

January 2001

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### Recommended Citation

Helmut Mach, *The Softwood Lumber Dispute*, 27 Can.-U.S. L.J. 287 (2001)

Available at: <https://scholarlycommons.law.case.edu/cuslj/vol27/iss/48>

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## THE SOFTWOOD LUMBER DISPUTE

*Helmut Mach\**

The Canada-U.S. softwood lumber issue has been with us for twenty years. It is an issue that involves Canadian exports to the U.S. of about nine billion dollars annually. Canadian lumber currently makes up about thirty-four percent of the U.S. consumption of softwood lumber. We have undergone in the last twenty years, three countervailing duty investigations, two agreements to restrict exports, as well as one formal consultation process.

The main issue underlying the disputes over the last twenty years has been U.S. views that Canadian forest management systems confer a subsidy to Canadian producers, and that this is causing injury to U.S. producers when Canadian softwood lumber enters the U.S. market. We have gone through quite a number of procedures, as I have mentioned. I am going to comment briefly as to how the provinces have been involved with federal governments in Canada and the U.S. in dealing with these situations and how this involvement has changed over the years.

The first countervailing duty investigation was in 1982. This was really the first time Canadian industry had to face this sort of situation; and the response was really handled by the Canadian industry.

There was one legal counsel representing all Canadian interests. Canadian provincial governments worked in cooperation with the industry without their own legal counsel; and the Canadian industry was at the forefront of the defense process.

The conclusion of the 1982 countervailing duty investigation was that there was no countervailing duty imposed, that provincial stumpage programs were found not to confer a countervailable subsidy.

The U.S. industry launched another complaint leading to an investigation in 1986, Countervail 2. This had a rather significant effect in Canada at the time. Again, the challenge of the exports involved the fact that we had just gone through one investigation a few years before, and the fact that Canada was now embarking on Canada/ U.S. free trade negotiations with the U.S. This heightened the political attention to such a huge dispute.

The change amongst provinces at the time was that some of the provinces started to retain their own legal counsel to get independent advice as to how to deal with situations, as the allegations were directed specifically at provinces, their forest management systems, and their stumpage systems. The

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\* Government of Alberta.

other aspect that raised the degree of provincial involvement in the political focus of this was the discussions that began parallel to the preliminary Canada/U.S. free trade discussions, recognizing that having such a huge dispute might, in fact, cause difficulties in being able to proceed successfully with Canada/U.S. free trade negotiations.

At the time, in the fall of 1986, the Prime Minister of Canada and Provincial Premiers were meeting in Vancouver at a regularly scheduled First Ministers meeting on the economy. This was a regular type of event that happened in Canada at that time. Underlying the discussion of the economic prospects for Canada was concern about what was happening on the softwood lumber countervail. The Federal Minister for International Trade came to Vancouver at the time and informed the Prime Minister and Premiers that a deal was available if Canada wished to avoid the softwood lumber countervail process.

The message conveyed was essentially was along the lines that a preliminary determination of a fifteen percent duty existed, that there would be a final determination of fifteen percent, and there would be a fifteen percent duty after all appeals. There would be no getting away from the fact from the U.S. perspective there would be a fifteen percent duty.

That was the message delivered to the Prime Minister and Premiers with the option being that if we wished to avoid this entire political disruption, there was the prospect of Canada imposing an export tax of fifteen percent; and, essentially, funds that would have been normally collected by the U.S. Treasury could be collected in Canada.

This, obviously, caused some controversy amongst the Premiers and Prime Minister there.

The message was not totally greeted with enthusiasm, but, finally, the decision was made that this was a better prospect than going through the countervailing duty process, and, as you know, at the time, we did not have the benefit of North American Free Trade Agreement (NAFTA) or Free Trade Agreement (FTA) impartial panel countervail review procedures. Underlying the consideration was also a concern about the nature of an export tax on a provincial resource product. You might be familiar with Canada's National Energy Program that the federal government implemented in 1980, which imposed an export tax on natural gas. That was particularly important to the province of Alberta. It was contested in the Supreme Court of Canada.

The idea of the Canadian federal government entering into a new export tax on another resource product, setting aside the fine line as to whether lumber was a resource or a manufactured product, and who had the Constitutional authority to do this or not, raised the prospect of constitutional differences that no one wanted to get into again.

It was a very difficult decision to make. The only way it was made was with federal assurances that whatever revenues were collected from the export tax would be sent back to the province that was the province of origin of the lumber export, minus an administration fee.

So the conclusion was that the Softwood Lumber Memorandum of Understanding was entered into. This involved an export tax of fifteen percent, as long as the Memorandum of Understanding (MOU) was in effect. The other aspect of it that involved the provinces was really the ultimate objective of the MOU. It was not to have an export tax in perpetuity, but the objective of the U.S. was to bring about an increase in the cost of Canadian lumber production. So an aspect of the Agreement was the facilitation of replacing the export tax by increased provincial cost structures in their provinces. So each province had the option of implementing "replacement" measures. The difficulty was this value had to be agreed upon with the U.S. that it really did have the equivalent effect of a fifteen percent export tax. So this involved a situation, where if provinces chose to implement replacement measures of increased cost for the industry, it involved a direct negotiation between the province and the U.S. government, through the auspices of the federal government to reach an agreement on the actual value of the replacement measures.

After five years, British Columbia had completely replaced the fifteen percent and imposed about six hundred million dollars worth of additional charges on its industry. Quebec did the same, not the full fifteen percent, but about twelve percent. At the end of about five years, roughly eighty percent of the value of the exports was no longer subject to the fifteen percent export tax, being in large measure replaced by increased provincial charges. Alberta and Ontario did not implement any replacement measures.

So by that time, as a result of industry and government views about the replacement measures being in place and the export tax having been around long enough, the Canadian Federal Government decided to give notice of termination of the Softwood Lumber MOU. Such a termination provision did exist as part of the MOU. That caused some controversy in the U.S.

The result was the U.S. government took actions resulting in a new countervail case, being Countervail 3. Because of all the provincial involvement up to that point, they had all been involved directly since so much of the focus was on the provincial forest management systems. There was heightened provincial concern with the conduct of a new countervail investigation. So by Countervail 3 every individual province that was affected by the process had their own legal counsel. This, obviously, created a situation in terms of federal-provincial coordination on the defense, the nature of the arguments, who would do what work, who would pay for what work, and how to make

sure that no one, in advancing their own particular interests, undermined the overall case for Canada as a whole.

The countervailing duty investigation, Softwood 3, brought about a national rate subsidy finding of 6.51 percent. This was composed of both the determination that the provincial stumpage programs provided a subsidy and also a determination that Canadian log export restrictions provided a countervailable benefit to Canadian producers.

The final determinations were appealed through the Free Trade Agreement review panels that were now available. This was something that Canadian governments did not have recourse to before. The FTA appeal procedures ended up in remanding the determinations back to the U.S. Commerce Department, eventually essentially eliminating the subsidy finding. This then led to the U.S. taking the unusual step of invoking "Extraordinary Challenge" procedures under the FTA, which challenged the the legitimacy of the panel in reaching its decision and in directing the Commerce Department to reverse those rulings. The Extraordinary Challenge procedures, again, also upheld the Canadian position.

By that time, the U.S. had, however, collected eight hundred million dollars worth of duties. The procedure was over; and then there was a question of how and when Canadian producers received refunds of the duties collected. Associated with that were suggestions that there might be U.S. industry challenges of the Constitutionality of the FTA Chapter 19 panel review procedures, preventing the return of the eight hundred million dollars in duties as well. So there were a lot of potential threats still on the horizon even though the actual countervail investigation had been won by Canada.

The prospect of continuing this type of acrimony led to a suggestion and eventual agreement by everybody that there would be Softwood Lumber Consultations held. These occurred between 1994 and 1996. They, again, fully involved the provinces. The Canadian federal government was not in a situation where it could explain provincial government forest management systems. The provinces entered this with an expectation, an over expectation, that the process of consultation involving the U.S. industry, as well as governments concerned, would serve to bring about a better understanding of the Canadian system, that there was no subsidy, and to get a better sense of cooperation amongst the governments and the industry. But, really, at the end of the consultation process, essentially the U.S. industry reaction could be summed up as "That's all very well, now, what are you going to change your system to eliminate your subsidies?" So, by the end of the consultation process, it was evident that we were headed into a negotiation process if we were to avoid a Countervail 4.

The provinces entered this negotiating process with varying degrees of enthusiasm. Ontario had no enthusiasm to negotiate at all. British Columbia was hoping to find a way to avoid another countervail, as was Quebec. Alberta was the smallest producer involved, being swept along in the stream, knowing that since it was caught up in the countervails, it would probably have to deal with whatever negotiations and demands that were put in as well.

The result of that was a Canada/ U.S. Softwood Lumber Agreement that was in effect from 1996 to April 2001.

The aspect of that was interesting in terms of negotiations that occurred in the spring of 1996, is that negotiations were all based on provincial forest management systems and provincial charges that were in place for stumpage and other various types of forestry dues. The process was similar to the situation that was described earlier on the Pacific salmon negotiations, only reversed; negotiations were going on by the U.S. federal government on one side with sub-federal government on the Canadian side.

So we had a situation where provinces were in Washington in the early spring of 1996, where United States Trade Representative (USTR) would be going from a meeting with British Columbia, to a meeting with Quebec, to a meeting with Alberta, wondering what Ontario would finally do, and then going back to the first meeting again and the second and the third meeting; and so on. In between provinces were reconvening back at the Canadian Embassy to share the results of their discussions. Trying to manage this type of negotiating process was a challenge on both sides, probably more so for USTR officials. Obviously, since the provincial forest management practices were all different in each of the provinces, what each of the provinces were willing to put forward as items for potential change were different in each of the provinces. It was that much more of a difficulty for USTR to determine what they were getting in offers from one particular province in terms of changes to their systems to satisfy their interests in terms of increasing costs.

The other aspect was that Ontario still did not wish to have this type of negotiation of its forest management practices. It was a very reluctant participant and not really get involved in these negotiations until very late in the process. British Columbia and Quebec had essentially reached a point where it seemed a deal was possible. The USTR at the time asked to see the representatives from Alberta and Ontario to agree in principle to the basis of an agreement. By February of 1996, there was an announcement, seemingly, of an agreement in principle. It would be finalized over the coming weeks.

An element of that deal was a system of some type of system that would lower the volume of lumber going into the U.S. in addition to increasing costs. What was found to be a major problem, again, because USTR was

dealing with a number of different provinces, was that the numbers were not adding up. USTR was looking at the numbers from British Columbia, the numbers from Alberta, and the numbers from Ontario, and the numbers from Quebec for a target of about a ten percent reduction of exports of lumber going into the U.S., but the numbers that the provinces were putting forward in terms of their exports and how much they were prepared to reduce were not adding up to ten percent and the total numbers were not adding up to the numbers that U.S. thought were the total export numbers from Canada.

By March, USTR and the U.S. industry were throwing up their hands, saying, "We cannot do this, nothing adds up."

So there was pressure to change the whole negotiations from this province based system into a Canadian national export restraint program based on a quota system with a total number for all of Canada. It was left up to Canada to try to allocate the distribution of quota inside Canada. That is what we ended up with in the Softwood Lumber Agreement of 1996-2001.

This Agreement caused more difficulties in Canada on federal/ provincial issues. There was the question of how the distribution of the fee-free export quotas from Canada would be allocated inside Canada, questions on the statistical basis that would serve as the basis for the quotas, questions on what provision would be made, particularly from the view of the eastern provinces, for new entrants for new investments announced, for construction underway, for plants that had not been able to ship in the U.S. and did not have a historical record of shipment to the U.S. So it caused quite a lot of controversy inside Canada.

For the first three years things went relatively well. The restraints had the effect, it has been suggested, of bumping up lumber prices by about one hundred dollars per thousand board feet

Mills that had quota made a lot of money. The difficulty was that the Asian market started to experience difficulties; and all those companies that shipped to the Asian market suddenly had no outlet for their product. These companies started looking to the U.S. market but found that they could not ship there because they had no quota because they did not ship there on a historical basis when the Agreement had come into effect.

It caused divisions in the Canadian industry ultimately leading to a situation where, after five years, coming to this last year, it became apparent amongst the Canadian industry that the current softwood Lumber Agreement was no longer sustainable. It could not continue existing in its current form. A process started of trying to determine what should happen at the end of the five-year period: should another agreement be negotiated, should the agreement be allowed to expire, and what would be the consequences of allowing it to expire, and what should happen after that.

The Canadian federal government started a process of consultation in Canada trying to see if a consensus could be developed amongst the industries of all the various regions and provinces to see if there was an agreed view as to what should happen with the Agreement. No consensus was possible. There were those people that felt that really the only way to achieve free trade was to fight another Countervail. There were those industries that had experienced previous countervails and had concerns about what they knew they would have to face in terms of potential duties. There were varying views as to what would happen after NAFTA reviews in terms of the level of ultimate duty, and the likely chances of winning on reviews.

That is where we were with the end of the Softwood Lumber Agreement. In terms of my comments about the future and the prospects, there is no doubt that whatever happens, the provinces are going to be significantly involved either in terms of defense or other scenarios.

We have had two five-year agreements resulting from all that bargaining.

The U.S. industry still has not accepted the concept that although our Canadian systems are different, that they do not necessarily provide a countervailable subsidy. They are not inclined to accept that argument and appear to be willing to start one trade action after the other. If necessary these would be proceeded by getting some legislative changes with respect to their U.S. countervailing duty laws to make sure the next case is easier to win and not reversed by NAFTA review panels.

On the Canadian side, there is non-acceptance that there should be anything other than open and free trade, even though Canada has thirty-four percent of the U.S. market, and this causes industry and political difficult. Some Canadian industry representatives do not accept that something other than the current situation might have to be considered. Whether, at some time, provincial forest management practices may have to change, I guess, is also not yet accepted, but may have to be to bring about a lasting solution.

What happens now? We have a countervailing duty investigation started. My conclusions as to what happens now, and what the solution is to the softwood lumber dispute, is that I do not see a solution at all.

We could have a scenario that after NAFTA reviews of its current countervail, Canada wins; and there is no duty in place. That would be a satisfactory outcome for Canada, but I do not think it would solve the issue for the U.S. It would just likely lead to a lot of consternation and an effort sometime in the future to do something again.

If, after a NAFTA review there happened to be countervailing duties left in place, there would be a long series of ongoing annual Administrative Reviews provided for under U.S. countervail law that provinces would have to cope with, and there would be ongoing pressures to change provincial for-

est management systems so Administrative Reviews would eventually find there is no subsidy left.

The other alternative, negotiation of some sort of deal of export restraint, whether it is another export tax with some process of eliminating the export tax by changes in provincial forest management systems, again, is going to place a burden on provinces in terms of having to revisit their forest management systems to see if they are prepared to make the types of changes that would be acceptable to the U.S. industry.

The other aspect to what has happened that from my perspective is probably the only positive aspect is the process of greater integration of Canadian and U.S. industries with a number of U.S. companies previously involved in starting the trade complaints now present substantially in the Canadian market as a result of a series of acquisitions of Canadian forest companies. We have had a situation where the President of one U.S. multinational, after long being one of the greatest proponents of the countervail actions, now saying, that he had looked at the situation from the Canadian side and he does not see any subsidies.

So these things have occurred, but I guess the prospect for a satisfactorily outcome is not great.