SOFTWOOD LUMBER: HARD FACTS

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On April 24, 2017, the American Department of Commerce imposed preliminary countervailing duties on softwood lumber from Canada. Press reports in Canada have complained that this was due to protectionists sentiments in the United States, even blaming the President for this action. This article will attempt to provide a clear explanation of what has transpired, and what the future may hold.

Did President Trump do this?

No. Despite press reports claiming that the President has taken credit for this action, the countervailing duty investigation was undertaken under anti-subsidy laws that are permitted by the World Trade Organization[1]. Subject to certain rules and limitations, where producers in a country are being injured by low-priced goods from another country that are made possible by the provision of subsidies in the country of export, those producers may initiate proceedings to have countervailing duties put in place. These duties are intended to offset (or countervail) the amount of the subsidies that are causing harm. Canada has similar provisions under its *Special Import Measures Act*, and Canada currently maintains countervailing duties against a range of products from countries including China, India, and the European Union member states.

The American Department of Commerce has imposed preliminary measures based upon an investigation initiated at the request of American softwood lumber producers. This is a quasi-judicial process. Final duties will require a finding by the International Trade Commission that the subsidies are causing (or threaten to cause) injury to domestic producers in the United States. The imposition of duties can be appealed by Canadian producers to the Court of International Trade in the United States or to a section 19 *NAFTA* Panel (under the current version of *NAFTA*). Canada can also seek a remedy through the Dispute Resolution Body at the World Trade Organization.

What goods are covered?

Basically, all cut softwood timber and many further manufactured products. These further manufactured products are essentially those in which the cost of the lumber constitutes the majority of the total cost of the goods. This would include products such as wooden box springs, door and window frames, and flooring. These further manufactured goods were not included in earlier softwood lumber trade cases, but were later added as

previous findings had led to a dramatic increase in Canadian exports of these types of processed softwood products.

What are the subsidies being alleged?

The Department of Commerce has found subsidies in four general groups; stumpage rates, log export restrictions, grants and tax incentives.

The key target is Canadian stumpage rates payable on lumber harvested from provincial Crown lands. The Department of Commerce has found that these rates are below the cost of logs harvested from private lands or purchased through open auction. The difference in amounts charged may be seen in the different countervailing duty rates. In New Brunswick where lumber pricing from private lands prevails, the preliminary countervailing duty rate for J.D. Irving was set at 3.02%. For companies purchasing from Crown lands, preliminary countervailing duty rates were in the range of 20% to 24%.

The Department of Commerce also found that a financial benefit was given to Canadian lumber producers by restrictions on the export of logs from Canada. This was a measure for which Canada sought an exemption from trade liberalization in the *Canada-US Free Trade Agreement*[2]. It was carried over into *NAFTA*[3]. Export of logs from Canada is controlled and requires permits both federally and provincially. These controls were held to reduce the cost of logs to Canadian producers of softwood lumber, because they limit the export of logs, even if they come from private lands. Ironically, the United States also maintains the right to control the export of logs in these same agreements.

The remaining subsidies were grants and tax incentives that the Department of Commerce determined were not generally available to all Canadian businesses, but were specific to the lumber industry.

Why is the U.S. charging retroactive duties?

The World Trade Organization permits a retroactive assessment of duties up to 90 days prior to initiation of an investigation, where there is a surge of imports before a finding comes into place[4]. In the United States, this is called critical circumstances. In Canada, we refer to this practice as “massive importation”, and it is defined (in Canada) as an increase in the subsidized (or dumped) imports by more than 15% compared to a representative period in the past.

Didn’t Canada beat the United States on appeal in past softwood subsidy cases?

Yes and no. On the major factor of stumpage rates, Canada won an important case at the World Trade Organization where it was found that the United States should not have applied American market pricing to determine what would constitute a financial benefit from provincial stumpage rates. It was found, as a general

rule, that a determination of a financial benefit should be based upon a comparison with open market pricing in the country of export. Using the cost of logs in New Brunswick yielded a lower amount of subsidy, though it did not eliminate subsidies completely. The finding did agree that provincial stumpage rates could provide a financial benefit that constituted a countervailable subsidy. In the current investigation, the Department of Commerce has, for some producers, relied upon the Canadian selling price of timber from private lands or from auction. It has continued to use American-based surrogate pricing for certain lumber exports from British Columbia, and that may constitute a weakness in the American position.

Canadian interests also had some relative successes in Chapter 19 *NAFTA* panels. In the most recent panels in 2002, remands were made on the sufficiency of an evidentiary basis for a threat of injury finding at the International Trade Commission. There were also remands on the Department of Commerce methodology to determine an amount of subsidy related to Crown lands. Both the International Trade Commission and the Department of Commerce faced additional remands for declining to follow the directions of the Chapter 19 panels. These cases were ultimately withdrawn upon the signing of the Softwood Lumber Agreement in 2006. While the Chapter 19 panels ultimately proved to be ineffective in providing a direct remedy, their findings did assist in pushing towards the Agreement that led to withdrawal of the countervailing and anti-dumping measures at that time.

Can Canada resolve this case in the NAFTA renegotiations?

Most unlikely. In 2016, Canadian sales of softwood lumber products exceeded US$5.6 billion. Even if an accommodation of subsidized exports to the U.S. were possible, Canada would have to give up a lot to get any kind of concession from the United States in this regard. Canada and the United States might agree to end restrictions on the export of logs. With access to Canadian logs, American producers would be less concerned about low stumpage rates, since they might also benefit.

Press reports seem to indicate that one of the goals of the United States will be to terminate the *NAFTA* Chapter 19 panel process. This would reduce the options available to Canadian lumber interests to challenge American findings; though appeal avenues would still exist through the Court of International Trade (in the United States) and in panels at the World Trade Organization.

What happens next?

The U.S. Department of Commerce will continue its investigation into the alleged Canadian subsidies. On June 26, the Department of Commerce also imposed preliminary anti-dumping duties on Canadian softwood lumber. These two matters will go to the International Trade Commission to determine whether the subsidies (and any dumping that might be found) have caused or threaten to cause injury to American producers. If such a finding is made, duties on Canadian lumber may go into effect for a period of five years, with the

potential for subsequent renewals every five years. If there is no injury finding, duties are terminated.

If there is an injury finding, Canadian producers and the Canadian Government will likely take some form of action, whether appeals through the American Court of International Trade or through section 19 panels (if these continue to exist after *NAFTA* renegotiation), and in panels before the World Trade Organization.

In the meantime, negotiations between Canada and the United States will continue to determine if there is a mutually-acceptable alternative form of trade restraint that might be substituted for anti-dumping and countervailing duties on softwood lumber. In the past, agreements have involved market sharing arrangements, quotas, and export taxes assessed by the Government of Canada (essentially a tax on American consumers).

Ultimately, a resolution by agreement will depend on a number of factors including, the relative success of reducing amounts of duties through appeal processes, the political pressure that can be brought by American home builders and other consumers of softwood products, and the agreement of American producers on the sufficiency of protection that a negotiated agreement would confer upon them.

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[1] Agreement on Subsidies and Countervailing Measures ("SCM Agreement")
[2] Article 1203 *Canada-United States Free Trade Agreement*.
[3] Annex 201.3.
[4] SCM Agreement, Article 20.6.

A Cautionary Note