

# Softwood Lumber Trade Dispute with the United States

## A. Introduction

- Since 1982, Canada and the US have been involved in four lumber trade disputes (widely called Lumber I, II, III and IV). The latest dispute began when the five-year Softwood Lumber Agreement expired in April 2001.
- British Columbia, which accounts for about 50% of Canadian softwood lumber exports to the US, is the prime target of these disputes.
- This note looks at international trade rules and countervailing and anti-dumping duty investigations, gives a brief history of the Canada-US softwood lumber dispute, and gives a more detailed description of the current dispute.

## B. Background on International Trade Rules

- Under world trading rules, as negotiated at the General Agreement on Trade and Tariffs (GATT) and now at the World Trade Organization (WTO), governments have in general agreed to lower trade restrictions against each other.
- In general, governments have agreed not to impose new trade restrictions such as tariffs or quotas, have capped existing levels of tariffs and have also agreed to reduce these tariffs.
- There are a number of exceptions in the WTO that allow trade restrictions to continue including:
  - Anti-dumping duties to offset countries/companies selling unfairly at a low price
  - Countervailing duties to offset government subsidies
  - Emergency trade restrictions designed to “safeguard” domestic industries
- Past softwood lumber trade disputes between the U.S. and Canada had only taken the form of countervailing duty cases. In Lumber IV, the US has imposed both anti-dumping and countervailing duties on Canadian lumber imports.

### 1. Countervailing Duties (CVD)

- A countervailing duty is a tariff imposed against imports from a specific country in order to offset an unfair advantage caused by a government subsidy.
- Not all government subsidies are countervailable. Under WTO rules, the “Agreement on Subsidies and Countervailing Measures”, for a subsidy to be countervailable, it must meet certain criteria:
  - there is a financial contribution by a government
  - a benefit is conferred
  - the subsidy is specific to an enterprise or industry
  - the subsidy results in injury to the domestic industry requesting the duties
- Each country has its own rules to investigate whether countervailing duties are justified.

- Under US law, the U.S. Department of Commerce (Commerce) investigates whether a countervailable subsidy exists and what level of duty is required to offset it, while the U.S. International Trade Commission (ITC) investigates whether the US industry has been injured. Each agency makes a preliminary and then a final determination.
- Following a Department of Commerce preliminary determination of subsidy, bonds to cover the duty are required on shipments to the U.S. If the final determinations of Commerce and the ITC find that a subsidy exists and is causing injury to the US industry, then a countervailing duty order is issued and cash deposits are required on shipments.
- The duties determined in an investigation are preliminary, based on prior years' information and Commerce must recalculate the duties actually owed once the information is available. This is done in an 'Administrative Review'; this recalculation may result in a partial refund of duties, or the requirement to pay more.

## **2. Anti-Dumping (AD) Duties**

- If a company exports a product at a price lower than the price it normally charges in its own home market, it is said to be “dumping” the product.
- The WTO agreement does not pass judgement on whether this is unfair competition, in contrast to its position on countervailable subsidies. The WTO focus is on how governments can or cannot react to dumping.
- Similar to countervailing duty cases, US anti-dumping cases involve a determination of the level of dumping by the Department of Commerce, and a determination of injury to the US industry by the International Trade Commission.
- Since an anti-dumping allegation involves the actions of companies, rather than governments, the Department of Commerce anti-dumping investigation focuses on companies' actions and records rather than government programs.
- As with the CVD, the preliminary determination sets the bond requirements, the final determination sets the cash deposit requirements, and the administrative review sets the actual duties owing.

## **3. NAFTA and WTO Appeals of US Determinations**

- Since 1988, Canada has been able to appeal a U.S. countervailing duty determination to an arbitration panel established under the Canada-US Free Trade Agreement (now NAFTA).
- NAFTA panels can only determine whether the US finding was made in accordance with US law, not whether US law is consistent with international trading rules. NAFTA panels have the authority to require the US to change its finding.
- An appeal to a WTO panel can determine whether U.S. law is consistent with the WTO agreement. However, the WTO has no legal authority to require the US to change its decision. It does give authority for countries to employ retaliatory trade measures on imports of products from the US if the US does not comply with the WTO panel decision.

## **4. Roles and Responsibilities**

- In a countervailing duty case, the federal government has overall responsibility for coordinating the legal defence. Provincial governments have the lead in addressing the allegations of subsidy that relate to provincial programs.
- Industry has the lead on an anti-dumping case. The federal government is not a direct participant in an anti-dumping case but has overall responsibility for international trade and monitors the investigation to ensure it is in accordance with the WTO.

**Note:** more information on international trade agreements, trade dispute resolution and countervailing and anti-dumping rules can be found at:

WTO website:

[http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/agrm1\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm1_e.htm)

NAFTA website:

<http://www.nafta-sec-alena.org/DefaultSite/index.html>

Canadian Department of Foreign Affairs and International Trade (DFAIT) website:

[www.dfait-maeci.gc.ca/tna-nac/dispute-en.asp](http://www.dfait-maeci.gc.ca/tna-nac/dispute-en.asp)

US Department of Commerce website:

<http://ia.ita.doc.gov/intro/index.html>

## **C. History of Previous Countervailing Duty Cases and Negotiated Agreements**

### **1. Lumber I (1982-1983)**

- In October 1982, at the request of a group of US sawmillers, the Department of Commerce investigated the stumpage programs of B.C., Alberta, Ontario and Quebec. In May 1983, the Department of Commerce determined that stumpage programs were not countervailable because they are not limited to a specific industry.

### **2. Lumber II and the MOU (1986-1991)**

- At the request of the US lumber industry, the Department of Commerce started another CVD investigation in May 1986.
- Contrary to its Lumber I determination, in Lumber II Commerce found that stumpage programs did meet the specificity test, and levied a 15 per cent CVD in its October 1986 preliminary determination.
- 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 per cent export charge on lumber exports to the U.S. This MOU remained in place until October 1991 when Canada terminated the agreement.

### **3. Lumber III (1992-1994)**

- Almost immediately after Canada terminated the MOU, the US Department of Commerce (DOC) started a new CVD investigation. In May 1992 the DOC set a CVD rate of 6.5%. Canada appealed Commerce's subsidy (CVD) finding and the ITC's injury finding to a bi-national panel under the NAFTA. The Panel found that Commerce had not presented sufficient evidence that Canadian exports were subsidized, nor had the ITC shown that the US industry was injured. In August 1994 Commerce finally complied with the Panel decisions and revoked the countervailing duty order.

### **4. The Softwood Lumber Agreement (1996-2001)**

- In December 1994, Canada and the U.S. agreed to begin consultations to find an alternative to another trade dispute. These consultations led to the negotiation of the five-year Softwood Lumber Agreement (SLA) effective April 1996.
- Canada agreed to the consultations, 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 NAFTA arbitration panel process. Also, the U.S. had amended its trade law to ensure that Canada could not succeed at a NAFTA panel on the same basis as it had in Lumber III.
- The SLA allowed BC, Alberta, Ontario and Quebec to export up to 14.7 billion board feet annually, duty free. An export fee was paid on shipments over that volume. The U.S. agreed not to initiate a trade case for the duration of the agreement.
- However, the SLA 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. In addition U.S. Customs reclassified products (rougher headed lumber and drilled and notched studs) from tariff codes that were outside the softwood lumber agreement into codes that were covered by the agreement.
- The SLA quota system was also difficult to administer and seriously hampered many segments of the Canadian lumber industry. BC coastal companies were especially disadvantaged as they did not have quota to ship to the U.S. market when the Japanese market collapsed in 1997-1998. New entrants and growing companies also had difficulties accessing quota.

**Note:** More detailed histories are available at

BC Ministry of Forests website:

[www.for.gov.bc.ca/HET/Softwood/disputes.htm](http://www.for.gov.bc.ca/HET/Softwood/disputes.htm)

Random Lengths website:

[http://www.randomlengths.com/base.asp?s1=In\\_Depth&s2=U.S.-Canada\\_Trade\\_Dispute](http://www.randomlengths.com/base.asp?s1=In_Depth&s2=U.S.-Canada_Trade_Dispute)

## D. The Current Softwood Lumber Trade Dispute Lumber IV (2001- present)

- Immediately following the expiration of the Softwood Lumber Agreement in March 2001, the U.S. Coalition for Fair Lumber Imports filed a countervailing duty petition and an anti-dumping petition against Canadian softwood lumber.
- British Columbia has followed a two-track approach in dealing with the softwood lumber trade issue:
  1. **Litigation:** The government has defended its programs during the litigation of the countervailing duty case with Commerce, and supports challenges in international courts, both under the NAFTA and at the WTO.
  2. **Negotiation:** The government has actively participated in discussions with the US government about possible policy changes that could lead to a resolution of the dispute, including proposals for an interim agreement until the changes take effect.

### 1. Litigation

#### a. Countervailing Duty (CVD) and Anti-Dumping (AD) Cases

- On August 9, 2001, Commerce made a *preliminary* CVD determination that Canadian softwood lumber exports to the United States were subsidized at a rate of 19.3 percent.
- In its *preliminary* AD determination on October 31, 2001, Commerce applied company-specific rates to six investigated companies (Canfor, Slocan, West Fraser, Weyerhaeuser, Abitibi Consolidated and Tembec); all other Canadian companies were required to post bonds at the average rate of 12.6%.
- On May 22, 2002, the Commerce published its *final* CVD and AD orders. As a result, the U.S. Customs Service requires cash deposits for duties on all softwood lumber imported from Canada on or after May 22, 2002.
- The final duties enacted May 22, 2002 are as follows:
  - CVD rate: 18.79%.
  - AD average rate: 8.43%.
  - **Combined CVD/AD rate: 27.22%**
- The 27.22% CVD/AD rate imposed by Commerce on May 22, 2002 is a preliminary cash deposit rate based on a calculation using government and company data for the period April 2000 to March 2001.
- Each year (unless the case is settled), an administrative review will be conducted to recalculate the actual duty rate for shipments during the previous year, and to establish a new cash deposit rate for future shipments. The first administrative review began on June 1, 2003 and reviewed the period from April 1, 2002 to March 31, 2003. The second administrative review began on June 1, 2004 and will review the period of April 1, 2003 to March 31, 2004. Subsequent reviews will begin on June 1 of the given year and will review the most recently ended government fiscal year.

- On June 2, 2004 Commerce released a preliminary determination in the first administrative review with a country wide CVD rate of 9.2%, and AD rate of 4% (nearly half of the amount that has been paid by companies since May 2002).
- The final rate in the first CVD administrative review will be determined in December 2004. If Commerce determines that the actual CVD/AD rate over the period was lower than 27.22%, companies should receive refunds. On the other hand, if the administrative review results in a higher duty rate than the cash deposit rate, companies will have to pay the difference. Either Canada or the US Coalition could appeal the Administrative Review final determination.

#### b. WTO and NAFTA Challenges

- To date Canada has filed seven appeals against the imposition of softwood lumber duties - three before NAFTA and four before the WTO. In addition, members of the forest industry have also launched challenges.
- The most important result received to date is the NAFTA Panel ruling on the ITC injury finding. That NAFTA panel has essentially found that the ITC has not proved that the US industry was injured by Canadian imports. If this ruling is upheld through an extraordinary appeal by the US Coalition (perhaps by the end of 2004), then the CVD and AD cases will be terminated, and Canada will have won the Lumber IV litigation.
- A NAFTA panel has also been ongoing since April of 2002 regarding the subsidy (CVD) determination. Among other topics, the panel has reviewed a number of issues related to the calculation of the CVD rate and is now awaiting the US DOC's recalculation given their findings. If the recalculation results in a rate less than 0.5% Canada-wide, then the CVD order would be revoked; otherwise the impact of the Commerce Department re-calculation will be minimal.

**Note:** more information on Canada's NAFTA and WTO challenges of the softwood lumber duties can be found at the BC Ministry of Forests website:

[www.for.gov.bc.ca/HET/Softwood/disputes.htm](http://www.for.gov.bc.ca/HET/Softwood/disputes.htm)

and at the Department of Foreign Affairs and International Trade website at:

[http://www.dfait-maeci.gc.ca/eicb/softwood/legal\\_action-en.asp](http://www.dfait-maeci.gc.ca/eicb/softwood/legal_action-en.asp)

## **2. Negotiations**

- Because of the length, expense and uncertainty associated with the legal cases, the US and Canada have held discussions to assess whether there is an alternative to litigation to resolve the softwood lumber trade dispute. British Columbia and other Canadian provinces have actively participated in these discussions since the summer of 2001.

### Policy Changes (Long Term Settlement Discussions)

- In January 2003, Under Secretary of Commerce for International Trade, Grant Aldonas<sup>1</sup>, publicly released a draft proposal for a long-term solution based on Canadian forest policy changes.
- Under a long-term, policy-based solution, BC and other provinces would make forest policy changes, and Commerce would assess the changes using its 'changed circumstances' provisions. If Commerce determines that the new policies meet certain criteria, then it would revoke the CVD order.
- Discussions with Commerce on its criteria for assessing policy changes were largely finalized in February 2003 and on June 18, 2003 the US Department of Commerce officially published a draft policy bulletin based on these discussions. A final policy bulletin has not been published.

### British Columbia Forest Policy Changes

In March 2003, the British Columbia Ministry of Forests announced major changes to make provincial forest policy more transparently market oriented and to encourage a more competitive industry. Major aspects of these policy changes have been implemented, as follows:

- Revise minimum cut control regulations to remove requirements to log when markets dictate otherwise. Maintain restrictions on maximum allowable cut for sustainability reasons.
- Eliminate timber-processing requirements, including appurtenancy requirements.
- Eliminate mill closure penalties.
- Allow tenure holders to transfer or subdivide licences without penalty, as long as certain concentration thresholds are not exceeded.
- Maintain restrictions on the export of logs from Crown land.
- Implement an auction-based system for selling Crown timber. Under this system, about 20 per cent of Crown timber will be sold each year to the highest bidder through timber auctions. The auction results will be used to determine the stumpage rates of the other 80 per cent of Crown timber. The new timber pricing system was implemented on the Coast in February 2004, and is being prepared for implementation in the Interior.
- In order to fully implement the new pricing system, a portion of tenure will be reallocated from large long term tenure holders to BC Timber Sales, First Nations, woodlots and community forests. 20% of licensees with AAC over 200,000 cubic metres has been taken back, amounting to about 8.2 million cubic metres. Tenure holders will be compensated for the fair market value of the AAC and any lost improvements.

**Note:** More information on negotiations, the policy bulletin, and BC's forest policy changes are available at:

BC Ministry of Forests Softwood Lumber webpage:

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<sup>1</sup> Interestingly, Grant Aldonas was the defence lawyer for BC in Lumber III.

[www.for.gov.bc.ca/het/softwood/index.htm](http://www.for.gov.bc.ca/het/softwood/index.htm)

BC Ministry of Forests Forestry Revitalization Plan webpage:

<http://www.for.gov.bc.ca/mof/plan/>

## **E. Economic Effects of the Dispute on British Columbia**

- Canada supplies about one-third of US lumber requirements, and BC accounts for about half of Canada's softwood lumber exports to the US. Softwood lumber is BC's largest export, and in many BC communities, forestry is the primary income source.
- In 2003, exports of softwood lumber from BC totalled \$5.3 billion (US \$3.8 billion). Shipments to the U.S. accounted for 69% of BC's softwood lumber exports, or \$3.7 billion (US\$2.6 billion) in 2003.
- During the first 2 years of the duties being imposed, BC producers paid about \$2 billion CAD (combined countervailing and anti-dumping) which amount to roughly \$85 million CAD per month.
- Over the years, the US has imposed or negotiated various types of trade barriers to hamper softwood lumber imports from Canada (import tariffs, export taxes and export quotas). Economic theory suggests that these trade barriers will affect prices and quantities in the North American lumber market. In particular, since Canada supplies a major portion of US consumption, a trade barrier is expected to increase the price in the importing country (US), decrease the price and quantity produced in the exporting country, and reduce the quantity traded.
- However, in reality, the economic effects of trade barriers are often difficult to discern because of other factors. Some significant events over the past 20 years affecting Canada/US softwood lumber trade have been:
  - Reduced supply of timber from US public lands in the early 1990s
  - Collapse of Japanese market in the late 1990s
  - Increase in softwood lumber supply from third countries in late 1990s and early 2000s
  - Increased use of wood substitutes
  - Canada/US exchange rate changes
- In addition, in the current dispute (Lumber IV), uncertainty about the outcome (i.e. whether Canada will win legal appeals with all duties being refunded) appears to have led to the duties having a smaller-than-expected impact.
- However, the BC sawmill industry has experienced layoffs, and temporary and permanent shutdowns of several mills, along with added shifts and increased production at the more efficient mills. The significant increase in the value of the Canadian dollar in 2002 also contributed to the pace of restructuring in the industry. High North American lumber prices in the first half of 2004 have partially offset the negative effects of the duties and the exchange rate appreciation.

- Remanufacturers (who use lumber inputs to produce products such as finger-jointed lumber) have been particularly hard hit by the tariffs since they tend to run on tight margins and must pay the duties on the final value of their product. Higher valued products also tend to be hit harder by an *ad valorem* tariff because the tariff rate is a percentage of the selling price.
- In conclusion, optimism about winning legal cases and the return of duties, increased efficiency in lumber production, and higher lumber prices in the first half of 2004 have allowed the BC industry, in the aggregate, to maintain production in spite of the 27% duties. However, as lumber prices fall off from current highs, some combination of the appreciation of the Canadian dollar and either a negotiated trade barrier, such as a quota or export tax, or increased uncertainty as the legal challenges stretch out, may cause reduced lumber production in BC.

## **F. Next Steps**

- Can litigation lead to a durable resolution?
- What are the pros and cons of litigation vs negotiation?
- Will the Policy Bulletin process for a long term solution work?
- Will the US be convinced that BC's policy reforms meet the criteria laid out in the Policy Bulletin?
- Will US actions be able to undermine decisions resulting from NAFTA & WTO panel processes?