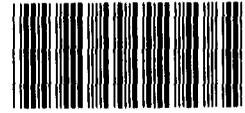


GAO

Testimony



139933

November 7, 1989

**Administration of the Federal Ban on
Exports of Unprocessed Federal Timber**

A Statement for the Record by
John W. Harman, Director, Food and Agriculture
Issues
Resources, Community, and Economic Development
Division

Submitted to the
Subcommittee on International Finance and
Monetary Policy
Committee on Banking, Housing, and Urban Affairs
United States Senate



047007 / 139933

Mr. Chairman and Members of the Subcommittee:

We are pleased to submit for your hearing on federal log exports, this statement for the record on the implementation of the federal ban on exports of unprocessed federal timber. The current restrictions were established in 1973, when the Congress banned the export of unprocessed timber from federal lands in much of the western United States because of the adverse impact on the domestic wood-processing industry. Through regulations, however, timber-exporting companies have been allowed to maintain their historic export levels and to continue buying federal timber for replacement of the private timber they exported. It is our understanding that, as part of your hearing, you will consider whether changes should be made to the current legislation.

Between 1984 and 1988, exports of unprocessed timber from Washington and Oregon ports have increased by about 1 billion board feet.¹ Domestic manufacturers have been concerned that this increase, coupled with other restrictions on federal timber sales, has threatened to cause potential domestic timber shortages and higher prices. The two principle agencies responsible for administering the sale of timber from federal lands are the Forest Service, Department of Agriculture and the Bureau of Land Management, Department of the Interior. At Congressman DeFazio's

¹A board foot is the equivalent to a piece of wood 1-inch thick, 1-foot wide, and 1-foot long.

request, we examined how these agencies have administered the regulations governing the replacement of private timber exports with federal timber purchases.

The results of our work can be summarized in three main points:

- First, the Forest Service and the Bureau differ considerably in the extent to which their regulations control timber replacement. While the Forest Service's regulations make it fairly difficult for a company to buy more Forest Service timber to replace increased exports of private timber, the Bureau's current regulations allow companies to increase their purchases and exports, over time, without limit. Neither agency regulates federal timber that has been acquired through intermediaries as replacement for exported private timber.

- Second, the control mechanisms both agencies use to monitor the level of private timber exports are vulnerable because they rely almost solely on reports from purchasers. The accuracy of these reports is generally not tested or audited. Both agencies also depend on members of the industry to inform them of suspected violations. To the extent that inaccurate reporting occurs and independent verification does not occur, the Forest Service and the Bureau have little assurance that the regulations are being followed.

-- Third, enforcement of the regulations is difficult because the historic export levels are established by geographic area, the boundaries of which is often vague and, therefore, disputable. Also the penalties available to the government for violations of the regulations are limited.

Before elaborating on these points, we would like to provide some background on the federal timber legislation and to explain briefly the regulations governing replacement of exported private timber with federal timber.

BACKGROUND AND
LEGISLATIVE RESTRICTIONS

In October 1973, a provision was attached to the Interior and Related Agencies Appropriations Act of 1974 that, in effect, prohibited the export of any unprocessed timber from federal lands in the western United States.² This provision has been attached to all subsequent Interior and Related Agencies Appropriations Acts.

As written, the provision also prohibited purchasers from using timber harvested from federal lands in their processing plants while exporting private timber that could have been used in those plants. However, in a February 1974 letter to the Chief of the

²The provision specifically identifies this as those federal lands in the contiguous 48 states west of the 100th meridian.

Forest Service, the Chairman, Subcommittee on Interior and Related Agencies, House Committee on Appropriations, explained that the Committee intended to allow historic patterns of trade to continue without disruption. According to the Chairman, this provision was intended to prohibit firms in the export trade from increasing future log exports by replacing private timber with federal timber.

The agencies developed regulations that permitted firms to maintain both their historic export levels and their purchases of federal timber. The regulations prohibit what is called direct substitution--that is, using federal timber to exceed the level of replacement established by historic purchasing and exporting patterns. The regulations also prohibit companies that do not have historic exporting patterns from replacing private exported timber with federal timber.

Over half of the permitted timber replacement using Forest Service timber occurs in Washington State; the remainder occurs in California and Oregon. All of the replacement using Bureau timber occurs in Oregon. According to Forest Service records, 53 firms in California, Oregon, and Washington have combined annual replacement quotas of nearly 570 million board feet. The Bureau could not provide information on the total amount of annual replacement quotas for its timber purchasers because the quotas were constantly changing as export sales were made.

To provide a perspective on the amount of replacement taking place, we obtained information covering a 2-year period. In 1987, 9 companies exported private timber and bought Forest Service and/or Bureau timber for domestic processing. These companies exported a total of 128 million board feet of private timber and purchased 189 million board feet of federal timber. In 1988, 7 companies exported 92 million board feet of private timber and purchased 235 million board feet of federal timber.

Another type of substitution, commonly referred to as indirect or third-party substitution, is not covered by the regulations. In this type of substitution, a purchaser of federal timber resells the timber to a company that is ineligible to buy it directly from the federal government because of its private timber-export activity. The company buying the timber from the original purchaser substitutes it for private timber normally used in its processing plants and then exports this private timber. However, the company is prohibited from directly exporting the federal logs.

The total amount of third-party substitution of federal timber is not precisely known. In 1987 and 1988, the Forest Service estimated 107 million board feet and 114 million board feet, respectively, in third-party substitution in Washington and Oregon. Bureau officials in Oregon had no statistics on such substitution but believed it to be limited.

AGENCY REGULATIONS DIFFER

The Forest Service established its regulations in 1974; the Bureau established its regulations in 1976. Despite their common origin, the two sets of regulations differ significantly, with respect to computing what the regulations call "historic levels" of trade. These levels serve as the basis for computing quotas that determine the maximum amount of federal timber that can replace exported private timber.

Forest Service regulations define the historic levels as the average annual volume of unprocessed timber purchased and exported during calendar years 1971-73. Replacement quotas are limited to whichever is less: 110 percent of the historic level of exports or 110 percent of purchases. Exceeding this level constitutes direct substitution, which is prohibited.

Although, the Forest Service's definition of the historic levels makes it difficult for companies to increase their replacement levels, they can manage to do so by purchasing other companies that have established historic quotas. For example, when two companies with separate replacement levels totaling 62 million board feet a year recently combined, the new replacement level rose to 80 million board feet a year. One of these companies had higher purchase levels than exports; the other had higher exports than

purchase levels. The combination of the two produced the higher replacement level.

By contrast, the Bureau defines historic levels as the volume of purchases and the volume of exports made during the 12 months preceding the last export date. Accordingly, a purchaser would have to exceed its annual historic levels for both purchases and exports to be in violation of the Bureau regulations. These regulations, in effect, permit purchasers to increase either their annual purchases or annual exports over the prior historic level.

Under this definition, a purchaser can increase Bureau timber purchases while holding private exports constant in the first year, purchase Bureau timber at the same level the second year while increasing exports, increase Bureau purchases again the third year while holding exports constant, and continue this pattern indefinitely. This practice is called "ratcheting." Thus, the Bureau's regulations allow companies to increase their federal timber purchases and private export volumes, over time, without limit.

An example will clarify how ratcheting works. Before 1980, a certain company did not have a historic level of timber exports. In 1980, this company exported 8 million board feet of private timber and purchased 68 million board feet of Bureau timber. By

1985, the company had increased its exports to 92 million board feet while continuing to buy Bureau timber.

The Bureau's Oregon State Office proposed changes in Bureau regulations in 1986 that would have made this practice more difficult. In September 1989, a Bureau official said that the impetus behind the proposed changes died when the company sold its processing plant and stopped buying Bureau timber. The Bureau and the Department of Interior's Assistant Secretary for Land and Minerals Management decided not to pursue changes to the regulations. While this was the only company that has taken significant advantage of increasing its historical levels under the Bureau's regulations, the potential still exists for other companies to take advantage of the regulations.

CONTROL MECHANISMS FOR MONITORING

COMPLIANCE ARE VULNERABLE

To monitor compliance, both agencies require the purchasers to submit certified reports showing their export activities. However, officials of both agencies said that they generally do not verify the reported amounts by independent test or audit. In addition, they said that they rely on members of the industry to inform them of suspected violations by other members.

These limited control mechanisms are vulnerable because purchasers could report false information on their export activities that could go undetected. For example, in two recent instances, purchasers had submitted the required reports to the Forest Service, but had omitted the sections indicating private exports. Both companies had been exporting and were suspected of exceeding their historic quotas. When the Forest Service requested and finally received the completed reports, both companies were found to have exceeded their quotas.

In our opinion, good internal controls including at least selective testing of information submitted by the companies would allow the agencies to have better assurance that the regulations are being followed. Bureau officials told us that their regulations require purchasers to retain records of Bureau timber acquisitions and private timber exports for 3 years. However, they said that they have not audited the purchaser's records. Forest Service officials said that they do not routinely verify the information reported. Instead, they audit a purchaser's records only when they suspect violations.

According to an industry expert, because agencies rely on the industries to inform them of suspected violations by other companies, violators often continue their illegal practices for lengthy periods before the government can be convinced that violations are occurring. For example, a case of possible illegal

substitutions that occurred in 1986, 1987, and 1988, was brought to the Forest Service's attention in the spring of 1988 but was not resolved until August 1989.

ENFORCEMENT ACTIVITIES AND

PENALTIES ARE LIMITED

In addition to problems in detecting violators, the Forest Service and the Bureau encounter difficulties in enforcing regulations when violations are found. First of all, the boundaries of the geographic areas used to determine the historic export quotas are often vague and disputable. These general geographic areas, called tributary areas or marketing areas, are the designated territory for a processing facility's log supply. Ordinarily, tributary area boundaries are not specified until a purchaser makes a request for assistance or a complaint is received. As a result, detecting a violation is difficult.

Furthermore, unless criminal intent and/or fraud can be proven, the penalty for violation of log export regulations--the cancellation of related federal timber sale contracts or non-award of pending contracts--is generally inconsequential. A Forest Service official said that if contracts are cancelled, the government may resell the contract. If the proceeds on resale are less than the current contract values at the time of termination, the violator can be charged damages for the difference. He stated

that if the contract sells for the same or higher price, there are no damages. For more serious offenses, violators can be debarred or suspended from bidding on future awards of federal timber contracts.

From 1981 to August 1989, the Forest Service and the Bureau identified eight instances involving seven purchasers, in which purchasers of federal timber had allegedly or actually violated substitution rules. The agencies took no action against two purchasers because the violations were considered minor. The agencies cancelled the affected federal timber sale contracts for the other five purchasers. However, in only one instance could the cancellation be considered to have a significant effect on the purchaser: forfeiture of the costs that had already been incurred for site preparation and logging roads.

Officials of both agencies advised us that no purchasers have been debarred for substitution violations since the regulations have been in effect. However, as of August 1989, a Forest Service official stated that the decision on debarring one violator was still pending. In addition, Bureau officials stated that this same violator has been suspended for one year.

CONCLUSIONS AND RECOMMENDATIONS

We have not reviewed the merits of the policy of banning the export of federal timber. Nor did we review the use of historic levels as determining the basis for the replacement of federal timber for exported private timber. If, however, the Congress desires to effectively limit the export of federal timber, several steps should be taken. It is clear, first, that the implementing regulations adopted by the Forest Service and the Bureau are inconsistent and need to be made uniform. The Bureau's regulations allow companies to increase their levels, over time, without limit; whereas the Forest Service limits the levels to the 1971-73 period. In addition, penalties for noncompliance should be increased to encourage compliance. Furthermore, both agencies' monitoring mechanisms need to be improved and strengthened.

Accordingly, we recommend that the Congress take action to make changes in the current legislation to: (1) clarify its intent with regard to the use of historic levels which serve as the basis for the replacement of federal timber for exported private timber and (2) establish appropriate penalties for those companies that violate the law. In addition, we recommend that the Secretary of Agriculture and the Secretary of the Department of the Interior direct the Forest Service and the Bureau, respectively, to institute improved internal controls which would include at least selected testing of information provided by the companies.

This concludes our prepared statement.