

Comments on DOC Notice of Preliminary Results of Countervailing Duty Review

Susan Athey and Peter Cramton, Market Design Inc.
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The Department of Commerce contends that the BCTS auctions are not a suitable benchmark on two grounds: 1) the auction volume was “not significant,” and 2) the auction prices were effectively limited by the administratively set stumpage fee on tenured lands, since the Allowable Annual Cut (AAC) typically was not binding during the Period of Review. We highlight below why each of these reasons makes little sense.

Volume was “not significant”

The DOC makes no attempt to define what would constitute a significant volume. The DOC simply contends that 7.1% of the harvested timber was not significant. The appropriate definition of significant volume should depend on what the data are being used for. In this case it is to estimate what the average auction price would be on the harvested timber from tenured tracts. As we argue in our March report and the subsequent rebuttal report, we need two things: 1) the auctioned tracks need to be representative of the tenure tracks, and 2) sufficient volume is needed to estimate with some precision the average auction price. Both of these conditions are met with the auction data from November 4, 2003 to March 31, 2004.

The DOC seems to be arguing that the auction volume needs to be a large or even dominant fraction of the market in order to avoid being influenced in some way by the presence of harvests from tenured land. However, the DOC fails to state the mechanism through which this influence occurs. Any logical argument to this end would rely on an intermediate mechanism whereby too much timber is harvested, relative to the competitive benchmark. Yet, we have argued that if anything, too little timber will be harvested.

Auction prices were limited by the stumpage fee on tenured lands

Here the DOC argument is that since the AAC typically does not bind, and since most of the logs were purchased by mills with tenured land, the price paid for the logs at auction was limited by the stumpage fee on the mill’s tenured land. This argument seems intuitive, but it is wrong. Our rebuttal report goes to great length to dismiss this argument. Our rebuttal does not depend on whether the AAC is binding as the DOC and Stoner contend. It is true that the stumpage fee may distort the auction price, but only by restricting supply and thereby raising the auction price beyond the competitive benchmark.

The correct reasoning follows from beginning with the competitive benchmark in which all land is privately held and the markets are fully competitive. Then the market price for logs as well as the quantity of logs harvested is determined from standard supply and demand analysis, such that the marginal cost of supply (including harvesting costs and opportunity costs) is equal to the marginal value of the logs to the mills.

Now suppose some fraction of the land is publicly held, with similar characteristics as the privately held land, and the timber rights are sold in a competitive auction. Then we get the same outcome as in the competitive case and the auction prices are the same as the expected profits to the private landholders.

Now suppose that some fraction of the publicly held land is under long-term tenures and a fixed stumpage fee is paid on this land and the remainder of timber rights are sold in a competitive auction. In this case, we would only get the competitive benchmark if the stumpage fee is set to zero. The reason is that the positive stumpage fee prevents the harvest of the marginal tracts on tenured land where profits would not cover the fee. Thus, less timber is harvested from the private and tenured lands, and this reduction in quantity supplied increases the auction prices.

The argument has nothing to do with the AAC being binding. However, a binding AAC would further distort the outcome away from the competitive outcome. The quantity supplied on the tenured lands would be further restricted, resulting in even higher auction prices.

To see that the auction price is not limited by the stumpage fee, consider an especially valuable tract of timber with extremely low harvesting costs. The price in a competitive auction for such a track would be well above a modest stumpage fee. And indeed, we see auction prices well above the stumpage fees.

Indeed, it would seem that taking DOC's arguments to their logical conclusion, we should not expect to see auction prices above the stumpage fee. After all, if the AAC is not binding, then the DOC's arguments would imply that there is a cheaper source of supply available that would crowd out the auction supply. The tenure-holders could simply harvest more and resell the logs. The fact that the auction prices are substantially higher than stumpage fees while the AAC does not bind indicates that the auction prices as well as the harvesting decisions of tenure-holders are being determined by other forces, namely the market value of the logs and the cost of harvesting.

Put more succinctly, if the prices tenure-holders are willing to pay at auctions are limited by stumpage fees, how can the auction prices be so high?

Our report laid out in some detail the reasons why the market value of the logs, and thus auction prices, are if anything too high.

The DOC later makes the point that on a sample of auctioned tracts, 65% of the logs were sold to tenure-holders. That also means that 35% were sold to buyers other than long-term tenure-holders. Perhaps the presence of that 35% is DOC's explanation for the high auction prices. However, one might also argue that the 35% is a substantial portion of the market for the final products from auctions. This line of argument might raise new complexities that would distract from the main message, however.