

Summary and Explanation of the U.S.-Canada Lumber Dispute *

Definitions

Stumpage: the price charged by a land owner to companies or operators for the right to harvest timber on that land. Stumpage used to be calculated on a "per stump" basis (hence the name). It is now usually charged by board feet or by cubic metres. Because so much Canadian lumber is on government land, the government can use stumpage fees as a way to influence the logging industry by charging low or high stumpage fees.

Countervailing duty: a subsidy that provides an importer with an advantage in the importing market, causing the importing market to impose a duty on the incoming goods. The U.S. looks to two criteria when evaluating whether to impose a countervailing duty- subsidy and injury. To be subsidized, the goods must be specifically and preferentially treated in the exporting country.

Dumping: the sale of goods to another country at less than what they cost to produce.

Historical Background¹

Lumber I: In October 1982, the Department of Commerce investigated the stumpage programs of B.C., Alberta, Ontario and Quebec. In May 1983, the Department of Commerce ended its investigation, finding that stumpage programs were not countervailable because stumpage was generally available and not limited to a specific industry (i.e., the specificity test was not met). Under U.S. trade law, a countervailing duty case is an investigation of an alleged subsidy that provides an importer with an advantage in the U.S. market. With lumber, the U.S. contends that provincial stumpage provides a subsidy to lumber producers. Other provincial programs may also be alleged to provide subsidies.

To impose a countervailing duty or tariff, the U.S. must establish two things:

1. Subsidy - imported goods are subsidized.
2. Injury - the subsidized goods are injuring the U.S. industry.

Two factors determine whether goods are subsidized:

1. Specificity - programs are available only to a specific industry.
2. Preferentiality - goods are provided at a preferential rate.

* Summarized and written by Abby C. Foster, JD anticipated 2008 Penn State Dickinson School of Law

¹ Summarized portions compiled from the following sources:

<http://www.for.gov.bc.ca/het/softwood/disputes.htm>, British Columbia Ministry of Forests and Range, July 5, 2002. Canada- U.S. Lumber Trade Disputes.

http://canada.usembassy.gov/content/textonly.asp?section=can_usa&subsection1=trade&document=softwood_lumber , Embassy of the United States of America, Ottawa. periodically updated. Softwood Lumber.

<http://hir.harvard.edu/blog/?p=102> , Harvard International Review, July 9, 2006. A Blossoming Friendship? U.S.-Canadian Softwood Negotiations.

http://www.cbc.ca/news/background/softwood_lumber/ , CBC News, August 23, 2006. Indepth: Softwood Lumber Dispute.

The U.S. Department of Commerce investigates subsidy, while the quasi-judicial International Trade Commission investigates injury. Each agency makes a preliminary and then a final determination.

Following a Department of Commerce preliminary determination of subsidy, bonds are required on shipments to the U.S. If the Department of Commerce finds that "critical circumstances" apply, this duty can be made retroactive for 90 days. After the final determinations of the Department of Commerce and the International Trade Commission, a countervailing duty order is issued and cash deposits are required on shipments.

Lumber II: The Department of Commerce started another investigation in May 1986. Two things changed between the end of Lumber I and the onset of Lumber II: The Department of Commerce began to more aggressively apply U.S. trade law, especially in natural resource countervailing duty cases. More important, the Coalition for Fair Lumber Imports – the U.S. lumber industry coalition – became a large, well-funded and politically well-connected lobby group.

Contrary to its 1983 determination, the Department of Commerce found that stumpage programs did meet the specificity test, and levied a 15 percent tariff in its October 1986 preliminary determination. The preferential benchmark used by the Department of Commerce was "cost to government." The Department of Commerce determined that stumpage revenues received by provincial governments were exceeded by applicable government costs.

Since 1988, Canada has been able to appeal a countervailing duty to an arbitration panel established under the Free Trade Agreement (now NAFTA). However, a NAFTA panel can only determine whether the finding was made in accordance with U.S. law. An appeal can also be made to a WTO panel, which can determine whether U.S. law is consistent with the WTO.

Under U.S. trade law, an anti-dumping case is an investigation on whether an importer is selling goods in the U.S. at prices lower than in the home market or is selling goods at prices below cost.

A final determination was never reached. The case ended when Canada and the U.S. agreed, in December 1986, to a memorandum of understanding (MOU) under which Canada imposed a 15 percent export charge on lumber exports to the U.S.

The MOU let provinces replace the export charge through increased stumpage or other policy changes. B.C. implemented replacement measures in October 1987 – increasing stumpage and transferring the responsibility for silviculture to industry.

Lumber III: Canada's attempts to have the U.S. agree to termination were rebuffed; eventually, in October 1991, Canada unilaterally terminated the MOU.

Almost immediately, the Department of Commerce started an investigation and imposed temporary bonding requirements. It was the first time the department had initiated a countervailing duty case on its own.

In May 1992, the Department of Commerce issued a final determination, which set a countervailing duty rate of 6.51 percent.

Canada appealed the Department of Commerce's subsidy finding and the International Trade Commission's injury finding to binational panels under the Free Trade Agreement. After a number of redeterminations by the two agencies and further appeals by Canada, the Department of Commerce finally reversed its finding – consistent with the panel decision.

The U.S. then challenged the panel's decision to an extraordinary challenge committee, also established under the Free Trade Agreement. The committee affirmed the panel's decision, and the Department of Commerce revoked the countervailing duty order in August 1994.

The 1996 Softwood Lumber Agreement: In December 1994, Canada and the U.S. agreed to implement a consultative process on lumber trade as an alternative to another trade dispute. Canada agreed to the consultative process, in part because the U.S. agreed to refund a significant part of the duties collected in Lumber III (about \$500 million), and the U.S. Lumber Coalition agreed to drop a constitutional challenge against the Free Trade Agreement arbitration panel process.

Also, in its implementation of the WTO Uruguay Round agreement, the U.S. had amended its trade law to ensure that Canada could not succeed on the same basis as in Lumber III. The consultations led to the negotiation of the five-year Softwood Lumber Agreement in April 1996.

The agreement limited U.S. lumber exports from B.C., Alberta, Ontario and Quebec to 14.7 billion board feet (fee-free base) annually, with escalating fees payable on shipments over that volume. The U.S. agreed not to initiate a trade case for the duration of the agreement.

However, the Softwood Lumber Agreement did not bring the expected five years of trade peace. The U.S. challenged B.C.'s 1998 stumpage reduction under the dispute settlement provisions of the agreement. U.S. Customs, on at least three occasions, reclassified products from tariff codes outside the softwood lumber agreement into codes covered by the agreement. Canada and the U.S. agreed to negotiated settlements in the stumpage cases. On March 29, 2001, the arbitral panel ruled that the United States breached the softwood lumber agreement when it chose to reclassify drilled studs and notched lumber.

Lumber IV-Summer 2006 Resolution: Following the expiration of the Softwood Lumber Agreement, on April 2, 2001, the U.S. Coalition for Fair Lumber Imports filed a countervailing duty petition and its first anti-dumping petition against Canadian softwood lumber.

British Columbia has followed a three-track approach in dealing with the softwood lumber trade issue. The government has defended its programs during the litigation of the countervailing duty case, and supports challenges, both under the NAFTA and at the WTO. The government actively participated in discussions with the American government about possible policy changes that could lead to a resolution of the issue. It also supports market diversification and increased advocacy within the U.S. on the softwood lumber issue.

On August 9, 2001, Commerce made its preliminary determination that Canadian softwood lumber exports to the United States were subsidized at a rate of 19.31 percent. It compared BC stumpage rates with those of Washington State and did similar calculations for other provinces. In addition, Commerce found that "critical circumstances" were present in the case, deciding that there was a "massive surge" in Canadian softwood lumber exports to the US in the three months following the expiration of the Softwood Lumber Agreement. As a result, lumber producers were required to post bonds to cover duties on all lumber shipments made to the US beginning May 2001.

Softwood lumber producers that do not benefit from the programs under investigation may be eligible for exclusion from the investigation. Only one lumber producer

from the Yukon was excluded from the countervailing duty investigation at the time of the preliminary determination, because it sourced its timber from private land.

The countervailing duty investigation was aligned with the anti-dumping case. As a result, the final subsidy determinations in both cases took place on March 21, 2002. Under the WTO, a provisional countervailing duty order can apply for a maximum of four months. Between December 15, 2001 and the final determination in May 2002 (the "gap period"), countervailing duties were not required for lumber shipments to the US.

In August 2001, the Bush administration backed a U.S. forest industry bid to hit Canadian lumber with billions of dollars in duties. Two months later, the duty was increased when the government imposed an anti-dumping duty on top of the original duty. Dumping is a term used to describe the sale of goods to another country at less than what they cost to produce.

The duties were applied separately following the expiration of the softwood lumber agreement between Canada and the U.S., which governed exports from April 1, 1996 to March 31, 2001. Under that agreement, the U.S. guaranteed market access to Canadian exporters for five years and permitted the import of 14.7 billion board feet per year of lumber without fees. The agreement applied to \$10 billion worth of lumber produced in British Columbia, Alberta, Ontario and Quebec.

The agreement didn't apply across Canada. Since lumber harvested in the Maritimes comes mostly from private land, Maritime provinces weren't subject to the U.S. rules. With no extra duties to deal with, Maritime producers saw business rise.

When the agreement was signed, Maritime provinces accounted for about five per cent of Canada's lumber production. In the five years following, production in Nova Scotia and New Brunswick soared 62 percent to more than 1.2 billion board feet. That compares with 1.5 billion board feet produced in Ontario. In New Brunswick, 90 per cent of softwood lumber exports go to the United States.

On July 29, 2003, officials on both sides announced a draft deal. As part of the draft, Canada had agreed to cap lumber exports to account for 30 percent of the U.S. market, down from 34 percent. If the quota was exceeded, Canada would have to pay a penalty. The plan was nixed two days later when U.S. producers said Canada needed to make more compromises.

A NAFTA decision on Aug. 13, 2003 was considered a partial victory for the Canadian side. A panel ruled that, while the Canadian lumber industry is subsidized, the 18 percent tariff imposed on softwood lumber by the United States is too high. While the ruling didn't throw out the duty imposed more than a year earlier, it ordered the U.S. Commerce Department to review its position.

The NAFTA report said the U.S. made a mistake in calculating its duties based on U.S. prices, and by not taking Canadian market conditions into consideration. It ordered Washington to recalculate them. NAFTA decisions are legally binding and must be put into effect within 60 days.

Two weeks later, a WTO panel concluded that the U.S. wrongly applied harsh duties on Canadian softwood exports. The panel also found that provincial stumpage programs provide a "financial benefit" to Canadian producers. But, the panel made it clear that the benefit is not enough to be a subsidy, and does not justify current U.S. duties.

On Aug. 10, 2005, an "extraordinary challenge panel" under NAFTA dismissed American claims that the earlier NAFTA decision in favor of Canada violated trade rules. But by November 2005, the U.S. Commerce Department said it would comply with the NAFTA ruling, even though it disagreed with it.

The following month, the U.S. Commerce Department said it had recalculated its countervailing and anti-dumping duties on softwood. The result? The new duties would be set at a total of 10.8 percent, almost halving the old rate. The decision was expected to save Canadian lumber companies \$600 million a year.

In February 2006, the U.S. lumber lobby said the World Trade Organization had ruled that the U.S. had complied with its international obligations while applying anti-dumping duties against Canadian lumber imports. Canadian officials countered that the U.S. was continuing to artificially inflate anti-dumping rates by using different calculation methods to avoid complying with an earlier WTO decision.

In March 2006, a NAFTA panel again ruled in Canada's favor, finding that Canadian softwood lumber exports are not subsidized. At this point, the total duties collected by the U.S. had reached \$5.2 billion.

In April 2006, a World Trade Organization appeal body rejected Canada's request to overturn an earlier decision by the U.S. International Trade Commission. A group of lumber producers in the United States known as the Coalition for Fair Lumber Imports claimed this ruling as another victory in their long-running softwood lumber dispute with Canada. Then, on April 26, 2006, came word that Canada and the United States had reached a framework agreement that could form the basis for an end to the dispute.

The framework agreement called for the U.S. to return about 80 percent of the \$5 billion in duties that U.S. Customs has collected in the previous four years. Canadian-sourced lumber would also be kept to no more than its current 34 percent share of the U.S. softwood market.

Canada will also collect an export tax on softwood lumber exported to the United States if the price drops below \$355 a thousand board feet. On July 1, 2006, trade ministers from Canada and the U.S. signed the final legal text of the softwood lumber deal. The deal is based on the April 26 framework agreement.

Parts of the deal included:

- Import duties of \$4 billion the U.S. charged Canadian companies since 2002 will be returned. But the U.S. keeps \$1 billion.
- A seven-year term, with a possible two-year extension.
- A ban on the U.S. launching new trade actions.
- Restrictions on Canadian exports will kick in if prices fall too far.
- Neutral trade arbitrators will provide final and binding settlements of disputes.

The newest version of the agreement includes concessions that make it harder for the U.S. to pull out of the softwood lumber agreement before it ends, and that foster stability in the forest industries. For example, if the agreement isn't renewed, or if the U.S. decides to bail out, the Americans cannot re-impose duties until one year after the deal was killed. The U.S. also must give Canada six-months notice, up from three months. These extra clauses give the lumber industry more stability, which could help producers to recoup their losses over the years.

What Next?

While the current seven-year agreement remedies many of the ills left over from the 1996 agreement, the underlying cause of the dispute remains- Canadian lumber is cheaper to harvest and export than American lumber. The new agreement is a good solution for the current market situation, but when economic or environmental factors change, the Americans may well back out or file complaints and the agreement may need to be adjusted or thrown out and reworked completely.