

**Fair Trade Vs. Free Trade?
Antidumping Remedies and the Management of the Softwood Lumber Trade in
North America**

Marc D. Froese
Robarts Centre for Canadian Studies
York University

Abstract

This paper examines Canada's softwood lumber dispute with the United States in the context of current trade remedy law and ongoing dispute settlement action. Two questions are of central importance to this study. First, what does the proliferation of antidumping regimes mean for Canada's regulatory model? Strong antidumping legislation has created a new order of trade conflict at a time when intra-sectoral competition has increased state support in a number of sectors. Second, how do the ensuing complications come to bear in this dispute? In the softwood case, dispute settlement has been less effective because Canada, as the smaller economy, faces the challenge of enforcing panel decisions when the respondent has the power to avoid compliance. Antidumping actions are difficult to counter through multilateral mechanisms because these trade remedies double as industrial policy. They effectively blur the distinction between national competition strategies and non-tariff protectionism. In many ways the Canada/US dispute is symptomatic of larger governance issues at the WTO. The Dispute Settlement Mechanism has consistently raised the standard by which panels determine if a country has made a case for antidumping remedies. But this has not led to an overall reduction in the number of dumping and countervailing duty actions notified to the WTO. Second-best outcomes to long-running disputes, such as voluntary export restraints and other bilateral mechanisms for managing trade, are explained in part by the WTO's power-blind institutional architecture. This institutional myopia is one of the main challenges to WTO legitimacy today.

Introduction

Two movements have featured prominently in the recent history of the globalization of trade. The first is a limited diversification of internal markets with broad and shallow benefits for consumers. The second is an increase in intra-sectoral competition accompanied by increased friction at the interface between national regulatory systems. One of the WTO's central functions is the adjudication of disputes that develop at these friction-points between trade partners. For the past decade

antidumping trade remedies have been the preferred non-tariff barrier used by embattled domestic producers in North America. The Canada/United States softwood lumber dispute provides a timely and highly illustrative example of the evolving nature of trade remedy action in the WTO system.

Two questions are of central importance to this study. First, what does the proliferation of antidumping regimes mean for Canada's regulatory model? Aggressive antidumping legislation has created a new order of trade conflict at a time when intra-sectoral competition and state support have risen in a number of sectors. Second, how do the ensuing complications come to bear in this dispute? Antidumping actions are difficult to counter through multilateral mechanisms because these trade remedies double as industrial policy. They effectively blur the distinction between national competition strategies and non-tariff protectionism.¹ In the softwood case, dispute settlement was not effective because Canada, as the smaller economy, faced the challenge of defending its competition strategies against a much larger trading partner.

The first section examines the use of antidumping trade remedy measures in the context of international economic relations, paying particular attention to current trade tensions around softwood lumber.² Thanks in no small part to GATT-based tariff reductions, antidumping regimes and other non-tariff trade barriers are on the rise in both developed and developing nations.³ Dumping is the single largest competition issue currently facing the international trade regime and in the first ten years the Dispute Settlement Mechanism (DSM), antidumping and subsidies cases have been the most litigated disputes.

The second section examines Canada's softwood antidumping cases at the NAFTA and WTO. The DSM has consistently raised the standard by which panels determine if a country has made a case for antidumping remedies.⁴ Paradoxically, this has not lead to a reduction in the number of cases brought to the WTO. Canada's trade with the US is valued at \$270 billion USD and growing (at a rate of 15% last year).⁵ Most of it is conflict free, but softwood is a significant exception. Much to the dismay of its NAFTA partners, the US Department of Commerce has been especially aggressive in the protection of domestic industry through antidumping litigation.⁶ Canada has concluded eleven legal challenges of American antidumping duties – four at NAFTA and seven at the WTO. The issue is complicated by the fact that Canada and the US regulate their forestry industries in very different ways. Despite a high degree of corporate integration in the North American forestry industry, Canada has persisted in maintaining

¹ Gilbert Gagné. "The Canada-US Softwood Lumber Dispute: A Test Case for the Development of International Rules." *International Journal* 58, no. 3 (2003).

² José Tavares de Araujo Jr., Carla Macario, and Karsten Steinfatt. "Antidumping in the Americas." In *Serie Comercio Internacional*. Santiago, Chile: Organization of American States, 2001.

³ Daniel Drache and Marc D. Froese. "Ten Years of Dispute Settlement at the Wto: Litigation Trends from Marrakech to the Doha Round." Toronto: Robarts Centre for Canadian Studies, York University, 2005.

⁴ Lawrence Herman. "The Assessment of Injury by the Canadian International Trade Tribunal." *The Canadian Bar Review* 84 (2005): 305-26.

⁵ *International Trade Statistics 2005* [PDF file]. World Trade Organization, October 27th, 2005 [cited October 27 2005]. Available from http://www.wto.org/english/res_e/statis_e/its2005_e/its05_toc_e.htm.

⁶ I. M. Destler. *American Trade Politics*. 4th ed. Washington, DC: Institute for International Economics, 2005.

a unique regulatory model designed to address environmental and employment issues in provinces that are economically dependent upon the forestry industry.⁷

The final section analyzes the outcome of these panel decisions and the negotiated settlement which recently ended this round of the softwood lumber trade war. Voluntary export restraints and other bilateral mechanisms for managing, rather than liberalizing, softwood trade have been the most popular methods for managing the friction that arises from the interface between different regulatory models. Canadian policymakers originally hoped that litigation would force a better export deal for softwood producers. They preferred a settlement in line with the decisions of the panels, in which, at the very least, the US lowered its duties and returned all of the duties collected since 2001. The American industry and its powerful timber lobby in Congress wanted a settlement that would limit the flow of cheap Canadian lumber into the US market and allow forestry companies to keep all or most of the \$5 billion in duties collected and disbursed under the Byrd Amendment. The current arrangement, much like the Softwood Lumber Agreement of 1996, is a second-best outcome to an intractable dispute. In many ways it is symptomatic of larger governance issues in the international trade regime. Canadian policymakers are now aware that the WTO's power-blind dispute settlement architecture is not effective in bilateral disputes with the United States. They need to incorporate this knowledge into future litigation and compliance inducement strategies.

Trade Remedy Measures and WTO Litigation

Dumping is the practice of exporting a product for less than the cost of producing it, or for less than the 'normal value' of the product on the firm's home market.⁸ Dumping is a popular way to reduce a glut on one's own market, and agricultural goods are sometimes treated this way. Canadian dairy producers have been taken to the WTO for this practice.⁹ Dumping is also a useful way to gain access to a foreign market dominated by other firms. Chinese goods are often hit with antidumping duties for this reason.¹⁰

In economic terms dumping is a rational, profit-maximizing action, with little or no harm to global welfare.¹¹ In many cases, dumping goods on foreign markets can even improve consumer welfare by lowering prices. On the domestic market, producers sometimes sell their goods below cost in an effort to clear inventory or break into a market dominated by rival producers. However, in international trade, where countries have very different factor endowments, selling goods for less than the cost of production is considered by the WTO to be an unfair form of competition.

⁷ Dan Ciuriak. "Antidumping at 100 Years and Counting: A Canadian Perspective." *The World Economy* 28, no. 5 (2005).

⁸ Department of Finance. *Antidumping Information Paper* [HTML document]. Department of Finance, Canada, November 17th, 2004, 2003 [cited October 21 2005]. Available from http://www.fin.gc.ca/activity/pubs/antidmp01_e.html.

⁹ Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products WT/DS 103, 113.

¹⁰ David Livdahl and Yukiko Masuda. "Anti-Monopoly Law Edges Closer." *Financial Times*, October 26th 2005.

¹¹ Gregory N. Mankiw and Philip L. Swagel. "Antidumping: The Third Rail of Trade Policy." *Foreign Affairs* 84, no. 4 (2005): 107-19.

The WTO regulates the use of antidumping duties and countervailing measures through the Agreement on Implementation of Article VI of the GATT (also known as the Antidumping Agreement, or AD) and the Agreement on Subsidies and Countervailing Measures (ASCM).¹² Article VI of the GATT provides for the right of contracting parties to apply anti-dumping measures. At the end of the Uruguay Round, more detailed rules for the application of such measures were spelled out in the Anti-dumping Agreement.¹³ A companion to the AD, The ASCM is intended to delineate acceptable forms of state support from unfair subsidy practices. It sets out disciplines on the initiation of countervailing cases, investigations by national authorities and rules of evidence to ensure that all interested parties can present information and argument.

The AD and ASCM require that domestic agencies undertake an objective investigation of the volume of dumped imports, their effect on prices in the home market, and their impact on domestic producers. If the dumped goods have resulted in material injury to domestic producers, antidumping trade remedies are allowed. The trend in dispute settlement has been towards a higher standard of proof in recent years. This attempt to dam the tide of injury actions notified to the WTO each year has not been entirely successful.¹⁴ Members continue to enact AD legislation because they've noted its effective use by European and North American governments to protect domestic producers.

Antidumping Action at the WTO

Sixty antidumping disputes had been taken to WTO dispute settlement by the beginning of 2005, but the number of antidumping measures in place is much higher.¹⁵ Figure 1 below shows the trend in antidumping actions notified to the WTO. It includes both dispute settlement initiations as well as national trade remedy actions reported as per the Antidumping Agreement. Antidumping action, while formerly the domain of developed countries,¹⁶ has quickly become a global issue, with Argentina, Brazil, Mexico, India, Korea and South Africa, among others, actively using this form of domestic protectionism. Actions rose sharply between 1995 and 1999, and peaked in 2001. Since then, reports of trade remedy action have fallen, although not to 1995 levels.

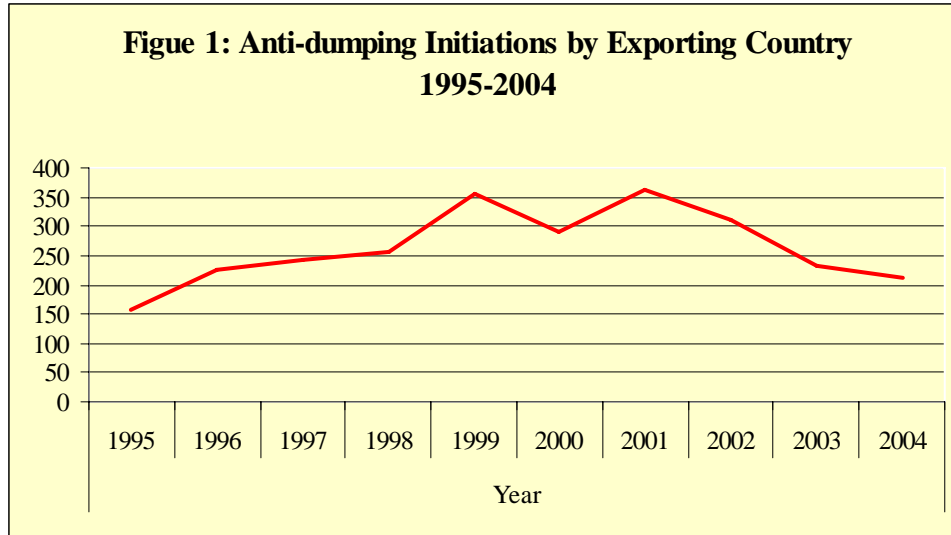
¹² For full text of these agreements go to www.wto.org/english/docs_e/legal_e/legal_e.htm.

¹³ The revised Agreement provides a more systematic method for determining whether a product is dumped and sets criteria for determining injury, and clarified procedures for initiating and conducting anti-dumping investigations.

¹⁴ See Herman 2005. Nobody knows what the future trajectory of antidumping will look like, but Blonigen and Bown suggest that the current tit-for-tat pattern of antidumping actions may lead to a sort of 'cold war' equilibrium. See Bruce A. Blonigen and Chad P. Bown. "Antidumping and Retaliation Threats." In *NBER Working Papers*. Washington: National Bureau of Economic Research, 2001.

¹⁵ This in comparison to the six antidumping cases heard under the old GATT Antidumping Code. See Ciuriak 2005

¹⁶ Between 1980 and 1988, the US, EU, Canada and Australia accounted for almost all the antidumping action in the world. See Trebilcock and Howse 1999.



Source: WTO online antidumping databases

One reason for the sustained rate of antidumping notifications is a favorable export climate over the past decade. But an artificially high American dollar and strong growth in China and India (whose GDP growth rates sit at 10% and 6% respectively¹⁷) do not fully explain the surge in antidumping action. The regulation of non-tariff protectionism is now an important part of any modern trade regime because liberal antidumping laws at the transnational level often act as a stand-in for an international competition policy.¹⁸ The WTO has made much of an apparent slump in antidumping actions, but it remains unclear whether this is cyclical fluctuation or a clear trajectory away from using these protectionist policy measures.¹⁹

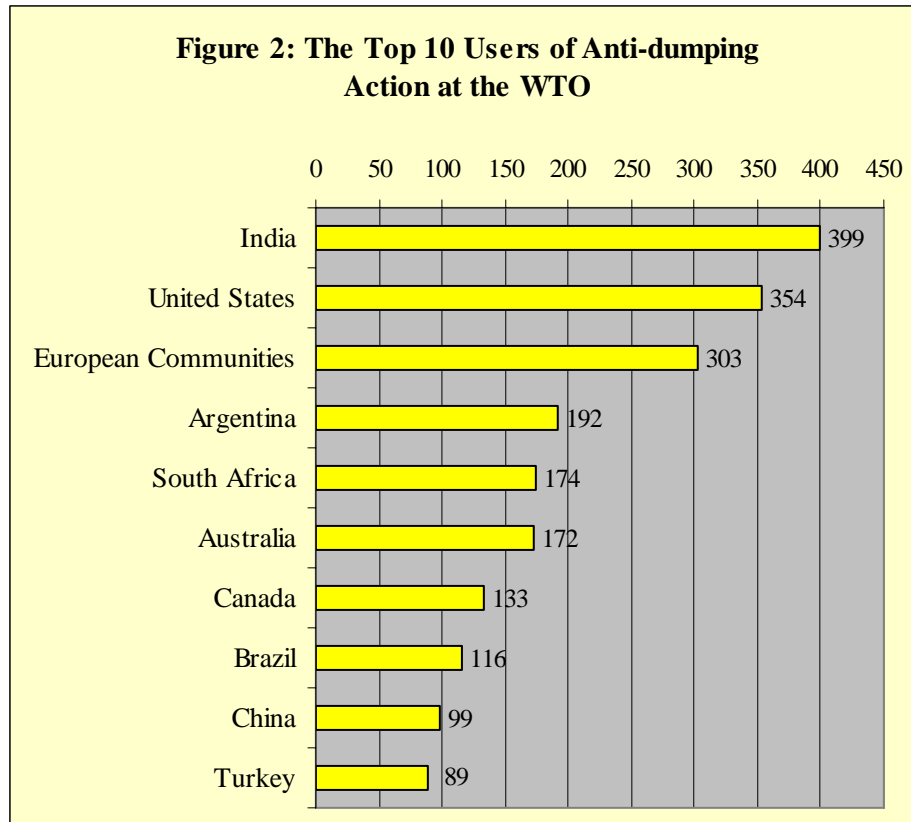
The US, in particular, has antidumping legislation to attack a wide range of subsidies in an attempt to enforce a more rigorous standard on subsidy usage.²⁰ Many of the large developing nations who implemented the Tokyo round tariff reductions have also begun to equip themselves with antidumping legislation. (see Figure 2 below). As for the least-developed member countries, most do not have domestic anti-dumping regimes and the concept is foreign to them. State support is their first line of defense, as they are primarily worried about supporting a small industrial base, and consumer protection is much less developed.

¹⁷ Sinclair Stewart. "The Trouble with Mumbai." *The Globe and Mail*, October 3rd 2005, B7.

¹⁸ Mankiw and Swagel 2005

¹⁹ Trade analysts suggest that the decrease in anti-dumping activity -- particularly new anti-dumping investigations -- in recent years may be attributable to the fact that a round of negotiations is currently underway. See BRIDGES Weekly Trade News Digest - Vol. 9, Number 36, 26 October 2005.

²⁰ Destler 2005



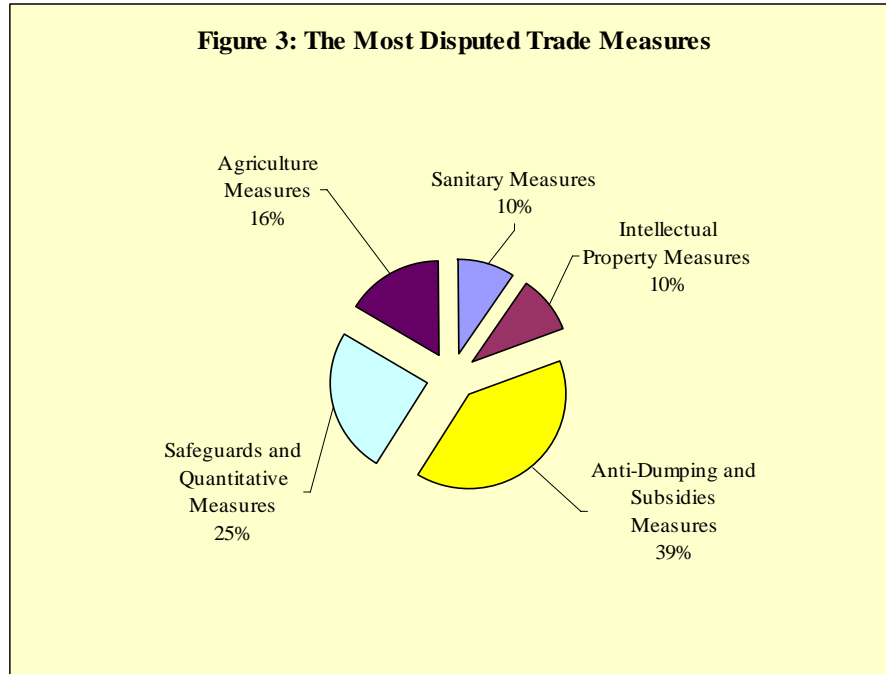
Source: WTO online antidumping databases

Comparing Anti-Dumping to Other Trade Measures

Ruggie reminds trade watchers that the goals of trade liberalization have never been literally free trade. Rather they have been to move from the strictures of managed trade to a more liberal and multilateral governance model. Nevertheless, the WTO has facilitated a shift on the part of many Members towards the use of ad hoc, non-tariff measures to shelter their domestic producers.²¹ The US and EU's reliance on subsidies and non-tariff barriers suggests that large economies prefer to use domestic measures rather than look to the WTO exclusively to create a level playing field for exports.

AD and ASCM measures are most often invoked in dispute settlement, at 39% of all agreements cited (see Figure 3 below). Safeguard measures and quantitative restrictions are the second largest category brought in front of the WTO, at 25% of all cases. By comparison, agriculture measures, sanitary and quarantine measures and intellectual property measures are categories which represent a far fewer number of disputes. This tells us that the WTO's Dispute Settlement Mechanism is far more often used to defend the industrial practices of developed nations than it is used for opening markets of other members.

²¹ John Gerard Ruggie. "Trade, Protectionism and the Future of Welfare Capitalism." *Journal of International Affairs* 48, no. 1 (1994).



Source: WTO dispute settlement database

Hudec likens the rise of non-tariff barriers to the uncovering of submerged stumps when draining a swamp.²² As tariff barriers fall, other forms of trade protectionism rise in importance. There are two reasons that states rely, first and foremost, on antidumping laws to deal with predatory trade practices. First, WTO jurisprudence is not far advanced and cannot give clear guidance in the areas of public policy dealing with predatory subsidies, dumping, and international competition policy.²³ At the interface between domestic regulatory systems, the WTO remains blind to the complex tradeoffs that national governments must make when promoting and protecting domestic firms in the international marketplace. Second, dispute settlement was supposed to be time-saving, money-saving and result in high-quality, enforceable jurisprudence. For many nations this has not been the experience.²⁴ Canada's antidumping/subsidy battle with the US over softwood is a case in point that highlights the challenges states face when trying to litigate disputes involving issues where industrial policy overlaps with competition practices.

Antidumping and Competition Policy

The regulation of non-tariff protectionism is now an important part of the modern trade regime because the Antidumping Agreement at the WTO must operate as a stand-in in the absence of an international competition policy.²⁵ Dumping becomes a public

²² Robert Hudec. *Essays on the Nature of International Trade Law*. London: Cameron May, 1999.

²³ John O. McGinnis and Mark L. Movsesian. "The World Trade Constitution." *Harvard Law Review* 114, no. 2 (2000): 511-605.

²⁴ Robert Howse. "From Politics to Technocracy-and Back Again: The Fate of the Multilateral Trading Regime." *American Journal of International Law* 96, no. 1 (2002): 94-117.

²⁵ N.Gregory Mankiw and Philip L. Swagel. "Antidumping: The Third Rail of Trade Policy." *Foreign Affairs* 84, no. 4 (2005): 107-19.

policy issue when jobs, growth and national competitiveness are undercut by the profit-maximizing behavior of foreign firms.²⁶ Empirical evidence supports this hypothesis. Bourgeois and Messerlin examined European antidumping cases between 1980 and 1997. They found an inverse relationship between the height of the tariff wall protecting domestic firms and the frequency of their involvement in antidumping cases.²⁷ As tariffs fell, countries engaged more frequently in antidumping trade remedy actions.

The conventional wisdom that antidumping trade remedies are designed to combat the anticompetitive practices of exporters misses the main thrust of these laws – protecting certain domestic industries from the predations of low priced foreign imports. Governments rely on aggressive litigation strategies to shelter industries faced with competitive pressure to cut costs up and down the production chain.²⁸ Nevertheless, as Anderson argues, trade remedy action in the softwood context is necessarily central to the compromise of embedded liberalism because Canada and the US have structured their respective forest products industries in different ways.²⁹

Canada maintains a strong state presence in the forestry industry, owning forest lands and setting the cost of cutting on these lands. The American compromise consists of generous trade remedy measures which offset the relatively higher cost of cutting on privately owned timber reserves. National institutions shape the trade advantages of domestic firms in very different ways.³⁰ The biggest unintended outcome of the dispute settlement system has been the attempt by domestic producers and national governments to use the uncomfortable fit between national regulatory systems as a pretext for foot-dragging, preemptive litigation and other political roadblocks designed to avoid compliance.³¹

The Softwood Lumber Dispute

Trade experts trace the current lumber battle with the US back to the early 1980s, although disagreements over lumber date back as far as the 19th century.³² The dispute revolves around the methods used sell trees to timber producers. In the US, many timber harvesters buy trees from the owners of timber lots. Harvesters hold contracts for cutting

²⁶ José Tavares de Araujo Jr., Carla Macario, and Karsten Steinfatt. "Antidumping in the Americas." In *Serie Comercio Internacional*. Santiago, Chile: Organization of American States, 2001.

²⁷ Jacques H. J. Bourgeois and Patrick A. Messerlin. "The European Community's Experience." In *Brookings Trade Forum 1998*, edited by Robert Lawrence. Washington D.C.: Brookings Institution Press, 1998.

²⁸ Douglas A. Irwin. *Against the Tide: An Intellectual History of Free Trade*. Princeton, NJ: Princeton University Press, 1996.

²⁹ Greg Anderson. "The Compromise of Embedded Liberalism, American Trade Remedy Law, and Canadian Softwood Lumber: Can't We All Just Get Along?" *Canadian Foreign Policy* 10, no. 2 (2003): 87-108.

³⁰ Peter A. Hall and David Soskice. "An Introduction to Varieties of Capitalism." In *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, edited by Peter A. Hall and David Soskice. New York: Oxford UP, 2001

³¹ Robert Howse. "Settling Trade Remedy Disputes: When the WTO Is Better Than the NAFTA." Toronto: C.D. Howe Institute, 1998; Steven Chase. "U.S. Brushes Off Canada's Nafta Softwood Victory." *The Globe and Mail*, August 11 2005, B1.

³² Gilbert Gagne. "The Canada-US Softwood Lumber Dispute: A Test Case for the Development of International Rules." *International Journal* 58, no. 3 (2003).

on dozens, and in the cases of the largest multinationals, thousands of lots. 60% of timber land is privately owned. In the case of government owned timber land (approximately 40% of timber land) harvesting rights are auctioned to the highest bidder. The cost of maintaining timber stands and various other environmental and administrative costs are borne by the lot owners, driving up the cost of timber.³³

In the Canadian regulatory model, the timber firm does not purchase trees from a private sector actor. Rather, they purchase the right to harvest trees from a provincial government. Stumpage fees are set by the provincial government and reflect the cost of maintaining forest land. These funds pay for some environmental and social programs. Unlike the long term contracts held by harvesters in the US, stumpage fees are adjusted periodically, four times a year in British Columbia for example, and better reflect the up-to-the-minute value of Canadian timber. Canada's publicly administered forestry model may be a more market-oriented approach to timber harvesting than is the current model south of the border because it is more responsive to changing market conditions.³⁴ As a result, the cost of harvesting timber in Canada is much lower than in the US.

The first round of the softwood lumber dispute began in 1982, and ended in a win for Canada at the US Department of Commerce (DOC). The U.S. industry petitioned against Canadian softwood lumber imports, arguing that under U.S. countervailing duty law, Canadian stumpage fees were subsidies for lumber exporters. By May of the next year, DOC concluded that stumpage did not confer a countervailable subsidy.³⁵ In 1986 American timber lobbyists reactivated their petition for countervailing duties using a federal court case from the year before (a dispute over imports from Mexico) as a favorable precedent.³⁶ After preliminary investigation, the DOC found that Canadian stumpage fees conferred a subsidy of approximately 15% on producers. Canada signed a Memorandum Of Understanding (MOU) agreeing to place a 15% export duty on lumber shipped to the US. The MOU remained in effect until 1991.

Canada terminated the MOU, Believing that it had a solid case for the new CUFTA Chapter 19 dispute settlement mechanism. This touched off the third round of trade conflict. One of the first countervailing duty cases under CUFTA, the panel remanded the DOC's subsidy determination three times, finding that the DOC had not made the case that provincial stumpage fees constituted an industry specific subsidy payment. In December 1993, Canada won the final case by a narrow margin (three to two), and the US Trade Representative took the case to the Extraordinary Challenge Committee (ECC), alleging a conflict of interest on the part of the two Canadian panelists. The challenge was struck down and DOC terminated the countervailing duty order in 1994, agreeing to refund the duties collected. In 1996 the Softwood Lumber Agreement was signed, restricting Canadian lumber exports for 5 years.

³³ S.M. Osman Rahman and Stephen Devadoss. "Economics of the Us-Canada Softwood Lumber Dispute: A Historical Perspective." *The Estey Centre Journal of International Law and Trade Policy* 3, no. 1 (2002): 29-45.

³⁴ Ron Haggart. "Everything You Always Wanted to Know About Softwood but Were Afraid to Ask." *The Globe and Mail*, October 28 2005, A23.

³⁵ For an overview of the past two decades of softwood conflict, visit www.dfait-maeci.gc.ca/eicb/softwood/chrono-en.asp

³⁶ SM Osman Rahman and Stephen Devadoss. "Economics of the Us-Canada Softwood Lumber Dispute: A Historical Perspective." *The Estey Centre Journal of International Law and Trade Policy* 3, no. 1 (2002): 29-45.

The fourth and current round of the softwood battle began on May 19, 2000 when Canada launched a judicial challenge to the current trade arrangements at NAFTA. In April 2001 the DOC investigated timber lobby allegations that Canadian lumber is subsidized and dumped on the American market. The Coalition for Fair Lumber Imports alleged that Canada's stumpage fees and log export restraints constituted a subsidy of approximately 39%. Along with countervailing duty investigations, the DOC conducted a nation-wide investigation to determine whether Canadian timber was being dumped on the US market. The International Trade Commission (ITC) whose job it is to determine whether American firms have been injured by dumping, found that there had been no material injury, only a threat of injury. The DOC found that Canadian timber was subsidized at a rate of approximately 19%, and that timber was being dumped on the US market at unfair prices – with dumping margins ranging from 5.94% to 19.24%.³⁷ Since 2001, Canada has concluded eleven legal challenges – four at NAFTA and seven at the WTO, but trade litigation has failed to deliver a judicial knockout.

Table 1: A Timeline of the Canada/US Softwood Lumber Dispute

Experts divide the past 20 years into four eras in the ongoing trade battle.

Lumber I – 1981-1983: A win for Canada at the US Commerce Dept.

Lumber II – 1986: a Memorandum Of Understanding was concluded, in which Canada agreed to place export duties on lumber shipped to the US. It remained in effect until 1991.

Lumber III – 1991-1996: one of the first countervailing duty cases under CUSTA. Canada wins, and the CVD order is terminated in 1994. In 1996 the Softwood Lumber Agreement is signed, restricting Canadian lumber exports for 5 years.

Lumber IV – 2000-2006 Canada launched a judicial challenge to the current trade arrangements at NAFTA. In April 2001 USDOC investigated timber lobby allegations that Canadian lumber is subsidized and dumped on the American market. Since then Canada has concluded eleven legal challenges – four at NAFTA and seven at the WTO. On April 27th, 2006 a deal was reached that imposed restrictions on Canadian timber exports for the next seven years, with the possibility of a two year extension.

Source: Rahman and Devadoss 2002, Globe and Mail 2005, DFAIT, WTO

Softwood became an AD issue because American industry made little headway in classifying stumpage fees as subsidies, and now had a new weapon in their arsenal - the Byrd Amendment. If a case could be made for dumping, the subsequent subsidy case would be easier to make. In most trade arrangements, comparative advantage rests on institutional foundations. Timber firms, frustrated by Canada's comparative advantage in timber, have long argued that Canada's timber industry should be organized the way that the American industry is in order to smooth market transactions across the continent.

³⁷ See footnote 51

They argue that Canada's regulatory system is based upon public rather than private ownership of timber land, and stumpage fees set by the provinces are tantamount to state subsidization of the Canadian timber industry. With the Byrd Amendment, the DOC had a new mechanism to mollify the timber lobby by allowing affected firms to recoup lost profits.

NAFTA Chapter 19 Binational Panel Decisions

Canada took its cause to the NAFTA in 2002. The panel's finding of July 17, 2003 was an unmitigated win for Canada. The panel ordered the Department of Commerce to correct its flawed determination of dumping against Canadian lumber producers.³⁸ In a second decision that same summer, the panel decided that Canadian stumpage fees are not countervailable subsidies under US law.³⁹ In September of 2003, Canada won a third round at NAFTA, when the panel disagreed with the International Trade Commission's finding that Canadian lumber posed a threat of injury to American lumber producers.⁴⁰

As of 2005, the DOC's countervailing duty determination first ruled by NAFTA to be in contravention of US law in July 2003 has been remanded three times, each time another win for Canada. The same is true for the August 2003 decision against the International Trade Commission (ITC) on stumpage fees. In March 2006 it was remanded back to the DOC for the fifth time.⁴¹ The second decision against the ITC of August 2004 has now been remanded three times as well.

Most significantly, the extraordinary challenge launched by the US Trade Representative to appeal this decision was also in Canada's favor. On August 10, 2005, the ECC upheld the decision of the panel in *USA-CDA-2002-1904-07*, which determined that there was no substantial evidence that Canadian lumber exports posed a material threat to the US lumber industry.⁴² Under CUFTA, and now under NAFTA, panels have consistently ruled that Canada's softwood lumber industry does not pose a threat of injury to American producers.

WTO Panel Decisions

On May 19th, 2000, Canada requested consultations with the US regarding the DOC's determination that Canada's export restraint on unprocessed logs was a subsidy to other producers who use logs as a manufacturing input.⁴³ The DOC argued that the export restraint lowered the price of logs for domestic mills. In the panel's report released on June 29, 2001, the Panel found that "an export restraint as defined in this dispute cannot constitute government-entrusted or government-directed provision of

³⁸ CERTAIN SOFTWOOD LUMBER PRODUCTS FROM CANADA (Department of Commerce Final Determination of Sales at Less Than Fair Value) *USA-CDA-2002-1904-02* (Active)

³⁹ CERTAIN SOFTWOOD LUMBER PRODUCTS FROM CANADA (Department of Commerce Final Affirmative Countervailing Duty Determination and Final Negative Critical Circumstances Determination) *USA-CDA-2002-1904-03* (Active)

⁴⁰ CERTAIN SOFTWOOD LUMBER PRODUCTS FROM CANADA (USITC Final Injury Determination) *USA-CDA-2002-1904-07*

⁴¹ CERTAIN SOFTWOOD LUMBER PRODUCTS FROM CANADA (Decision of the Panel on the Fifth Remand Determination) *USA-CDA-2002-1904-03*

⁴² CERTAIN SOFTWOOD LUMBER PRODUCTS FROM CANADA (Decision of the Extraordinary Challenge Committee) *ECC-2004-1904-01USA*

⁴³ United States — Measures Treating Export Restraints as Subsidies WT/DS194.

goods in the sense of subparagraph (iv) and hence does not constitute a financial contribution in the sense of Article 1.1(a) of the SCM Agreement.”⁴⁴ The first round was a substantial win for Canada.

In August of 2001, Canada again requested consultations with the US, this time concerning the DOC’s countervailing duty determination against Canadian softwood.⁴⁵ The panel released on September 27th, 2002 was Canada’s second win. The Panel found that the DOC’s countervailing duty determination was not inconsistent with Article 1.1 (a) SCM Agreement. This means that the DOC did not err when it classified Canadian stumpage fees as a subsidy – it is possible to make a successful legal argument that stumpage fees convey a financial contribution. However, the US failed to determine whether a material benefit had been conferred on Canadian harvesters by current stumpage rates. It also failed to establish that a benefit was conferred to Canadian mills through Canada’s stumpage program and log export restraint. Therefore, the panel decided that the DOC’s countervailing duty determination was inconsistent with US obligations under the Subsidy and Countervailing Measures Agreement. At the implementation phase, the US argued that it had implemented the panel’s recommendations because the particular CVDs in question were no longer active. Canada responded that the US had not changed the trade legislation that allowed for the original determinations.

The next panel on the same issue was released in August of 2003. The panel ruled that the DOC had acted inconsistently with SCM obligations because it failed to properly analyze the material injury suffered by American timber harvesters.⁴⁶ It did, however, rule upon the basic legality of challenging Canada’s regulatory model. The Appellate Body upheld the panel’s finding that provincial methods for granting timber rights are actionable under the SCM. The US reported that it would comply with the AB recommendations for implementation, but later announced that a new countervailing duty determination from the DOC was forthcoming and it would wait to see the outcome of the newest investigation. Canada launched a compliance panel which reconfirmed that the US remains in violation of its treaty obligations.

The fourth case dealt with the DOC’s determination that Canadian lumber was dumped on the American market. Canada argued that the DOC erred by using a “zeroing” methodology to calculate dumping duties. “Zeroing” treats price comparisons which do not show dumping as zero values in the calculation of a weighted average dumping margin.⁴⁷ This means that when calculating the dumping margins, the DOC did not factor into calculations the Canadian timber sold at higher prices – zeroing these transactions instead of factoring them into the equation – this allows DOC to levy higher antidumping duties and penalties. The Panel found that the DOC failed to comply with the requirements of the Antidumping Agreement when it did not take into account all export transactions by applying the “zeroing” methodology when calculating the margin of dumping. The Appellate Body Agreed.

⁴⁴ All panel reports can be accessed at www.wto.org

⁴⁵ United States — Preliminary Determinations with Respect to Certain Softwood Lumber from Canada WT/DS236.

⁴⁶ United States — Final Countervailing Duty Determination with respect to certain Softwood Lumber from Canada WT/DS257.

⁴⁷ For a more indepth discussion of zeroing and its effects on antidumping determinations, see United States — Laws, Regulations and Methodology for Calculating Dumping Margins (Zeroing) DS/WT264.

At the end of November in 2004 the DOC revisited its method for calculating dumping duties. The methodology was revised based on a transaction-to-transaction comparison of the 'normal value' of Canadian lumber on the domestic market and its price in the United States. This method was justified under Article 2.4.2 of the AD which allows such comparisons. Canada disagreed and launched a compliance dispute. The panel reported back in April of 2006, allowing the DOC's revised dumping methodology.⁴⁸ This case was the only one which undercut Canada's legal position vis-à-vis American softwood producers. Subsequently, DS264 will likely be a hinge case around which the US industry will base subsequent legal defenses.

The final case dealt with the International Trade Commission's finding that Canadian timber posed a threat to the US industry.⁴⁹ In its report released March 22, 2004, the panel found that the ITC failed to comply with the requirements of Articles 3.5 and 3.7 the Antidumping Agreement and 15.5 and 15.7 of the Subsidy and Countervailing Measures Agreement in finding a causal link between imports and the threat of injury to the domestic softwood industry. The Appellate Body upheld the panel's decision. However, in the subsequent implementation dispute, the panel found that the US had brought its measures determining material threat into compliance with the AD and SCM.

Related WTO Panel Decisions

Two other cases not directly related to softwood are also central to this dispute. The first is a Canadian complaint that Section 129(c)(1) of the Uruguay Round Agreements Act requires that authorities not consider Dispute Settlement Body rulings when making dumping determinations. This was an especially difficult case to make because nothing in WTO law requires that states formulate domestic law explicitly under the rubric of completed WTO agreements. If legislation is inconsistent with WTO obligations, members may raise the issue through dispute settlement. The Panel ruled in July of 2002 that Canada had not made its case that section 129(c)(1) of the Uruguay Round Agreements Act was inconsistent with American obligations under the GATT, AD and SCM agreements.⁵⁰

The second was Canada's and Mexico's complaint about the Continued Dumping and Subsidy Offset Act of 2000 (CDSOA), commonly known as the Byrd Amendment.⁵¹ The CDSOA changes the way that dumping duties are collected. Rather than going into the US treasury, duties are placed into separate accounts set up for each antidumping case. At the end of the fiscal year, they are distributed to companies directly involved in the case. Along with Australia, Brazil, Chile, the European Communities, India, Indonesia, Japan, Korea, and Thailand they argued that the Continued Dumping and Subsidy Offset Act of 2000 nullified or impaired benefits accruing to the complaining parties under the GATT, SCM and AD agreements, and the panel agreed. However, in its report, the panel also noted that the this sort of legislation is a new and complex issue for

⁴⁸ United States – Final Dumping Determination on Softwood Lumber From Canada – Recourse to Article 21.5 of the DSU by Canada WT/DS264/RW

⁴⁹ United States — Investigation of the International Trade Commission in Softwood Lumber from Canada WT/DS277.

⁵⁰ United States — Section 129(c)(1) of the Uruguay Round Agreements Act WT/DS221.

⁵¹ United States — Continued Dumping and Subsidy Offset Act of 2000 WT/DS217 and 234.

the WTO because it deals with the use of subsidies as trade remedies – a sensitive area where industrial policy and trade governance intersect. The Appellate Body upheld the main provisions of the panel report. In April 2005, the European Communities and Canada notified the DSB that they were suspending trade concessions under the GATT on imports of certain products originating in the US in retaliation for American non-compliance with the panel ruling.

By the end of 2005, the United States repealed the Byrd Amendment. Congress' Governmental Accountability Office reported that duties collected, far from being a form of support for firms contending with unfair trade practices, were in fact a highly lucrative system of payments going to only a handful of companies, three of which were related. In Congress, prominent Democrats and Republicans agreed that the Byrd Amendment was, in the words of Jim Ramstad (R – MN) “the ultimate combination of protectionism, corporate welfare and government waste.”⁵²

What did Canada Accomplish?

On April 27th, 2006 Canada and the United States agreed to a truce. The US agreed to lift the 10% countervailing duty on softwood imports and agreed to refund 80% of the \$5 billion in duties collected. Canada agreed to cap its market share at 34%, by collecting a sliding tax which rises as the price of lumber in the US falls below \$355 per thousand board feet.⁵³ This deal is in place for seven years, with an option to renew for two more years. There are few substantive differences between this deal and the Softwood Lumber Agreement negotiated in 1996. The combination of export charges and volume restraints in this deal is remarkably similar to the fees charged for exceeding quantitative limits set out in the SLA.⁵⁴ This is the third time Canada has imposed quantitative restrictions on its lumber industry.⁵⁵

The outcome of Canada's softwood litigation has been mixed. Certainly, 10 wins reinforce the basic legality of the Canadian regulatory model in the context of WTO law. But the issue is not so clear cut. The panels allowed that stumpage fees are actionable under the ASCM, but disagreed with US methods for determining duties. Stumpage fees fall into the vast area in Article I of the Subsidies and Countervailing Measures Agreement which delineates actionable, non-actionable subsidies and prohibited subsidies. This means that stumpage fees are not illegal under WTO law, but they can be challenged by any Member who can make the case that its Most Favored Nation benefits have been nullified or impaired by Canada's framework for regulating softwood lumber

⁵² Bruce Odessey. *House Panel Approves Repeal of Byrd Amendment after WTO Ruling* [HTML File]. Washington File, 2005 [cited May 10th 2006]. Available from www.usinfo.state.gov.

⁵³ *Basic Terms of a Canada-United States Agreement on Softwood Lumber* [HTML file]. International Trade Canada, 2006 [cited May 4th 2006]. Available from <http://www.dfait-maeci.gc.ca/eicb/softwood>.

⁵⁴ *Softwood Lumber Agreement between the Government of Canada and the Government of the United States of America*. April 1, 1996.

⁵⁵ Steven Chase and Barrie McKenna. "Conservative Government Wins Softwood Truce." *The Globe and Mail*, April 28th 2006.

Table 2: Eleven Rounds with the World Heavyweight Champ

NAFTA Chapter 19 Binational Panel Decisions

USA-CDA-2002-1904-02 (Active) – July 17, 2003 – Win for Canada – The panel ordered USDOC to correct its flawed determination of dumping against Canadian lumber producers.

USA-CDA-2002-1904-03 (Active) – August 13, 2003 – Win for Canada – The panel decided that Canadian stumpage fees are not countervailable subsidies under US law.

USA-CDA-2002-1904-07 – September 5, 2003 – Win for Canada – The panel disagreed with the USITC's threat of material injury determination against Canadian lumber producers.

USA-CDA-2005-1904-01 (Active) – Investigation initiated, no report to date

USA-CDA-2005-1904-03 (Active) – Investigation initiated, no report to date

USA-CDA-2005-1904-04 (Active) – Investigation initiated, no report to date

NAFTA Chapter 19 Extraordinary Challenge Committee Decisions

ECC-2004-1904-01USA – August 10, 2005 – Win for Canada – The EEC upheld the decision of the panel in *USA-CDA-2002-1904-07*, which determined that there was no substantial evidence that Canadian lumber exports posed a material threat to the US lumber industry.

WTO Dispute Settlement Mechanism Panel Decisions

DS 194 – Panel released June 29 2001 – Win for Canada – The Panel found that an export restraint does not constitute a financial contribution in the sense of Article 1.1(a) of the SCM Agreement.

DS 236 – Panel released Sept. 27 2002 – Win for Canada – The Panel found that the USDOC's imposition of provisional CVD measures was inconsistent with the US obligations under the SCM Agreement.

DS 257 – Panel released Aug. 29, 2003, Appellate Body report June 19, 2004, DSU Article 21.5 panel report August 1, 2005 – Win for Canada – The Panel found that the USDOC Final Countervailing Duty Determination was inconsistent with Articles 10, 14, 14(d) and 32.1 SCM Agreement and Article VI:3 of GATT 1994.

DS 264 – Panel released April 13, 2004, Appellate Body report Aug. 11, 2004, DSU Article 21.3 arbitration report Dec. 13, 2004. – Win for Canada, but a loss in the compliance phase – USDOC failed to comply with the requirements of Articles 2.4.2 of the AD Agreement because it did not take into account all export transactions by applying the “zeroing” methodology when calculating the margin of dumping.

DS 277 (Active) – Panel released March 22, 2004 – Win for Canada – The panel found that the USITC failed to comply with the requirements of Articles 3.5 and 3.7 the AD Agreement and 15.5 and 15.7 of the SCM Agreement in finding a causal link between imports and threat of injury to the domestic softwood industry.

Related WTO Panel Decisions

DS 221 – Panel released July 15 2002 – Loss for Canada – The panel decided that Canada had not made the case that section 129(c)(1) of the Uruguay Round Agreements Act was inconsistent with American obligations under the GATT, AD and SCM agreements.

DS 234 – Panel released Sept. 16 2002 – Win for Canada – The panel found that the Continued Dumping and Subsidy Offset Act of 2000 (the Byrd Amendment) nullified or impaired benefits accruing to the complaining parties under the GATT, SCM and AD agreements.

Source: Rahman and Devadoss 2002, Globe and Mail 2005, DFAIT, www.wto.org

harvesting. In practice this means that even though a deal has been reached in this round of the lumber dispute, there is nothing in US law or WTO law that would prevent future challenges to Canada's system of stumpage fees. This places Canada in the ambiguous position of being neither onside nor offside in the international legal environment.⁵⁶

When National Regulatory Models Collide

The softwood lumber dispute raises significant questions asked by all trade watchers. Can the WTO reconcile its free trade mandate with the reality of a system in which states with vastly different power differentials and regulatory models use dispute settlement for protectionist ends?⁵⁷ Further, how does the WTO's antidiscriminatory regulatory model understand the complex relationship between trade and industrial policy which takes place at the national level?⁵⁸ In a practical sense, the Dispute Settlement Mechanism was created in response to concerns that the GATT's dispute procedure was inadequate to the task of sorting through the complex legal issues that arise in the more deeply integrated international economy. But the new system has not proven itself up to the challenge in a number of areas, including antidumping, agriculture, textiles and services liberalization. The putative aim of the Uruguay Round signatories was to create a flexible interface between different market economies. At least in the context of antidumping, this has not happened.

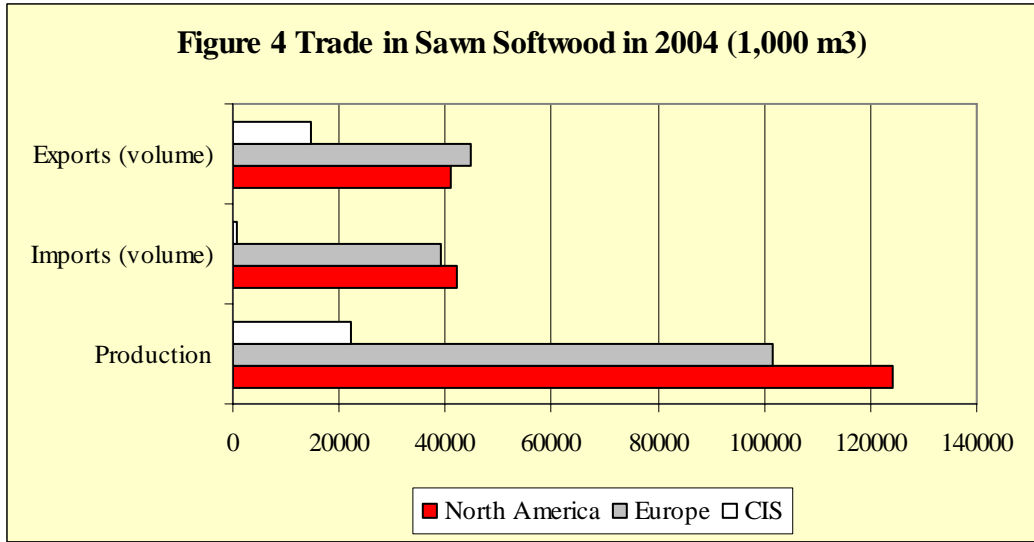
The rise of antidumping actions at the WTO has created a new order of trade conflict at a time when intra-sectoral competition has increased the pressure on states to support domestic producers in a number of sectors, including agriculture, steel, textiles, wood products and high value-added manufacturing such as automobiles and aircraft. In 2005 North America experienced a net trade deficit in sawn wood for the first time ever.⁵⁹ Despite continuing high levels of production in North America, massive influx of lumber from the former Soviet states is making deep inroads on this continent. The Russian Federation, Ukraine and Belarus export approximately 70% of their softwood production, totally more than 15 million cubic meters (see Figure 4 below). Much of it goes to China, but a significant amount of cheap timber is finding its way to North America.

⁵⁶ Lawrence Herman. "Here's the Path to a Deal on Softwood." *The Globe and Mail*, November 3rd 2005, A23.

⁵⁷ Gilbert Gagné. "State Policy Autonomy and the Canada-US Softwood Lumber Dispute: Theoretical and Philosophical Aspects." Paper presented at the Canadian Political Science Association Annual Meeting, University of Western Ontario, London, Ontario, June 2-4 2005.

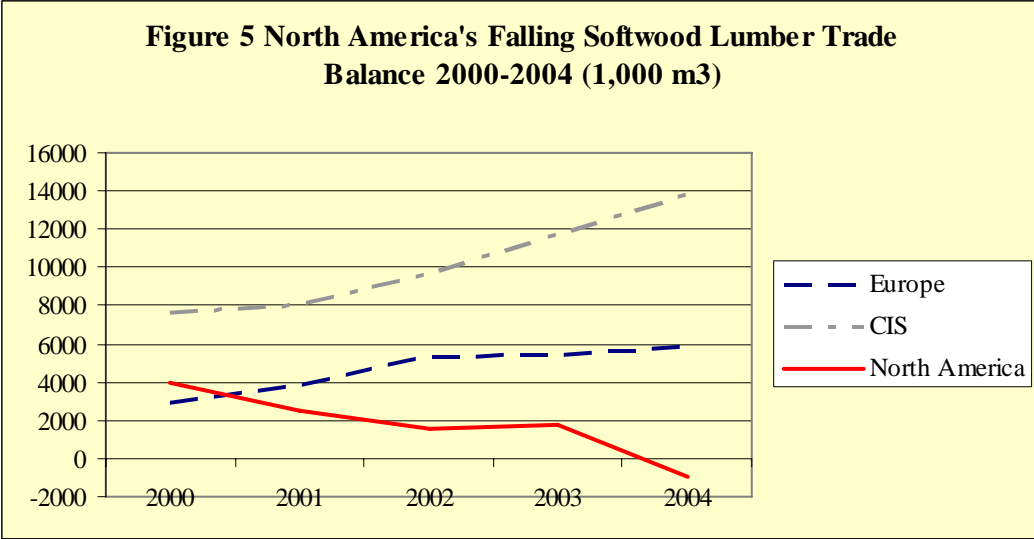
⁵⁸ McGinnis and Movsesian 2000

⁵⁹ United Nations Economic Commission for Europe (UNECE) and the Food and Agriculture Organization of the United Nations (FAO). "Forest Products Annual Market Review 2004-2005." *Timber Bulletin* LVIII (2005), no. 3.



Source: UNECE 2005

Trade liberalization squeezes both Canadian and American timber producers. They have responded in a fashion according to the compensations built into their regulatory model – the Americans through recourse to aggressive trade remedies, the Canadians to government intervention in the form of competitively priced stumpage fees. What to the uninformed trade watcher appears to be a simple subsidy issue is in fact the clash of regulatory models due in large part to competitive pressure in the North American timber industry (see Figure 5 below).



Source: UNECE 2005

The current governance environment offers several challenges and possibilities for small economies engaged in complex subsidy and antidumping disputes. A singular short term challenge remains unaddressed – that of enforcing compliance against a larger competitor. Canada is not always a loser in WTO power politics. In its recent disputes

with Brazil over the financing of civil aircraft sales, Canada refused to comply with a panel decision which struck down Canada's secret cabinet-level loans to Bombardier to secure financing for large aircraft orders.⁶⁰ Brazil had the opportunity to impose retaliatory trade measures, but given the sparse trade relations between the two countries, chose to enter into bilateral talks aimed at finding a solution to the dispute which would balance the right to support domestic industry with the need for fair and open international trade.⁶¹

In the WTO system, Dispute settlement is most likely to result in an enforceable decision when the parties are of similar economic weight and share a dense set of trade relations. Small economies are often in the position of being unable to enforce compliance – and bilateral diplomacy is increasingly critical to brokering a deal, despite the fact that it always involves a number of tradeoffs between domestic producers and foreign complainants. Therefore, the DSM is unlikely in the future to result in predictably enforceable wins for Canada vis-à-vis the US. Canada needs to rethink its strategy for managing the economic relations with the United States.

The second challenge is how to negotiate good dispute settlements in the context of bilateral trade arrangements in North America. Confidence in NAFTA is at an all-time low and policy makers are quickly realizing that WTO panels are only as effective as national governments allow them to be. In this case, the Bush Administration was not willing to expend the political capital required to settle this dispute, unless Canada made a number of concessions, most prominently on the amount of the duties which would be returned to Canadian lumber producers.

With a new deal in place until 2013, Canada must decide whether or not to defend its regulatory model in an increasingly integrated industry. Some experts argue that this is not possible and long-term stability in the sector requires that Canada harmonize its policies and practices, to a greater extent, with the US.⁶² However, this prescription misses the main issue at play. Canada is the largest exporter of timber to the US. Approximately 49% of American timber imports come from Canada. Even if Canada were to radically transform its timber industry, it still remains the largest foreign competitor in the embattled American timber sector. Regulatory harmonization is no guarantee that Canada won't feel the protectionist pressure of the American timber lobby in the future. Nevertheless, Canadian regulators need to decide if further harmonization will reduce regulatory friction, at least in the short and medium term, or if maintaining a distinctive regulatory model is more conducive to long-term stability and growth in the sector.

There are, however, at least two possibilities for better outcomes afforded to Canada in the current governance environment. While these are not silver bullets in the current dispute, they are part of a long-term strategy for effective use of multilateral and bilateral dispute settlement processes in future trade remedy disputes with the US. The creation of strategic alliances among like-minded states through shared negotiating positions and bilateral understandings on the use of state support would go a long way in clarifying the issues. The Canada/Mexico relationship in NAFTA is one example of

⁶⁰Canada – Export Credits and Loan Guarantees for Regional Aircraft WT/DS222/ARB

⁶¹ See WT/DS 222 *Canada — Export Credits and Loan Guarantees for Regional Aircraft*

⁶² Lawrence Herman. "Here's the Path to a Deal on Softwood." *The Globe and Mail*, November 3rd 2005, A23.

where strategic partnership can offset the inequality built into the Canada/US relationship. Cooper has noted recently that Canada's habit of developing tactical, ad-hoc relations with Mexico has hampered the creation of deeper commitments between the two countries on many issues.⁶³ Canada cannot afford to leave the management of the forces of economic integration to the private sector. Proactive government intervention is required to broaden and deepen diplomatic ties and build viable partnerships because market integration has produced an uneven set of relations – especially in the North American context. Some scholars have begun to question the future relevance of NAFTA, suggesting that the benefits accruing to Canadian business from the agreement's competitive effects, have been more than offset by its unequal distributional effects.⁶⁴ American noncompliance with NAFTA and WTO panel decisions amplifies this inequity.

Also of first-rank importance is the possibility that the DSM will, in the future, provide jurisprudence which better defines best-practice antidumping action. The WTO may yet develop trade norms which have a chilling effect on predatory antidumping in the long term, but only if Members indicate the importance of an equitable international competition policy. The WTO has gone some way in this area by raising the evidentiary standard in antidumping disputes. In other areas as well, where state support is actionable under WTO law, the growing body of panel reports may provide some guidance as to which legal, political and economic variables affect dispute settlement outcomes – which cases are winnable both in legal terms and in compliance terms, and which are best dealt with in bilateral negotiations, or some other institutional forum.

Canadian policy makers must examine these two possibilities because the only other enforcement measure available, trade retaliation across sectors, is a political non-starter in a small, trade dependent economy such as Canada's. Cross-sector retaliatory strategies tend to burn more good will with consumers and domestic producers than they create. However, trade litigation is not for the squeamish. A certain amount of brinksmanship is the norm in WTO dispute settlement, and Canadian policy makers and politicians need to recognize that litigation is never risk free.

Conclusion

Many states now look to the WTO's dispute settlement process as a model for similar supranational bodies at the regional level. But the WTO's institutional blindness to the complex tradeoffs that participation requires of members has not helped its reputation as a champion of a level playing field for trade – an issue at the heart of the current impasse in the Doha round. The institution's ambiguous record on antidumping trade remedy measures has undoubtedly hurt its external legitimacy. In refereeing the grey areas of subsidy litigation, the WTO's track record has been mixed. The Dispute Settlement Mechanism has won diplomatic and legal legitimacy, but more countries use

⁶³ Andrew F. Cooper. "Thinking Outside the Box in the Canada/Mexico Relations: From Convenience to Commitment." Paper presented at the Robarts Centre Canada Mexico Seminar - Canada-Mexico Big Picture Realities: NAFTA Plus, Immigration, the Security-First Border, The Bush Revolution in Foreign Policy and the Global South, York University, Toronto, November 7-8 2005.

⁶⁴ Daniel Drache. "Bon Anniversaire Nafta: The Elusive and Asymmetrical Benefits of a Decade of North American Integration." Paper presented at the Robarts Centre Canada Mexico Seminar - Canada-Mexico Big Picture Realities: NAFTA Plus, Immigration, the Security-First Border, The Bush Revolution in Foreign Policy and the Global South, York University, Toronto, November 7-8 2005.

antidumping measures now than ever before. Further, large economies such as the US are able to exploit the DSM in their attempts to remake foreign regulatory environments to their own liking. The WTO has not neutralized the role of power politics in dispute settlement.

Without a doubt, WTO governance has broadened and deepened the legal and institutional web that binds together the international society of states. However a daunting task still remains for trade policy experts. More work needs to be done to better develop the current model of dispute settlement in order to emphasize multilateral interests in fair and open trade, rather than state power. Canada recognizes that support for the development of other multilateral institutional mechanisms for the purpose of protecting the environment, cultural diversity and international labor standards is central to its goal of greater leverage in the dispute settlement process. UNESCO's embryonic framework for the protection and promotion of cultural diversity is one such initiative that has received much attention lately. For small economies, dispute settlement can and should be part of a larger strategy which includes building coalitions of like interests with other Members and litigating those cases which highlight the connections between trade law and public international law.

Ironically, through its halting treatment of antidumping measures, the WTO may have opened the door to linking trade to other issues. This is a bad thing according to many trade lawyers, because it broadens the WTO's institutional mandate at a time when it is already unable to clear the negotiating logjam at the Doha round. But it is a good thing according to many civil society activists because embedding liberalism at the international level requires moving substantive debates about the costs and benefits of trade liberalization beyond the limited boundaries of the WTO. Will the WTO sink or swim? Its troubled track record to date leaves the future in some doubt.