau of the Census.

Source: Office of Housing and Monetary
Policy, AFL-CIO

APPENDIX A-2

National Average of Interest Rates
on Conventional Home Mortgages
for Which Commitments are Issued*
1978-1981

1978	9.69
1979	11.27
1980	14.00
1980	
Jan.	13.07
Feb.	13.13
March	14.72
April	16.59
May	15.70
June	13.37
July	12.57
Aug.	12.52
Sept.	13.23
Oct.	13.86
Nov.	14.26
Dec.	14.95
1981	
Jan.	15.38
Feb.	15.34
March	15.47
April	15.53
May	16.12
June	16.82
July	16.96
Aug.	17.31
Sept.	17.71

*Average for all types of lenders for loans with 75 percent loan-to-value ratios and 25 year maturities

Source: Federal Home Loan Bank Board

Source: Office of Housing and Monetary Policy, AFL-CIO

APPENDIX A-3

Prices of Existing and New Homes - Annually 1978-1980; Monthly, 1981

	Median Existing Home Sales Price	Median New Home Price
1978	$48,700	$55,700
1979	55,700	62,900
1980	62,200	64,500
1981		
Jan.	64,500	67,900
Feb.	64,100	65,800
Mar.	64,400	67,100
April	65,300	68,400
May	66,300	71,200
June	67,700	68,700
July	67,500	69,600
Aug.	68,100	73,600
Sept.	67,700	67,100

Source: National Association of Realtors; Bureau of the Census

Source: Office of Housing and Monetary Policy, AFL-CIO

APPENDIX B-1

Table 1.3.6 *

U.S. Softwood Log Exports by Customs District
-Billions of Board Feet, Scribner Scale-

	Washington	Oregon	Northern California	Alaska
1970	1.58	0.64	0.19	0.05
1971	1.32	0.52	0.10	0.04
1972	1.91	0.73	0.08	0.07
1973	1.83	0.81	0.10	0.07
1974	1.42	0.77	0.08	0.03
1975	1.43	0.80	0.09	0.03
1976	1.79	0.94	0.11	0.03
1977	1.67	0.88	0.07	0.05
1978	1.92	0.93	0.07	0.07
1979	2.21	0.98	0.07	0.13

Source: Data for 1970-1978 are republished in "Production, Prices, Employment, and Trade in Northwest Forest Industries," compiled by Florence K. Ruderman of the Pacific Northwest Forest and Range Experiment Station. 1979 data are available in "Random Lengths Export Market Report," Random Lengths Publications, Inc. The original source of this information is the U.S. Bureau of Census.

Japan was the destination of 92% of all U.S. softwood logs exported during the 1970s. Almost the entire balance is exported to South Korea (where a significant volume is manufactured into lumber for sale to the Japanese). The importance of Japan in the U.S. log export market is demonstrated in Table 1.3.7.

Table 1.3.7 *

U.S. Softwood Log Exports to Japan
-Billions of Board Feet, Scribner Scale-

	Total U.S. Log Exports	Log Exports to Japan	Japanese Share -Percent-
1970	2.46	2.37	96
1971	1.98	1.84	93
1972	2.78	2.52	91
1973	2.82	2.62	93
1974	2.30	2.07	90
1975	2.34	2.12	90
1976	2.87	2.66	93
1977	2.68	2.45	92
1978	2.99	2.64	88
1979	3.38	3.16	94

Source: Same as Table 1.3.6.

* Preliminary report prepared by Data Resources Inc. for the Pacific Northwest Regional Commission.

APPENDIX B-2

Table 3.1.3

Canadian Softwood Lumber Market Shares
-Percent-

	U.S.	Northeast	North Central	South	West
1970	19	43	16	19	4
1979	27	52	31	25	13

Table 3.1.6

Canadian Softwood Lumber Production and
Exports to the U.S.
-Billions of Board Feet-

	Canadian Production	Exports to the U.S.	Exports to the U.S. as a Percent of Production
1970	10.79	5.77	54
1971	12.28	7.25	59
1972	13.44	8.98	67
1973	14.94	9.00	60
1974	13.00	6.81	52
1975	11.15	5.71	51
1976	14.84	7.95	54
1977	17.23	10.38	60
1978	18.39	11.83	64
1979	18.71	11.12	59

Note: Exports represent U.S. softwood lumber imports as reported by NFPA. Included is less than 0.1 BBF per year from sources other than Canada.

Source: Demand for Pacific Northwest Timber and Timber Products, a preliminary report by Data Resources, Inc., 1980.

Table 1.3.2

U.S. Softwood Lumber Exports by Destination
-Millions of Board Feet-

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Western Hemisphere:										
Canada	201	205	288	387	379	395	434	377	380	428
Central America	95	78	79	86	89	98	122	133	128	182
South America	14	10	10	13	14	16	13	12	5	8
Europe:										
Belgium	3	2	1	18	20	9	15	12	11	17
France	6	7	8	15	5	7	9	12	6	8
Italy	116	87	115	179	115	101	130	113	105	161
Netherlands	25	19	22	30	11	9	17	13	12	11
United Kingdom	29	22	26	91	77	23	42	30	23	37
West Germany	61	58	77	110	30	47	66	65	65	58
Other Europe	43	21	22	51	29	27	40	47	33	52
Asia:										
Japan	405	288	408	565	570	515	475	437	407	641
Korea	26	12	6	3	1	7	1	2	6	7
Other Asia	9	6	6	11	18	16	37	24	46	49
Oceania:										
Australia	81	84	94	151	119	105	165	107	101	94
New Zealand	7	2	4	11	9	2	4	3	2	2
Other Oceania	17	15	19	16	23	18	13	15	13	21
Africa:	17	14	4	12	27	8	16	35	11	5
TOTAL EXPORTS:	1,155	930	1,187	1,740	1,536	1,401	1,599	1,437	1,354	1,781

Source: Western Wood Products Association, "Statistical Yearbook," 1979. The original source of this information is the U.S. Bureau of Census.

Source: <u>Demand for Pacific Northwest Timber and Timber Products</u>, a preliminary report by Data Resources, Inc., 1980.

APPENDIX C-1

Artificial regeneration is used by nearly all the public land management agencies, forest industries, and a sizable portion of non-industrial private landowners. This method of reforestation can reduce the harvest rotation period by two to ten years depending upon the particular site and climatic conditions.

Several problems are encountered in the reforestation effort. Adverse site conditions (poor soil, dry or exposed slopes, etc.) slow down and sometimes prevent stand establishment. Animal damage is a major problem that occurs throughout the state, causing otherwise successful efforts to fail. The first step toward eliminating animal damage is to recognize the potential problems in the planning stage and provide alternatives or control measures in order to secure successful stand establishment.

Artificial regeneration generally yields high returns, except on lower site classes with longer rotation lengths. High returns from this practice result from low investment costs (stand establishment costs), shorter rotation lengths, and increased yields. The economic rotation age, the point where growth is maximized for each dollar invested, occurs at 50 years for the higher sites and at 60 years on the lower sites. (Landowner objectives and management decisions will vary and are not always based upon economic rotation age.) Growth rates decrease after 50 to 60 years, while the costs of holding the investment for longer periods continue to build.

APPENDIX C-2

Converting underproductive forest lands, including low-value hardwoods and undesirable brush areas, to conifer species has rapidly increased in the last three to five years. Recent projections of declines in timber supply, increasing timber prices, withdrawals from the commercial forest land base, and the disappearance of readily available high volume old-growth stands all have contributed to a rapid increase in the rehabilitation of underproductive forest lands.

Because of increased costs for site preparation, converting underproductive forest lands will yield lower returns than artificial regeneration on an area following final harvest. Stand establishment costs increase from $102/acre for artificial regeneration to a cost of $331/acre for brush and hardwood conversion (stand establishment costs included). Brush and hardwood conversion on Site Class II at 50 years shows a benefit/cost ratio of $1.22 returned for every dollar invested, as compared to 13 cents returned for every dollar invested if the lands were not converted, but left in an underproductive condition for 50 years.

The economic rotation age for brush-hardwood conversion occurs at age 50 on the higher site classes and at 60 years for the lower site classes. Most of the lower site classes will not return the initial investment costs during the first rotation, but will provide substantial returns on subsequent rotations.

APPENDIX C-3

A current survey of the Coast Range area compiled preliminary estimates of the extent of underproductive forest land*. The study area contained some 3.2 million acres of commercial forest land of which 25 to 30 percent is classified as underproductive in varying degrees. This area also contains approximately 70 to 75 percent of the highest site forest land in western Oregon. Converting these underproductive forest lands to productive forests would dramatically increase the amount of wood fiber available in the long term.

Precommercial thinning is purely an investment in the future growth of the stand. None of the thinned material will be processed for profit. This practice is designed to capture the full potential of the site at the earliest possible age and provides an opportunity to select the trees that exhibit superior genetic characteristics.

Precommercial thinning generally tends to give higher returns than artificial regeneration. However, high site lands have similar returns for both practices. The increased yields resulting from precommercial thinning tend to offset the increased costs. Precommercial thinning increases the yield as much as 25 percent if done early enough to eliminate crowding.

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*The Underproductive Lands Study is being conducted by the Oregon State Department of Forestry under a grant from the Pacific Northwest Regional Commission. A final report is expected by April, 1977.

APPENDIX C-4

<u>Commercial thinning</u> in immature stands redistributes the growth potential of the stand and permits greater utilization of the merchantable material produced by the stand during the rotation. Commercial thinnings slightly increase net merchantable volume available over a rotation. Usually all or most of the material in a commercial thinning is processed, leaving only tree tops and branches as residue. Commercial thinning may remove as little as 10 percent or as much as 40 percent of the total growing stock, depending upon management goals and stand structure. Commercial thinning decreases the capital investment in the form of standing volume and, in turn, increases the profitability of growing trees.

Some landowners commercially thin their land for other than economic reasons; for instance, thinning may be practiced because of scenic beauty that may have an intangible value, to improve stand composition, to prepare for establishment of new crops, or to reduce the risk of insect damage.

Repeated commercial thinnings provide lower returns on investment than any current silvicultural technique except conversion of underproductive forest lands. Although positive returns can result, higher returns can be realized from other intensive management practices.

Commercial thinning can provide immediate income at thinning age instead of waiting until rotation age. This practice is highly desirable in maintaining a stable cash flow system.

APPENDIX C-5

Nitrogen fertilization of timber stands is a relatively new silvicultural practice. Most forest soils cannot provide an adequate supply of nutrient elements that are readily available for tree use and are necessary to maintain an optimum growth rate during a 50- to 70-year rotation cycle. The majority of nutrients usually are tied up in the forest litter. Litter decomposition normally is too slow to provide the continued nutrient availability that is needed throughout the growing period of the stand. Recent research has shown that lower site classes respond more favorably in terms of percent of growth increase than do the higher site classes. Repeated applications of nitrogen fertilizer (up to a maximum of three) result in the highest volume returns on the higher sites even though lower site classes have a higher percent gain. For instance, fertilization increases yields on Site Class I lands, at rotation age 60, by 3.8 MBF/acre as compared to only 1.4 MBF/acre increase on Site Class V lands for the same rotation length. The economic rotation age for fertilized stands occurs at age 50 for the higher site classes and age 60 for the lower site classes.

Developing genetically superior seedlings through the use of seed orchards is recognized as a prime opportunity for increasing timber growth and yield while reducing the rotation length. Trees with superior characteristics are identified and used to produce seedlings that exhibit

Source for Appendix C:
Forest Program for Oregon

APPENDIX C-6

Area of identified biological opportunities by ownership in Western Oregon, 1976-77.

OWNERSHIP CATEGORY	REGENERATION FOLLOWING HARVEST OF MATURE TIMBER	PRE-COMMERCIAL THINNING	SITE REHAB	HARDWOOD CONVERSION	SITE PREP AND PLANT OPENINGS	FERTILIZATION AND/OR COMMERCIAL THINNING	TOTAL
	acres						
National Forest	2,821,000	55,800	64,200	[1]	18,200	300,000	3,259,200
BLM	779,500	16,500	57,700	22,600	15,000	271,600	1,162,900
Other Public	44,600	13,400	48,000	86,300	8,800	54,900	256,000
Forest Industry	443,700	211,100	340,600	213,100	40,600	198,100	1,447,[illegible]00
Other Private	129,400	22,400	317,600	199,900	13,400	92,600	775,300
Total	4,218,200	319,200	828,100	521,900	96,000	917,200	6,900,600

[1]Included in site rehabilitation acres.
Rehab = rehabilitation.

Area of identified biological opportunities by ownership in eastern Oregon, 1976-77.

OWNERSHIP CATEGORY	REGENERATION FOLLOWING HARVEST OF MATURE TIMBER	PRECOMMERCIAL THINNING	SITE REHAB	PLANTING	TOTAL
	acres				
National Forest	3,874,500	101,100	131,600	[1]	4,107,200
Other Public & BLM	152,600	10,100	4,600	45,300	212,600
Forest Industry	310,500	69,900	48,600	381,800	810,800
Other Private	101,500	40,500	42,500	286,000	470,500
Total	4,439,100	221,600	227,300	713,100	5,601,100

[1]Included in site rehabilitation.
Rehab = rehabilition.

Source: Oregon Forest Productivity Report

APPENDIX D-1

OREGON'S IMPORTANT DEFOLIATORS

Oregon's forests periodically suffer from the attack of defoliating insects. Defoliating insects damage the foliage of trees, thus injuring trees by reducing photosynthesis, by interfering with transpiration, and by interfering with the process of translocation of food within the tree. A combination of these effects is reflected in a decreased growth rate for the tree or mortality in the case of a severe attack.

Appendix 8 lists Oregon's four main defoliators, the tree specie(s) preferred, infestation cycle, duration and damage caused.

Agent	Preferred Host	Infestation Cycle	Duration	Loss
Douglas-fir Tussock Moth	Douglas-fir True fir	approx. 10 years	approx. 3 years	Mortality, top-killing growth loss of $28 million in 1972 and 1973 in Northeast Oregon. Increased susceptibility to bark beetles.
Western Spruce Budworm	80% of Eastern Oregon fir stands each cycle	approx. 25 years	approx. 8 years	Reduction of growth and top-killing, some mortality, 98% growth reduction over the period of epidemic if untreated. Increased susceptibility to bark beetles.
Hemlock Loopers	Hemlock Northwest Oregon	approx. 25 years	approx. 3 years	1889-1891 unknown 1918-1921 One half billion board foot mortality 1945-1962 (loss to be determined) NOTE: Arsenicals and DDT used to control this pest are no longer available for use.
Larch Casebearer	Larch Eastern Oregon	Introduced: Cycle and duration undetermined		Up to 80% growth loss during heavy infestations.

SOURCE: Forest Program for Oregon

APPENDIX D-2

Estimated Annual Disease Impact on Oregon by Subregion*
Disease Group and Form of Loss
(Thousand Board Feet)

Sub-region	Disease Group	Growth Loss	Mortality	Cull	Total
East Side	Dwarf Mistletoe	419,830.4	289,538.2	0.0	709,368.6
	Root Rots	123,053.7	86,861.5	0.0	209,915.2
	Heart Rots	0.0	0.0	260,584.4	260,584.4
	Other Diseases	133,911.4	14,476.9	10,857.7	159,246.0
	Subtotal	676,795.5	390,876.6	271,422.1	1,339,114.2
West Side	Dwarf Mistletoe	144,769.1	235,249.8	0.0	380,018.9
	Root Rots	296,776.7	238,869.0	0.0	535,645.7
	Heart Rots	0.0	3,619.2	1,299,302.6	1,302,921.8
	Other Diseases	54,288.4	3,619.2	3,619.2	61,526.8
	Subtotal	495,834.2	481,357.2	1,302,921.8	2,280,113.2
Oregon	Dwarf Mistletoes	564,599.5	524,789.0	0.0	1,089,387.5
	Root Rots	419,830.4	325,730.5	0.0	745,560.9
	Heart Rots	0.0	3,619.2	1,559,887.0	1,563,506.2
	Other Diseases	118,193.8	18,096.1	14,476.9	220,772.8
	TOTAL	1,172,629.7	872,233.8	1,574,363.9	3,619,227.4

SOURCE: <u>Forest Program for Oregon</u>

Senator PACKWOOD. Let me ask you this: you suggest banning the log exports. In your estimation, how many additional jobs would that produce in the Northwest timber industry? And if you could include both your membership and nonmembership, I would appreciate it, if you know.

Mr. WITT. OK.

According to Forest Service statistics for region 6, which is Oregon and Washington, there are about three to four times more jobs that are generated by domestic production than there are by log exports.

Senator PACKWOOD. But are you presuming that, if we ban the exports, we would sell that much timber? That there is no question that the Japanese or others will buy the lumber?

Mr. WITT. Yes.

Senator PACKWOOD. All right.

Mr. WITT. Yes.

Senator PACKWOOD. Because that's the key premise. It does you no good to ban it if nobody will buy your lumber.

Mr. WITT. That is correct.

Senator PACKWOOD. That, of course, is one of the problems we have faced domestically. Almost nobody wants to buy the lumber. It doesn't matter how much you turn out or how much the Canadians compete. If there is no market, then we are all dead.

Mr. WITT. Just a couple of points in this regard. Our imports of finished lumber from Canada exceed our exports of logs three times over.

Senator PACKWOOD. I know it.

Mr. WITT. In addition, the Canadians also have a ban on log exports. Their exports to Japan of finished lumber have increased over time.

Senator PACKWOOD. I had a chance to read your testimony last night. I appreciate your giving it. It is very good and very helpful. I don't have any other questions for you, but I want to thank you again for taking the time to come back. Good job.

Mr. WITT. Thank you, Senator.

Senator PACKWOOD. Now we will move on to Bud Johnson, Fred Sohn, Cliff Lansdon, Bob Spence, and Don Fisher.

Do you have an order determined among yourselves in which order you are going to testify?

Mr. JOHNSON. Yes, Senator.

Senator PACKWOOD. Bud, you are going first?

STATEMENT OF EVERETT P. "BUD" JOHNSON, C&D LUMBER CO., RIDDLE, OREG.

We certainly appreciate the opportunity to testify today concerning some very serious problems that a critically wounded timber industry in Oregon has.

I would like to introduce our panel, and we are going to be making a joint presentation that utilizes the time for all of us as one block. On my left is Cliff Lansdon, Superior Lumber Co., Glendale, Oreg. On my right, Fred Sohn, Sun Studs Inc., Roseburg, Oreg., and on his right is Bob Spence, of Pacific Lumber & Shipping of Seattle, Wash. My name is Bud Johnson. I am the managing partner of C&D Lumber Co., in Riddle, Oreg. C&D has been operating in Douglas County since 1943. Our family has been in the lumber business in Coos and Douglas Counties since the 1880's. I am the fourth generation of my family. My son Phil is the fifth generation that is involved in this.

In 1979 our C&D produced 50 million board feet of lumber in our sawmill. At that time we were employing about 200 people. Today we are employing less than 100 people, many of them are only working part time, and at this point in time we are producing less than 35 percent of what we were in 1979.

Each of our companies has a similar problem. We have found ourselves caught up in an inflationary spiral of bidding on the price of public timber. We have been bidding higher and higher, and today we cannot afford the stumpage that we have bought.

I would like to speak specifically to one item that we feel has contributed very materially to this inflation, and it is an abusive tax shelter scheme that has been developed in the last couple of years. It is a tax-sheltered limited partnership that artifically converts ordinary income into capital gains on public timber sales. Cliff Lansdon will explain with some charts just how this system works.

[The prepared statement follows:]

STATEMENT OF E. P. (Bud) JOHNSON
MANAGING PARTNER, C & D LUMBER CO., GLENDALE, OREGON
BEFORE THE
U. S. SENATE FINANCE SUBCOMMITTEES ON
TAXATION AND DEBT MANAGEMENT, AND INTERNATIONAL TRADE
NOVEMBER 24, 1981

My name is Bud Johnson. I am the managing partner of C & D Lumber Co. in Riddle, Oregon. C & D has been operating in Douglas County since 1943. Our family has a history we are proud of in the lumber industry in Oregon, starting in Coos County in the 1880s. I am the fourth generation of our family that has been involved in the lumber business and my oldest son, Phil, is the fifth generation. In 1979, we produced about 50 million board feet of lumber in our sawmill. We also were doing all of our logging and road building, as well as running a rock crushing plant to do our own work and contract crushing jobs for others. At that time, we were employing about 200 people.

Today, we are employing less than 100 people, and many of them are working only part time and our production is less than one-third of what it was.

The logs to operate our mill come almost entirely from Forest Service and BLM timber sales.

Looking beyond the critical problems of today's economy and the issues related to the administration of timber sales, we must not forget that the cornerstone of our industry and of our state is Timber Supply. The future of our firms, our employees, our families, our communities and our segment of American society, is directly dependent upon assuring an adequate and continued timber supply. There are two essential elements in maintaining supply:

First is the maintenance of the land base for forest production--an issue which has been a major focus for well over a decade and remains for the most part unresolved. Secondly, once we have a land base, we must assure that our future crops are available when needed--that is, we must assure that all the elements are available to practice good forestry.

The most important element of this entire process, that small step that assures our future, is the placing into the ground of the seedling. With this investment, begins the dedication for the future.

With reforestation, we begin the process that not only assures the economic stability of the timber communities of our nation, but it assures future Americans that the thousands of products that come from wood will be available.

Senator Packwood's recognition of this key element and his dedication to assuring a future supply for Americas, has placed him in high esteem among all those concerned with our future forest resource. We all owe him a debt of gratitude.

In looking at this matter of reforestation and the workings of SB 100 and the proposed changes, one should recognize that there are two elements:

I. First, there is the element of current reforestation. Lands that are harvested today, must be replanted as soon as possible and cultivated to maturity.

II. Secondly, is the importance of reclaiming, as soon as possible, the backlog acres--that portion of the land base, public and private, that can grow commercial timber but, because of fire, lack of knowledge or because it was logged before good forestry became economical, sits non-productive today. There are many thousands of acres of land in southwestern Oregon that, today, support only brush or non-commercial species or are less than fully stocked, that can and must be brought back into production.

The first problem is the less significant of the two. Most private timberland owners recognize the value of the land and the importance of replanting after harvest. The days of "cut out and get out" are long gone. However, even the most prudent landowner is faced with the short term economic realities and the problems with making cash investments which take many decades to return. The tax incentive approach developed by Senator Packwood in SB 100, goes a long way to overcoming this problem and will greatly help assure timely reforestation after harvest.

On Forest Service lands, the K-V funding approach should adequately provide for the needed funding for reforestation of currently harvested acreage. I would, however, suggest that a review of this process to see if the financial needs are being met and if the funds are being efficiently managed, would not be out of order.

The second element of reforestation, the matter of backlog acres, is a most serious and important item.

On some lands, due to exposure, moisture, brush competition or soil conditions, reforestation is a difficult task. As you know, over 100,000 acres of productive timberland was removed from the harvest base on the Medford District of the BLM because of lack of knowledge on reforestation. The Forest Intensified Research (FIR) program is attacking this problem and we are confident that, in the future, much of this land will be returned to the timber supply base. This project and others like it, must be continued and supported.

Most of the non-reforested backlog acres in western Oregon can grow trees. We have the knowledge and technology--it is just a matter of getting the job done. The process is basically one of removing the existing brush and vegetation, planting the new trees, followed up by protection and management of the new stand. SB 100 was a big step toward this goal, and revision can only help.

For example, increasing the limit on reforestation amortization to $25,000 per year, with the opportunity to accumulate it to $100,000, will allow many landowners to undertake the expensive job of establishing new forests on backlog acres which would otherwise remain brush-covered and idle for many more years. The current limit of $10,000 may, to a large extent, be absorbed in replanting current harvest sites rather than flowing to the backlog acres. For this reason, I believe the expansion will be a great benefit.

Funding of the backlog reforestation effort on public land, has always been a major problem. Despite the wisdom of the investment, it seems that short-term budgetary constraints have continually constrained the needed efforts. Clearly, the concept of a trust fund, as put forth by the Senator's legislation, provides the needed insulation from short-term budget problems. This approach recognizes the infeasibility of managing a long-term renewable resource under our annual budgeting process.

The problem with the annual appropriation process is not limited to just reforestation, but affects all the timber management activities. In order to assure that the annual harvest does not exceed the sustained capability of the land, it is necessary that timber management activities proceed in an orderly and continuous manner. When the management is reduced, the harvest level must also be reduced. Just such a lack of annual funding resulted in the BLM reducing harvests in western Oregon this year by 80 million board feet. There is now talk that similar actions may require another 100 million foot reduction in 1982. All this, in a time when increased supply is needed as part of the solution to our current problems. In short, it is essential that a method of funding timber management on public lands be found, which assures that needed intensive management practices can continue in an efficient even-flowing manner. To sacrifice such practices in the name of the annual budget, is to reduce not only current supply, but to jeopardize future supplies.

The Senator's proposal to switch funding of the trust fund to federal timber receipts, appears to clearly be a step in the right direction. Once completed, this approach may well provide a model for future changes in total funding structure for timber and other renewable resources.

Using a figure of 65% of the federal share of receipts as a future ceiling on the trust fund, appears on the surface to be exceedingly high for just reforestation and TSI, especially as related to western Oregon timber, I am, however, convinced that given a reasonable share of the federal receipts on a continuing basis, our timber resource can be managed efficiently with a very handsome profit still being returned to the federal treasury.

Moving the funding source away from tariffs on imported lumber to timber receipts is particularly appealing since, hopefully, we will see decreasing imports available for tariff! Indeed, Congress itself, in its revised statement on RPA goals, set a national objective to move toward making our country not only self-dependent for wood products, but to make us a net exporter early in the next century.

I cannot intelligently comment on the adequacy of the current 30 million dollar limit on the trust fund. These type questions can clearly be best analyzed by the managing agencies.

In conclusion, quick reforestation of our lands after harvest and the return of all timberlands to full timber production, is the key to the survival of much of our industry and most of our communities in Oregon. I fully support the concepts that Senator Packwood has put forth on this issue, both in last year's legislation and the improvement he is now proposing.

In the continuing battle over setting commercial forest land aside for wilderness and old growth preserves, we always hear the preservationists talk of doing something for future generations. In my mind, we can present no greater gift to our children and grandchildren, than to provide the mechanism that will assure reforestation, sound timber management and an adequate supply of timber and wood products, permanently. I urge that you proceed with your full energy on this problem.

STATEMENT OF CLIFF D. LANSDON, JR., SUPERIOR LUMBER CO., GLENDALE, OREG.

Mr. LANSDON. Thank you for inviting me, Senator.

To give you a little background so that perhaps what I have to say will have some credibility, I have been involved as general manager of Superior Lumber Co., for the last 5 years. We employ in good times 60 people. Today we employ 25 in our mill.

I am also a CPA, spending some 15 years serving the industry in that capacity. So over the years I have seen a lot of limited partnerships used for tax shelter. I was amazed at your statement about closing them off over the years, because, really, most generally, they die of their own weight. And I think this is true of this one. But let's talk about it for a minute.

This shelter is based on a timber company buying a timber contract from a public agency. The timber company then assigns that contract to somebody we are going to call a promoter. The promoter then forms a limited partnership in which he is the general partner and then sells his assigned contracts to the limited partnership. The limited partnership then hires the timber company to manage those properties.

Now, to put that in some perspective—and it's in our written presentation, incidentally, in some depth, but just to summarize it—those particular numbers in the first one of these limited partnerships that hit the board went something like this: The timber company bought public timber with an estimated value of approximately $23 million, involving 95 million board feet of logs, all species.

The timber company sold that tract to the promoter for assumption of the debt to the public agencies, $23 million, plus a million dollar override, with an understanding that he would manage the timber, as I showed you in that prior schedule.

The promoter sold those same sales to the limited partnership for $16 million, plus interest, which amounts to $8 million.

Now, the flim-flam on this thing, the creation of capital gains out of ordinary income, is on this next schedule that I am going to describe for you. And it works like this: with that interest deduction the cost basis in the limited partnership is then reduced to some $15 million for the limited partnership. And when you compare that to a timber value of $23 million, then you have a capital gain of $8 million. So, in effect, we have created an ordinary deduction and a capital gain.

Now, just for purposes of knowing what the rest of us have got to work with, in that same transaction we have no capital gains.

This is where it really gets interesting, Senator, when we talk about what that does to us when we are trying to acquire public timber. To the individual limited partner, whether he is in the 70 percent tax bracket in 1981 or in a 50 percent in 1982, someplace between a 10 and a 14 percent advantage because of that tax benefits, and that's a swing between capital gains and ordinary income.

The definition of a limited partnership tax shelter that I have come up with is that it's a highly leveraged transaction involving properties subject to incentive tax treatment. For example, years ago it was the cattle-breeding herds or coal. It usually involved investors in high income tax brackets who knew very little if anything about the property, who believed, thanks to good promotional schemes, that their net after-tax risk of loss was very slight, that in fact they had a great opportunity.

Senator PACKWOOD. Mr. Lansdon, let me do this, if I might.

Mr. LANSDON. Sure.

Senator PACKWOOD. Because you are all going to be up against a time limit. When Fred and Bud first brought this device to my mind, I checked it with the attorney in Seattle that they advised, and I know how it works.

What intrigues me is, it's not something that grows out of any recent tax law. Somebody who had spotted this 20 years ago or 15 years ago could have done it. The present market encourages it. I am going to do what I can to stop it, but you don't have to give me any more detailed explanation. As soon as they put me on to it, I found out how it worked. But I had never heard about this.

When was it, Fred, when you and Bud talked to me? Six months ago?

Mr. JOHNSON. About that.

Senator PACKWOOD. Yes, that's the first I had ever heard of it. And I was stunned to realize for the last 10 years people could have been doing this and somebody had not thought up the gimmick as to how to do it.

Mr. LANSDON. My only comment, Senator, is that we have submitted a very well-documented written presentation. We think that the Internal Revenue Service, the Treasury, could stop this right now by issuing a ruling.

Senator PACKWOOD. I think they can.

Mr. LANSDON. I think the Treasury Department this morning said that the recharacterization, what I call flim-flam, was very accurate. I don't think we need legislation. I think it can be done within existing rules.

Senator PACKWOOD. I think you're right. And the Internal Revenue Service and Treasury is well-familiar with this type of scheme. They had not seen it in the timber industry before, but it is not unusual to other industries. Frankly, we were all caught napping, and it was just never called to our attention.

Mr. LANSDON. In my opinion, it is like most tax-sheltered limited partnerships that I have seen over the years. They would fail of their own weight because they are not based on economic reality. They are based on two things: number one, a big front-end load that goes to a promoter; number two, tax shelter; and three, an uninformed investor who doesn't know what the risks are.

Senator PACKWOOD. Fred.

STATEMENT OF FRED SOHN, SUN STUDS INC., ROSEBURG, OREG.

Mr. SOHN. Mr. Chairman, I am Fred Sohn, president of Sun Studs, a small business wood products manufacturer located in Roseburg, Oreg. We have been there for 32 years, and have never shut down, nor curtailed our operation. Today we are operating at 30 percent of our capacity, with most of our people sharing the work that is available. We are directly affected by a tax scheme that might put us out of business.

I would like to give a quick example showing what has happened to our company in the Umpqua National Forest and in Roseburg, where a small company started with a relatively small public timber inventory of one and a half years and built it up to one exceeding six years, for no purpose at all. The mill itself cannot use that raw material; it is not designed nor built to use it. During a 2-year period this company accumulated this inventory that cost our company, our small company, $3 million by overbidding public timber sales. They have cost other companies in our area many times that amount. And so it was no surprise to us that they formed a limited partnership this past summer. This limited partnership basically, as Mr. Lansdon explained, is doing two things. It uses a tax gimmick to take an advantage over us, and secondly, whatever they purchase does not relate to the mill's capacity or needs. It endangers our employment; it endangers our community stability; it serves no economic need; it has no economic purpose; it is rank speculation financed by tax-sheltered dollars; and, in fact, it is a sham of doing business and a sham of using the Internal Revenue Code for their own short-term needs.

I would like to present my short statement to the committee, if I may.

Senator PACKWOOD. You may. I love your short statement.

Mr. SOHN. Thank you.

In addition, I would like to also state that I commend you on your reforestation trust fund, and I would like to give also a quick example.

On the Umpqua National Forest, where we have nonforested and unforested lands—I call them "opportunity lands," the neglected lands of our forest—have increased in 1961 from 20,000 acres to 100,000 acres. I think they need to be taken care of. We can't just sweep it under the rug; we have got to do something about it. Your proposal is opening the way to do that.

The same is true on your reforestation incentives where you increase the tax credit limit from $10,000 to $25,000. We are a small timber-growing company. We have a tree farm of our own, but it costs us $200 to $300 an acre to really reforest our land. Even $25,000 would only reforest, even at the low number, 125 acres. It wouldn't go very far. May I suggest that we increase that limit, because it's the small woodlot owner and the small industrial landowner who will finally supply the forest fiber that we need in the future.

I would like also to have this short statement in the record, and I thank you very much.

[The prepared statement follows:]

STATEMENT OF
FRED SOHN, PRESIDENT, SUN STUDS INC., ROSEBURG, OREGON
BEFORE THE U.S. SENATE FINANCE SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT, AND INTERNATIONAL TRADE
NOVEMBER 24, 1981

Thank you, Mr. Chairman. In addition to the statement on limited partnerships in which I have joined, I want to comment on important reforestation issues before the committee today.

Reforestation Trust Fund

One of the most important jobs left undone today on the National Forests is the successful reforestation of the backlog of unstocked lands. Senator Packwood's Reforestation Trust fund significantly addresses this need.

To show the seriousness of the problem, I would like to give as an example the Umpqua National Forest in Southern Oregon. The Umpqua National Forest comprises a total of about 800,000 acres. I call the non-stocked and unforested acres opportunity lands, because with new knowledge and technology these lands could be made productive to grow timber and at the same time enhance the beauty of our public lands. These opportunity lands for various reasons have increased from 19,900 acres in 1961 to over 100,000 acres in 1978.

Senator Packwood's reforestation bill addresses this problem by setting up a trust fund of monies collected from tariffs on imported lumber to be used exclusively for this reforestation effort. We share the Senator's concern, however, that the tariff will not raise quickly enough the monies needed. His proposal to tie the collection rate to federal timber cutting fees instead of the tariff on imported lumber would more quickly raise the funds needed. We strongly support this change and must compliment the Senator for his efforts in the worthwhile cause.

Reforestation Tax Incentives

We also support Senator Packwood's proposal to raise the tax credit dollar limit from $10,000 to $25,000/year.

This raise will encourage more reforestation on private lands, which can be an important source of wood products for our Nation's future. I would like to suggest that a further increase of up to $100,000 per year be considered. This would give the small industrial landowners like ourselves the incentive to continue the reforestation of rundown lands. Our present reforestation costs average $200 per acre. The suggested limit of $25,000 would only allow the reforestation of 125 acres. The $100,000 limit would raise this to a modest acreage of 500 acres per year. Without some tax incentive it may not be possible to continue our rehabilitation work of about 2000 acres per year. Small woodlot owners and small industrial landowners may hold the key to our future wood supply. Thank you Mr. Chairman for the opportunity to present these views.

Senator PACKWOOD. I might say yours went up against opposition from the Treasury Department, when Mr. Chapoton was here today. The Treasury Department, and it's not unique to this one, is normally opposed to all tax incentives except theirs, of any kind, and trust funds, and the poor devil has to come up here—and I'll have hearings, maybe, on 10 bills—and it will just be no, no, no, no, no, no, no. They are opposed.

So one of the reasons I put this limit at $25,000 was to less attract their attention than raising it to $100,000, but change it to a 4-year carry forward. I realize it takes it out of cycle a bit, but it means that you could put up $100,000 every fourth year and still get the $100,000 credit. But you wouldn't be reforesting every year.

We'll get there. It is slow and it is tedious, and, frankly, the credit is not designed so much as an aid to Weyerhaeuser or Georgia Pacific as it is designed for people who have got a few hundred or a few thousand acres that they can't quite justify reforesting without some incentive. And they are not going to reforest it without some incentive. But, having been here a dozen years now, I begin to think more in terms of years and decades than I do weeks and months, in terms of getting something passed.

Who is next?

STATEMENT OF BOB SPENCE, PACIFIC LUMBER & SHIPPING CO., TACOMA, WASH.

Mr. SPENCE. Mr. Chairman, my name is Bob Spence. I am from Washington State. I am vice president of the Pacific Lumber & Shipping Co. We have three sawmills that operate in the Upper Calais River Valley.

I would like to thank you for taking the time to hear our problems. I hope the Washington delegation will take as active an interest in the problems of the forest products industry as you have.

We have been in business since 1932. Our company is a family-owned operation, and we consider ourselves responsible people. We have been investing the profits of our company, as we have operated it through the years, continuously back into improving our operations, modernizing our mills, putting in the latest technologies that we thought was available to make ourselves more competitive. We continually expanded our marketing network; we have gone international with our lumber production, and we have developed a reputation worldwide for being very aggressive and tenacious in this field.

We are appalled at the fact that we have been confronted with something such as this in the last few years. In bidding on the timber we know that we have a responsibility to the people in our community; we have a responsibility to pay the people that help finance our operations; and we have a responsibility as Americans to continue to try to be productive and be competitive in an international trading market.

The type of bidding that has been developed in the last few years because of the tax scheme is abominable to us. There is no way that we can justify continuing our operations if this kind of an effort continues, because we cannot compete against it. Indeed, the people that are involved in this have a vested interest in seeing that timber prices go higher, because if timber prices do fall that jeopardizes their position and creates a loss risk for them and a loss on their potential capital gains, which is their long-term goal here.

We feel that something must be done and something must be done now, and that's why I'm here today. We have many problems to deal with in the forest products industry. Speculation will not totally be solved by eliminating this, but it is indeed a major factor that must be dealt with. And in the interests of time, Mr. Chairman, I will reserve my remarks to that.

Senator PACKWOOD. I think you are very wise in limiting yourselves in this panel to this topic. I know people who say "Well, what difference does speculation make? That's just this much of the problem." And then they say, "Well, what difference does the stumpage price in Canada make? It's just this much of the problem." By the time you add together the different parts of the problem, then you have got a whale of a problem. And to sit back and say, "Oh, well, just because I can take care of one part of it, that's not enough," nobody is going to take care of any part of it.

There are some things I can do very little about, one of which is interest rates. I can vote to support the President's budget cuts, and I have, and I will continue to; but, as I indicated earlier, he is faced with an infinitely greater problem than just his budget cuts now. If he gets all of his budget cuts, every one that he asked for, he is still going to be looking at, roughly, accumulated deficits of $250 to $400 billion over the next 3 years. If he doesn't get all of his budget cuts, for whatever reasons, it would increase the deficit by the amount he doesn't get. Then if that happens, then the interest rates will not only be out of sight; my hunch is there won't be any long-term lending. Nobody is going to put up money for 5 or 10 or 15 years when they have no idea if inflation is going to be 20 percent or 40 percent or 60 percent or 100 percent. They can't afford it. They won't take that risk. I don't need, at that stage, to say what that means for our industry in the Northwest.

Mr. JOHNSON. Mr. Chairman, to give you an example of something that has happened that is quite current, last Wednesday on the Umpqua National Forest they sold three timber sales. Two of those three timber sales were purchased by people putting together packages for these limited partnerships.

I think one last important point that I would like to make is that Governor Atiyeh and several of the witnesses have spoken very strongly to speculation in Government timber sales. I would certainly like to see the Forest Service look at their policy and position on speculation. It needs to be strengthened considerably, and a policy that would specifically state that they not assign timber sales to tax-sheltered limited partnerships would be very helpful.

I think, in that area, that is something that is directly within the jurisdiction of this committee, and it may be something that I can do something about quickly, rather soon. That closes a little bit of a gap, and we'll plug away at some other ones. But, gentlemen, we just cannot suffer $300 million deficits over the next 3-year period. I hate to say the other things are diminimous, but, indeed, if we suffer that it won't matter what we do on the other things, because none of us would be here.

Gentlemen, thank you very much. I appreciate it.
[The joint statement of the panel follows:]

JOINT STATEMENT OF
FRED SOHN, SUN STUDS INC., ROSEBURG, OREGON
CLIFFORD D. LANSDON JR., SUPERIOR LUMBER CO., GLENDALE OREGON
ROBERT SPENCE, PACIFIC LUMBER AND SHIPPING, TACOMA, WASHINGTON
EVERETT P. JOHNSON, C & D LUMBER CO., RIDDLE, OREGON
C. DON FISHER, BOHEMIA INC., EUGENE, OREGON
BEFORE THE U.S. SENATE FINANCE SUBCOMMITTEES ON
TAXATION AND DEBT MANAGEMENT, AND INTERNATIONAL TRADE
NOVEMBER 24, 1981

I. INTRODUCTION

Mr. Chairman, we appreciate the opportunity to testify today concerning the problems of the critically wounded timber industry of Oregon and the Pacific Northwest. We each represent an independent company which is heavily dependent on federal timber for our source of raw material supply.

We have worked together in development of our presentation today. We concluded that a joint statement for the record would present our views to the committee in the most cohesive and useful way.

II. INDUSTRY CRISIS

As the Committee is no doubt aware, our industry, our employees and our entire communities are in real trouble. The problem can be summarized simply: The price that we must pay for our timber supply is way up, while the price that we receive for our products is way down.

The volume of timber offered for sale has declined markedly over the last several years, while the milling industry's capacity has remained substantially the same. The resulting disparity between timber supply and milling capacity has resulted in supply anxiety and an accelerated bidding pattern for our entire industry.

Mill operators bid higher to assure the timber supply they need to continue operating. High-priced timber is better than no timber at all. At the same time, the nation has been caught in an inflationary spiral that accelerated at a frightening pace. The expectation of continued inflation has been calculated into bids, adding to the pressure on the price of our timber supply. In other words, to assure supply, we bid prices that did not make economic sense at the time of bidding, but many in the industry counted on inflation to bail them out by the time the timber had to be cut.

Inflationary expectations were founded on the widespread belief that the Federal Government lacked the will to resist the political forces favoring continued inflation. Today, we have an administration and a Congress that have demonstrated their commitment to do battle with inflation. You deserve the support of all of the American people in that effort. Unfortunately, some results of the new policies, particularly high interest rates, have devastated the housing and construction industries and, in turn, the lumber and plywood business. While our costs are up, demand for our products, and thus our prices, are down.

A number of different possible actions to assist the industry have been proposed in recent months, some of which other witnesses will discuss here today. We wish to focus on one new practice that is adding to the inflationary pressures on timber prices. Until your invitation to this hearing, this practice had drawn no significant public notice as one of the industry problems. That practice uses timber sale contracts as part of an abusive tax shelter scheme. Tax benefits of that scheme are obtained by establishing limited partnerships. These syndicates, through their associates, are bidding for timber against legitimate timber companies that must look to the lumber market, rather than the U. S. Treasury, for their return. The potential tax benefits provide a bidding edge that the legitimate timber companies cannot match. The result exacerbates the severe economic problems that already threaten the livelihood of so many in our industry.

III. THE TAX SHELTER SCHEME

The principal purpose of the tax shelter scheme is to convert part of the purchase cost of timber into a deduction to be offset against ordinary income of the limited partners in early years. This deduction reduces the income tax which they must otherwise pay at regular rates. Then in later years, when income comes back through the sales of timber, it is taxed only at the favorable capital gains rate. The vehicles for accomplishing that result are timber sale contracts on public lands. Since timber sale contracts on Forest Service lands are used most frequently, we will use that type of contract for our discussion.

Briefly, the scheme works as follows:

A company (herein referred to as the "timber company") successfully bids for and receives the right to cut timber on Forest Service land. Under the timber sale contract from the Forest Service, payments are due as the timber is cut and scaled. The contract prohibits its assignment without prior written Forest Service approval.

Nonetheless, the promoter of the scheme then takes what purports to be an assignment of the rights and obligations under the timber company's timber sale contract in return for a payment to the timber company that is essentially equivalent to the deposit made by the timber company to the Forest Service. There is no interest imputed on the Forest Service contract; the timber company has an obligation to pay the Forest Service only as the trees are cut.

The promoter then sets up a limited partnership, with the promoter as general partner. The partnership then "purchases" the promoter's "rights" under the purported assignment of the timber sale contracts for a "lump sum" amount, to be paid off with "interest" as the timber is cut and payments to the Forest Service become due. The payment of principal and interest to the promoter exactly matches the payments from the timber company to the Forest Service plus the override payment from the promoter to the timber company. The timber company or a company related to it agrees to perform the obligations under the Forest Service contract to supervise the logging and to deal with the Forest Service as if the purported assignment of the timber sale contract had never taken place. As far as the timber company, promoter and partnership are concerned, however, the company is merely the "agent" of the limited partnership in its dealings with the Forest Service. When the timber is cut, the limited partnership will claim it recognizes capital gain under Section 631(a) of the Internal Revenue Code, equal to the difference between the "principal" amount of its payments to the promoter and the fair market value of the timber at the first of the year when cut.

Thus, by use of the purported assignment to the promoter and its subsequent sale to the partnership an interest component in the payments for timber has been manufactured, and further, the "sale" locks in a capital gain that otherwise does not exist. The limited partners use this deduction to offset against ordinary income from other sources. The tax on that income is thus deferred until the timber is cut, and then, because of the locked-in gain that is created, paid only at capital gain rates rather than ordinary rates--a potential tax rate savings on conversion of between 30 and 42 percentage points, depending on the year and tax bracket (without consideration of deferral advantages). As a result, a bidder acting in concert with a limited partnership can afford to pay more for the timber because his bidding stake is increased by the amount of money available because of the extra tax advantage.

Advocates of these schemes likely will tell you that they are a means of injecting new capital into the timber industry. But they do not produce the sort of capital the industry needs. It is short-term capital thrown in for tax purposes and extracted back out within the few years' life of the timber contract. It does not expand the means of production or modernize the industry. It only forces raw material prices higher and thus takes away from the ability of the permanent, legitimate participants in the industry with already high capital investments to expand and modernize.

To further illustrate how this scheme works, we have included as an appendix to this statement an example based very closely on an actual limited partnership timber venture. Understanding how the numbers flow in our example will demonstrate how the scheme in effect uses tax dollars to inflate timber prices.

[see Appendix]

Although the scheme has a certain appeal to those who are interested solely in sheltering their income from taxation, we believe the scheme in fact is not valid for two principal reasons. First, it requires the circumvention of both the Internal Revenue Code and Forest Service regulations and policy. The Code requires a utilizer of the timber capital gains provision to own the timber or have a contract right to cut it, while the Forest Service regulations and policy make it clear that these limited partnerships have neither. Second, the interest deduction which is used to convert ordinary income to capital gains income is a manufactured deduction which has no economic reality.

IV. SECTION 631

The predecessor of Section 631 was enacted as part of the Revenue Act of 1943 to remedy the discrimination that existed prior to that time in favor of timber owners who sold their standing timber outright, as opposed to the timber owners who cut their own timber. Essentially, Section 631(a) allows a timber owner who cuts his own timber to treat the act of cutting as a "sale or exchange" of the timber. Section 631(b) provides the same treatment for a timber owner who disposes of the standing timber while retaining an economic interest in it. An example of this latter situation would be where a timber owner contracts with a logging company to do the cutting of the timber while retaining the actual economic interest in the timber. In recognition of the fact that timber sales frequently take the form of cutting contracts, Section 631 treats one who has a "contract right to cut" timber as an owner of the timber. Obviously, this is a simplified explanation of a very technical tax provision. It is intended merely to provide an overview before going into greater detail.

Section 631(a) reads, in part:

> If the taxpayer so elects on his return for a taxable year, the cutting of timber (for sale or for use ~~in~~ the taxpayer's trade or business) during such year <u>by the taxpayer who owns, or has a contract right to cut, such timber</u> (providing he has owned such timber or has held such contract right for a period of more than 1 year) shall be considered as a sale or exchange of such timber cut during such year. If such election has been made, gain or loss to the taxpayer shall be recognized in an amount equal to the difference between the fair market value of such timber, and the adjusted basis for depletion of such timber in the hands of the taxpayer. Such fair market value shall be the fair market value as of the first day of the taxable year in which such timber is cut, and shall thereafter be considered as the cost of such cut timber to the taxpayer for all purposes for which such cost is a necessary factor.... (Emphasis added.)

Reg. 1.631-1(b)(1) adds:

> In order to have a "contract right to cut timber" within the meaning of Section 631(a) and this section, a taxpayer must have a right to sell the timber cut under the contract on his own account or to use such cut timber in his trade or business.

Even where the taxpayer bears some of the investment opportunity and risk from changes in the market price of the timber, the benefits of Section 631(a) have been denied where the taxpayer does not also have the right to dispose of the timber on his own account. <u>See Ellison v. Frank</u>, 245 F.2d 837 (9th Cir. 1957) (Taxpayer who provided logging services, and was paid the market price of the logs for those services, denied the benefits of the predecessor of Section 631(a)).

The location of the investment opportunity and risk, even if coupled with the right to sell the timber after it is cut, does not by itself determine who is entitled to the benefits of Section 631(a). <u>See Weyerhaeuser Company v. United States</u>, 402 F.2d 620 (9th Cir. 1968). For example, a taxpayer who purchases timber under a contract providing for delivery of the timber after it is cut and scaled for a price fixed in the contract would not be entitled to the benefits of Section 631. Even though the taxpayer would have the right to sell the timber for his own account, and would bear the investment opportunity and risk associated with that sale, he would not own or have a contract right to cut the timber at the time of cutting as is required by Section 631. In other words, the requirement of Reg. 1.631(b)(1) that a taxpayer have the right to sell the timber for his own account is an <u>addition</u> to, not a <u>substitute</u> for, the statutory requirement that he have a "contract right to cut" the timber.

Plainly, the limited partnerships involved in the tax shelter scheme neither own nor have a contract right to cut the standing timber entitling them to the benefits of Section 631(a). Forest Service Regulations, the Forest Service Manual, and the Timber Sale Contracts themselves all make it clear that the contracts are not assignable to the limited partnerships without the written consent of the Forest Service.

V. FOREST SERVICE REGULATIONS

The Forest Service Regulations provide, at 36 C.F.R. 223.8(e):

> No agreement permitting a third party to acquire the rights of a purchaser under a timber sale contract may be recognized and approved by the Forest Service except in writing.... Such approval shall not relieve the purchaser of his responsibilities or liabilities under the timber sale contract and may be given only if (1) the third party is acceptable to the Forest Service as a purchaser of timber under the conditions and requirements then in effect for similar timber sales and assumes in writing all of the obligations to the Forest Service under the terms of the timber sale contract as to the uncompleted portion thereof, or (2) the rights are acquired in trust as security and subject to such conditions as may be necessary for the protection of the public interest.

The Forest Service Manual ("FSM") Section 2433.32, citing the above regulation, provides:

> No timber sale contract may be transferred except through sale of the purchaser's entire business or by operation of law such as through death or bankruptcy of the purchaser. The Forest Service, by terms of the timber sale contract, holds the purchaser responsible for the operation of the sale strictly in accordance with that contract. The purchaser may subcontract parts or all of the operation, but subcontractors are responsible to the purchaser, not directly to the Forest Service. If the purchaser desires to stop operating the sale and arrange for performance by a third party, the purchaser may do so under certain conditions, but only upon approval by the Forest Officer who signed the contract, the Officer's successor or superior.

FSM 2433.34 states:

> <u>Speculation in National Forest timber sales will not be permitted</u>. Purchasers are expected to complete contracts in accordance with their terms.... When assignment of a contract is permitted, the original purchaser is not relieved of responsibility.... (emphasis added)

FSM 2433.34 goes on to detail the very limited conditions under which the assignment of a timber sale contract may be approved, none of which would allow an assignment pursuant to a tax shelter of the kind presented here. See 46 Fed. Reg. 22628-29 (April 20, 1981).

In accordance with the provisions cited above, the Forest Service's standard timber sale contract provides:

> The acquisition or assumption by another party under an agreement with Purchaser or [sic] any right or obligation of Purchaser under this contract shall be ineffective as to Forest Service, until Forest Service has been notified of such agreement and has given written approval by the forest officer who approved this contract, his successor or superior officer; and in no case shall such recognition or approval:
>
> (a) Operate to relieve Purchaser of the responsibilities or liabilities he has assumed hereunder....

Standard Provisions for Scaled Timber Sales, paragraph B8.4.

The Forest Service Contract also provides, in paragraph B8.11:

> All right, title, and interest in and to any Included Timber shall remain in Forest Service until it has been cut, scaled, removed from Sale Area or other authorized cutting area and paid for, at which time title shall vest in Purchaser.

Forest Service officials have told us that the Forest Service has never approved nor been asked to approve the sale or assignment of a timber sale contract to a limited partnership in a situation such as the present tax shelter scheme. Such approval would violate the clearly articulated policy of the Forest Service prohibiting speculation in timber sale contracts.

VI. INVALIDITY OF SCHEME

It follows that the purported assignment of timber sale contracts upon which the tax shelter scheme rests is entirely ineffective. The limited partnerships have acquired no rights or title in the standing timber from the Forest Service. Title to the timber in any event remains in the Forest Service until after the timber is cut, removed and scaled. Only the timber company that was a party to the timber sale contract has a right to cut the timber, and that contract right is non-assignable. The limited partnership is not a party to the contract with the Forest Service. In the event of bankruptcy or default by the timber company, the limited partnership has no rights to the standing timber with respect to the Forest Service, the owner of the timber. The partnership may have a claim against the timber company, but it does not have a contract right to the standing timber that could be enforced against the Forest Service. In short, the limited partnerships neither own timber nor possess a contract right to cut timber as required by Section 631(a). Therefore they are not entitled to capital gains treatment under that section.

VII. MANUFACTURED DEDUCTION AS POLICY

Regardless of the lack of qualification for capital gain under Section 631, the other part of the conversion system in this scheme--the interest deduction-- is suspect because it is an attempt to manufacture a deduction. The transaction is designed <u>in form</u> to appear to be an installment sale, with a stated principal price plus interest. The sale is at a "loss" from the price that must be paid to the timber company and in turn the Forest Service. In economic reality, the price paid in the "sale" together with interest is the same amount owed to the timber company by the promoter. To describe this as a sale at loss but with interest by the promoter is to stretch form well beyond substance.

It's as if one of us went into a car dealership and wanted to buy a particular car model. The dealer indicates that the car costs $14,000 but that he can't deliver it until March. You agree, but specify that when you pay the $14,000 in March you want $4,000 to be designated as interest. The car dealer has no objection because it's ordinary income to him either way. But it's obvious that there is no interest component to the $14,000 payment. You don't receive anything until March, and you don't owe anything until March.

The same situation exists under the timber sale contracts. The payments aren't due to the Forest Service until the timber is cut and scaled, and the title to the timber remains with the Forest Service until that time. The promoter acquires rights to the logs at that time; this is the right he has transferred to the partnership. The promoter isn't in an adverse position as a result of the interest income from the limited partnership because it will claim an offsetting ordinary loss on the "sale" of the timber contract. The only losers are the U. S. Treasury, and the legitimate timber companies that have to pay artificially inflated prices for the timber supply that they need to stay in business.

VIII. CONCLUSION

We aren't afraid to compete. We wouldn't be in this industry if we were. But that competition should be won or lost on the basis of the skill with which we manage our resources, and the price and quality of our products. It should not turn on how adroitly one can circumvent the tax laws.

In this industry, market demand rather than seller's requirements tends to determine price. As a result, artificially forcing stumpage prices higher tends to increase the chance of contract default, since market prices for the logs or lumber may not increase to match the artificial increase in stumpage. In event of a default, orderly marketing of timber by the Forest Service is disrupted and additional costs to the government are incurred. Although the defaulter is liable for damages, the chances of the government's actually collecting damages ultimately are less where a limited partnership is involved because the partnership has few or no assets.

We hope that a legislative solution is not necessary at this time. These tax shelters do not fit the letter or spirit of the existing tax laws. Therefore administrative action by those at the Internal Revenue Service concerned with abusive tax shelters should be all that is necessary to correct the problem.

Many in our industry will not survive this period. Our problems are immense. We don't need highly speculative bidding with tax sheltered dollars. If administrative action cannot deal with these abusive tax shelters, we may recommend to this committee a legislative solution.

APPENDIX

EXAMPLE OF LIMITED PARTNERSHIP TIMBER SALES CONTRACT VENTURE

This example is based very closely on an actual venture. Some of the facts and figures have been simplified to help clarify the example. However, none of the simplifications distorts the actual operation of the tax shelter. The parties' relationships are diagrammed on Exhibit 1 to this Appendix.

1. Timber Co. is the successful bidder on the sale of timber from the Forest Service for a bid price of $23,000,000. The timber deposit is $850,000 and the estimated volume of timber to be harvested is 95,000,000 board feet. Payments are due to the Forest Service as the timber is cut.

2. Timber Co. purports to assign its timber cutting rights to Promoter for an override payment of $1,000,000.

3. Promoter organizes Limited Partnership with Promoter as the general partner. The contributions to Limited Partnership are as follows:

Promoter	$ 50,000
Limited Partners	$2,950,000
	$3,000,000

Promoter is paid a syndication fee of $500,000 by Limited Partnership.

4. Promoter "sells" the timber cutting rights that it purportedly received from Timber Co. to Limited Partnership for a

"lump sum" of $16,000,000 to be paid in installments with 16-1/2% interest payable quarterly on the unpaid balance. The payments of "principal" and "interest" correspond closely to the payments due to the Forest Service as the timber is cut. The total of the "interest" payments is $8,000,000. The total of the "principal" and "interest" is $24,000,000 -- the same as the total of the payments due to the Forest Service plus the override to Timber Co.

5. Timber Co. (or a related company) agrees to act as the "timber manager" for Limited Partnership, supervising the cutting of the timber, and to act as sales agent to handle log sales by Limited Partnership. Timber Co. also agrees to continue dealing with the Forest Service as the "agent" of Limited Partnership. To the Forest Service, it is as if there had been no purported assignment. In return, Timber Co. receives $2,750,000 over the life of the venture as a management fee. Timber Co.'s expenses are estimated at $1,800,000. Those expenses do not include the actual costs of harvesting, estimated at $11,000,000, for which Limited Partnership will be responsible.

6. Promoter receives a monthly "management fee" totalling $1,000,000 over the life of the venture. In addition Promoter receives 30% of any profit that remains after all expenses have been paid and the limited partners have had their investment returned.

7. Limited Partnership ultimately pays out $39,250,000 as follows:

To Promoter:

Syndication Fee	$ 500,000
Management Fee	1,000,000
"Principal"	16,000,000
"Interest"	8,000,000
Subtotal	25,500,000

To Timber Co. (or related company):

Harvesting Costs	$11,000,000
Management Fee	2,750,000
Subtotal	$13,750,000
Total	$39,250,000

Of the $24,000,000 "principal" and "interest" paid to Promoter, $23,000,000 ultimately is paid to the Forest Service as the original bid price on the timber. The other $1,000,000 goes to Timber Co. as an override.

Aside from the tax benefits, the limited partners receive an economic gain only if the cut timber can be sold for more than the $39,250,000, in expenses.

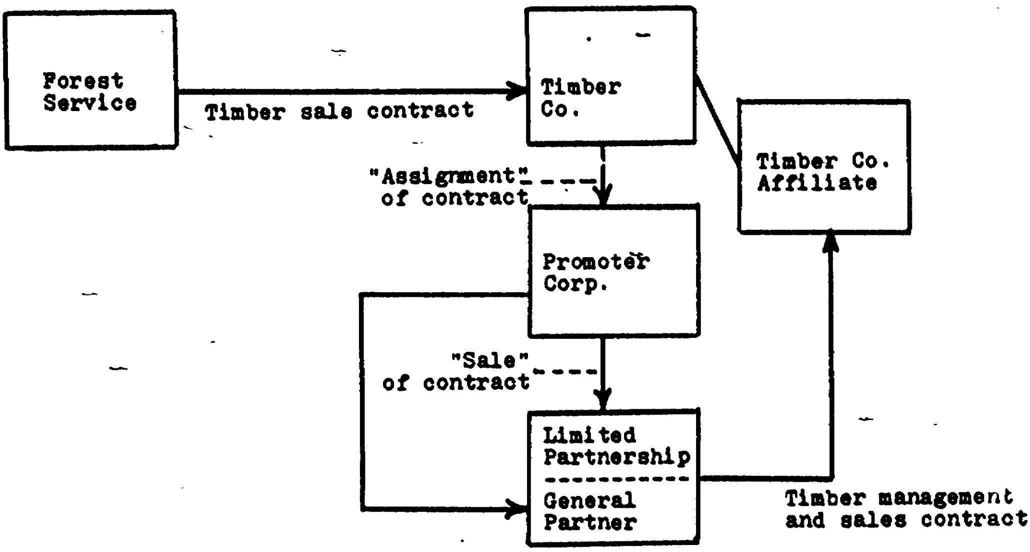
8. Total tax benefits to the limited partners, assuming full conversion of $8 million interest deduction into capital gains without considering the additional deferral advantages, are as follows:

	At 70% Tax Bracket (with 28% Capital Gain Rate)	At 50% Tax Bracket (with 20% Capital Gain Rate)
Tax benefit of interest deduction	5,600,000	4,000,000
Tax on capital gain	(2,240,000)	(1,600,000)
Total potential cash after tax benefit	$ 3,360,000	$ 2,400,000
Percentage of bid price	14.0%	10.44%

(assumes all sales in more than twelve months at capital gains)

9. This results in inflationary impact on bidding. If the acquisition costs are equal and harvesting costs are equal and the cut timber is sold at a price that just covers costs so that there is no economic gain on the purchase and sale of timber, the manufactured interest deduction would provide the limited partners with a significant after tax return but Legitimate Co. would have no before or after tax return. The advantages of this manufactured deduction and locked in capital gain (although there is no increase in value in the timber) allow the Promoter and its associates to bid at levels above those that would allow operating companies to make any profit.

Exhibit 1


Forest Service
Timber sale contract
Timber Co.
Timber Co. Affiliate
"Assignment" of contract
Promoter Corp.
"Sale" of contract
Limited Partnership
General Partner
Timber management and sales contract

SUMMARY OF PRINCIPAL POINTS

1. The timber industry is in trouble because raw material prices are up while finished product prices are down. Previous inflationary expectations have led to higher raw material prices.

2. The use of tax shelter limited partnerships is substantially contributing to inflation in raw material prices.

3. The essential feature of the limited partnership plan is the conversion of part of the purchase price of the timber to an "interest" tax deduction and locking in a capital gain that did not otherwise exist. This results in the deferral and reduction of taxes by converting immediate ordinary income into delayed capital gains income.

4. This tax advantage enables entities involved with limited partnerships to bid more for federal timber than can other operators.

5. This scheme, however, is invalid because it depends on recognition of the created interest deduction and recognition of capital gains under Section 631 of the Internal Revenue Code for the created gain. Because of Forest Service regulations and policies concerning the assignment of timber sale contracts the limited partnerships do not in fact acquire an interest that qualifies under Section 631 and the installment sale interest deduction and corresponding capital gain lack economic reality.

6. The Internal Revenue Service should take administrative action to insure that the claimed manufactured tax advantages are not available to such limited partnerships. Industry will recommend legislation to curb this tax shelter abuse if administrative action is not taken.

Senator PACKWOOD. Now we will move to Joe McCracken, Harvey Bones, and Tim Bueller.

That looks like Dan Goldy to me.

Mr. MCCRACKEN. Mr. Chairman, this is Harvey Bones.

Senator PACKWOOD. That's Harvey Bones? All right.

Mr. MCCRACKEN. We changed appearances.

Senator PACKWOOD. It's just the two of you, Joe? You and Dan?

STATEMENT OF JOSEPH W. McCRACKEN, WESTERN FOREST INDUSTRIES ASSOCIATION, PORTLAND, OREG.

Mr. MCCRACKEN. Yes. In the interests of time, it will be myself, and Dan will represent Mr. Bones of Bosfor Lumber Co.

I am Joseph McCracken, executive vice president, Western Forest Industries Association in Portland. We are an association of about 100 independent lumber and plywood manufacturers in the Western States. We also are very pleased, Senator, that you would conduct this hearing, this inquiry, and I want to say I am particularly pleased to see the tremendous understanding of the complexities and the seriousness of the problem on all parts, the Governor, yourself, and the others.

It has been a shocker, and a lot of us have been slow to realize the dimensions of this; but it is pleasing, indeed pleasing, to see everyone coming up to speed so quickly on this problem.

I would just give you a little background about the Canadian side of this picture. I went to work for WFI in 1955, and one of the first telephone calls I had was from some friends of mine in British Columbia. They asked me to come up and spend a week with them. I did so.

It turned out that British Columbia, in 1955, was just in the process of deciding what their forest policy was going to be. And the issue, really, was whether they were going to have competitive bidding on their timber, like the United States, or whether they were not going to have competitive bidding. And these people were in favor of a competitive bidding system and wondered if I would come up from the United States and make a speech at the major industry meeting and try to persuade the Government to have competitive bidding.

I did that, but unfortunately I was not successful. I made a speech in January of 1956 in Vancouver, British Columbia, and tried to persuade them that they ought to be as farsighted as the United States and have competitive bidding. But, as I say, they appointed a royal inquiry, the Sloane Commission. He took exhaustive testimony about forest policy, and they decided not to have competitive bidding. And at the time that the legislature in Victoria was deciding whether to adopt Sloane's recommendations, which was then 1958, I was invited to come up once more and debate the Ministry of Forests and try ultimately to persuade them to go to competitive bidding; and, again, I was not successful.

But I give you that, because I could see, from 1956, 25 years ago, that the two policies were in potential conflict. And it has been rather interesting to observe that up until the current time they really only got into conflict once, and that was in 1961, when the Canadian share of the American lumber market went up dramatically, and the industry in the Northwest got excited, and we came back and filed an escape clause proceeding with the, then, Tariff Commission. It proved, as Senator Cohen said this morning, an illusory exercise, and terribly expensive. By the time it was over with, the lumber market solved all of the problems: It went back up again, and everyone was happy. But that is the only time until the current time that the potential collision in policies—we could see it.

I am afraid that we now do see, indeed, a collision in policies. As you all see now, we have a large capacity to produce lumber in Canada and in the United States, south and west, and for now and some years, I'm afraid, a shrunken market.

The only relief that will allow the mills in the Pacific Northwest to some degree to go back into production will be for the Federal Government to deal with the existing Federal timber under contract. The log price on the existing timber under contract will simply have to come down if we are going to have any hope over the next 1 or 2 years.

In addition, some changes in policies for bidding on new sales will be helpful, but that fruit will bear off, hopefully, in the future. They'll have to do something about existing contracts. And I was glad to see that Governor Atiyeh and the panel recognized that point.

I would comment on only one other thing. You asked, again, several witnesses: Do we believe that we should not have competitive bidding anymore? I would simply say that I think we should not give up competitive bidding in the United States. I would be hopeful that if we can reconform or do something about the existing contracts that maybe we will have broken the cycle on competitive bidding, and maybe the advantages of competitive bidding will inure to us in the future.

Thank you, Senator.

STATEMENT OF DANIEL L. GOLDY, REPRESENTING THE MOUNTAIN FIR LUMBER CO., SALEM, OREG.

Mr. GOLDY. Mr. Chairman, I am Daniel L. Goldy. I am a consulting economist in Portland. I am here representing the Mountain Fir Lumber Co. this morning, replacing Mr. Bones. I say that because, as you know, there are differences of view within the industry. And I will be representing the view of a company, but a company that operates on both sides of the mountains, west and east.

First let me say, Senator, that I appreciated very much your own analysis of the problem. One of the most difficult things that has divided the industry is a lack of understanding that this is not a problem that is going to go away right away, that it's a very deep-seated problem. We're going to have it for a while.

One of the elements in the problem that I didn't hear mentioned this morning is the fact that before the Congress right now, before the Senate Finance Committee or the Banking Committee are measures that would totally deregulate the financial institutions and would, in effect, dismantle the thrift institution, which is the best system for delivery of mortgages that has ever been devised.

It's been the envy of the world. If it's dismantled, the problem will last a lot longer.

Senator PACKWOOD. I'll interrupt you and tell you how that happened. I told our mutual friend, Dave Barrows, this for years. I was on the Banking Committee for 8 years, and you had the savings and loans, and you had the banks, and you had the credit unions. And they all wanted to have an advantage over the other without having the liabilities of the other. The savings and loans wanted to pay a slight bit more interest, but then they wanted to get into the checking account business. And I told Dave a dozen years ago, if they continued down that road, you were going to end up having all financial institutions looking the same. And, indeed—I don't agree with it—I think that's where we are going. And they brought it all on themselves, each of them wanting a legislated advantage over the other without any of the disadvantages the other had, be it regulations, legislation, or otherwise.

Mr. GOLDY. The important thing, Mr. Chairman, as you know, in this situation is that even if short term interest rates come down in the present free-fall of the economy, it is not going to solve the problem of mortgage rates, because of the delivery system.

Senator PACKWOOD. Dave gave me your paper, by the way, and I read that.

Mr. GOLDY. Thank you very much.

Let me just say, you have asked the question: Do we now have too much mill capacity, given the problem? My view is that we've got to hope that we are going to go back to home building in the United States again. I don't think we've got too much mill capacity, given any kind of a normal situation. Right now we are faced with Japan being down and Europe being down and the Canadians being down.

Our problem is to be able to take back on a competitive basis a more reasonable share of our own market from the Canadians. The way to do that, in our judgment, is to modify existing Forest Service contracts. There is some 20 billion feet that will never come out if, in effect, the market doesn't improve any more than we can anticipate it improving now. That means that if it comes out, the mills will go bankrupt; if it doesn't come out, there are going to be defaults. If you modify those contracts, and then index forward, and modify them down to what the Forest Service said was a fair market price at the time they were bid, we could compete with the Canadians. We would not be under water.

Now let me also address quickly the issue of speculation. It appears everybody thinks that this timber was bid up there, the reason we are under water, is because of speculation. Indeed, there has been speculation by people who don't have mills and who have come into the marketplace to peddle logs. But the prudent operator has timber up there at very high prices, and he's got the timber up there because he took the Government's figures from the Resources Planning Act assessment, the home builder's projections. He said in order to put a backlog behind his mill—and the timber he bought today he would be logging 2 or 3 years down the road—he had to guess where the inflation would take the prices and bid the best he could in order to get it. And that's what put those prices up there. And those prices up there are at a level where that timber won't come back out if you don't modify the contracts.

Now, all this business about extensions, about putting up front money for new contracts will not change the basic overhang of all those billions of feet of timber out there that won't come out unless the contracts are modified.

Senator PACKWOOD. And they won't come out unless the housing industry goes up, no matter what.

Mr. GOLDY. There is a market. You have to accept the fact that, even at 837,000 housing starts, which are absurdly low, and a remodel market, there is a market out there. But the Canadians are now taking about 33 percent of it.

If we get our prices down, stumpage prices back down, to where we can compete, and that doesn't mean we have to have a $14 stumpage price like they had in the west coast of British Columbia, or 250 on the east side, just get them down where we can compete, we'll take our own market back and we'll have a market, even if it's a small one.

Senator PACKWOOD. Let me ask you this. Your assessment of the savings and loan industry is exactly right. There no longer is going to be, unfortunately, a unique industry that is going to finance housing. So the question is, is this conglomerate financial industry going to finance housing? Or are they going to be so reluctant to get into the long-term fixed or even variable rate contracts that they won't do it thence? I don't care what you call it, a bank or a savings and loan, or a credit union.

Mr. GOLDY. My answer to that would be that there is a story in the Wall Street Journal yesterday that bears directly on it. If mortgage rates came down to a soupcon, but all the banks are giving up fixed-rate mortgages to go into variable rates, we have no indication that variable rates are going to produce, in any effect, any degree of housing.

My view is that we are going to have to go back if we want housing as a national priority. We are going to have to go back to a situation in which the individual homeowner does not have to compete with General Motors and Exxon for the money, but that there is a delivery system for mortgages that has some priority in the financial market.

Senator PACKWOOD. OK. Or a double deduction or a tax credit instead of a tax deduction, or something. And that something doesn't necessarily have to be a subsidy to what used to be the savings and loan industry. It can be a subsidy to the homeowner. There is a variety of ways of doing it. But the critical point is, the policy of this nation must be that we want to house this Nation. If we have that policy, then the method will flow. We may stumble around; we may make a mistake or two as we go at it, and it will take some experience, but if we don't have that policy it doesn't matter what you and I talk about. If it is not a real commitment of this Nation, to adequately house this Nation, then we are all wasting our time.

Mr. GOLDY. I agree with you completely about it.

Mr. MCCRACKEN. We agree, Senator.

Senator PACKWOOD. Joe, take me once more through the road that you talked about. You said you thought you could keep the competitive bidding, no matter what Canada does. But, run by what you said again, because I didn't quite follow it.

Mr. McCRACKEN. All right.

There are a lot of advantages, Senator, that we have gained through competitive bidding. One of the key advantages I think we have by all odds in the west, and certainly in the Pacific Northwest, is the most efficient lumber and plywood industry in the world. I think no one disputes that. And that is a great advantage.

We ought to keep that. If you allocate timber as they do in Canada, you don't get that kind of efficiency. You just simply don't have the incentives to do it. And you don't get it.

I would hate to give up that advantage, just bingo, like this. And I think if we can take the fever, do something with this overhang of 20 billion feet of timber that is just impossible to live with, do something with it so that we can go back into business, I think that may break this tremendous surge of speculative or inflationary bidding, or whatever you want to call it.

And then, with some of the changes that are being considered on the new sales, we maybe will go back to where we could live with the system, as we did prior to 1979.

Senator PACKWOOD. Well, as you indicated, with one exception, until 1979 we lived with it very well for 24 years.

Mr. McCRACKEN. Reasonably well. It was only in 1979, roughly, 1978-79, that for the first time this industry did not bid timber with respect to the current market. That's when it started.

In region 6, Oregon and Washington, in the 1978 fiscal year they sold 5 billion feet of timber for $500 million, a hundred dollars a thousand. One year later they sold 5 billion feet of timber for $1,300,000,000. That's the year it happened, Senator.

And once you get into that kind of a system, then you get into things like water-level bidding.

Senator PACKWOOD. Well, when you get into it, it is also a cycle. The only way to get out of it is to bid it up more.

Mr. McCRACKEN. That's right. And keep it up.

Senator PACKWOOD. Yes. You have to keep it up. That's the only way you can possibly reclaim your previous bids.

Mr. McCRACKEN. Precisely.

Mr. GOLDY. May I add, Senator, to what Joe said?

Senator PACKWOOD. Yes.

Mr. GOLDY. Joe and I arrived on the scene. He came after me. I brought him, when I was administering the oversea lands. And I found a situation where was virtually no competitive bidding. We helped install competitive bidding, and we did it in order to stimulate the investments in increased efficiency. When there was no competitive bidding they used to take only about 35 percent, 40-45 percent, of a stand of timber out because they couldn't process the rest of it.

That whole thing changed once you got the investments that went into the mills, once there was competitive bidding.

I want to add to that that the very thing I was talking about before, about we don't have to get down to the stumpage prices that they have in British Columbia to compete with them. Part of it is log cost, to be sure; part of it is quality of timber; but a great deal of it is that our mills are much more efficient because we have had competition.

Senator PACKWOOD. Gentlemen, I have no other questions. Thank you very much.

We will conclude, today, with Tom Barlow.

Mr. BARLOW. Thank you, Senator.

Senator PACKWOOD. How are you doing?

Mr. BARLOW. On my right is Mr. Kaid Benfield, who has recently joined our staff to work on forestry matters. Mr. Benfield is an attorney, was formerly with the Justice Department, and he will be with me today.

Senator PACKWOOD. Well, let me say to you, Mr. Benfield, if you do as well as Mr. Barlow does over the years, he is probably one of the best witnesses we have, and he has a very consistent philosophy. He and I will often disagree, but what he testifies about he knows about, and he knows very well. And I appreciate him as a witness.

Mr. BARLOW. Well, thank you very much, sir.

If I may, I would like to submit my testimony for the record and just briefly summarize it.

Senator PACKWOOD. By all means.

[The prepared statement follows:]

Testimony of Tom Barlow on Packwood Resolution for Section 1332 Investigation and on S. 1824

We support the Packwood Resolution for Section 1332 Investigation. We too are concerned with the low stumpage rates for Canadian timber as compared to Northwest timber. The low Canadian stumpage gives their mills the pricing flexibility to undersell Northwest mills in U.S. markets. We would point out for purposes of the Investigation that the appraisal process in the U.S. National Forests and the pricing process used by the Canadians on Crown Lands are essentially the same -- they are extractive pricing systems with no regard to recovering costs of management for a sustained crop to timber.

The NW prices do recover costs of management for sustained yield however, not because of any built in recovery methodology but because of competition among mills. The Canadian pricing and sale procedure process with the low stumpage is truly mining economics.

We would support an import management system that would prohibit the dumping of wood products in U.S. markets at less than costs of sustained yield management and urge the commission to focus on this concern. To allow wood products into this country at less than these price levels would be to discourage long term forest investment for sustained yield by U.S. producers be they government, industrial or other private. Less investment means less timber in future years.

We would also support a certification process managed by the U.S. Forest Service that the shipment of a product that is being received at U.S. entry points is coming from a sustained yield tree management operation in the exporting nation. This certification would ensure that the U.S. is not supporting a progressive degrading and deforestation process in its international wood fibre trading relationships.

But for full justification to implement these measures regarding imports, we must reform the extractive economics of our own timber sale system in our National Forests. A substantial number of federal sales are transacted at prices as low or lower than the Canadian stumpage figures quoted in Senator Packwood's 11/9/81 statement on the Senate floor. In Calendar year 1978, a year of high priced fibre in U.S. markets, some 11.9% of green timber sales in the National Forests, some 900 million board feet of timber, were transacted under $20.00 per thousand board feet. I attach a categorization chart of the price ranges for these 1978 National Forest non-salvage sales.

We shouldn't point fingers at the Canadians for their extractive economics on Crown Lands for that is what the issue really is, while we practice the same such extractive economics in our National Forests. Incidentally, in that year, 1978, Region 6 (Oregon and Washington) green timber sales totalling some 200 million board feet were sold for under $20.00 per thousand board feet. Such low price levels are exactly what North West producers are complaining about not in their regional National Forests but from their Canadian competetion.

Turning to S.1824 we want to focus particularly on Section 2, the Reforestation Trust Fund for the National Forests. We are opposed generally to any self financing mechanism for turning the National Forests into intensively managed tree farms. We are not satisfied that authorities in other statutes are strong enough to prevent such timber management systems from coming to pass given the necessary level of funding. We are therefore very leary of the creation of such a funding mechanism which is what this legislation does for all National Forest timberland. We would point out that this issue was very bitterly thrashed out in the National Timber Supply Act battle earlier in the decade.

We would point out that limiting expenditures to "reforestation" is not as worthy from a conservation standpoint as it sounds at first blush. "Reforestation" as defined by Forest Service timber managers can encompass virtually every prescription from site preparation (the total stripping of low quality forest cover) to planting of superior stock in rows, to intensive herbiciding and chemical pest control. There is considerable controversy over the intensive application of these methods allowed by all forestry law and regulation. To the extent S.1824 legislation provides a rich funding source for such prescriptions to be applied we oppose this legislation.

However, let me suggest that if the legislation could be amended to specify that these reforestation funds be applied to management prescriptions which the conservation community supports than maybe constructive breakthrough could be made on all sides. If funds could be used only for hand rather than chemical suppression of competing brush, if timber management prescriptions other than even-age management and clearcutting were the focus of these funds then maybe we could secure some harmony thru this trust fund that has eluded us in National Forest management to date, more timber for industry and a more satisfying forest management effort from the conservation standpoint.

Despite Federal timber purchasers' claims that they pay astronomical prices for National Forest timber, considerable volumes of timber are sold at very low prices. Below are the price categories for healthy trees sold for milling into lumber.

CATEGORIZATION OF TIMBER SALES (Excluding Salvage Sales), CALENDAR YEAR 1978, PRICE PER THOUSAND BOARD FEET.
Category percents are in parentheses below the total figures; cumulative category percents for the year are next to them.

See reverse side for a list of the states in the respective Forest Service regions.

Any sales or parts of sales priced by raw material units other than thousand board feet were not included in this table.

*In Region 9, no sales were made using thousand board feet as the unit of measure.

REGION	PRICE PER THOUSAND BOARD FEET $ 0.00-9.99	10.00-19.99	20.00-39.99	40.00-79.99	80.00-149.99	150.00-199.99	200.00-299.99	300.00+	TOTAL
1	223,229 (25.5) 25.5	45,267 (5.2) 30.7	113,336 (13.0) 43.7	200,956 (23.0) 66.7	189,980 (21.7) 88.4	62,386 (7.1) 95.5	31,647 (3.6) 99.1	7,068 (0.8) 99.9	873,869
2	56,351 (21.5) 21.5	35,500 (13.5) 35.0	93,714 (35.7) 70.7	76,891 (29.3) 100.0	57 (0.0) 100.0				262,513
3	5,279 (1.6) 1.6	3,241 (1.0) 2.6	6,786 (2.1) 4.7	80,891 (24.8) 29.5	214,595 (65.7) 95.2	14,468 (4.4) 99.6		1,510 (0.5) 100.1	326,770
4	41,538 (19.4) 19.4	42,105 (19.6) 39.0	35,515 (16.6) 55.6	53,768 (25.1) 80.7	38,074 (17.8) 98.5	964 (0.4) 98.9	1,813 (0.8) 99.7	660 (0.3) 100.0	214,437
5	113,024 (8.5) 8.5	47,328 (3.5) 12.0	111,209 (8.3) 20.3	196,338 (14.7) 35.0	310,168 (23.2) 58.2	169,084 (12.7) 70.9	167,807 (12.6) 83.5	221,621 (16.6) 100.1	1,336,579
6	97,201 (2.2) 2.2	107,345 (2.5) 4.7	261,477 (6.1) 10.8	632,288 (14.6) 25.4	936,223 (21.7) 47.1	527,640 (12.2) 59.3	927,293 (21.5) 80.8	831,075 (19.2) 100.0	4,320,542
8	15,149 (2.8) 2.8	5,686 (1.1) 3.9	20,068 (3.7) 7.6	59,596 (11.0) 18.6	244,284 (45.2) 63.8	149,345 (27.6) 91.4	46,352 (8.6) 100.0	299 (0.1) 100.1	540,779
9*									
10	118,260 (77.1) 77.1			11,140 (7.3) 84.4	17,770 (11.6) 96.0		6,310 (4.1) 100.1		153,480
TOTAL	670,031 (8.3) 8.3	286,472 (3.6) 11.9	642,105 (8.0) 19.9	1,311,868 (16.3) 36.2	1,951,151 (24.3) 60.5	923,887 (11.5) 72.1	1,181,222 (14.7) 86.8	1,062,233 (13.2) 100.0	8,028,969

CATEGORIZATION OF ALL TIMBER SALES MADE BY BOARD FEET FROM THE NATIONAL FORESTS, CALENDAR YEAR 1978
(Excluding Salvage Sales)

PRICE PER BOARD FOOT	0¢ - 1¢	1¢ - 2¢	2¢ - 4¢	4¢ - 8¢	8¢ - 15¢	15¢ - 20¢	20¢ - 30¢	30¢ +
VOLUME SOLD, BOARD FEET	700 Million	300 Million	600 Million	1.3 Billion	2.0 Billion	900 Million	1.2 Billion	1.1 Billion
PERCENT OF TOTAL IN PRICE CATEGORY	8.3%	3.6%	8.0%	16.3%	24.3%	11.5%	14.7%	13.2%
CUMULATIVE PERCENT	8.3%	11.9%	19.9%	36.2%	60.5%	72.1%	86.8%	100.0%

Region 1: Northern: Idaho, Montana

Region 2: Rocky Mountain: Colorado, Nebraska, South Dakota, Wyoming

Region 3: Southwestern: Arizona, New Mexico

Region 4: Intermountain: Idaho, Nevada, Utah, Wyoming

Region 5: Pacific Southwest: California

Region 6: Pacific Northwest: Oregon, Washington

Region 8: Southern: Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, Puerto Rico, South Carolina, Tennessee, Texas, Virginia

Region 9: Eastern: Illinois, Indiana, Michigan, Minnesota, Missouri, New Hampshire, Ohio, Pennsylvania, Vermont, West Virginia, Wisconsin

Region 10: Alaska: Alaska

STATEMENT OF TOM BARLOW, NATURAL RESOURCES DEFENSE COUNCIL, WASHINGTON, D.C.

Mr. BARLOW. We, sir, are very much for your resolution for section 1332 investigation of Canadian imports in the United States. However—and this is for the benefit of that investigation, should it take place—we would urge that they look at the system of pricing of timber, and I am talking about the national forests in this country as well as the Canadian forests, because, essentially, the residual pricing process which is practiced both in Canada and down here in our national forests is based on extractive economics. To the extent that prices recovered in either nation for the timber do not provide for a sustained yield of timber, for regeneration expenses and management expenses, and so forth, we are practicing mining economics.

Now, on the face of the figures in your statement, sir, that you put in the Congressional Record on November 9, with the Canadians paying for stumpage from 1976 of $1.65 per thousand up to 1980 when they paid $13.06 per thousand board feet, that, in our estimation from our analyses of the cost of management, is truly extractive economics.

Most of the timber sales in the Northwest are recovering much more than the cost of management. The averages there would probably be in excess of the cost of managing the forests of the Northwest for a sustained yield.

But there is a little Achilles heel in this residual pricing process, if we don't focus on it. For instance, in 1978, in Region 6, Oregon and Washington, because of the residual pricing process and because perhaps there was very little competition in these particular sales, some 200 million board feet of green timber in that year, 1978, were sold for under $20 per thousand board feet out of the National Forests in Oregon and Washington.

So if we are going to point fingers at the Canadians for extractive economics, they can come back to us with similar criticism if we hang on to this type of a pricing process down here. That's just a cautionary word for the investigation commission when it gets going.

And, sir, as far as your reforestation bill for the National Forests, we are concerned that under existing law a great many types of activity and levels of activity are allowed in reforestation activities, which many of our people have problems with. The definition of reforestation as it is practiced by the Forest Service in timber management runs from site improvement, which may be the total clearing of vast acreages, and planting of softwood seedlings, which is fine, but then coming in and very intensively managing the growing with herbicides and pesticides. And to the extent that your bill would provide for a vast source of funding for these practices which cause people a lot of concern, we've got to oppose it as long as that intensity of management could be applied.

Mr. PACKWOOD. Let me ask, I think what you are saying is this: If we give them $300 million for "reforestation," they will spend $300 million in reforestation. And it may go way beyond what you or maybe even I might think is legitimate reforestation; or it may not even be reforestation, but they will call it that to get the money.

But I don't think you and I would quarrel as to objectives of legitimate reforest areas that have been legitimately cut. We might even quarrel as to the method of putting the tree in the ground and whether you do it by hand and whether you use herbicides or not, but you don't quarrel with the goal of the reforestation.

Mr. BARLOW. No.

Senator PACKWOOD. I have seen this in trust funds before. And this one has a cap on it, so there is no danger at the moment. But you guarantee anyone—it doesn't matter if it is a highway commission—you guarantee a highway commission or a school board a certain source of revenue for purposes of highways or for purposes of education, they would use the entire source of revenue for that purpose. It's amazing how close they come out to what the revenue will be each year if they know that they're going to have it.

Mr. BARLOW. Well, I suggested that perhaps there would be ways that we could come to agreement on the trust fund if it could be written into the legislation that it would be used for certain management practices in the reforestation effort, which, generally, people are comfortable with.

Senator PACKWOOD. Let me ask you this: Assuming that we could agree on what reforestation should be done and how, do you have any quarrel with shifting the source of the funding from the tariffs to the cutting fees?

Mr. BARLOW. We are concerned about it as long as there is not a clear understanding on all sides as to the practices and the intensity.

Senator PACKWOOD. I understand.

Tom, thank you very much, as usual. Mr. Benfield, welcome to the committee. We look forward to seeing you.

Mr. BENFIELD. Thank you.

Senator PACKWOOD. That will conclude our hearing today.

[Whereupon, at 12:50 p.m., the hearing was adjourned.]

[By direction of the chairman the following communications were made a part of the hearing record:]

Statement of
U.S. Representative Don Bonker of Washington
for the Senate Subcommittee on Taxation hearing on
Canadian Lumber Imports
November 24, 1981

Cheap Canadian lumber is flooding U.S. markets and threatens to devastate our domestic wood products industry.

None of this is an accident. The Canadian government is unfairly subsidizing its lumber industry. And more and more Canadian lumber is crossing our borders at a time when domestic saw mills are closing down and throwing thousands of people out of work.

These are very timely hearings on a subject that is especially vital to the economy of the Pacific Northwest, and I urge the subcommittees and the full Finance Committee to give favorable consideration to what I understand will be a formal request for an investigation of Canadian lumber imports by the International Trade Commission in accordance with 19 U.S.C. 1332.

The Canadian share of the U.S. lumber market was 18.7 percent in 1975; that has increased every year but one since then to a new high of 32.2 percent this year. The chief reason is cheaper stumpage prices for Canadian wood. The Canadian mills can buy trees to cut for about one-eighth of what U.S. mills have to pay. Both buy trees from their governments, but U.S. mills are required to bid against one another. Canadian companies are not.

A study by Associate Prof. David Haley of the University of British Columbia's School of Forestry points out that in 1978, Canadian mills paid $4.58 per cubic meter of stumpage, while mills in the U.S. Pacific Northwest paid $39.11 per cubic meter for comparable trees. This amounts to a $60 per thousand board feet subsidy for British Columbia mills, or a cost advantage of 25 percent of the price of the manufactured product.

In effect, the Canadian province is accepting less money for the right to cut trees on its land than U.S. federal and state governments are accepting for cutting on their lands. This amounts to a subsidy. British Columbia sets its fee for cutting rights at anappraisal far below market value and awards them without bids.

The cheaper stumpage prices for Canadian lumber give the Canadian producers an unbeatable advantage in selling finished products to Japan. This is the main reason why Japan buys most of its finished lumber from Canadian producers, while purchasing unfinished logs from the United States.

I have contacted the Department of Commerce and have had personal discussions with Lionel Olmer, the department's Undersecretary of Trade on this matter. There is discussiOn in the NOrthwest about applying to the Department of Commerce and the U.S. International Trade Commission for a countervailing duty which would bring Canadian lumber import prices more in line with domestic industry costs.

U.S. Trade Representative Bill Brock has said, while outlining the trade policies of the Reagan Administration, "where . . . foreign advantage is based upon government subsidies and other trade-distorting practices, U.S. policy will be to enforce U.S. trade laws and to work to eliminate such policies."

That is sound thinking, and I hope that this committee will be prepared to help move that process along.

STATEMENT OF CONGRESSMAN DENNY SMITH (Oregon)

BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
AND THE SUBCOMMITTEE ON INTERNATIONAL TRADE
COMMITTEE ON FINANCE
REGARDING CANADIAN LUMBER IMPORTS

November 24, 1981

Mr. Chairman, I am delighted to have an opportunity to comment today on the tremendous increase in U. S. imports of dimension lumber from Canada and the effect this is having on domestic mills in the Pacific Northwest. The timber industry is the principle industry, and employer, in my home State of Oregon, and the industry is currently experiencing its worst decline since the Great Depression of the 1930s. Granted, this problem is primarily brought on due to high interest rates and the lack of housing starts; however, increasing U. S. imports of dimension lumber from Canada is only heightening the economic slump in the Northwest.

British Columbia is the major timber producer in Canada. Approximately 80% of British Columbia's lumber is exported with more than 50% of it coming into the United States. Canadian sawmills have a tremendous raw material cost advantage over the U. S. A recent study by the Northwest Independent Forest Manufacturers (NIFM) shows that the average price for timber sold on national forest lands in Oregon and Washington in 1980 was \$286/MBF in comparison with \$24/MBF for timber sold from provincial lands in British Columbia. This translates into a 12-to-1 raw material cost advantage that the British Columbia mills enjoy over our mills in the Pacific Northwest.

There have been arguments that to compare our finished products over the price of stumpage is like comparing apples and oranges, and that allegations of an unfair advantage by the Canadians are not accurate. British Columbia will say that the price of stumpage is a reflection of differences in the type of forest resource, their wage rates, stumpage appraisal systems, forest policy, and taxation.

The NIFM study compared individual species and in looking at the coastal Douglas Fir, we find an even greater difference. In the Northwest during 1980, Douglas Fir was sold at about $432/M as compared to $76/M for Douglas Fir sold from provincial lands in British Columbia. This is quite a large advantage. Even if the argument is true that their timber value is worth less than those on our national forest lands, there is not enough validity to that argument to substantiate the significant difference when comparing stumpage prices.

Canadian transportation costs have proven another government-subsidized advantage. The railway owned by the Canadian government moves the lumber from the west to eastern markets in the United States for $25 a thousand board feet less than rates domestic railways charge Northwest timber companies.

I also recognize that some of the problems being experienced by the timber industry were brought on by the industry itself. When timber was sold several years ago, the purchasers took into account a 15% inflation rate. Therefore, companies felt they could bid a large percentage over the appraised value of the timber. Also, the uncertainty of future available timber has contributed to speculative bidding. As a result, many companies are forced to harvest timber at prices far above any profit they will ever realize.

The manner in which the U. S. sells national forest timber compared to the Canadians is also quite different. Mills in the U. S. must competitively bid on timber and the highest bidder receives the sale. However, in British Columbia, the government sets the price of timber and it is then allocated to mills on a noncompetitive basis. With the housing slump and demand for lumber on the decline, the Canadian government can reduce the price of stumpage to reflect the current market for lumber. This way, the government can, in essence, subsidize the industry in order to keep Canadian mills in operation which keeps jobs for Canadians.

During the current economic downturn, the Canadians have increased their exports into U. S. markets by 4.2 billion board feet. This translates into approximately 6000 primary wood working jobs; and for each of those jobs, you can count on two service-related jobs at a minimum. A conservative estimate of this means that approximately 18,000 Oregonians are out of work due to the large Canadian presence in our lumber market.

The wood products industry is in a severe recession which recently plunged to a new low. According to the Western Wood Products Association, Oregon had 71 lumber mills closed and 69 working on curtailment at the end of October. Each week these figures increase and unemployment continues to soar. The association found that 61,788 or 61% of the 102,000 sawmill employees in the twelve western states are currently unemployed or working a reduced shift.

I have discussed the severity of Oregon's economic situation

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with the President and a number of other Administration officials. I have been criticized by the press for my statements that the President should immediately place a temporary ban on Canadian imports of dimension lumber. If Canada does have an unfair competitive edge, then our two countries need to achieve an understanding which will satisfy the industry's current needs. I do not want a government bailout of the industry...I am a firm believer in free trade. However, we must have <u>fair</u> trade.

In the meantime, I feel it is important that we push a "buy American" effort. It's time for Americans to help Americans by boycotting Canadian lumber. I recognize that the Canadians have some economic problems in their wood products industry, too, but it is time we took steps of our own to help our fellow Americans.

Thank you for the opportunity to present my testimony to the subcommittees. I hope this information will prove beneficial toward a fair resolution of this problem.

WRITTEN STATEMENT OF NORTH AMERICAN WHOLESALE LUMBER ASSOCIATION INC.
2340 South Arlington Heights Road, Suite 680
Arlington Heights, Illinois 60005

TO THE JOINT HEARING OF THE:

Sub-Committee on Taxation and Debt Management
The Honorable John C. Danforth, Chairman

and

Sub-Committee on International Trade
The Honorable Bob Packwood, Chairman

November 24, 1981

Room 2221, Dirksen Senate Office Building

Gentlemen:

My name is Harlan M. Niebling and I serve as Executive Vice President and Secretary of North American Wholesale Lumber Association. Our offices are located at 2340 South Arlington Heights Road, Suite 680, Arlington Heights, Illinois, 60005.

North American Wholesale Lumber Association is a trade organization of 576 firms. Our Membership consists of 399 independent wholesale forest products companies, 135 forest product manufacturing companies and 42 affiliate firms providing services to the wholesale distribution of forest products in North America. Our Members are located in 46 states, 5 provinces of Canada and in Puerto Rico. Approximately 18% of our total Membership is Canadian.

This statement is made on behalf of our 399 Member wholesale firms and at the direction of our Executive Committee. This segment of our Membership distributes approximately 60% of the softwood lumber used in the United States. The volume involved in the year 1979 was over 10 billion dollars.

During the current housing slump of unprecedented length all of our Members have been severely affected. There has been substantial curtailments of sales staffs throughout the U. S. and Canada by wholesale firms. U. S. and Canadian manufacturers have been affected even more seriously. This has resulted in deep production cuts beginning first in the U. S. and now becoming widespread in Canada.

There is general agreement within our industry that current high interest rates coupled with the inflationary costs of housing over the past five or six years have led to the slump in residential construction. This deep slump has resulted in bankruptcies of building firms, retail lumber dealers, wholesale firms and lumber producers. It is likely that there will be additional failures in the coming months.

Such a bleak outlook has everyone concerned, and this concern is reflected by numerous hearings, meetings and suggestions on what might be done to alleviate the situation.

Your November 24th hearing is a case in point.

Senator Packwood, representing the largest producing state in the U. S., is vitally interested in the problems contributing to the distress of Oregon's timber industry. On November 9 he spoke to these problems in the Senate.

Senator Packwood's remarks covered three areas. Two of these areas had to do with reforestation tax incentive legislation and tax shelters by limited partnerships of public timber. We can support such investigation or actions that will insure an adequate U. S. timber base for U. S. producers.

Our concern is in the third area relating to the call for the International Trade Commission to investigate Canadian exports of lumber into the United States.

North American Wholesale Lumber Association opposes such an investigation by the International Trade Commission for the following reasons:

a) A proper and thorough investigation by the ITC will require the consultation of the forest products industry of North America. The costs can be ill-afforded by an industry in a depression and a government in deficit unless there is validity to the charges that Canada is somehow taking advantage of the adverse housing situation in the U. S. The majority of our Member wholesale firms distribute Canadian lumber to some degree. We have no indication that there have been any unfair trade practices involved.

b) Canadian lumber exports to the U. S., as a percentage of U. S. consumption, have been increasing for many years. The reasons for this increased market share are many. Canadian manufacturers are doing nothing different today that they were doing a year ago, five years ago or ten years ago. Now in 1981 there are allegations of unfair trade practices and/or competitive advantage because these exports to the U. S. are approaching 33% of U. S. consumption. In 1979 they were 29.4% and in 1980 they were 31.9% and nary a word has been said until this year.

c) The plight of U. S. manufacturers, especially in the Pacific Northwest, has to do with high-priced government timber previously acquired. This timber, converted into lumber for a severely depressed housing market, has many producers facing liquidation. Something needs to be done and quickly in regard to this situation. Looking to Canada will not be a solution either long-term or short-term.

d) Ever since the controversy and questions about Canadian lumber exports to the U. S. began in early 1981, there has been a lack of accurate and complete information on the subject. Our organization has much concern about the material that will be introduced before the sub-committees on November 24. We refer to the Congressional Record, November 9, 1981, pages S 13104-6.

For example:

a) On Congressional Record page S-13105, first column, a case is made that Canadian lumber exports as a percentage of U. S. consumption increased from 18.7% in 1975 to 31.9% in the first half of 1981. (Source: Western Wood Products Association). These figures are accurate, but incomplete. A serious strike in British Columbia resulted in a production loss by B. C. coastal mills of approximately 2 billion board feet. Additionally, the U. S. was experiencing its last housing slump of 1974-75. Prior to 1975, the Canadian percentage of U. S. consumption was 20.9% in 1974; 23.2% in 1973; 22.5% in 1972.

b) Production statistics (Source: National Forest Products Association) show that between 1973 and 1980, the Canadian lumber percentage of U. S. consumption went from 23.2% to 29.4%, an increase of 6.2%. During this same period Western U. S. production dropped 12.7% from 21,796,000,000 to 19,023,000,000. We would suggest that the shortfall on government timber sales in the U. S. Northwest during the late seventies was a primary factor. This shortfall was then compounded by severe competitive bidding for what timber was available.

ITEM: There is much controversy over the relative stumpage costs between Canada and the U. S. There are many conflicting statistics and statements on this subject. There are differences in the product (the tree) and the grade recovery from the trees. There is the difference in sales unit measurement (U.S.-boardfeet/Canada-the cunit) with argument on the formula for conversion to board footage. There is the difference between U. S. timber buyer requirements and those of the Canadians, i.e., administration and access costs. There is the difference called "bid stumpage" (U.S.) and "stumpage received" (Canadian) that materially affect so-called averages of stumpage costs.

Suffice it to say that Canadian timber is somewhat less than U. S. timber. The former fluctuates with the market while in the U. S. northwest there is competitive bidding, under a shortage created by federal timber practices, which led to a higher U. S. cost.

Nevertheless, we must take serious issue with the comparison used in the second column on page S-13105 (Source: International Trade Commission). These statistics indicate a 1980 average price in the "United States" of $285.50 per M board feet, while the average price in Canada in 1980 was $13.05 per thousand in Canadian dollars. A footnote acknowledges that the U. S. average stumpage price is for Oregon and Washington National Forests which is the extreme cost in the entire U. S.

Frankly, we can't determine the origin of the $13.05 Canadian average offered by the International Trade Commission. In 1980, Crown Timber sold for $7.76 per cubic meter in British Columbia. At that time, the conversion to U. S. dollars was $6.63 per cubic meter (Source: Council of Forest Industries of British Columbia). The conversion factor from cubic meter to board footage continues to be argued. Professor David Haley, of the University of British Columbia, submits that the conversion factor should be 5.2 x the cubic meter price, while the Council of Forest Industries states that the conversion factor is 7.5 x the cubic meter price. Thus, the 1980 average price was somewhere between $34.48 and $49.73 U. S. funds.

A Canadian consulting firm, Stirling Wood Associates, has come up with a 1980 average stumpage price in Oregon, Washington and Northern California of $250.87 off the national forests. The consultant reduces this price to $126.01 on the basis of stumpage bid averages to stumpage actually received (the way it is done in Canada). Some refute these figures on the basis that lesser species were included in these averages.

So much for statistics! Our point is that the ITC figures can be refuted substantially notwithstanding the non-comparable differences between the two countries.

ITEM: Senator Packwood correctly points out the freight differentials in transcontinental costs between the U. S. and Canada. He states that Canadian competitors pay government-set rail rates and that this is an advantage.

If you ask any shipper in the U. S., we believe he or she will tell you that U. S. rail rates are government-set....or is the I.C.C. a figment of our imagination? The U. S. government has legislated deregulation of the railroads. Everyone hopes that it will lead to competition and reduced relative costs eventually. The fact is that for the near term it has added to the costs of U. S. rail transportation. Ever since the Staggers Act of 1980 was passed, there has been confusion and the need for added traffic staffing and services. Again, the Canadian railroads have a lead on their U. S. competitors, but nothing different has occurred in 1981 that wasn't a prior advantage.

SUMMARY

We support Senator Packwood in his effort to alleviate short and long term problems of the NW timber industry. Our organization will support those U. S. manufacturers severely affected should they devise logical solutions to the problem of an adequate timber base that can subsequently be converted to lumber profitably. We are opposed to hearings and investigations that will be costly and prove fruitless. We are opposed to trade restrictions as we view a "quota" as unworkable and a "tariff" as an artificial market increase. Anything beyond tariffs involves jobs. Canadian lumber exports to the U. S. provide supply to many distributors, retailers, re-manufacturers, the mobile home manufacturers, practically all the lumber cargo (water-borne) market and to others. The lumber futures market on the Chicago Mercantile Exchange recently went to a Canadian species contract from a U. S. species contract. Canadian supply is interwoven within the total lumber marketplace and it is needed in any normal housing year. A trade restriction of any sort on Canadian lumber will not add one housing start in the U. S.

We respectfully request that careful consideration be given to any further action in relation to Canadian exports to the U. S.

As an addendum we are submitting our Association position on this subject. This position was taken by the officers of our Association on October 5, 1981.

Respectfully submitted

Harlan M. Niebling

Harlan M. Niebling
Executive Vice President

HMN:br
11-16-81

ADDENDUM

POLICY: IMPORTS OF CANADIAN FOREST PRODUCTS TO THE U.S.

North American Wholesale Lumber Association

October 5, 1981

PREAMBLE

High interest rates in the U. S. economy have substantially affected home construction in the U. S. The housing slump has, in turn, resulted in a serious recession in the forest products industry. Lumber, a commodity that is sold in a totally free market environment, has become tremendously ~~depressed in~~ the marketplace. U. S. producers of lumber and plywood are in serious circumstances with low market return compounded by high timber costs.

For many years Canada has supplied a substantial portion of U. S. softwood lumber needs. In the seventies, Canadian imports ranged from 25 to 28% of the total softwood lumber used in the U. S. An even higher percentage of these imports flowed to the housing market because of the nature of the Canadian product. Most recently, Canadian imports of softwood lumber have been pegged at 33% of U. S. usage. Given the slump in U. S. housing activity along with the fact that the Canadian lumber product is conducive to home building, the increase in Canadian imports as a percentage of the total is not surprising.

Nevertheless, there have been charged by some that the Canadian manufacturer is engaging in unfair trade by:

a) Import "dumping" of product in the U. S.

b) Is being subsidized by the Canadian government in the area of stumpage (raw material).

c) Is being subsidized by the government in transportation of product to market.

d) Is subsidized by the monetary exchange rate between the two countries.

A belief in such charges leads to the question of possible U. S. trade restrictions or tariffs on Canadian lumber. In addition to the obvious interference in free trade with all its detrimental aspects, the imposition of trade barriers to Canadian lumber imports is impractical, short of a total embargo. The aforementioned charges should, therefore, be closely examined for their validity.

a) Dumping. The definition of dumping is the sale of goods to another nation at a cost less than that charged customers within the exporting country. There is absolutely no indication that Canadian manufacturers or distributors are engaging in this practice. There are nearly 400 independent wholesaler members of North American Wholesale Lumber Association. Less than 10% are Canadian wholesale firms, yet over half of the total wholesale membership distributes Canadian lumber to some degree.

They are operating in a free market and sell, at auction, to the highest bidder. It is the weak U. S. market that is depressing prices, not unfair trade practices.

b) Subsidization by the Canadian Government in the area of stumpage. North American rejects this charge. The Canadian government, for economic vitality in the forest product sector, recognizes the employment and tax base the industry represents. Thus, Canada manages their timber to keep the industry competitive world-wide through sliding scale timber valuation and by guaranteeing a perpetual supply to each manufacturer.

The U. S. government has chosen to go a different route. Due to environmental pressures and inadequate funding in past years, the U. S. government had a substantial shortfall in timber sales offerings: a shortfall that was substantially lower than their announced allowable cut. Relying on the bidding process, timber prices were bid up. With the advent of a slump, many U. S. producers are faced with either fulfillment of cutting contracts or default of contracts. These alternatives are leading to serious losses and very possibly numerous bankruptcies. As it will serve our nation poorly to put our own timber customers out of business, it is in this area that the government should adjust.

c) Canadian imports are being subsidized by transportation costs. A closer examination of this charge can hardly be validated. Here again the U. S. government has selected a policy of transportation deregulation, i.e., advocating a free market. Thus, we are witnessing both increases and decreases in transportation costs on a regional basis. In the past year, we have noted increased costs for Canadian lumber to one area of the U. S. and decreased costs to another area. Additionally, rail transportation across Canada and then into U.S. markets is highly advantageous. The question to be asked is whether the U.S. is in favor of competition in transportation or not? Should the U.S. erect trade barriers in relation to transportation costs in all imported products?

d) Canadian manufacturers are subsidized by the monetary exchange rate. As a nation's currency strengthens or weakens, its exports and imports are affected. U. S. economic policy is aimed at controlling inflation, and thereby strengthening the dollar. To use this trade argument is to invite retaliatory trade actions of the worst kind.

In conclusion, a tariff on Canadian lumber imports will not increase U. S. demand. The ensuing higher cost to Canadian producers would quickly be reflected in their sliding scale of timber valuation. Many small U. S. businesses would have their sources of supply affected. The futures markets would be affected (the lumber contract is Canadian S-P-F 2 x 4's). It would worsen relations between the two countries. If such action met with any success, it would lead to inflation -- inflation created not by demand chasing too few goods, but because of government intervention.

POLICY

North American Wholesale Lumber Association continues to advocate a policy of free flow of forest products between the U. S. and Canada. Our Wholesaler Members do not recognize the international border in the distribution of forest products in the two countries.

At the same time, a healthy and viable U. S. manufacturing forest products industry is imperative. We petition the U. S. government to explore all alternatives for relief of U. S. producers caught between recent high timber costs and an industry in depression. Further, we support additional action to insure an adequate and consistent supply of raw material from the nation's forest through better management of a renewable resource.

The Administration's commitment to the control of inflation and enhanced free enterprise in the United States can be best served by a policy of free trade of forest products between the U. S. and Canada.

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