Order Code IB10081

Softwood Lumber Imports from Canada: Issues and Events

Updated May 9, 2006

Ross W. Gorte
Resources, Science, and Industry Division

Jeanne J. Grimmett
American Law Division

CONTENTS

Softwood Lumber Imports From Canada: Issues and Events

SUMMARY

U.S. lumber producers have raised concerns about softwood imports from Canada for many years. Alleged Canadian subsidies (a prerequisite for establishing countervailing duties [CVDs]) were investigated in 1982, 1986, and 1992. No subsidies were found in 1983. Subsidy findings led to a 15% Canadian tax on lumber exports in 1986 and to a 6.51% CVD in 1992. The CVD was challenged and ended in 1994. A 1996 Softwood Lumber Agreement restricted Canadian exports until March 31, 2001.

U.S. Industry Arguments. The U.S. producers argue that they have been injured by Canadian subsidies, especially for provincial *stumpage fees* (for the right to harvest trees). In Canada, the provinces own 90% of the timberlands, which contrasts with the United States, where 42% of timberlands are publicly owned and where government timber is often sold competitively. These differences in land tenure make comparisons difficult.

In addition, U.S. lumber producers argue that Canadian log export restrictions subsidize producers by preventing others from getting access to Canadian timber. U.S. log exports from federal and state lands are also restricted, but logs are exported from U.S. private lands. Canada argues that U.S. treatment of export restrictions violates the WTO Agreement on Subsidies and Countervailing Measures.

Finally, U.S. producers argue that they have been injured by imports of Canadian lumber. They point to the growth in Canadian exports and market share, from less than 3 billion board feet (BBF) and 7% of the U.S. market in 1952 to more than 18 BBF per year and a market share of more than 33%. Canadians counter that the U.S. industry has been unable to satisfy U.S. demand. Homebuilders and other lumber users assert that Canadian lumber is needed to satisfy U.S. demands.

Current Issues. In March 2002, the Department of Commerce (DOC) determined that Canadian lumber was subsidized and was being dumped. The U.S. International Trade Commission (ITC) found that imports threatened to injure U.S. industry, and final anti-dumping (AD) and CV duties were set at 27%. Lumber duties have since been lowered as a result of annual DOC reviews.

Canada filed NAFTA and WTO challenges to the final agency actions and has challenged other U.S. actions in federal court; most of the litigation is pending. However, the challenges and litigation might be moot under the tentative agreement announced on April 26, 2006. This 7-year agreement would establish Canadian export charges, with the level depending on weighted average lumber prices, and with lower charges possible if the Canadian exporting region also accepts volume restraints. The various parties to the many proceedings must concur in the agreement before it can become effective.

Canada has also been concerned that the roughly $5 billion in deposited lumber duties may eventually be disbursed to U.S. lumber firms under the Continued Dumping and Subsidy Offset Act (the "Byrd Amendment"). The act was repealed in P.L. 109-171, with a mandate that duties on imports through September 2007 be disbursed; in April 2006, a U.S. court ruled that the Byrd Amendment does not apply to Canadian imports. Under the agreement, at least 80% of the duties would be returned to the importers of record.

MOST RECENT DEVELOPMENTS

On April 26, 2006, the United States and Canada announced a 7-year agreement to resolve the long-standing dispute over U.S. imports of Canadian lumber. The agreement would establish Canadian export charges, with the level generally depending on average lumber prices, except for lumber from logs harvested in the Yukon, Northwest Territories, Nunavut, and Atlantic Provinces. Most of the duties collected to date would be returned to the importers of record. The agreement still needs to be finalized, which includes termination of all pending litigation..

Four developments occurred in April 2006 in Canada's legal challenges to the softwood lumber duties.

- On April 27, the United States requested a NAFTA Extraordinary Challenge Committee to review the binational panel decisions on subsidy margins, but suspended the request, pending acceptance of U.S.-Canada lumber agreement.

- On April 13, the WTO Appellate Body reversed a WTO panel decision upholding the November 2004 ITC "threat" determination, on the ground that the panel had used an overly deferential standard of review, but in effect left the ITC determination intact.

- On April 7, a U.S. federal court ruled that the distribution of duties under the Continued Dumping and Subsidy Offset Act (the "Byrd Amendment") does not apply to imports from Canada.

- On April 3, a WTO panel upheld the DOC dumping determination with higher rates issued to comply with a 2004 WTO decision.

BACKGROUND AND ANALYSIS

Concerns among U.S. lumber producers about softwood lumber imports from Canada have been raised for decades; the current dispute has persisted for at least 20 years. U.S. producers argue they have been harmed by unfair competition, which they assert results from subsidies to Canadian producers, primarily in the form of low provincial stumpage fees (fees for the right to harvest trees from Province-owned timberlands) and Canadian restrictions on log exports. Canadians defend their system, and U.S. homebuilders and other lumber users advocate unrestricted lumber imports. This issue brief provides a concise historical account of the dispute, summarizes the subsidy and injury evidence, and discusses current issues and events. (For more historical background and analysis, see CRS Report RL30826, *Softwood Lumber Imports From Canada: History and Analysis of the Dispute*, by Ross W. Gorte.)

Historical Background

The current dispute began in 1981, when letters from Members of Congress and a petition from the U.S. lumber industry asked the U.S. Department of Commerce (DOC) and the U.S. International Trade Commission (ITC) to investigate lumber imports from Canada for a possible countervailing duty (CVD).[1] The ITC found preliminary evidence of injury to the U.S. industry, but in 1983, the DOC's International Trade Administration (ITA) determined that subsidies were de minimis (less than 0.5%), ending the CVD investigation.

In 1986, the U.S. lumber industry filed a petition for another CVD investigation with the DOC and the ITC. A 1985 court ruling on an ITA determination of countervailable benefits on certain imports from Mexico was seen as a favorable precedent for reversing the ITA finding on Canadian lumber subsidies. The ITC again found preliminary evidence of injury to the U.S. industry, and the ITA reversed its 1983 determination, with a preliminary finding that Canadian producers received a subsidy of 15% ad valorem (i.e., 15% of lumber market prices). On December 30, 1986, the day before the final ITA subsidy determination, the United States and Canada signed a Memorandum of Understanding (MOU), with Canada imposing a 15% tax on lumber exported to the United States, to be replaced by higher stumpage fees within five years. The U.S. industry then withdraw its petition.

In September 1991, the Canadian government announced that it would withdraw from the MOU, because most of the provinces had increased their stumpage fees. The U.S. Trade Representative (USTR) responded by beginning a §301 investigation,[2] pending completion of a new CVD investigation by the ITA and the ITC. In March 1992, the ITA issued a preliminary finding of 14.48% ad valorem subsidies, with a final determination in May establishing a 6.51% ad valorem subsidies, leading to a 6.51% ad valorem duty. This was confirmed in July with a final ITC finding that the U.S. industry had been injured by Canadian lumber imports.

The Canadian federal government appealed both the ITA and the ITC final findings to binational review panels under the U.S.-Canada Free Trade Agreement (FTA), which was signed on January 2, 1988. In May 1993, the binational subsidy panel remanded the ITA finding for further analysis, and in September, the ITA revised its finding to 11.54% ad valorem subsidies. In December, the binational subsidy panel again remanded the ITA finding and ordered the ITA to find no subsidies. In January, the ITA complied with the order. Using a provision of the FTA, the USTR requested an Extraordinary Challenge Committee (ECC) to review the binational panel decisions, but the ECC was dismissed in August 1994 for failing to meet FTA standards. In August, the DOC revoked the CVD, and in October, the USTR announced that it would terminate the Section 301 action.

Two events in September 1994 induced Canada to negotiate restrictions on its lumber exports to the United States. First, the U.S. lumber industry filed a lawsuit challenging the constitutionality of the FTA review process. Second, the Uruguay Round Agreements Act (URAA; P.L. 103-465) explicitly approved the President's "statement of administrative action" (SAA) that had accompanied his proposed legislation; the SAA stated that, because

---

[1] U.S. trade law (19 U.S.C. §§1671-1671h) authorizes countervailing duties on imported goods, if the DOC determines that the imports are being subsidized (directly or indirectly) by a foreign country and if the ITC determines that the imports have materially injured a U.S. industry. The duty is set at the calculated level of the subsidies.

[2] Under §301 of the Trade Act of 1974 (19 U.S.C. §§2411-2420), the USTR can investigate and can respond, with a broad range of feasible actions, to foreign trade practices which are found to be illegal, unreasonable, or discriminatory, and are burdensome to U.S. interests.

of Canadian practices, lumber imports from Canada could be subject to a CVD. In February 1996, the two nations announced an agreement-in-principle — a fee on Canadian lumber exports to the United States in excess of a specified quota for five years — with the final U.S.-Canada Softwood Lumber Agreement (SLA) signed in May and retroactive to April 1, 1996. The SLA was effective through March 31, 2001.

Analysis: Subsidies and Injury

Annual Canadian lumber imports have risen from less than 3 billion board feet (BBF), about 7% of the U.S. market, in the early 1950s to more than 18 BBF, more than a third of the U.S. market, since the late 1990s. U.S. lumber producers argue that subsidies to Canadian producers give them an unfair advantage in supplying the U.S. market and that this has injured U.S. producers. These two issues — subsidies and injury — are the basis in U.S. trade law for determining if a CVD is warranted. In addition, *critical circumstances* — which allow for retroactive duties — are deemed to exist, if imports rise significantly after ending import restrictions. Finally, dumping — selling imports at less than the cost of their production — can lead to additional duties.

Subsidies: Canadian Stumpage Fees. The U.S. lumber industry has argued that the stumpage fees charged by the Canadian provinces are less than the market price of the timber would be and are therefore a subsidy to Canadian producers. About 90% of the timberlands in the 10 provinces are owned by the provinces. The provinces require management plans for forested areas and allocate the timber harvests through a variety of agreements or leases, often for 5 or more years with renewal options. Stumpage fees for the timber are determined administratively, often with adjustments to reflect changes in market prices for lumber. This contrasts with the U.S. situation, where 42% of the forests are publicly owned and where public timber is typically sold in competitive auctions; thus, much of the timber in the United States is sold by public and private landowners at market prices.[3] The use of administered fees in Canada opens the possibility that the Canadian system results in transfers to the private sector at less than their fair market value, as the U.S. lumber industry has charged. However, comparisons of U.S. and Canadian stumpage fees are often disputed, because of: differences in measurement systems and the imprecision of converting Canadian cubic meters of logs to U.S. board feet of lumber; differences in the diameter, height, quality, and species mix of U.S. and Canadian forests; differences in management responsibilities imposed on timber buyers (e.g., road construction, reforestation); differences in environmental conditions and policies; and other factors.

Subsidies: Export Restrictions. Export restrictions by British Columbia (BC) were identified as a subsidy to BC lumber producers by the ITA in its 1992 CVD investigation. BC generally prohibits the export of logs from Crown (provincial) lands, to assure domestic production, provide jobs, and encourage economic development. Export restrictions on public timber in the United States indicate substantially higher prices for export logs than for comparable logs sold domestically. Most economists would consider

[3] Some argue that U.S. federal agencies are not comparable to traditional, market-oriented private "willing sellers," because they do not make investments or sales based on profitability, as a private landowner presumably would. However, the U.S. federal government owns only 33% of U.S. timberlands, and thus probably has less impact on timber markets than do the Canadian provinces.

restrictions that reduce domestic prices below the world market price to be subsidies, and the General Agreement on Tariffs and Trade (GATT) generally prohibits export restrictions. In addition, current U.S. trade law allows the DOC to consider an export restraint on a product to be a subsidy if the private parties who would be exporting the product provide the restrained good to domestic purchasers for less than adequate remuneration. Nonetheless, Canada challenged the ITA treatment of export restrictions as a subsidy, arguing that this treatment is inconsistent with the World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures. This challenge is discussed more below.

Injury to the U.S. Lumber Industry. Proving injury or threat of injury to U.S. lumber producers is also essential to establishing a CVD. The share of the U.S. softwood lumber market provided by Canadian lumber has grown substantially over the past 50 years. In 1952, lumber imports from Canada were less than 3 BBF, and Canada's market share was less than 7%. In 1998 and 1999, Canadian lumber imports were more than 18 BBF, and Canada's market share has fluctuated between 33% and 35% since 1995. These facts are cited by U.S. producers as evidence that Canadian imports have come at the expense of normal domestic growth in industrial lumber production. U.S. homebuilders and other lumber users counter that Canadian lumber is essential to meeting domestic demand, and argue for unrestricted imports. Despite consistent ITC findings of injury, indisputable proof of injury to U.S. producers is difficult to establish.

Current Issues and Events

Several aspects of this situation are currently the focus of attention in the long-running dispute over the exports of softwood lumber from Canada to the United States. One is the 2001-2002 countervailing and antidumping investigations. Others are the several NAFTA and WTO challenges by the Canadians questioning the countervailing and antidumping investigative processes. Finally, the United States and Canada have announced a tentative agreement to resolve the situation for the next 7 years.

The 2001-2002 Countervailing and Antidumping Investigations

The 1996 U.S.-Canada Softwood Lumber Agreement expired on March 31, 2001. On April 2, the U.S. Coalition for Fair Lumber Imports filed antidumping and CVD petitions. On April 24, the DOC announced that it was initiating the antidumping and CVD investigations, because the petitioners had standing and had shown adequate industry support. On May 16, the ITC issued its preliminary determination that there was "a reasonable indication that a U.S. industry is threatened with material injury by reason of imports of softwood lumber from Canada that are allegedly subsidized and sold in the United States at less than fair value" (Investigations Nos. 701-TA-414 and 731-TA-928 (Preliminary)). On August 17, the DOC published its preliminary determination of Canadian subsidies of 19.31% ad valorem, and established a preliminary duty at that level. DOC also found that critical circumstances existed, allowing retroactive application of the duty. On November 6, DOC published its preliminary determination that Canadian firms were dumping lumber, with margins ranging from 5.94% to 19.24% (12.58% for most firms). The DOC also announced it would align, and postpone until March 25, 2002, final determinations in the CVD and antidumping cases.

Negotiations were undertaken to forestall final determinations of injury, subsidy, and dumping. The negotiations collapsed on March 21, 2002, and on March 22, the DOC issued final determinations, which, as later amended, found Canadian subsidies to be 18.79% ad valorem, and dumping margins to range from 2.18% to 12.44% for individually investigated companies and 8.43% for all other firms. On May 2, by a 4-0 vote of the commissioners, the ITC issued a final finding of injury. Duties averaging 27% went into effect May 22, 2002, when DOC published the final duty notice in the *Federal Register*, and the United States began collecting duty deposits at this rate.

The United States uses a "retrospective" system of duty assessment whereby final liability for AD and CV duties is determined after goods are imported; ordinarily, the amount of duties is determined in an administrative review of the AD or CVD order for a specific period of time (19 C.F.R. § 351.212(a)). Liquidation of softwood lumber entries, or the final computation or ascertainment of duties, has generally been suspended pending ongoing softwood lumber litigation. Estimated duties on softwood lumber are currently being collected at the rates determined in the most recent administrative review, discussed below.

In December 2004, the DOC announced the final results of the first administrative review, covering entries from May 22, 2002, through March 31, 2003, for the CVD review, and from May 22, 2002, through April 30, 2003, for the AD review. This action established a new official rate for imports entered during the covered period. As corrected in mid-February 2005, the countrywide ad valorem subsidy rate was lowered to 16.37%. The resulting dumping rate, as corrected in January 2005, was an average of 4.40% for individually investigated companies and a "review-specific average"of 3.78%. The latter applies to producers who participated in the administrative review but were not individually investigated.

Rates were further lowered in the final results of the Department's administrative review for the 2003-2004 period, announced in December 2005. The average dumping rate for individually investigated producers was reduced to 2.43%; the review-specific average to 2.11%; and the subsidy rate to 8.70%. In June 2005, the Department announced its third administrative review covering imports for 2004-2005; preliminary results are expected on May 31, 2006.

NAFTA Panel Reviews of Antidumping and Countervailing Duty Determinations

Canada and Canadian lumber producers sought binational panel reviews of DOC and ITC final determinations in both the antidumping and countervailing duty cases, an option available under Chapter 19 of the North American Free Trade Agreement (NAFTA) in lieu of judicial review in the country in which the determinations are issued. The panels were established to examine whether the DOC and ITC determinations are in accordance with U.S. antidumping and countervailing duty law.

As a result of these challenges, Canada has obtained a significantly reduced subsidy rate and a negative threat of injury determination from the ITC. While DOC originally lowered AD rates for individually investigated companies, it raised dumping rates in its most recent remand redetermination.

Canada seeks eventual removal of the antidumping and countervailing duty orders and return of more than $4 billion in duty deposits, thus avoiding the potential availability of duties for distribution to U.S. producers under the Continued Dumping and Subsidy Offset Act. (See "Softwood Lumber and the Continued Dumping and Subsidy Offset Act," below.) At the same time, the U.S. position has been that even were the orders to be rescinded, duties would not be refunded absent a negotiated settlement.

Canada has also requested binational panel review of further administrative actions in the U.S. antidumping and CVD proceedings. In September 2005, the U.S. lumber industry filed a constitutional challenge to the binational panel process in the U.S. Court of Appeals for the District of Columbia Circuit.

DOC Final Dumping Determination (USA-CDA-2002-1904-02). In a report issued in July 2003, the binational panel reviewing the DOC's final dumping determination unanimously affirmed in part and remanded in part. DOC was directed to publish revised dumping margins in light of the panel's remand instructions, which focus in part on DOC's product comparisons. In October 2003, DOC submitted its new determination to the panel, which resulted in lower antidumping duty rates for all but one individually investigated producer (Slocan), as well as a slightly reduced "all others" rate. The panel's decision on the remand, issued in March 2004, found the DOC determinations to be inconsistent with U.S. law and ordered new determinations for three Canadian exporters (Tembec, Slocan, and West Fraser). In its April 2004 redetermination, DOC lowered the dumping margin slightly for Tembec and Slocan, though still retaining for Slocan a rate that was higher than that in the original AD order. Slocan is now merged with another Canadian lumber producer, Canfor, and is no longer a separate corporate entity. DOC also found a de minimis (negligible) margin for West Fraser and recalculated the "all others" rate to 8.85%, which slightly exceeds the rate in the original AD order.

The panel remanded the dumping determination in June 2005, with instructions to DOC to revoke the antidumping duty order with respect to West Fraser. Instead of ordering DOC to direct U.S. Customs and Border Protection to liquidate West Fraser's entries without assessing antidumping duties and to return cash deposits with interest, as the firm had requested, the panel found that U.S. law requires that West Fraser request this relief directly from DOC or "from any court or panel that reviews a Commerce final determination respecting its entries." Additionally, the panel directed DOC to recalculate dumping margins without using "zeroing," a methodology under which DOC assigns a zero value to non-dumped sales. Citing the earlier WTO decision that DOC's use of zeroing in the final softwood dumping determination conflicted with the WTO Antidumping Agreement (see below), together with the U.S. Supreme Court's long-standing *Charming Betsy* canon of statutory interpretation, under which a statute "ought never to be construed to violate the law of nations if any other possible construction remains," the panel determined that DOC's use of zeroing was inconsistent with a U.S. international legal obligation and, in light of the *Charming Betsy* doctrine, unreasonable and not in accordance with law.

In its July 2005 remand redetermination, DOC took the approach that it had employed in responding to the adverse WTO decision: it used the transaction-to-transaction method of price comparison, a methodology that was not involved in the WTO case; applied zeroing in comparing prices under this method; and calculated dumping margins that exceed those in its original 2002 determination, specifically an average of 10.06% for individually investigated producers and a 10.52% "all others" rate. Moreover, citing the need to apply the same methodology to all producers, DOC calculated a rate of 3.21% for West Fraser, a margin that is no longer de minimis. DOC is also asking that the panel reconsider its WTO-related analysis as well as its seeming approval of using the legally discredited zeroing methodology with respect to West Fraser. The panel's decision on the remand has not yet been issued.

DOC Final Subsidy Determination (USA-CDA-2002-1904-03). In its August 2003 report on the DOC's final determination in the CVD case, the binational panel upheld the DOC treatment of provincial stumpage programs as subsidies and the DOC finding that the programs are "specific" to an industry (a necessary element of a domestic subsidy finding). At the same time, it found as contrary to U.S. law DOC's use of cross-border market comparisons to calculate the subsidy, the blanket refusal of DOC to exclude from the scope of the CVD order reprocessed Maritime-origin softwood lumber, and other aspects of DOC determination related to the exclusion of products.

DOC submitted its new determination in January 2004, lowering the duty rate from 18.79% to 13.23%. According to a DOC press release, the recalculated rate was based on a revised methodology using a benchmark "constructed on the basis of Canadian log prices and import value of logs, adjusting for harvesting costs." DOC also excluded certain Maritime-origin lumber and old lumber, including used railroad ties, from the scope of the CVD order. In a June 2004 decision, the binational panel granted DOC's request for a remand "to reconsider certain limited implementation issues" and additionally remanded to DOC with instructions to recalculate various provincial benchmark prices, to reconsider the adjustment for profit with respect to the benchmarks for all Canadian provinces, and to make two other recalculations.

In July 2004, DOC issued its second remand redetermination, lowering the CVD rate to 7.82% ad valorem and determining that five companies and a mill of a sixth company were eligible for exclusion from the order. After a third remand, DOC issued a new determination in January 2005, with a subsidy rate of 1.88% ad valorem. The panel remanded the DOC decision for the fourth time in May 2005. In response, DOC issued a new determination in July 2005, in which it further lowered the subsidy margin to 1.21%. After a fifth remand, DOC, which continued to take issue with the panel's benefit rationale, issued a determination on November 22, 2005, lowering the rate to 0.80%, a de minimis rate that does not permit the imposition of duties. The panel upheld the DOC determination on March 17, 2006; the panel did not consider Canadian parties' request to order DOC to revoke the CVD order, as the issue was not before the panel. On April 27,2006, the United States requested an Extraordinary Challenge Committee (ECC) to review the panel decision, but immediately suspended its request in light of the April 26 U.S.-Canada lumber agreement.

ITC Final Injury Determination (USA-CDA-2002-1904-07). The binational panel examining the ITC's final injury determination issued its report in September 2003, remanding in part and affirming in part. The panel directed the ITC to reconsider its threat of injury determination, its like product determination relating to bed frame components and flangestock, and its decision to cross-cumulate dumped and subsidized imports in its threat of injury determination. The panel upheld the ITC on a number of points, including its like product determination regarding Western Red Cedar and Eastern White Pine and its finding that it did not have statutory authority to treat the Maritime Provinces as a "country" entitled to a separate injury determination. The panel also affirmed that the ITC was not required as a matter of law to determine that the threat of material injury was caused through the effects of subsidies or dumping, and that the ITC adequately considered the nature of the subsidy and its likely trade effects so as to have met its statutory burden regarding the evaluation of relevant economic factors in assessing threat.

The ITC in December 2003 issued a new determination in which it reaffirmed its earlier affirmative injury rulings. In an April 2004 decision, the panel (with one concurrence) remanded this determination, having found that the ITC's finding of threat of injury to the domestic industry was not in accordance with law and not supported by substantial evidence. In particular, the panel faulted ITC findings involving Canadian producer capacity, volume and price of imports, and domestic overproduction, with a deadline of May 10, 2004. ITC asked for an extension to July 22, 2004, in part because of a cited delay in receiving the decision and further to "reevaluate all of the record evidence and collect further information as necessary in order to make a remand redetermination consistent with the Panel's findings." The panel, finding no basis that would preclude it from restricting the ITC's second redetermination "to the existing administrative record where no reason has been given to justify reopening the record," gave the ITC until May 27, 2004, to file its remand redetermination "based solely on the existing administrative record and the conclusions of the Panel's review."

In its second remand redetermination, filed June 10, 2004, the ITC found once again that the U.S. industry was threatened with material injury and, in addition, requested the panel to reconsider its April 2004 decision on the ground that the panel "manifestly and repeatedly overstepped its authority as established by the North American Free Trade Agreement ... by failing to apply the correct standard of review and by substituting its own judgment for that of the Commission." Instead of remanding for a third time, the panel on August 31, 2004, directed the ITC to issue a "no threat of injury" determination in 10 days. With the Commission chairman dissenting, the ITC did so under protest on September 10, 2004. The panel affirmed the new determination October 12, 2004. A NAFTA Extraordinary Challenge Committee requested by the United States unanimously affirmed underlying panel decisions August 10, 2005.

While Canada maintains that the ECC decision requires the United States to remove the antidumping and CVD orders in question, the United States claims that the affirmative threat determination issued by the ITC on November 25, 2004, in response to the adverse WTO decision on the same issue (see below) supersedes the earlier NAFTA-related determination and legally supports the continued imposition of duties. Canada has challenged implementation of the November 2004 ITC determination in the U.S. Court of International Trade.

NAFTA Panels Requested by Canada and Canadian Producers in 2005 and 2006. Three binational panels requested in 2005 by Canada, Canadian producers, or both, involve the review of further U.S. administrative actions in the softwood AD and CVD investigations. At issue are the final results of DOC's first administrative review of the CVD order; implementation of the affirmative ITC determination on threat of injury issued in response to the WTO ruling (see DS277, below); and the DOC dumping determination issued in connection with a separate WTO proceeding (see DS264, below). The binational panel on the injury determination was stayed as of March 22, 2005, pending the outcome of

the NAFTA ECC proceeding, described above; the proceeding has not been reactivated to date. A panel decision on the WTO-related dumping determination is due April 11, 2006.
.

In addition, Canada filed panel requests in January 2006 regarding the final results of DOC's second administrative review of both the antidumping order and the CVD order. Decisions in each case are due November 22, 2006.

WTO Challenges to the Antidumping and Countervailing Duty Determinations

Canada has initiated six WTO cases involving U.S. actions in the softwood antidumping and CVD proceedings. This discussion focuses on the three major challenges, which have produced mixed outcomes for the parties.

Final DOC Softwood Subsidy Determination (DS257). In May 2002, Canada challenged the final subsidy DOC determination in the countervailing duty investigation involving Canadian lumber imports as violative of the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement) and the GATT. Under the SCM Agreement, a subsidy is deemed to exist where there is a financial contribution by a government and a benefit is conferred thereby; where a domestic subsidy is being granted, countervailing duties may be placed on subsidized imports only if (among other requirements) the subsidy is found to be specific to an industry. In an August 29, 2003, report, the WTO panel upheld the U.S. determination that provincial stumpage programs constitute a financial contribution to the industry in the form of the provision of goods and that the stumpage programs were specific. At the same time, the panel faulted two aspects of U.S. findings as to the existence and amount of the benefit conferred. First, the panel concluded the United States, which had viewed the commercial market for timber in Canada to be in large part distorted by government intervention, violated the SCM Agreements in using timber prices in U.S. border areas as the benchmark for determining the benefit from the financial contribution involved. Second, the panel found that the United States had failed to examine whether a subsidy had passed through an unrelated upstream supplier to a downstream user of lumber inputs. The United States appealed.

In a January 19, 2004, decision, the WTO Appellate Body (AB) upheld the panel's ruling that the stumpage program could be considered the provision of goods, but it reversed the panel on its finding that cross-border comparisons were prohibited by the SCM Agreement and on its consequential finding that the U.S. determination of the existence and amount of the benefit violated WTO rules. Because of insufficient information, however, the AB could not complete the analysis as to whether the alternative benchmark that the United States did use was WTO-consistent and consequently whether the U.S. benefit finding and ultimately its imposition of countervailing duties based on that determination comported with WTO obligations. Regarding downstream users, the AB upheld the panel's finding that DOC had violated WTO obligations when it failed to conduct a pass-through analysis regarding arm's-length sales of *logs* by tenured harvesters/sawmills to unrelated sawmills, but it reversed the panel on its finding that DOC acted inconsistently with WTO obligations when it failed to conduct a pass-through analysis regarding arm's-length sales of *lumber* by such sellers to unrelated remanufacturers.

In response to the WTO decisions, DOC issued a new determination, effective December 10, 2004, lowering the subsidy rate from 18.79% to 18.62% ad valorem. In January 2005, Canada asked that a compliance panel be established to review the determination and requested authorization to impose sanctions against the United States covering trade in the amount of approximately $200 million (Can.). The United States objected to the retaliation request, sending it to arbitration. Under an agreement between the parties, the arbitration is currently suspended until the rulings in the compliance procedure are adopted. If the rulings are adverse to the United States, either party may request that the arbitration be resumed.

In a report circulated August 1, 2005, the compliance panel found that DOC had not carried out the necessary pass-through analysis regarding non-arm's-length sales of logs by tenured timber harvesters to unrelated lumber producers, and it found that DOC, in both its compliance determination and its first administrative review, had made its calculations using transactions for which it had not demonstrated that the benefits of subsidized log inputs had passed through to the processed product. The United States appealed the decision in September 2005, arguing that DOC's first administrative review was outside the scope of the panel's jurisdiction. In a report issued December 5, 2005, the AB upheld the conclusion of the panel that examination of the first administrative review fell within its mandate to the extent the pass-through analysis was involved. The United States had not requested that the AB review the panel's substantive findings regarding the use of this analysis in the administrative review, and the AB went on to find that the panel had acted within the scope of its authority in making its legal conclusions regarding U.S. actions in the review. The panel and AB reports were adopted by the WTO on December 20, 2005.

Final DOC Softwood Dumping Determination (DS264). On September 13, 2002, Canada requested consultations with the United States regarding DOC's final affirmative softwood dumping determination. Canada claimed various violations of the WTO Antidumping Agreement and the GATT, arguing that DOC had improperly initiated the case; improperly applied a number of methodologies, resulting in artificial or inflated dumping margins; not established a correct product scope for its investigation; and failed to adhere to various WTO requirements involving procedural matters in the investigation.

The panel report, issued April 13, 2004, generally rejected Canada's claims, though (with one dissent) it faulted the United States on its use of "zeroing." The practice, used in calculating dumping margins, involves assigning a "zero" value to transactions in which the export price or constructed export price exceeds normal value (i.e., where there is no dumping), and as a result not using the higher prices in these transactions to offset the lower prices in other sales. The United States appealed on this issue, and in August 2004, the Appellate Body upheld the panel's conclusions. In addition, on an issue appealed by Canada, the appellate decision reversed the panel's finding that the United States had not infringed various Antidumping Agreement provisions in calculating financial expenses for softwood lumber for one company under investigation (Abitibi). Since the reversal focused only on the panel's interpretation of the legal standard that the panel used to evaluate the DOC's approach, the Appellate Body did not make any findings as to whether the United States acted consistently or inconsistently with the WTO obligations involved. The rulings were adopted August 31, 2004, and the parties agreed on a compliance deadline of May 2, 2005.

On January 31, 2005, the Department of Commerce issued a preliminary determination in which it continued to find dumping and moreover increased dumping margins. DOC compared prices on a transaction-to-transaction basis, rather than the weighted-average-to-weighted-average basis which it used in its original determination. DOC maintained that the WTO ruling applied only to the use of "zeroing" in the methodology involved in the case and did not apply to other modes of price comparison that Commerce has discretion to use in dumping investigations. Commerce used transaction-to-transaction comparisons in its final determination, which again resulted in higher margins, ranging from 3.93% to 16.35% for individually investigated producers and an "all others" rate of 11.54%, approximately three percentage points higher than the original rate (70 *Fed. Reg.* 22636). At Canada's request, the new determination was referred to a WTO compliance panel on June 1, 2005. Canada is also seeking to suspend approximately $400 million (Can.) in concessions owed the United States, but on the U.S. objection, the request has been sent to arbitration. Under an agreement between the United States and Canada, the arbitration has been suspended pending completion of the compliance proceedings. In a decision circulated April 3, 2006, the compliance panel found that the use of zeroing in transaction-to-transaction comparisons was consistent with U.S. obligations under the Antidumping Agreement and that the United States had thus implemented the WTO ruling in the case. While Canada has 60 days to appeal under WTO rules, it has agreed to terminate pending ligation under the U.S.-Canada lumber agreement announced April 26, 2006.

ITC Injury Investigation in Softwood Antidumping and Countervailing Duty Cases (DS277). Canada challenged the ITC final affirmative threat of injury determinations, alleging, among other things, that the ITC based its threat of injury determination "on allegation, conjecture and remote possibility" and that it failed to consider properly a number of relevant factors in its determinations. A final panel report, publicly circulated March 22, 2004, faulted the ITC's threat determination and its causal analysis. While the United States took issue with the panel's negative findings, it chose not to appeal and the report was adopted April 26, 2004.

In making its new determination, the ITC reopened the administrative record and took into account additional evidence and, on November 25, 2004, found (with one dissent) that U.S. industry was threatened with material injury by reason of dumped and subsidized Canadian imports. In February 2005, Canada requested the establishment of a compliance panel as well as authorization to impose approximately $4.25 billion (Can.) in sanctions, an amount it stated represents the total amount of CVD and antidumping duty cash deposits collected and not refunded as a result of the United States' failure to revoke the May 22, 2002, CVD and antidumping orders, which Canada views as proper implementation of the WTO rulings in the case. As is it did in the other softwood disputes, the United States objected to the retaliation request, sending it to arbitration. Under an agreement between the parties, the arbitration has been suspended until the rulings in the compliance procedure are adopted, with either party able to request that arbitration be resumed if the rulings are ultimately adverse to the United States.

In a report issued November 15, 2005, the compliance panel found that the ITC determination was consistent with U.S. obligations under the Antidumping and SCM Agreements. In describing its standard of review, the panel noted, inter alia, that unless evidence and arguments "that detract from" the agency's conclusions "demonstrate that an unbiased and objective investigating authority *could not* reach a particular conclusion, we are obliged to sustain the investigating authorities' judgment, even if we would not have reached that conclusion ourselves" [emphasis in original]. Canada appealed the decision. On April 13, 2006, the WTO Appellate Body reversed the compliance panel, ruling that it had applied an improper standard of review and had not examined the ITC determination with an adequate level of scrutiny. The Appellate Body did not itself examine the ITC determination to determine whether it was WTO-consistent and thus did not recommend that the United States take any action regarding the determination.

Softwood Lumber Imports and the Continued Dumping and Subsidy Offset Act

Canada has been concerned that in cases where Canadian firms are subsequently excluded from an AD or CVD order, and were the orders to be eventually revoked, duty deposits would not be returned and would be available for distribution to U.S. lumber firms under the Continued Dumping and Subsidy Offset Act of 2000 (CDSOA), also known as the "Byrd Amendment." The statute, codified at 19 U.S.C. §1765c, mandates the annual disbursement of antidumping and countervailing duties to petitioners and interested parties in the underlying trade remedy proceedings for a variety of qualifying expenditures. As reported in December 2003 press accounts, a proposal to settle the softwood lumber dispute negotiated by U.S. and Canadian officials included an approximate 50/50 split of the CDSOA softwood duties; the proposed settlement was opposed by many Canadian producers and provinces and was not acted upon. While Congress recently repealed the CDSOA, it also required the continued distribution of duties collected on entries of goods made and filed before October 1, 2007 (Deficit Reduction Act of 2005, P.L. 109-171, § 7601). At the same time, a federal court ruled in April 2006 that the CDSOA does not apply with respect to goods from Canada.

According to Customs, approximately $8.7 million in softwood lumber duties has been distributed to U.S. firms under the CDSOA. Customs has also reported that as of October 1, 2005, more than $4 billion in softwood duty deposits was contained in so-called "Clearing Accounts," an amount that increases as additional Canadian softwood lumber enters the United States. Each Clearing Account contains estimated duties received pursuant to a specific AD or CVD order; once an entry is liquidated (i.e., the duties on the entry are finally assessed), the duties are placed into a Special Account for the order and are available for disbursement to U.S. firms.

The CDSOA was successfully challenged in a WTO dispute proceeding brought by Canada and 10 other WTO Members. Canada was one of eight complainants who requested and received authorization to retaliate against the United States for its failure to repeal or modify the law by December 27, 2003 (i.e., the end of the compliance period in the case). An arbitral panel ruled that each could retaliate in an amount equal to 72% of the annual CDSOA disbursements relating to duties paid on imports from that country. Having identified a current annual retaliation level of $14 million, Canada began to impose a 15% surcharge on imports of U.S. live swine, cigarettes, oysters, and certain specialty fish as of May 1, 2005. Although the United States now considers that the repeal of the CDSOA has brought it into compliance with its WTO obligations, Canada and other complainants imposing retaliatory tariffs have expressed concerns about the continued payments authorized under the legislation and are continuing to impose added duties on U.S. goods.

In April 2005, Canada and Canadian industry groups challenged CDSOA distributions based on Canadian imports in a suit in the U.S. Court of International Trade, arguing that because of a provision in the NAFTA Implementation Act stating that any amendment to U.S. antidumping and countervailing laws enacted after the NAFTA enters into force "shall apply to goods from an NAFTA country only to the extent specified in the amendment" (19 U.S.C. § 3438), the CDSOA, in not expressly referring to Canada, does not apply to imports of Canadian goods. On April 7, 2006, the court held that Canadian producers, but not Canada, had standing to sue and that due to the cited statutory requirement, Customs does not have authority under the CDSOA to distribute antidumping or countervailing duties collected on Canadian or Mexican imports (*Canadian Lumber Trade Alliance* v. *United States*, slip op. 06-48). The court has given the parties until May 22, 2006, to file briefs regarding the remedy that should be issued by the court. Canada is seeking not only an injunction on future distributions, but also the return of past payments to U.S. producers.

Other Developments

Three Canadian lumber companies — Canfor Corporation, Tembec Inc., and Terminal Forest Products Ltd. — have filed arbitral claims against the United States under the investment chapter of the NAFTA, arguing that the United States has breached various NAFTA investment obligations by virtue of final agency determinations in the softwood lumber investigations. The cases have been consolidated and are currently pending.

The Tentative April 26, 2006, Agreement

On April 26, 2006, The United States and Canada announced a tentative agreement to terminate the antidumping and countervailing duties and related litigation under NAFTA and before the WTO. Under the agreement, the United States would revoke the CVD and AD orders on Canadian lumber. In exchange, the Canadians would impose export charges when weighted average framing lumber prices fall below $360 per thousand board feet (MBF). The weighted average price for April 2006 was $367 per MBF, and the monthly average price has not been below $360 since January 2004. The export charges can be significantly reduced if the Canadian region also agrees to volume restraints, which become increasingly restrictive as the average price falls.

There are several additional provisions relating to export charges and volumes. There is a 3rd country trigger, allowing export charge refunds if, for consecutive quarters, the 3rd country share of U.S. lumber consumption grows, the U.S. share increases, and the Canadian share decreases. A surge mechanism generally provides for substantially greater export charges if a Canadian region's exports exceed 110% of its allocated share of total Canadian exports. For high-value products — those valued at more than C$500 per MBF — the export charges are calculated at C$500 per MBF.

The agreement is for 7 years, and may be renewed for 2 additional years. Canada and the United States would make "best efforts" to define "policy exits" from the export charges for each province within 18 months of the final agreement. Also, the export measures would not apply to lumber products from timber harvested in the Atlantic Provinces, in the Yukon, Northwest Territories, or Nunavut, or for the companies excluded from the CVD order. The agreement requires that all litigation, by governments or by private firms, be terminated, with no new cases, no new investigations, and no new petitions, and with no actions to circumvent the commitments in the agreement.

Finally, on the issue of the roughly $5 billion deposited under the CVD and AD orders, the funds would be allocated. The greater of $4 billion or 80% of the deposits, plus interest, would be returned to the importers of record. The remainder would be split evenly between the members of the U.S. Coalition for Fair Lumber Imports and jointly agreed initiatives, such as activities to improve North American lumber markets and housing reconstruction in areas affected by Hurricane Katrina.

For Additional Reading

Benjamin Cashore, *Flights of the Phoenix: Explaining the Durability of the Canada-US Softwood Lumber Dispute* (Orono, ME: Canada-American Center, December 1997).

Brink Lindsay, Mark A. Groombridge, and Prakash Lougani, *Nailing the Homeowner: The Economic Impact of Trade Protection of the Softwood Lumber Industry* (Washington, DC: Cato Institute, 2000).

John A. Ragosta, Harry L. Clark, Carloandrea Meacci, and Gregory I. Hume, *Canadian Governments Should End Lumber Subsidies and Adopt Competitive Timber Systems: Comments Submitted to the Office of the United States Trade Representative on Behalf of the Coalition for Fair Lumber Imports* (Washington, DC: Dewey Ballantine LLP, April 14, 2000).

FLC Les Reed, *Two Centuries of Softwood Lumber War Between Canada and the United States: A Chronicle of Trade Barriers Viewed in the Context of Saw Timber Depletion* (Montreal, Canada: Free Trade Lumber Council, May 2001).

World Resources Institute, *Canada's Forest at a Crossroads: An Assessment in the Year 2000,* a Global Forest Watch Canada Report (Washington, DC: 2000).

CRS Report

CRS Report RL30826, *Softwood Lumber Imports From Canada: History and Analysis of the Dispute*, by Ross W. Gorte.

crsphpgw