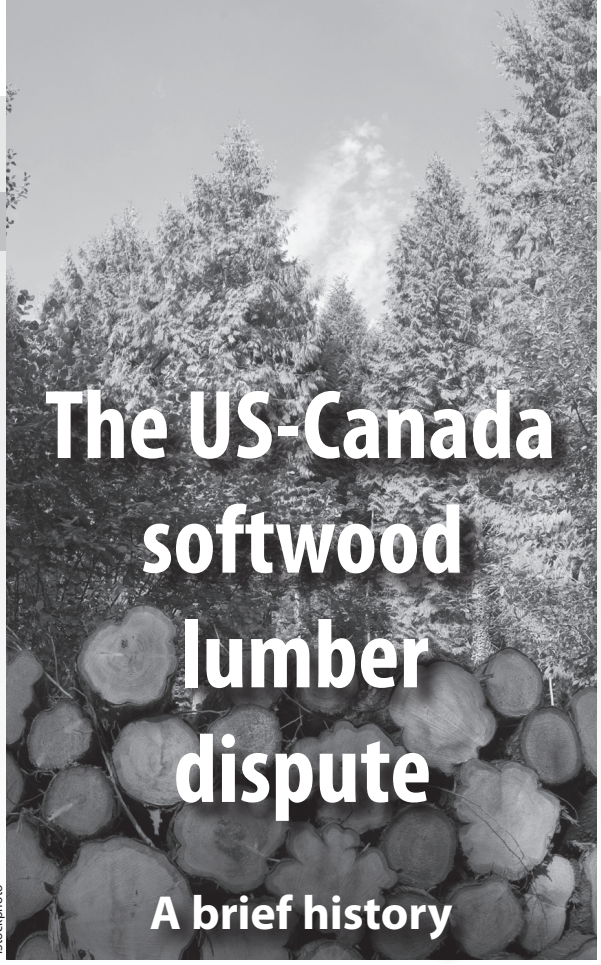

The US-Canada softwood lumber dispute

A brief history

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The moribund state of the North American forestry sector[1] is forcing significant changes to the structure of the industry in both Canada and the United States. World demand for forest products declined during the recent economic recession, especially in North America. Around the world, there has been a growing perception that the forest is more of an ecological preserve than an extractive renewable natural resource for forest products. This is particularly true in North America where the existence of "old-growth" forests has led environmental groups to push for preservation. There has also been a worldwide shift of production capacity to Asia, parts of Europe, and South America.

Many forestry companies in the United States and Canada continue to lose money. They have been reorganizing for survival, merging with other companies, investing in the most productive equipment, and, in cases where their borrowing capability has been damaged by losses, they have closed down mills. Some companies are pulling their timber resources out of timber production and preserving them as long-term investment trusts or as land for development. For example, TimberWest, the largest owner of private forest lands in Western Canada, has stopped producing lumber and has become, essentially, a land development company.

In both countries, the interdependent wood products and pulp and paper products manufacturing enterprises are struggling to find politically stable and economically viable combinations of a good regulatory environment, guaranteed timber availability, a stable supply of energy, a competent labor force, good transportation, and favorable corporate taxation. Unfortunately, the recurring problems with US-Canada trade relations in the forestry sector—principally with regard to softwood lumber—have added to the lack of stability and certainty. This article examines the recent history of the softwood lumber trade war between the two countries.

The softwood lumber conflict

The United States produces less lumber than it needs. It imports about one-third of its lumber from Canada.[2] Canada produces more lumber than it needs. It exports two-thirds of its lumber to the United States and the rest of the world.[3] This should be a happy coincidence, but it isn't. The two countries have different timber ownership systems that have left their respective lumber producers in continuous conflict. US producers feel that Canadians have access to cheaper timber that is not available to them. Canadians feel that a protectionist US lobby has the upper hand, imposing unfair levies on Canadians.

The last two decades of the softwood lumber trade war between the United States and Canada have simmered down to a continuous flow of complaining and periodic initiatives for arbitration. The relationship is popularly referred to as "Lumber V"—that is, the fifth period of lumber disputes in modern times.

The current softwood lumber agreement (SLA) was signed in September 2006. The SLA is a seven-year agreement, extendable to nine years. It put an end to the costly litigation that followed the expiration of the previous SLA in March 2001. The Canadian view is that the SLA has created some winners on the US side and many losers on the Canadian side.

To appreciate "Lumber V," it is useful to review briefly the recent history of this trade dispute, ignoring the early friction between the two countries that goes back 200 years (Reed, 2001).

"Lumber I" started in 1982 with a petition from a group of US lumber producers for a countervailing duty (CVD). Countervailing duties are a type of trade penalty that can be imposed on a foreign exporter under WTO rules in order to neutralize the effects of foreign export

subsidies that harm domestic producers in an importing country. That duty was eventually rebated to Canada.

"Lumber II" followed in 1986 when the US Department of Commerce issued new CVD guidelines and the US Coalition for Lumber Imports (CFLI) petitioned the US International Trade Commission (ITC) for a 15% CVD. They claimed that the Canadian stumpage rate was lower than market value. Stumpage rates are the prices that logging companies pay to individual landowners or state land administrators for the right to harvest timber. The stumpage rate is usually calculated on a cubic meter basis. In 1986, a settlement was reached through a Memorandum of Understanding (MOU), under which Canada imposed a 15% export tax on lumber shipped to the United States. Provinces that increased their stumpage rates or imposed other taxes could reduce the export tax. In response, provincial charges were increased in British Columbia and Quebec, resulting in a complete elimination of the export tax in BC in 1987 and partial elimination in Quebec in 1988.

However, industry in Canada lobbied against excessive provincial tax increases and Canada withdrew from the MOU in 1991. The United States immediately imposed a cash deposit levy equal to the 15% tax that the MOU would have required, and the Department of Commerce initiated a new CVD investigation, which concluded that a 6.5% subsidy existed in Canada. Further, the ITC determined that lumber shipments represented a "threat of injury" to the US industry (Stanbury et al., 1999).

"Lumber III" followed. Canada renewed its challenge to the current CVD by appealing to both the dispute settlement panel of the General Agreement on Tariffs and Trade (GATT) and to the binational panel of the US-Canada Free Trade Agreement (FTA). Complex and expensive legal investigations and arguments ensued, at the end of which the US Department of Commerce recalculated the CVD rate at 11.54%. However, the FTA panel ordered that the CVD be revoked and the FTA extraordinary challenge committee affirmed the panel's decision since the Department of Commerce's order could not demonstrate the trade effects of the CVD. The US Congress affirmed both FTA panel decisions. Consequently, the CVD was revoked but the funds that had already been collected were not refunded until the two governments reached the five-year SLA in April 1996.

Under the 1996 SLA, quarterly tariff-free quotas were negotiated. Taxes were to be paid to the Canadian government for shipments above the quotas, though additional tariff-free quotas could be granted when lumber prices were high. However, problems emerged with the complicated agreement, which was difficult to oversee and enforce, as did court challenges regarding the nature and classification of lumber products with "added value." The result was that Canada chose to not renew the SLA upon expiration in March 2001.

At this point, the CFLI took the opportunity to file claims for both a CVD and an anti-dumping duty (ADD)[4] against Canada and "Lumber IV" followed. The Department of Commerce determined that a 18.8% CVD and an average 8.4% ADD applied. The ITC concluded in 2002 that "threat of injury" also applied. Canada challenged all three US charges before the NAFTA and World Trade Organization (WTO) dispute determination panels. Claims, counter-claims, appellate decisions, administrative reviews, and extraordinary challenges led to the current SLA and "Lumber V."

In the late stages of the protracted dispute process leading up to the 2006 SLA, the binational panel of judges of the North American Free Trade Agreement dismissed the ITC's claim that Canadian lumber exports posed a "threat of injury" to the US softwood lumber industry. However, the WTO sided with the US claim that a CVD and an ADD were legally enacted by the US against Canada (WTO, 2006).

Once all the extraordinary challenges within NAFTA were exhausted, the US Supreme Court was approached to determine whether NAFTA judges had the right to order US government departments to cease collecting lumber duties at the border. The desire to prevent an embarrassing Supreme Court decision gave urgency to the creation of a new softwood lumber agreement, a political settlement.

One can see the logic in the United States rushing to sign the SLA as it is putatively slanted in favor of the US. The Coalition for Fair Lumber Imports (CFLI, 2005), the group of US lumber producers that opposed Canada, feared that the Supreme Court may issue an unfavorable verdict and was already agitating for a review of the validity of NAFTA itself. Such a review would have locked the two countries in a much broader legal fight. That may be the strongest reason why Canada signed the SLA. Any possibility of the United States pulling out of NAFTA would have caused serious economic hardship, particularly among the manufacturing industries in Ontario and Quebec.

In the end, Canada withdrew its appeal to the US Supreme Court to eliminate the CVD and refund the

monies, and the United States withdrew its claim that any basis existed for a CVD and an ADD.

The 2006 SLA

At the time the agreement was signed, most Canadian forestry companies were mired in such dire financial circumstances that they supported the 2006 SLA just to get a share of the duty refund. Canadian exporters' paid duties, which were held in escrow pending the outcome of the litigation. In the end, US$4 billion were refunded. US$1 billion was retained and divided equally between the US federal government (for various worthy forest development projects) and the US companies that originated the dispute.[5] Canadian companies view this outcome as unjust.

In a recession, lumber demand drops and lumber prices decline. The SLA aims to reduce the volume of Canadian lumber entering the United States so as to protect US producers, reduce Canada's share of a shrinking economic pie, and thus shift more of the pain onto Canadians.

Canadians, in the view of their US competitors, receive government subsidies since they pay lower than market-determined prices for purchasing Crown (i.e., government) timber. This claim is the basis of decades of litigation. The agreed upon fact is that the two systems of timber pricing are different. Canadians feel that the Crown has been extracting maximum benefit in stumpage charges, taxes, regulated obligations, and the like, leaving less than competitive returns in the hands of investors (Stanbury, et al., 1999; Apsey, 1997). They point to the exodus of disenchanted US investors as poignant validation of their position.

Nevertheless, the aim of the SLA has been manifestly achieved: it has reduced Canada's share of the US market (Dufour, 2007). The result has been devastating to the Canadian industry, which has virtually collapsed. According to the Canadian Forest Service, between 2006 and 2009, 25,000 direct sawmill jobs and 23,000 pulp and paper jobs were lost permanently in Canada (NRC, 2010a).

The industry's financial results are similarly negative. PricewaterhouseCoopers (PWC) compares the financial performance of the 100 largest forest, paper, and packaging corporations in the world (PWC, 2008). According to the last PWC comparison, Canadians lost US$4 billion in 2008, in addition to a large loss in 2007. Canada suffered half of the US$8 billion in global losses. It is anticipated that the 2009 figures, when they become available, will also show massive losses.

The SLA provides two options for Canadian lumber exporting provinces. British Columbia and Alberta selected "Option A," which involves a lumber price trigger, while Eastern Canada selected "Option B," which involves a lumber price trigger and a quota (table 1).[6] Canadian lumber exporters earn a bonus export quota when the average price of softwood lumber is above a designated "trigger price." The SLA export charges are levied by the Canadian federal government and transferred to the provinces; the funds remain in Canada. This means there is less incentive for the government to negotiate support for Canadian companies.

The most important additional provision—which caused the most significant dispute since 2006—is called the "surge mechanism." This mechanism triggers a large penalty if any region's monthly shipment exceeds 110% of its export quota.[7] For this provision, the London Court of International Arbitration (LCIA) was chosen as the independent body for industrial dispute settlement.

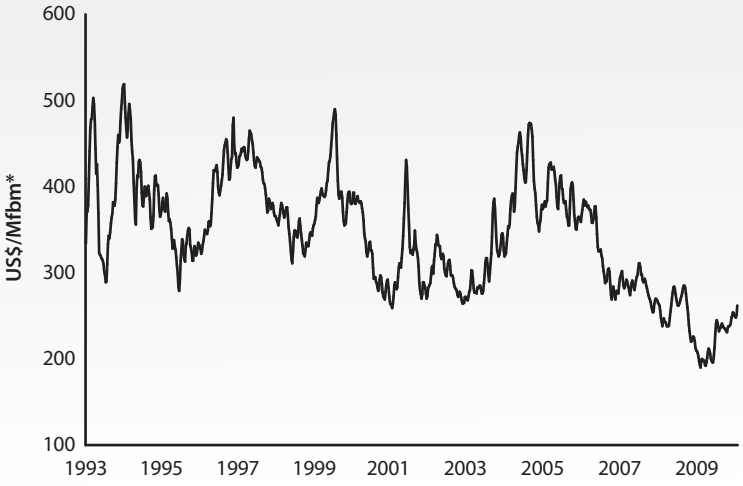
In August 2007, the US government, following a petition from the Coalition for Lumber Imports (CFLI),

Table 1: Softwood lumber export options under the 2006 US-Canada Softwood Lumber Agreement

US$/Mfbm*	OPTION A: Export charge (%)	OPTION B: Export charge and volume limit on regional share of US consumption
Over $355	0	0
$336-355	5	2.5% + 34% share
$316–335	10	3% + 32% share
$315 or under	15	5% + 30% share

* Random Lengths' Framing Lumber Composite price per thousand board feet in US dollars

Figure 1: Lumber price according to Random Lengths' Framing Lumber Composite, 1993 to 2010



* Price per thousand board feet in US dollars
Source: Random Lengths, 2010.

requested LCIA arbitration in order to resolve the dispute, claiming that there had been shipments in excess of quotas and improper quota calculations. The LCIA found that quotas were incorrectly calculated for the first half of 2007, but that the complaint did not apply to BC and Alberta. On February 26, 2009, the LCIA ordered Canada to collect from eastern Canadian exporters an additional 10% compensatory charge for this breach and use the monies to pay the US government CA$68.26 million (Cherniak, 2008). Canada delayed instituting the charge and instead offered to pay the US government CA$46.7 million while maintaining the collection of a 5% export charge in those regions. The United States rejected the Canadian offer and started levying a 10% duty as ordered by the LCIA for the collection of the judgment amount (USTR, 2009).

In British Columbia and Alberta, exporters are penalized more now than they were before the SLA. Under "Option A," they pay a 15% export charge to the Canadian government instead of a 11.54% CVD to the US government. That punitive 11.54% CVD was declared illegal by the NAFTA panel and was supposed to be repaid in full; however, it was only partially refunded as part of the SLA deal. The jump to 15% happened because of the low market price of lumber at the time and the low lumber prices since then.

Conclusion and recommendations

Will the softwood lumber war ever come to an end? In 200 years, the documented differences between the two countries' legal and taxation structures have not been given sufficient recognition to dismiss the US lobby's claim that Canada's industry is subsidized. Canada should look at what can and needs to be done at home. First, Canada should seek to emulate the mostly privately owned resource forest industry in the United States and elsewhere in the world (see Berry and Fretwell, 2007; Chittick, 2003). Canadians should establish private-like area-based long-term tenures of forest land as a second-best solution since outright privatization is legally and politically impractical in Canada. Second, the Canadian taxation system should be reformed to ensure that it is competitive with that of the United States. That means local and municipal governments should be less dependent on the forest industry for revenues, recognizing that the industry can no longer be viewed as a "cash cow."

Notes

1 The "forestry sector" includes logging, hauling, wood products manufacturing, and pulp and paper manufacturing.

2 Canada had 33% of the US lumber market in 2006 and 28% in 2008, according to the US Census Bureau (2010).

3 Canada exported 66% of its lumber in 2006 and 59% in 2008, according to Natural Resources Canada (2010b).

4 Anti-dumping duties usually entail charging an extra import duty on a product from a particular exporting country in order to bring the product's price closer to a prevailing market value or to remove the detrimental impact on domestic producers in an importing country.

5 Annex 2C(5) to the 2006 SLA states: "Canada or its agents shall distribute $US 1 billion pursuant to the irrevocable Directions to Pay to the accounts referred to in paragraph 4 in

the following amounts: $US 500 million to the members of the Coalition for Fair Lumber Imports, $US 50 million to the binational industry council, and $US450 million for meritorious initiatives."

6 Lumber made from logs harvested in the Atlantic provinces and the three territories, as well as certain companies exporting non-competing products, were exempted from the SLA and afforded free trade. The SLA also provides for a potential refund based on the possibility of third countries increasing their share of the US market by 20% in a given quarter.

7 The penalty is 150% of the "normal" export charge for that period. A region's US market share is its portion of total Canadian lumber exports to the United States during 2004 and 2005, applied against the 34% US market share for Canada as a whole.

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