



Softwood lumber deal tested federalism in Canada and U.S.

Settlement of dispute depended on Canadian provinces and U.S. regional interests.

BY WILLIAM DYMOND

An international trade dispute between two federal countries tests the wits of negotiators to find the deal that will please the highest number of constituent units — and displease as few as possible.

That was the way Canada and the United States eventually resolved the trade dispute over softwood lumber in the two countries where their federal governments are responsible for defending trade rights and disputing the actions of other countries, yet the economic impact of winning or losing a dispute is often regional.

Such tensions have always been present in Canada since well before Confederation, the time of Canada's first federal constitution in 1867, and have been part of the long-running saga that is the softwood lumber dispute between Canada and the U.S.

The elements of an intractable quarrel have always been in place. Canada has plentiful supplies of softwood lumber and the U.S. is virtually its only export market. Softwood lumber is made from trees that do not lose their leaves: spruce, pine, balsam, fir and other similar coniferous trees. The construction industry and furniture makers on both sides of the Canada-U.S. border use significant quantities of softwood lumber.

In Canada, the forests are government-owned in the principal producing provinces, British Columbia (B.C.), Alberta, Ontario and Quebec. Harvesting rights and stumpage fees, the prices paid for the right to cut the trees on government-owned land, are often embedded in long-term tenure arrangements negotiated between the province and the industry. In the U.S., and in Canada's Atlantic provinces, the forests are for the most part privately owned and market forces generally determine the price of the timber.

Should disputes arise, both Canadian and U.S. laws provide powerful weapons to fend off foreign competition — anti-dumping and countervailing duties. Once an industry has launched a complaint, history has shown that investigating officials are likely to find dumping and/or subsidization — only the extent remains in question. While the rules of both the World Trade Organization

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Photo: Tom Brandt

Canadian lumber heads south through Portland, Oregon. U.S. softwood producers claimed Canadian wood was unfairly subsidized.

(WTO) and the North American Free Trade Agreement (NAFTA) allow such actions to be challenged, dispute settlement cannot solve a problem when domestic interests are entrenched and enjoy substantial political support.

Canada's provinces: new players in the dispute

Over Canada's first 100 years as a country, from 1867 to 1967, there was little need or occasion for federal-provincial consultation on international trade issues. While the provinces might have been vitally interested in the economic impacts of trade, the federal government controlled the tools for handling trade disputes, essentially customs tariffs on imports and the negotiation of trade agreements with other countries, which opened markets to Canadian exports.

But this began to change in the 1970s, when issues falling partly or exclusively under provincial jurisdiction, for example, government procurement and trade in services, crept onto the multilateral negotiating table in Geneva. When a previous free trade agreement and then NAFTA came into effect, their rules and regulations caused the provinces to become more involved in the management of Canadian trade policy. Intensive federal-provincial consultations on trade issues became a permanent feature of Canadian trade policy making, negotiation, and implementation.

In Canada, the softwood lumber story brought all the dimensions of federal-provincial management of Canadian trade policy into play. At the heart of the dispute are stumpage fees under exclusive provincial jurisdiction. But only the Canadian federal government can challenge the

U.S. and negotiate for a settlement. However, unlike most other trade disputes, Ottawa does not control the measures at the origin of the dispute.

Regional differences

There had also always been important regional differences. B.C. as a single province accounts for about 75 per cent of Canadian exports. Quebec and the other provinces with stumpage practices of their own could reasonably apprehend being caught up in a dispute causing considerable damage to their lumber companies and workers. As each case wound its way through the U.S. system and subsequently in WTO and NAFTA actions, there was always a chance that the U.S. would pick off the provinces one at a time in separate deals. In these circumstances, Ottawa had to cross a minefield in order to construct and sustain a consensus.

The current dispute originated in 1982, when U.S. lumber producers complained that provincial stumpage practices subsidized Canadian exports. The complaint was dismissed in 1982, but then succeeded in 1986 with a countervailing duty of 15 per cent on most Canadian lumber exports to the U.S. Then the Americans agreed to drop the duties in return for a Canadian agreement to impose a 15 per cent tax on lumber exports.

When Canada terminated the agreement in 1991 the American government responded with a new countervailing duty. Three years of dispute settlement under the Free Trade Agreement ultimately vindicated Canada. However, in 1996, faced with threats of a new countervailing case, Canada agreed to limit exports from B.C., Alberta, Ontario, and Quebec to about 35 per cent of the total U.S. market for softwood lumber.

Agreement expires, dispute begins

This agreement expired on March 31, 2001, and Canadian industry, the provinces, and the federal government braced themselves for a new episode of strife. It came quickly in the form of the application by the U.S. of combined anti-dumping and countervailing duties of almost 28 per cent. Canada promptly replied with a flurry of legal challenges under NAFTA and the World Trade Organization. Canada usually won the NAFTA challenges, while the WTO cases produced wins and losses for both sides. A number of Canadian lumber companies sued the U.S. government separately under provisions of U.S. law. The Bush administration, however, consistently refused to eliminate the duties or return the monies collected, no matter the dispute settlement result.

In January 2006, a snap election in Canada brought the Conservative government into power in Ottawa at a time when both sides were exhausted. More than \$5 billion in duties had been collected from Canadian producers and under U.S. law would be remitted to the complaining U.S. companies. A stark choice faced the Conservatives: whether to renew the efforts to find a deal or continue dispute settlement actions with scant prospect of a final resolution.

On the U.S. side, while Canadian exports had fallen, imports from other countries had replaced Canadian

supplies and the U.S. industry was no better off. Moreover, a series of annual reviews had steadily reduced the duties to under 10 per cent, substantially eroding the protection from Canadian exports. From the perspective of the Bush administration, the dispute had come to dominate the complex Canada-U.S. relationship to the detriment of other issues. Both governments concluded that it was time to close the curtain on this episode.



Photo: Troy Holtzworth

Logs arrive at a lumber mill north of Coos Bay, Oregon. U.S. lumber producers felt disadvantaged by cheaper Canadian lumber.

2006 breakthrough: a compromise

The 2006 agreement captures the political reality of the last 20 years of Canada-U.S. trade in softwood lumber: peacefully managed trade is better than contentious free trade. The new agreement broadly provides for a Canadian export tax tied to the market price of softwood lumber and the U.S. consumption of lumber. The revenues collected will be returned to the governments of the exporting provinces. The B.C. coast and interior, Alberta, Saskatchewan, Ontario and Quebec can choose to pay the varying export tax, or a combined export tax and limits on export volume control, both varying with the price. Each province is allocated an export share based on historical shares of the U.S. market. If exports exceed 110 per cent of the base share, the export tax will be increased by 50 per cent. These measures do not apply to exports from the Atlantic provinces, the Yukon, Northwest Territories, or Nunavut. In addition, exports from 32 companies found by the U.S. not to benefit from subsidies are excluded.

The U.S. terminated all current anti-dumping and countervailing duties and has undertaken to dismiss any new petition, trade action, or investigations against Canadian softwood lumber while the agreement is in force. The U.S. is also returning to Canadian exporters more than \$4 billion of the \$5 billion in duties collected.

Two factors made the 2006 agreement possible: federal-provincial dynamics began to work in favour of a settlement and a subtle but important change occurred in the management of Canada-U.S. relations under the new Conservative government.

First, Ottawa aggressively asserted its jurisdiction over the dispute. As the deal began to come together, federal



Canadian lumber waiting to move out from a shipping yard in Hearst, Ontario.

ministers decided that Canadian interests were greater than the sum of provincial interests.

National interest replaces animosity

Second, from its early days in office, the Conservative government abandoned animosity as a position for the management of the relationship with the U.S. and replaced it with a realistic pursuit of national interest. This change in tone induced the Bush administration to run some political risks in concluding the deal. These were not inconsiderable in an election year that would produce serious losses for the administration. Under U.S. law, the president cannot terminate countervailing or anti-dumping cases without the agreement of the affected industry. U.S. lumber producers could count on robust congressional support from the U.S. southeast and northwest. In the end, the American producers were persuaded to forego countervailing or anti-dumping duties and the prospect of \$5 billion in exchange for seven years of stability under a scheme that offered protection in periods of low prices without the risks and costs of litigation.

The outcome of the softwood lumber saga validates the observation by Canada's new Liberal leader, Stéphane Dion, that Canada is a country that works better in practice than in theory. Acute tensions among the provinces and between the provinces and the federal government created an incendiary mix that frequently came close to ignition. Collaboration by all levels of government produced a good, if not perfect, agreement and prevented serious damage to the federation. In negotiation, timing is everything. All the players here deserve credit for seizing the moment. 

Canadian provinces considered separate treaties with the U.S.

The recent softwood lumber trade dispute between the U.S. and Canada saw a unified front of American companies do battle with divided Canadian provinces – provinces which considered striking individual treaty deals with the U.S. in a move that would have strained the Canadian federation.

The Canadian stance in the negotiations was hampered because key Canadian provinces could not agree among themselves about common strategies. Their interests were too divergent.

This contrasted sharply with the U.S., where a lobby group called the Coalition for Fair Lumber Imports, an alliance composed of large and small independent sawmills, maintained solidarity and basically sang from the same song sheet.

The coalition contended that American workers were being put out of work and U.S. mills were being forced to shut down because Canadian governments were unfairly subsidizing Canadian producers, who sell an estimated \$8 billion U.S. in softwood lumber per year to the U.S.

The head of the U.S. Coalition, Steve Swanson, said: "We can compete against any lumber industry in the world, but we can't compete against their government too."

Compared to Canada, the coalition's strength was its unity, which it trumpeted on its website saying: "We are united in opposition to Canada's unfair trade practice of virtually giving away its forestlands to companies that export lumber to the U.S., the world's largest wood products market."

A variety of trade rulings were rendered, some upholding the American contention, and others dismissing it.

However, the Americans did not have to divide their Canadian counterparts in order to try to conquer them, because the Canadians were already divided.

The province of British Columbia (B.C.) has a staggering oversupply of lumber in large part because of the alarming phenomenon of the pine beetle. According to the January-February 2007 edition of *Canadian Geographic* magazine, because of the ravages of the beetle, the annual allowable cut in that province more than doubled from about 2 million cubic metres in 2001 to 5 million cubic metres in 2004.

This is because the beetle is killing off B.C.'s pine tree forests at a frightening rate, and B.C. needs to sell the wood quickly before it goes bad and is willing to pay export penalties.

The beetle eats a sweet part of the bark, which eventually kills the trees – but the wood can be harvested for a short period thereafter.

Quebec and Ontario and a few smaller provinces have not been hit by the beetle, do not have an over-supply of lumber, and are content to voluntarily limit themselves to an export quota.

Pierre Vincent of the Quebec Forest Industry Council explained that the interests of B.C. were so divergent with those of Quebec and Ontario that a Pan-Canadian position was out of the question.

"So the provinces thought, perhaps the best solution was to have a Quebec-United States deal, an Ontario-United States deal and a British Columbia-United States deal."

But, "the constitutionalists and Ottawa said 'that is out of the question, it has to be a treaty between two countries. It must be a deal between Ottawa and Washington.'"

In the end, a deal was struck whereby the provinces have to make a choice.

"Option A or Option B. Option B involves paying a very small tax and respecting an export quota, and Option A involves paying a big tax without any export restrictions," said Vincent.

Quebec, Ontario, Manitoba and Saskatchewan chose Option B, while Alberta and British Columbia, the interior and the coast chose Option A.

- by Rod Macdonell