

1-1-1992

## Anatomy of a Trade Dispute: The Question of Softwood Lumber

Peter Piliounis

Follow this and additional works at: <https://digitalcommons.schulichlaw.dal.ca/djls>



Part of the [Law Commons](#)



This work is licensed under a [Creative Commons Attribution-Noncommercial-No Derivative Works 3.0 License](#).

---

### Recommended Citation

Peter Piliounis, "Anatomy of a Trade Dispute: The Question of Softwood Lumber" (1992) 1 Dal J Leg Stud 71.

This Article is brought to you for free and open access by the Journals at Schulich Law Scholars. It has been accepted for inclusion in Dalhousie Journal of Legal Studies by an authorized editor of Schulich Law Scholars. For more information, please contact [hannah.steeves@dal.ca](mailto:hannah.steeves@dal.ca).

---

---

## Anatomy of a Trade Dispute: The Question of Softwood Lumber

Peter A. Piliounis\*

It has been called “the longest and messiest trade war Canada and the United States have ever had.”<sup>1</sup> Without a doubt, the issue of softwood lumber pricing has long been a major irritant in Canada-United States trade relations. On three separate occasions, the United States has launched a countervailing duty investigation into Canadian timber pricing practices. Softwood lumber plays a key role in the economies of several Canadian provinces and American states.<sup>2</sup> The stakes are not only high for softwood lumber products,<sup>3</sup> but any decision made on softwood lumber could also have an enormous impact on other forest products and the trade in natural resources as a whole.

The question of subsidization of natural resources is a contested issue around the world. At issue with softwood lumber is the method in which certain Canadian provinces price their timber for cutting. Each province has its own procedure for setting the price to sell the rights to cut standing timber on provincial Crown land. This price paid by the logging companies for the timber is referred to as a ‘stumpage fee’. In general, Canadian stumpage fees are lower than their counterparts in the United States.

The softwood lumber case illustrates the controversy over valuation and possible subsidization of natural resources by posing two fundamental questions:

- 1) Do natural resource subsidies constitute countervailable domestic subsidies under Article XVI of the General Agreement on Tariffs and Trade (GATT)?
- 2) If natural resource subsidies are considered countervailable, do Canadian practices with regard to softwood lumber stumpage fees constitute such a subsidy?

The answers to both questions are not clear. This study traces the development of the softwood lumber dispute and United States trade law as they relate to both issues, including potential future actions and political implications.

The key points raised by this study rest on the definition of “subsidy” and whether a countervailable subsidy has been provided to Canadian softwood lumber producers, especially in the four major softwood producing provinces: British Columbia, Alberta, Ontario, and Quebec.<sup>4</sup>

The internal United States process for determining whether a countervailing duty should be imposed is made up of two components. The first requires an injury to an American industry, which is deter-

## DALHOUSIE JOURNAL OF LEGAL STUDIES

mined by the United States International Trade Commission (ITC). While this process might also merit analysis, the main areas of dispute for softwood lumber are over findings from the second element of a countervailing duty investigation.

This second component of the investigation is carried out by the United States International Trade Administration (ITA). The ITA decides whether the practices in question are ones that can be subject to a countervailing duty under United States trade law. Thus, this study focuses on the criteria used by the ITA and how they fit into international trade law under the Free Trade Agreement (FTA)<sup>5</sup> and the General Agreement on Tariffs and Trade.

### PREVIOUS DEVELOPMENTS

The two decisions of the ITA during the 1980s regarding softwood lumber turned on entirely different answers to the questions posed above. They differed not only on whether Canadian stumpage prices could be considered countervailable subsidies, but also whether any benefit provided by lower stumpage fees was in itself specific enough to be countervailable.

#### The 1983 Final Negative Determination

In 1982, a group of American lumber producers launched an action against Canadian lumber, alleging unfair subsidies and asking for a countervailing duty of sixty-five per cent.<sup>6</sup> In the *Final Negative Countervailing Duty Determinations; Certain Softwood Products from Canada (Lumber I)*,<sup>7</sup> the ITA rejected these arguments. It found that any benefits provided to manufacturers, producers or exporters in Canada were *de minimus* and, therefore, did not constitute countervailable subsidies under the United States *Tariff Act of 1930*.<sup>8</sup> However, those programmes that the ITA deemed to constitute *de minimus* benefits did not include Canadian stumpage practices (with the minor exception of some aspects of the Ontario and Quebec programmes).<sup>9</sup>

The ITA held that stumpage pricing practices did not constitute an export subsidy because "they do not operate and are not intended to stimulate export rather than domestic sales, and because they are not offered contingent upon economic performance".<sup>10</sup> The ITA also determined that stumpage practices did not constitute a countervailable domestic subsidy within the meaning of Section 771(5)(B) of the United States *Trade Agreements Act of 1979*,<sup>11</sup> which lists domestic subsidies as follows:

- (i) The provision of capital, loans or loan guarantees on terms inconsistent with commercial considerations.
- (ii) The provision of goods or services at preferential rates.

## SOFTWOOD LUMBER

- (iii) The grant of funds or forgiveness of debt to cover operating losses sustained by a particular industry.
- (iv) The assumption of any costs or expenses of manufacture, production, or distribution.

The ITA interpreted provisions (i)-(iv) to be mutually exclusive, so that if a programme clearly fell within one of the subsections, it had to be measured against the standard provided in that subsection.<sup>12</sup> In this situation, the ITA decided that the appropriate provision was Subsection (ii) because it involved the provision of goods (here, stands of timber) by a government. No subsidy was found since the ITA held that stumpage programmes did not provide softwood lumber producers with lumber at 'preferential rates'.<sup>13</sup>

This finding went against the American lumber industry petitioners, who had argued that the stumpage programmes should fall under Subsection (iv) as an 'assumption' of the cost of production. The ITA interpreted 'assumption' narrowly, to mean "government activity which relieves an enterprise or industry of a pre-existing statutory or contractual obligation."<sup>14</sup> The ITA also suggested that even a broader interpretation of Subsection (iv) would not find a subsidy since stumpage programmes did not reduce (or assume) a cost of production. In reaching this conclusion, the ITA rejected making a cross-border comparison of stumpage prices in Canada with those in the United States. It suggested that such a comparison would be "arbitrary and capricious" for several reasons, most notably the wide variations in climate, terrain, accessibility, size, quality, and density of timber.<sup>15</sup> The ITA even suggested that if all the appropriate differences were taken into account and adjusted for, Canadian prices for standing timber did not differ significantly from United States timber and in some instances might even be higher.<sup>16</sup>

Notwithstanding this, even if stumpage prices were considered to be subsidies, the ITA found that the benefits were not provided to a specific industry or group of industries as required by American trade legislation.<sup>17</sup> The ITA considered stumpage fees to be the same regardless of the industry or enterprise using the timber. Therefore, any benefit accruing from stumpage prices was considered to be available generally. Most notably, the ITA found that any limitation on use of the timber was attributable to the nature of timber extraction itself and not to any actions taken by Canadian governments.<sup>18</sup>

To further decide the specificity question, the ITA considered which industries benefitted from the stumpage fees and found that several different industries used the timber, each requiring different equipment and processing. Those industries were:

- 1) Lumber and wood products industries;
- 2) Veneer, plywood, and building boards industries;
- 3) Pulp and paper industries;
- 4) Furniture industries; and

## DALHOUSIE JOURNAL OF LEGAL STUDIES

- 5) Other industries- producing turpentine, charcoal, wood alcohol, and food additives.<sup>19</sup>

The ITA also noted that under both the Canadian and American industrial classification systems, the lumber, pulp and paper, and furniture industries constituted at least three different groups of industries. In light of the findings of general availability without government intervention and use by diverse industries, stumpage fees were held to be available generally.<sup>20</sup>

Some have even suggested that this ruling was decided in Canada's favour because of the political climate in Canada-United States relations and not on the merits of the case.<sup>21</sup> It has been alleged that at that time, Prime Minister Trudeau threatened President Reagan with ending cruise missile tests in Canada if a countervailing duty were imposed on softwood lumber. As we shall see, almost all aspects of this case are weighted with political overtones and could potentially have an impact in fields totally unrelated to softwood lumber.

### Developments in United States Trade Law 1983-1986

Between the *Lumber I* negative determination in 1983 and the subsequent preliminary positive determination in 1986, circumstances had not significantly changed in Canadian stumpage practices and policies. What had changed, however, was United States trade law. In *Cabot Corp. v. United States*,<sup>22</sup> the United States Court of International Trade (CIT) heavily criticized the ITA for its interpretation of what constituted a countervailable subsidy when considering natural resources. *Cabot Corp. v. United States* involved judicial review of an ITA decision in a Mexican case on the general availability of carbon black feedstock to producers of carbon black, which is used primarily in the rubber industry. In that case, the ITA had ruled against a countervailing duty for reasons similar to those given in *Lumber I*.<sup>23</sup> Upon review, the CIT made it very clear that "the generally available benefits rule as developed and applied by the ITA is not an acceptable legal standard for determining the countervailability of benefits".<sup>24</sup> The court instead found that certain programmes, while having the intention or appearance of being generally available, had the effect of being conferred upon specific industries or enterprises and, thus, were countervailable. The court held:

The appropriate standard focuses on the *de facto* case by case effect of benefits provided to recipients rather than on the nominal availability of benefits.<sup>25</sup>

The ITA applied the new test laid out by the CIT in its administrative review of the *Carbon Black* case in late 1986.<sup>26</sup> However, prior to the final determination, the ITA took the unusual step of briefing Senators from lumber states about the new test for specificity. Some argue that

## SOFTWOOD LUMBER

this briefing was little more than a “green light” for lumber producers to launch a new countervail action.<sup>27</sup>

### The 1986 Preliminary Positive Determination

Applying the newer broader specificity test, a different conclusion was reached in *Preliminary Affirmative Countervailing Duty Determination: Certain Softwood Lumber Products from Canada (“Lumber II”)*.<sup>28</sup> The ITA changed not only its ruling on whether stumpage prices were generally available, but also considered stumpage to be a method of preferential pricing and, therefore, countervailable.

To decide whether stumpage practices were *de facto* specific, the ITA laid out the following three factors to consider:

- [1] The extent to which a foreign government acts to limit the availability of a programme;
- [2] the number of enterprises, industries, or groups thereof which actually use a program, which may include the examination of disproportionate or dominant users; and
- [3] the extent to which the government exercises discretion in making the programmes available.<sup>29</sup>

When the ITA considered stumpage programmes against these criteria, it held that the Canadian governments involved exercised “considerable discretion in the allocation of stumpage licenses.”<sup>30</sup> Although the ITA admitted difficulty locating information on this point, it held that this discretion skewed the allocation of stumpage rights toward the softwood lumber industry.

The ITA also went on to state that the number of enterprises actually making use of the stumpage rights was not as large as suggested in *Lumber I*. First, it held that furniture manufacturers own ‘negligible rights’.<sup>31</sup> Second, it placed great emphasis on the integrated nature of the softwood lumber industry with the pulp and paper industry. It found that the two industries tended to be made up of horizontally-integrated companies involved in both activities.<sup>32</sup> In today’s world of huge multi-faceted corporations and conglomerates, this finding could have significant repercussions. In a small marketplace such as Canada’s, there is likely to be a number of large corporations involved in various aspects of natural resource extraction and production. This finding implies that any of these companies could be subject to the threat of countervailing duty even if the various divisions used different equipment and processing<sup>33</sup> and were in no way related other than in name.<sup>34</sup>

Once the ITA had determined that stumpage was not generally available, it considered whether or not stumpage was provided at preferential rates.<sup>35</sup> In deciding whether preferential rates were given, the ITA applied a new rate comparison test, based on one of the following four factors (ranked in order of preference by the ITA):

## DALHOUSIE JOURNAL OF LEGAL STUDIES

- [1] Prices charged by the government for a similar or related good;
- [2] prices charged within the jurisdiction by other sellers for an identical good or service;
- [3] the government's cost of producing the good or service; and
- [4] external prices.<sup>36</sup>

The ITA decided that the appropriate test to determine subsidization here was the third option, the government's cost of producing the good or service. Under this test, the ITA found that Alberta, British Columbia, Ontario, and Quebec did not recover the costs of providing standing timber to the holders of stumpage rights. However, in determining the cost of providing the lumber to the producers, the ITA added the "intrinsic value of the tree and the land", along with any costs directly associated with providing the timber.<sup>37</sup> This imputed cost for the intrinsic value of the timber has been the subject of much criticism, especially since the provincial governments incurred no cost in obtaining the standing timber in the first place.<sup>38</sup> As well, this approach is seen as "double counting" since any "retail" stumpage cost would already include direct costs. Therefore, adding the two costs would involve counting the direct costs twice.

To determine the intrinsic value of the timber (no mention is made of land by the ITA in this portion of the decision), the ITA uses various 'surrogates'. For stumpage in British Columbia and Alberta, the ITA used "competitive bid prices under government administered programmes". Since no competitive bid prices were available from Ontario and Quebec, the ITA used private prices as reported from New Brunswick.<sup>39</sup> These surrogates can be attacked on two grounds:<sup>40</sup>

- 1) Earlier in the decision, the ITA recognized the perils of comparing competitively bid and non-competitively bid stumpage sales, as the competitive sales were not seen as providing an accurate measure of price differences.<sup>41</sup> Nonetheless, the ITA used competitively bid prices as surrogates to determine the value of the timber. This suggests that the surrogate prices may not be an accurate measure.
- 2) In the case of Ontario and Quebec, New Brunswick prices were used as surrogates. However, in *Lumber I*, the ITA held that cross-border stumpage comparisons were "arbitrary and capricious", due to the many differences in timber quality, accessibility, and the like. Any drawbacks of a comparison between Canada and the United States would also exist when using New Brunswick stumpage fees as surrogate pricing for Ontario and Quebec timber.

The end result of the ITA's analysis was that it made a preliminary finding of a countervailable subsidy of fifteen per cent.<sup>42</sup> While it is possible that any defects in reasoning of *Lumber II* would have been

## SOFTWOOD LUMBER

corrected in a Final Determination, the subject never proceeded to that stage.

The political considerations at the time of this decision slanted toward the United States lumber concerns. In late 1986, President Reagan sought Senate approval for free trade talks with Canada. Several Senators made it clear that their approval of such negotiations depended upon a satisfactory outcome to the softwood lumber dispute.<sup>43</sup> The strength of such a Senate reaction has been attributed to the estimated \$2-3 million spent on lobbying by the American lumber industry.<sup>44</sup>

### The Memorandum of Understanding

On December 30, 1986, the same day that the ITA was due to release its Final Determination, Canada and the United States entered into a Memorandum of Understanding,<sup>45</sup> later enacted in Canada by the *Softwood Lumber Products Export Charge Act*.<sup>46</sup> The general thrust of the MOU is that Canada would impose a fifteen per cent export tax on softwood lumber destined for the United States in exchange for the withdrawal of the countervailing duty investigation. There are several possible reasons for Canada to enter into the MOU.

First, the MOU enabled Canada to keep the expected \$400 million (U.S.) in tax revenues in the country, rather than enriching American coffers.<sup>47</sup> The tax revenues would then be distributed to the affected provinces. In this way, Canada was able to make "the best out of a bad situation", since the ITA was unlikely to reverse its findings and since the MOU was:

... without prejudice to the position of either Government as to whether the stumpage programs and practices of the Canadian governments constitute subsidies under United States law or any international agreement.<sup>48</sup>

The mere signing of the MOU and the imposition of a fifteen per cent export tax may, however, have admitted implicitly that the United States position was correct.<sup>49</sup>

Second, the MOU had the effect of rendering the Preliminary Determination of *Lumber II* of no legal force and effect.<sup>50</sup> The purpose of such a provision appears to have been to halt the development of United States trade law and precedent regarding the newer tests for specificity and 'preferential rates'. If this were the intended purpose, however, the MOU was not successful in stopping the evolution of United States trade law.<sup>51</sup> In fact, the *de facto* test laid out in the decision of the CIT in *Cabot Corporation* was later codified into American law.<sup>52</sup>

Since the enactment of the MOU, it has been amended several times. Some of these amendments were made to reduce the amount of export tax payable in certain provinces after they implemented 'replacement measures' which increased the price of timber in order to offset the export tax. The first amendment, which took place in December 1987,



## DALHOUSIE JOURNAL OF LEGAL STUDIES

exempted the Atlantic provinces from the fifteen per cent export tax as most stumpage prices from those provinces were bid competitively from privately-held land. This amendment also approved certain replacement measures for the province of British Columbia that were considered equivalent to the export tax.<sup>53</sup> The new British Columbia measures, called the Comparative Value Pricing System, essentially target the amount of revenue that would have been raised by the export tax and increase the price of softwood stumpage accordingly. Quebec also later instituted some replacement measures under the MOU, but these were not enough to offset fully the export tax.<sup>54</sup>

The interesting feature about these replacement measures is that they had to be approved by the United States Department of Commerce. As well, in interpreting the MOU, the United States government stated that it would not approve any change to the MOU without the prior approval of the petitioning United States lumber interests.<sup>55</sup> In effect, the American lumber industry was in a position to dictate Canadian stumpage policy. Therefore, while a tariff at the border or an export tax would be completely in line with state sovereignty, having new stumpage policy 'cleared' by foreign competitors seems an odd step to be agreed by the Canadian government. Once the agreement was signed, however, the actions taken by the United States government were wholly appropriate, even if they served to infringe on Canadian sovereignty.<sup>56</sup> Any fault for limiting Canada's freedom to determine natural resource policies lay not with actions taken under the MOU, but the signing of the MOU itself.

On a purely economic level, the MOU led to increased timber prices for American consumers. In addition, replacement measures under the MOU were not as beneficial to Canadian consumers as had been the export tax. The export tax, by its very nature, applied only to softwood lumber leaving the country. On the other hand, replacement measures applied across the board to all stumpage and consequently increased the domestic price for Canadian consumers.

On October 3, 1991, Canada officially rescinded the MOU with the United States. The reasons for this were two-fold: first, Canada had conducted a study of the stumpage practices of British Columbia, Alberta, Ontario, and Quebec. The Canadian study utilized the Timber Sale Program Information Reporting System (TSPIRS) cost-accounting method of the United States Forest Service to determine the stumpage prices. TSPIRS had been developed by the Forest Service for internal use (and has since been approved by Congress) to determine the proper value of forest resources.<sup>57</sup> Its methodology includes a comparison of the costs and associated revenues of providing timber. The study adapted TSPIRS to the Canadian process and calculated that in each of the provinces revenues received from stumpage exceeded the costs of providing the timber.<sup>58</sup> This approach suggests that the Canadian position is based upon using TSPIRS as the methodology for the "cost of providing the service" test articulated in *Lumber II*.<sup>59</sup>

Second, when Canada and the United States concluded the FTA, the MOU was specifically 'grandfathered' into the agreement.<sup>60</sup> This

## SOFTWOOD LUMBER

meant that any disputes over softwood lumber would have to be addressed under the MOU, rather than through the dispute settlement mechanism under the FTA.<sup>61</sup> The United States, however, was unwilling to reopen the issue.<sup>62</sup> Therefore, by rescinding the MOU, Canada was hoping to bring the dispute under the possible binding arbitration of a Binational Panel created under Chapter 19 of the FTA.

The United States responded to the rescission of the MOU by requiring that a bond be posted by Canadian exporters, equivalent to the tax that would have been collected under the MOU.<sup>63</sup> As well, the United States government took the rare step of self-initiating a countervailing duty investigation into Canadian stumpage practices, without a formal complainant from the American lumber industry.<sup>64</sup> The United States considers that these measures are merely 'enforcement measures' under the MOU and, therefore, are exempt from consideration under the FTA.<sup>65</sup> This view also holds that any countervailing duty later imposed by the United States government would not be open for review under the FTA, since the MOU had been specifically exempted.

### CANADIAN AND AMERICAN POSITIONS

The arguments now presented by Canada are variations on the same theme that has run through the entire softwood lumber dispute. First, Canada rejects the contention that natural resource subsidies can be considered countervailable. Second, in the alternative, even if natural resource subsidies can be considered countervailable, Canada argues that its practices with regard to softwood lumber stumpage pricing do not constitute subsidies under United States trade law.

The first facet of the argument is being pursued by Canada at GATT. It is unclear why Canada decided not to pursue actions before GATT prior to the current investigation. The question of whether natural resources can be the subject of countervailing duties is the same today as it was in both 1983 and 1986. Once the MOU was signed, however, both parties probably assumed the dispute was settled and likely perceived no need to go before GATT. That Canada decided to bring the action to GATT is in itself not surprising, since the action requires expertise on the definition of 'subsidy' under GATT. Actions such as these do not suggest 'forum shopping' between GATT and Chapter 18 of the FTA,<sup>66</sup> at least not until Canada and the United States have agreed upon a subsidies code under the FTA.

### GATT

The arguments before GATT depend upon the interpretation of 'subsidy' and acceptable countervailing duties under Articles VI and XVI of GATT. This discussion will focus upon 'domestic subsidies' as both previous softwood lumber decisions have rejected stumpage fees as export subsidies.

## DALHOUSIE JOURNAL OF LEGAL STUDIES

Article XVI in no way prohibits the free pricing of government-owned resources, nor domestic subsidies on natural resources, except insofar as to say that any subsidy should not result in that country "having more than an equitable share of world trade in that product".<sup>67</sup> Article 11 of the *Subsidies Code* agreed upon at the Tokyo Round of GATT<sup>68</sup> recognizes the value of domestic subsidies and calls upon GATT signatories to "seek to avoid causing [injury to another signatory's industry] through the use of subsidies."<sup>69</sup> These provisions are not determinative of the issue at hand. Other applicable provisions can be found in GATT Article VI and its interpretation in the *Subsidies Code*.

Article VI deals with the imposition of anti-dumping and countervailing duties. Article VI:3 allows the imposition of countervailing duties to counteract a "bounty or subsidy ... granted, directly or indirectly, on the manufacture, production or export" of a product. In the *Subsidies Code*, an illustrative list of what is considered a subsidy was given.<sup>70</sup> While natural resource subsidies were not included in the list, Article VI:3 appears broad enough to cover low stumpage fees, if they are considered an indirect bounty or subsidy to Canadian lumber producers.<sup>71</sup> However, as an exception to the Most-Favoured-Nation treatment under GATT, Article VI:3 has in the past been construed narrowly, with the party relying on the exception being required to prove it.<sup>72</sup> If a panel were to give such a narrow reading to Article VI:3 in this case, the dispute would probably be resolved in Canada's favour, as the actual payment of a "bounty or grant" is not apparent in this case, where the issue is the selling price of a government-owned resource.

In addition to arguments based on the current formulation of GATT, some drafts of the GATT *Uruguay Round Subsidies Code* would work in Canada's favour.<sup>73</sup> For example, Article 14(e) reads (in part) as follows:

When the government is the sole provider or purchaser of the good or service in question, the provision or purchase of such good or service shall not be considered as conferring a benefit, unless the government discriminates among users or providers of the good or service ...<sup>74</sup>

Whatever the resolution of the dispute at GATT, any GATT Panel's results are not binding. The onus would be upon Canada or the United States to implement the panel's findings as they saw fit.<sup>75</sup> If the panel's findings were rejected, they would have no legal impact on any FTA Panel, but the decision might be of some persuasive merit.

On one hand, an extra benefit of a GATT Panel ruling would be that particular American legislation could be challenged as being inconsistent with GATT obligations. On the other hand, a panel created under Chapter 19 of the FTA would be bound to interpret the matter in accordance with existing United States trade law, whether or not they agreed with the validity of such legislation.

## SOFTWOOD LUMBER

### United States Trade Law

The situation has changed fundamentally since the preliminary positive determination of *Lumber II*. Since that time, Canada and the United States have signed the FTA and many Canadian lumber pricing practices are significantly different (including replacement measures under the MOU), while United States trade law is roughly the same.<sup>76</sup>

Chapter 19 of the FTA allows for a Binational Panel to be created to review final anti-dumping and countervailing duty determinations. The decisions of this panel are binding upon the appropriate administrative agency (here, the ITA). As the softwood lumber dispute is so vigorously contested, it is almost assured that no matter what determination is made by the ITA, the dispute will proceed to the Binational Panel. While the United States contends that the current 'enforcement measures' are components of the MOU and therefore exempted from FTA consideration, the following discussion is premised on the assumption that the rescission of the MOU will be considered sufficient to surpass the exemption given to the MOU under Article 2009 of the FTA. Since the FTA is intended to be an all-encompassing document, an exemption related to a validly rescinded agreement makes little sense. Therefore, it appears likely that investigations of softwood lumber practices will fall under the purview of the FTA, rather than being considered as 'enforcement measures' under the MOU.

Prior to the implementation of the FTA, analysts predicted that Chapter 19 Binational Panels would show considerable deference and not be willing to contradict ITA (or ITC) practice unless it were found to be 'unreasonable'.<sup>77</sup> However, this has not turned out to be the case; as of July, 1991, four panel decisions had been made reversing final determinations of the ITA or ITC in favour of Canadian interests.<sup>78</sup> In particular, one decision of the panel reviewing an ITA determination on pork<sup>79</sup> is of note for the softwood lumber dispute. In that decision, the panel showed a willingness to second-guess the application of the *de facto* specificity test by the ITA. The panel ruled not only against the ITA, but also placed the added burden on the ITA (or the complainant) to prove with "convincing circumstantial or actual evidence" that the exporting government was in fact limiting the benefits to a specific industry or group of industries.<sup>80</sup> Therefore, any decision of the ITA on softwood lumber would likely be subject to a higher standard of review than would have been the case in 1986. Because of this new level of scrutiny, Canadian officials are hoping that the ITA will take this into account in its reasoning, so that logical flaws similar to those which occurred in *Lumber II* will not repeat themselves in the current investigation.<sup>81</sup>

## DALHOUSIE JOURNAL OF LEGAL STUDIES

### CONCLUSIONS

Softwood lumber and natural resource subsidies have been the subject of many political, economic, and legal analyses. An overview such as this cannot but scratch the surface of the dispute. Nonetheless, it can serve to point out the substantive areas of dispute.

The true question of whether Canadian stumpage fees represent a countervailable subsidy is, in essence, a reflection of the difference in lumber practices between Canada and the United States. In the end, the cost of delivering cut logs to the sawmill is roughly the same in both countries.<sup>82</sup> Therefore, it can be argued that the ability to provide low cost stumpage in Canada and the ability to harvest the logs at a lower cost in the United States provides each country with a comparative advantage.<sup>83</sup> Neither country wishes to give up what it sees as its competitive edge over the neighbouring country. By the same token, American lumber interests would likely not complain about low stumpage rates if they could take advantage of them as well. Yet many provinces have placed restrictions upon the export of logs.<sup>84</sup> Therefore, only sawmills located in Canada can benefit from lower priced (or subsidized) stumpage. Thus, the true trade barrier could be seen as log export restraints rather than stumpage practices.<sup>85</sup>

Another complicating factor is that the market share of Canadian lumber in the United States does not appear to be as tied to the cost of stumpage as to the exchange rate of the Canadian dollar<sup>86</sup> and the sheer volume of timber actually available for harvest in Canada.<sup>87</sup> Thus, when the MOU came into force in 1987, the output of the Canadian lumber industry remained relatively unchanged.<sup>88</sup> While United States producers might benefit from the imposition of a countervailing duty (from increased costs to their competitors) in the short run, the long run picture would not be greatly affected. Canadian producers would still have a greater supply of timber and American producers would still be at a comparative disadvantage. In the long run, American producers would have a proportionately lower volume of timber than their Canadian counterparts due to the extra harvesting of timber that would take place with a short term increase in market share. Perhaps the appropriate remedy for the softwood lumber dispute (as well as others dealing with natural resources) is not the blunt imposition of trade laws. The nations involved should instead negotiate to remove the other barriers to trade, while recognizing each region's distinct comparative position (stumpage fees, quality of timber, accessibility, and so on). This argument especially rings true with the current focus on environmental concerns and the priority placed on preserving forests and reforestation.<sup>89</sup>

The political stakes of the current dispute are as high as ever. Both Canada and the United States will be facing major elections in the coming years and the politicians involved will probably take less compromising stances on this issue than would otherwise be the case. The American lumber lobby has already been pushing heavily for sanctions and has been accredited with the speed with which the United States

## SOFTWOOD LUMBER

Department of Commerce launched its current investigation.<sup>90</sup> As well, if this dispute goes to a Binational Panel, which is likely, the outcome will be very important for future Canada-United States trade disputes. In 1991, the highly politicized question regarding injury to American producers from lower priced Canadian pork resulted in the United States pursuit of an extraordinary challenge under the FTA.<sup>91</sup> In that matter, the ITC showed considerable displeasure with the functioning of the Binational Panel.<sup>92</sup> If a similar situation arose with the ITA over a decision of a Binational Panel on softwood lumber, the entire Chapter 19 dispute resolution process might be placed in jeopardy, as the United States government might consider the panels biased towards Canadian interests. Such a development is mere speculation at this point, however, as the dispute has not yet progressed through the full ITA process.

The apparent strength of the American lumber lobby and the comparative weakness of its Canadian counterpart suggests that the ITA will find in favour of the American producers.<sup>93</sup> Nonetheless, the Canadian lumber producers are confident that they will win in any decision 'on the merits'. As discussed throughout this study, the true 'merits' of this case are unclear. For example, the Canadian Maritime provinces have even decided to side with the American lumber industry against the other provinces,<sup>94</sup> while a prominent newspaper in the United States Pacific Northwest (a major softwood lumber-producing region) has supported the Canadian position.<sup>95</sup> Regardless of the outcome, it is unlikely that the affected provinces will give up the revenues obtained through any replacement measures. In British Columbia, for instance, revenues from stumpage fees account for five per cent of the total provincial budget.<sup>96</sup>

So long as there is an opportunity for one side to gain a short-term competitive advantage through the use of trade laws, the issue of softwood lumber will probably never be far from the forefront. Its importance to provincial and state economies guarantees that those affected will try to gain every competitive advantage possible. Because of this problem, it seems unlikely that there will be a negotiated comprehensive settlement of this dispute in the near future and potentially unpredictable trade laws will continue to be the method of choice. As was succinctly put by a former American lobbyist: "It's better than the lottery ... It's just such a jackpot; if you win, you win big. You do the financial calculations, and you'd be foolish not to roll the dice."<sup>97</sup>

---

\* Second year law student, Dalhousie University.

1. Former Canadian Minister of International Trade, Patricia Carney, quoted in K. Noble, "An industry at war", *The [Toronto] Globe and Mail* (November 16, 1991) B18.

2. See M.B. Percy & C. Yoder, *The Softwood Lumber Dispute & Canada-U.S. Trade in Natural Resources* (Halifax: Institute for Research on Public Policy, 1987), at 110 for a chart illustrating employment levels.

3. Canada-U.S. softwood lumber trade has been estimated at \$3 billion (U.S.) P. Wonnacott, *The United States and Canada: The Quest for Free Trade* (Washington: Institute for International Economics, 1987), at 97.

## DALHOUSIE JOURNAL OF LEGAL STUDIES

4. In 1990, the provinces of British Columbia, Alberta and Quebec accounted for ninety-two per cent of softwood lumber exports to the United States *Inside U.S. Trade*, 6 September 1991, at 15.
5. *The Canada-U.S. Free Trade Agreement* (Ottawa: External Affairs Canada, 1987) [hereinafter *FTA*].
6. F.J. Anderson & R.D. Cairns, "The Softwood Lumber Agreement and Resource Politics" (1988), 14 Can. Pub. Pol. 186, p.187.
7. *Final Negative Countervailing Duty Determinations; Certain Softwood Products from Canada*, 38 Fed. Reg. 24159 (31 May 1983) [hereinafter *Lumber I*].
8. *Tariff Act of 1930*, 19 U.S.C., as amended. This Act requires that benefits or subsidies be above a certain minimum (*de minimus*) level before the United States can impose a countervailing duty. See also *Lumber I*, *supra*, note 7 at 24159.
9. These programmes have not been the subject of much controversy and, therefore, are not discussed in this paper. See *Lumber I*, *supra*, note 7 at 24159.
10. *Lumber I*, *supra*, note 7 at 24167.
11. Pub. L. No.96-39, (1979).
12. *Lumber I*, *supra*, note 7 at 24167.
13. *Ibid.*
14. *Ibid.*
15. *Ibid.*
16. *Ibid.*
17. *Trade Agreements Act of 1979*, *supra*, note 11 S.771(5)(B); for a good summary of the requirement of specificity in United States trade law around that time, see J.H. Bello & A.F. Holmer, "Subsidies and Natural Resources: Congress rejects a lateral attack on the specificity test" (1984), 18 *Geo. Wash. J. Int'l L. & Econ.* 297.
18. *Lumber I*, *supra*, note 7 at 24167.
19. *Ibid.*
20. *Ibid.*
21. See, e.g., J.A. Ragosta, "Natural Resource Subsidies and the Free Trade Agreement: Economic Justice and the Need for Subsidy Discipline" (1990), 24 *Geo. Wash. J. Int'l L. & Econ.* 255, at 258, at note 9.
22. *Cabot Corp. v. United States*, 620 F. Supp. 722 (CIT 1983) [hereinafter *Cabot Corp.*].
23. *Carbon Black from Mexico*, 48 Fed. Reg. 29564 (27 June 1983).
24. *Cabot Corp.*, *supra*, note 22 at 732.
25. *Ibid.*
26. *Carbon Black from Mexico*, 51 Fed. Reg. 30385 (26 August 1986).
27. A.M. Rugman & S.D. Porteous, "The Softwood Lumber Decision of 1986: Broadening the Nature of U.S. Administered Protection" (1988) 2 R.I.B.L. 35 at 49.
28. *Preliminary Affirmative Countervailing Duty Determination: Certain Softwood Lumber Products from Canada*, 51 Fed. Reg. 37453 (22 October 1986) [hereinafter *Lumber II*].
29. *Ibid.*, at 37456.
30. *Ibid.*
31. *Ibid.*
32. *Ibid.*, at 37456-37457.
33. See *Lumber I*, *supra*, note 7, at 24167; See also note 19 and accompanying text.
34. For a fuller discussion of this phenomenon, see Percy & Yoder, *supra*, note 2, at 55-58.
35. See *Lumber I* discussion, *supra*, for a fuller discussion of the applicable legislation; or see Tougas, "Softwood Lumber from Canada: Natural Resources and the Search for a Definition of Countervailable Domestic Subsidy" (1989), 24 *Gonz. L. Rev.* 135 at 144-145.
36. *Lumber II*, *supra*, note 28, at 37457.
37. *Ibid.*
38. Rugman & Porteous, *supra*, note 27 at 52; Percy & Yoder, *supra*, note 2 at 58-60; for different reasons, see Ragosta, *supra*, note 21 at 290-291.
39. *Lumber II*, *supra*, note 28 at 37458.
40. See also Rugman & Porteous, *supra*, note 27 at 53.
41. *Lumber II*, *supra*, note 28 at 37457.
42. *Ibid.*, at 37453.
43. Percy & Yoder, *supra*, note 2 at 111-113; Ragosta, *supra*, note 21 at 259 at note
- 17.

## SOFTWOOD LUMBER

44. Noble, *supra*, note 1.
45. (Ottawa: Department of External Affairs, 1986) [unpublished] [hereinafter MOU].
46. R.S.C. 1985 (3rd Supp.), c.12.
47. Wonnacott, *supra*, note 3 at 91.
48. MOU, *supra*, note 45 at clause 3(b).
49. Percy & Yoder, *supra*, note 2 at 120.
50. MOU, *supra*, note 45 at clause 3(d).
51. Rugman & Porteous, *supra*, note 27 at 39.
52. See 19 U.S.C. S.1677(5)(B).
53. MOU, *supra*, note 45 at appendix 1 (16 December 1987).
54. MOU, *supra*, note 45 at appendix 2 (31 October 1990).
55. U.S. side letter accompanying the MOU, cited in Percy & Yoder, *supra*, note 2 at 118.
56. As argued by Ragosta, *supra*, note 21 at 269, Canada agreed to such a limitation on sovereignty by signing the MOU.
57. U.S. Forest Service, *Timber Sale Program Annual Report: Fiscal Year 1989* (Washington: U.S. Department of Agriculture, 1990).
58. Letter from D.H. Burney, Canadian Ambassador to Washington to U.S. Senator Max Baucus, 17 September 1991 (cited in *Inside U.S. Trade*, (20 September 1991) at 18).
59. See discussion under 'The Preliminary Positive Determination', *supra*.
60. *FTA, supra*, note 5 at Article 2009.
61. The *FTA* dispute settlement mechanism is discussed under 'United States Trade Law', *infra*.
62. (1991), 20 *Ottawa Letter* 300.
63. *Inside U.S. Trade*, (11 October 1991) at 6.
64. *Inside U.S. Trade*, (25 October 1991) at 22.
65. *FTA, supra*, note 5 at Article 2009; U.S. argument from *Inside U.S. Trade*, (11 October 1991) at 6.
66. *FTA* dispute settlement procedures (including Chapter 18) are well described in G.N. Horlick & F.A. DeBusk, *The Functioning of U.S.-Canada Free Trade Agreement Dispute Resolution Panels* (Washington: O'Melveny & Myers, 1991).
67. *General Agreement on Tariffs and Trade*, 30 October 1947, 55 U.N.T.S. 1987, Art.XVI:3 [hereinafter GATT].
68. *Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade* (Geneva: GATT, 1979) [hereinafter *Subsidies Code*].
69. *Ibid.*, art.11(3).
70. *Ibid.*, annex.
71. Ragosta, *supra*, note 21 at 267.
72. *United States - Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada*, GATT Panel Report, 18 September 1990.
73. Agreement (1990) on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade; (Geneva GATT, 1990) GATT Doc. No. MTN.TNC/W/35.
74. *Ibid.*
75. *Subsidies Code, supra*, note 68 Art. 18.
76. See *P.P.G. Industries, Inc. v. U.S.*, 928 F.2d 1568 (Fed. Cir. 1991) at 1576-1577.
77. Rugman & Porteous, *supra*, note 27 at 57-58.
78. S.A. Baker, "Chapter Nineteen: The Antidumping and Countervailing Duty Laws" (Washington: Steptoe & Johnson, 1991) [draft copy of article].
79. *Fresh, Chilled and Frozen Pork from Canada* (USA-89-1904-06), Memorandum Opinion and Order (28 September 1990).
80. *Ibid.*, at 49.
81. Interview with Canadian official, International Trade, External Affairs Canada, 18 November 1991.
82. See Anderson & Cairns, *supra*, note 6 at 190.
83. See Ragosta, *supra*, note 21 at 292-293 at note 179.
84. Wonnacott, *supra*, note 3 at 93; Ragosta, *supra*, note 21 at 272-273.
85. Late in 1991, the U.S. expanded the scope of its investigation into Canadian softwood lumber to include log export restraints *Inside U.S. Trade*, 3 January 1992 at 4.



**DALHOUSIE JOURNAL OF LEGAL STUDIES**

86. Percy & Yoder, *supra*, note 2 at 35-38.
87. Wonnacott, *supra*, note 3 at 98-99.
88. Anderson & Cairns, *supra*, note 6 at 191.
89. Ragosta, *supra*, note 21 at 273 argues that the poor Canadian record on reforestation can be traced to low stumpage fees.
90. Noble, *supra*, note 1.
91. Made pursuant to FTA Article 1904.13; *Fresh, Chilled, or Frozen Pork from Canada* (ECC-91-1904-01USA), Memorandum Opinion and Order Regarding Binational Panel Remand Decision II (14 June 1991).
92. *Fresh, Chilled, or Frozen Pork from Canada*, Inv. No. 701-TA-298 (Final—Second Remand) (12 February 1991).
93. For a discussion of this point, see Noble, *supra*, note 1, although there have been reports of a split in support for the U.S. lumber lobby group (K. Noble, "Split showing up in U.S. lumber lobby", *The [Toronto] Globe and Mail*, (30 December 1991) B1).
94. *Inside U.S. Trade*, (8 November 1991) at 20.
95. "Portland newspaper sides with Canada", *The [Toronto] Globe and Mail* (30 December 1991) at B6.
96. *Inside U.S. Trade*, (6 September 1991) at 15.
97. Quoted in Noble, *supra*, note 1.