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Tilting At Sawmills: America's Shameful Approach To The Softwood Lumber Dispute With Canada

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Donald Trump has called the North American Free Trade Agreement the "worst trade deal ever negotiated." If he were speaking on behalf of Canadian exporters or American consumers of softwood lumber, his point would have some validity. For more than 20 years, NAFTA has failed to deliver free trade in lumber. Instead, a system of managed trade has persisted at the behest of rent-seeking U.S. producers, egged on by Washington lawyers and lobbyists who know a gravy train when they see one.

Those who consider the United States a beacon of free trade in a swirling sea of protectionist scofflaws will be surprised by the sordid details of the decades-long lumber dispute between the United States and Canada. Among those details is the story of how the U.S. Commerce Department (DOC) ran roughshod over the rule of law to manufacture the leverage needed to extort from Canadian lumber mills a sum of $1 billion, which was used to line the pockets of American mills and the U.S. Forestry Service, while restricting lumber imports for nearly a decade through October 2015, at great expense to retailers, builders, and home buyers.

With that ugly history mostly expunged from the public's memory, the U.S. lumber industry is back at the trough again, demanding its government intervene to restrict Canadian supply, following a whole 13 month period during which it was forced out of the nest to operate in an environment rife with real market conditions! In the quiet shadows of the Friday after Thanksgiving, U.S. softwood lumber producers filed new antidumping and countervailing duty petitions with the DOC and U.S. International Trade Commission (ITC), alleging that dumped and subsidized Canadian imports were causing material injury to the domestic industry.

Whether the DOC finds legitimate evidence of dumping or countervailable subsidization is actually beside the point here. The agency has proven itself quite capable of producing evidence it is willing to defend as legitimate, which is all that matters when the game plan is to use the specter of a long, drawn out procedural battle – a period during which importers have no certainty about whether they will have to pay duties or how large that bill will be – to arm-twist the Canadians back to the table to agree, once again, to limited U.S. access in exchange for suspension of the unfair trade petitions.

If the investigations go forward and injurious dumping and/or injurious subsidization are found – a likely outcome given the discretion DOC has to administer these laws – preliminary duties likely would be imposed in April 2017 and final duties imposed by the end of that year. Depending on those duty rates (and how willing importers are to stomach the risk that their duty liability increases), imports of lumber from Canada could continue. But, the more likely outcome is that the two sides will reach a new agreement to limit Canadian access to the U.S. market, through quantitative restrictions, export taxes, or some combination of the two, before preliminary countervailing and antidumping duties are imposed.

Unfortunately, this wouldn't be the first time that the U.S. trade remedy laws have been used to extort settlements under which foreign producers agree to restrict their exports to the United States in exchange for the U.S. government dropping often spurious claims against them. But the lumber case provides an especially egregious example of how the United States – self-proclaimed champion of free trade – uses the threat of protectionism to strong arm even its closest trade partner.

Three Decades of Managed Lumber Trade – The Early Years

The bilateral friction over lumber trade dates back to 1982, when the U.S. softwood lumber industry brought a complaint under the U.S. Countervailing Duty (CVD) law against Canadian exporters, alleging chiefly that the fees charged by the Canadian national and provincial governments to harvest timber on government-owned lands—so-called "stumpage" fees—fall below market rates and thus constitute unfair subsidies to Canadian lumber producers. But the industry's effort to get duties imposed failed, as the DOC ruled in May 1983 that stumpage did not confer a countervailable subsidy to Canadian lumber producers. So the case ended – for the time being.

In 1986 the U.S. industry once again petitioned for countervailing duties and, this time, the DOC changed its tune, finding the Canadian stumpage system to constitute a countervailable subsidy. In lieu of duties, the two governments agreed to a Memorandum of Understanding (MOU), which required the Canadian government to collect a tax of 15 percent on lumber exports with the stipulation that the tax would be reduced if stumpage fees or other provincial charges increased.

After five years, the Canadians terminated the MOU, prompting the DOC to initiate a new countervailing duty investigation the following month. Nine months later, the DOC issued an affirmative finding and imposed duties of 6.5 percent on lumber from Canada, which prompted an August 1992 Canadian appeal to a binational dispute settlement mechanism established under the U.S.-Canada Free Trade Agreement.

Two panels established under that mechanism agreed with Canada's claims that the DOC's subsidy finding and the ITC's injury determination were based on insufficient evidence and had no legal bases, and remanded the cases to both agencies. After finding the changes in the DOC analysis insufficient, the panel remanded the determination a second time. The panel hearing the injury case had to remand the analysis to the ITC three times. Still, the United States would not budge.

In April 1994, after having lost on the merits in dispute settlement, the U.S. government alleged conflicts of interest on the part of two Canadians who were on the panel that reviewed the DOC's subsidy determination, and consequently requested the formation of an Extraordinary Challenge Committee (ECC) provided for under another paragraph of the U.S.-Canada Free Trade Agreement.

Four months later, the ECC ruled against the United States and the CVD order was officially, but grudgingly, revoked. Having been cleared of countervailable subsidy claims twice at this point, but facing the threat of new investigations and the burden of yet more legal costs, the Canadians accepted an agreement to limit exports to the United States.

The Softwood Lumber Agreement (SLA), which was effectively a tariff rate quota system that allowed in finite imports duty free and then subjected imports above those limits to extremely high tariffs, went into effect in May 1996 and lasted until March 2001.

A New Millennium, Yet More of the Same

Two days after expiration of the SLA, the U.S. industry filed new countervailing duty and antidumping petitions. The ITC ruled that the domestic industry was "threatened" with material injury by reason of less than fair value (i.e., dumped) and subsidized Canadian imports of softwood lumber. Final countervailing duties of 18.79 percent and final antidumping duties ranging from 2.18 percent to 12.44 percent were imposed in May 2002.

Canada responded by challenging those measures in the dispute settlement systems of NAFTA and the WTO. Under challenge were the threat-of-material-injury determination rendered by the ITC, and the DOC's subsidy and dumping findings. A total of six challenges were launched, as all three claims were before NAFTA and the WTO.

The NAFTA panels found each of the U.S. determinations to contravene U.S. law, and the WTO Dispute Settlement Body found all three determinations to violate U.S. obligations under the WTO. Here it is important to note that under NAFTA, dispute settlement is tasked with determining solely whether the relevant administrative agency (the ITC and/or the DOC in the case of U.S. actions) applied its national AD/CVD laws correctly. The NAFTA panels are available as an alternative to judicial review by domestic courts of final determinations in antidumping and countervailing duty cases. The NAFTA process provides the equivalent of domestic judicial review and, as such, its verdicts are binding on the administering authorities. In the lumber case, those verdicts were quite clear: the United States was obligated to terminate the restrictions and refund the duties.

Under the WTO agreement, the dispute settlement mechanism serves a different function. Rather than determine whether the administering authorities' actions are consistent with that country's laws, the relevant question is whether those actions are in conformity with the relevant WTO agreements. Whereas the WTO dispute settlement system can put pressure on members to bring their offending actions, regulations, or laws into conformity with the respective agreement, it has no authority to impose any remedial actions. At most, it can sanction retaliation from complainants that are victimized by the action found to be inconsistent with a member's obligations.

From the original investigation findings in May 2002, the three NAFTA panels collectively issued 11 remand orders to the U.S. administering authorities: five in the subsidy case and three each in the dumping and injury cases.

At issue in the subsidy case through its five remands was, not whether subsidies exist, but the proper methodology for calculating the benefits conferred by those subsidies. One thing that is clear was that the CVD rate declined from the original 18.79 percent through each successive remand determination. It last stood at 1.21 percent and would have become de minimis (less than 1 percent) had DOC followed the panel's instructions in the fifth remand.

The NAFTA panel hearing the antidumping case issued three remands, each containing specific instructions for DOC to incorporate into its revised determinations. In its third remand, issued in June 2005, the panel instructed DOC to render a new determination revoking the antidumping order with respect to a particular Canadian exporter and recalculating the rates for all the other respondents without relying on a discredited methodology known as "zeroing," which inflates dumping margins and had been found to violate U.S. WTO commitments.

But in July 2005, disregarding the panel's instructions, DOC issued its third remand redetermination, which still relied on the zeroing methodology and kept the rates above de minimis – and the antidumping order in effect.

The panel hearing the injury case found the ITC determination to be flawed primarily because it failed to distinguish between the contribution to the threat of injury attributable to dumped or subsidized imports and other factors, such as other Canadian wood products, imports from other countries, domestic competition, and consequences related to past decisions of U.S. producers. The case was remanded to the ITC in September 2003 with explicit instructions to consider certain factors and incorporate them into the remand determination.

When ITC's remand determination was published in December 2003, finding a threat of material injury again, Canada again challenged the finding and the panel, again, issued remand instructions to the ITC to "disregard assumptions that were not supported by substantial evidence." But the ITC published its second remand determination in June 2004, concluding, once again, that the industry was threatened with material injury. Once again, Canada challenged the finding. And this time, the panel's conclusions were quite explicit:

In its Second Remand Determination, the Commission has refused to follow the instructions in the First Panel Remand Decision. The Commission relies on the same record evidence that this Panel not once, but twice before, held insufficient as a matter of law to support the Commission's affirmative threat finding. By the Commission's so doing, this Panel can reasonably conclude that there is no other record evidence to support the Commission's affirmative threat determination. The Commission has made it abundantly clear to this Panel that it is simply unwilling to accept this Panel's review authority under Chapter 19 of the NAFTA and has consistently ignored the authority of this Panel in an effort to preserve its finding of threat of material injury.

Likewise, the panel's instructions for a third remand could not have been clearer:

This Panel remands this case to the Commission for the Commission to make a determination consistent with the decision of this Panel that the evidence on the record does not support a

finding of threat of material injury and to make that determination within ten (10) days from the date of this Panel decision.

In September 2004, pursuant to the panel's instructions, ITC published a determination that imports of Canadian lumber do not threaten injury to the domestic industry, thereby eliminating the justification for antidumping and countervailing duty measures.

But, apparently, the stake wasn't driven through the heart of the beast. In November 2004, the United States again alleged a conflict of interest on the part of a panelist and requested the formation of an Extraordinary Challenge Committee. The ECC ruled unanimously in Canada's favor in a report issued in August 2005, marking what should have been the end of U.S. stalling tactics.

Under NAFTA rules, the United States was obligated to revoke the measures prospectively and refund the duties—close to $5 billion—that had been collected in error since 2002. Instead, the Bush administration announced that the lumber duties would remain in place and that there would be no refunds.

Backroom Politics

The Bush administration's intransigence on lumber may have been motivated by something else – the now-repealed law known then as the Byrd Amendment. Formally called the Continued Dumping and Subsidy Offset Act, the Byrd Amendment, which became law in 2000, required antidumping and countervailing duties collected by Customs to be distributed to the domestic industries that filed or supported the original petitions in the underlying cases. Previously (and, once again, today), duties collected were (and are) commingled with funds in the general treasury.

Byrd was immediately challenged by several trade partners in the WTO and, ultimately, found to violate U.S. trade obligations because it punished foreign exporters twice—first, by imposing the duties as a remedy to dumping or subsidization (which is acceptable), and then by using the duties collected to directly subsidize U.S. producers (which is not).

Before ultimately repealing the Byrd Amendment, the U.S. Customs Service had collected $5 billion in duties from importers of Canadian lumber. Byrd repeal would throw into question the U.S. lumber producers' claims on that $5 billion, which was being held in escrow. Acceptance of the NAFTA panels' findings that the antidumping and countervailing duty measures were illegal would mean return of the $5 billion to importers and the loss of an opportunity for Congress to bestow massive subsidies on its constituents. So intent were some members of Congress to ensure preservation of the lumber restrictions that the issue became a central point of discussion in the confirmation hearings of Frank Lavin, a nominee for a DOC undersecretary position. Lavin testified before the Senate that he would find a way to keep the countervailing duties in place, and that officials at DOC had assured him that there are ways to recalculate the duties to produce a rate above de minimis.

Likewise, a group of Senators submitted a letter to then-Commerce Secretary Carlos Gutierrez urging him to preserve the duties. Reflecting total disregard for the purpose and legitimacy of the NAFTA dispute settlement system, the Senators opined that "NAFTA panel decisions cannot

and should not force the Department to deny legitimate relief under U.S. law to the domestic lumber industry and its workers."

Ultimately, with enough money available to grease the skids, the Bush administration worked out a deal on the backs of retailers, builders, and home buyers, which left U.S. and Canadian producers reasonably content, while ensuring an absence of free trade in lumber for another decade. Of the $5 billion of duties collected illegally, $4 billion was returned to the importers/Canadian producers and $1 billion was distributed to U.S. producers and the U.S. Forestry Service. In exchange, the Canadians agreed to a system of export taxes designed to limit supply in the U.S. market. That agreement expired last year and the related one-year legal standstill period expired last month.

Where to Now?

The U.S. lumber industry's filing of antidumping and countervailing duty petitions last week suggests that free trade in lumber will continue to remain elusive. And those who oppose duties are unlikely to find a sympathetic ear in president-elect Trump.

In all likelihood, the U.S. and Canadian producers will reach another agreement, which both sides will find preferable to the uncertainty created by antidumping and countervailing duty measures. The problem is that consuming industries and home buyers will suffer under any such agreement, which amounts to little more than government-endorsed collusion.

U.S. Trade Representative Michael Froman, in a recent meeting with Canadian lumber representatives, suggested that the Canadians likely would get a better deal from him than they would by waiting until a new USTR is in place. That may be true. But if President Trump expects to preside over a period of infrastructure-lead spending, he should take note of how much further taxpayer dollars would go if lumber in the United States were sold at market prices.

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