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## HOCKIN WELCOMES FTA INJURY PANEL DECISION ON SOFTWOOD LUMBER

The Honourable Tom Hockin, Minister for International Trade, said he was very pleased with today's decision in Canada's favour by a Canada-U.S. Free Trade Agreement (FTA) binational panel reviewing the U.S. final injury determination in the softwood lumber dispute.

The FTA panel did not uphold the U.S. International Trade Commission's (ITC) final injury determination. The panel concluded that "the Commission's determination of material injury by reason of subsidized Canadian imports is not supported by substantial evidence on the record." The ITC has until October 25, 1993 to respond to the panel.

"This is a very positive ruling for the Canadian softwood lumber industry," Mr. Hockin stated. "The binational panel has concluded that there simply was insufficient evidence available to the ITC to conclude that imports of lumber from Canada injured the U.S. domestic industry, an argument Canadian industry has made for some time."

The U.S. government self-initiated the countervailing duty investigation in October 1991. The U.S. Department of Commerce (DOC) made a final subsidy determination in May 1992, finding that provincial stumpage programs and British Columbia's log export restrictions provided a countervailable subsidy of 6.51 percent.

The subsidy determination was also appealed to binding binational panel review under the FTA. On May 6, 1993, an FTA panel reviewing the Department of Commerce subsidy determination unanimously instructed the DOC to re-examine its determinations on the key issues in the case, reflecting in large part the arguments made by the Canadian government, provincial governments and industry.

"We are fortunate to have the FTA dispute settlement mechanism to review the basis of these decisions in an objective and impartial manner," Mr. Hockin said. "We are confident that the U.S. duty will be overturned, resulting in a very real and tangible benefit to the Canadian softwood lumber industry."

The U.S. market is critical to the economic well-being of the Canadian industry. Canadian lumber exports to the United States exceeded \$4 billion in 1992, accounting for roughly 54 percent of Canada's total lumber production.

"The Canadian industry took the lead in mounting Canada's defence in the injury proceedings. I congratulate the industry on today's results."

- 30 -

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## Backgrounder

### SOFTWOOD LUMBER

#### HISTORICAL BACKGROUND

For the past 40 years, the United States has consumed more softwood lumber than it has produced. Canada has been an important and dependable supplier of quality lumber products. As a result of the need to import softwood lumber, Canada has had a relatively constant share of the U.S. market over the last 10 years.

Softwood lumber has been the subject of a difficult trade dispute for Canada and the United States for over a decade.

In 1982-83, the United States conducted its first countervailing duty (CVD) investigation of softwood lumber from Canada and concluded that Canadian programs did not confer a countervailable subsidy to lumber producers.

In May 1986, the United States initiated its second CVD investigation of softwood lumber from Canada. The U.S. Department of Commerce (DOC) reversed itself in October 1986, making a preliminary determination that Canadian programs did confer a countervailable subsidy of 15 percent on lumber producers. To resolve this contentious trade dispute, Canada and the United States entered into the Softwood Lumber Memorandum of Understanding (MOU). Under the MOU, Canada agreed to collect an export charge of 15 percent on the value of softwood lumber exported to the United States. In return, the U.S. industry agreed to withdraw its CVD petition and the United States terminated the investigation.

The MOU provided for elimination or reduction of the export charge as a result of changes in provincial forest-management regimes, particularly stumpage programs, and other forest-management charges. As a result of subsequent amendments to the MOU:

- Atlantic Canada was exempted from payment of the export charge;
- the export charge was reduced to 0 percent for exports of British Columbia lumber; and
- the export charge had gradually been reduced for exports of Quebec lumber, to a rate of 3.1 percent by late 1991.

In addition, Alberta and Ontario made various changes in their forest-management regimes that would have almost certainly reduced the rate of export charge for these provinces. The MOU

had not yet been amended to reflect these changes before it was terminated.

In February 1991, a high-ranking official in the DOC testified before Congress that the MOU was "sufficient to offset" all alleged subsidies on Canada's softwood lumber exports to the United States, as calculated in the 1986 preliminary decision.

On September 3, 1991, the Government of Canada informed the Government of the United States of its intention to terminate the 1986 Softwood Lumber MOU effective October 4, 1991. The MOU specifically provided for its termination on 30 days' notice. Before taking this action, Canada used the U.S. government's own Timber Sales Program Information Reporting System (TSPIRS) accounting system to compare government forestry costs and revenues in the four major timber-producing provinces. The analysis showed that each province obtained revenues far in excess of its allocated forestry costs. The Canadian government had concluded that circumstances had materially changed from 1986, that there was no subsidy of softwood lumber production in Canada, and that the MOU no longer served any purpose.

The United States government responded to Canada's termination of the MOU by self-initiating a CVD investigation on October 31, 1991, the third CVD investigation of softwood lumber in 10 years. The United States also imposed an interim bonding requirement on imports of lumber from Canada under Section 301 of the U.S Trade Act of 1930. New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland, were specifically excluded from the interim bonding requirement and CVD investigation.

Under U.S. trade remedy law, four decisions must be taken by two separate government agencies before a final countervailing duty can be imposed: a preliminary determination of injury (i.e. that subsidized imports have caused material injury to the U.S. industry) by the United States International Trade Commission (ITC); a preliminary determination of subsidy by the DOC; a final determination of subsidy by the DOC; and a final determination of injury by the ITC.

The Section 301 interim bonding requirement was ended on March 12, 1992, when the United States made a preliminary determination of subsidy in the CVD investigation. On July 13, 1992, the United States completed its investigation and imposed a countervailing duty of 6.51 percent on imports of softwood lumber from Canada. The Government of Canada, the provinces and the Canadian industry appealed the duty action to binding binational panel review under Chapter 19 of the Canada-U.S. Free Trade Agreement (FTA). As well, Canada challenged the U.S. Section 301 action and the initiation of the CVD investigation before the General Agreement on Tariffs and Trade (GATT).

## THE CANADIAN LUMBER INDUSTRY

The forest industry is one of Canada's most important industries. It employed almost 300 000 people in 1991 and contributed \$19 billion to Canada's gross domestic product. As an earner of export dollars, the forest industry is Canada's most important industrial sector. About 350 communities across Canada are dependent on the forest sector as their primary source of employment.

The softwood lumber industry is a significant component of the Canadian forest industry. The softwood lumber industry accounted for 21 percent of employment in the forestry sector in 1990. Canada is one of the largest producers of softwood lumber in the world. In 1990, Canada accounted for 14 percent of total world softwood lumber production, following only the United States (at 24 percent) and the former U.S.S.R. (at 22 percent). Within Canada, British Columbia is the principal producer of softwood lumber, accounting for 61 percent (by volume) of production in 1991. The next largest producer was Quebec, accounting for 17 percent of production by volume.

In 1990, Canada exported more softwood lumber than any other country, accounting for 37 percent (by value) of total world exports. The principal destination for these exports is the United States. In 1992, Canada exported over 13 billion board feet of softwood lumber to this market, worth approximately \$4.2 billion. Canada's share of the U.S. market varies from year to year. Market share peaked at 33 percent in 1985 and then dropped to a low of 27 percent in 1990. During the period 1990 to 1992, Canadian market share increased to 29 percent.

## NORTH AMERICAN LUMBER PRICES AND DEMAND

During 1992, the financial situation for most Canadian forestry companies improved over 1991. However, the industry continues to incur losses. Losses in 1992 were approximately \$1.4 billion, or just over one half the losses recorded in 1991. The improvements in 1992 are attributed to a sharp jump in lumber prices during that latter part of 1992 and a decline in the value of the Canadian dollar. Western spruce-pine-fir two-by-four prices peaked at a record US\$475 per thousand board feet (MBF) in mid-March 1993, double the 1992 average price of US\$231 and 80 percent greater than the previous peak of US\$262 per MBF in 1979.

The sharp increase in lumber prices reflected the anticipated timber supply reductions in the U.S. Pacific Northwest, along with a forecasted increase in housing starts in the United States. However, the level of housing starts in the United States has not reached the anticipated levels. As a result, demand for lumber is below earlier expectations. While the

anticipated timber shortage in the Pacific Northwest has become a reality, mills in the southern U.S. and eastern Canada have been able to boost production to make up for losses in production elsewhere. Since mid-March 1993 lumber prices have dropped significantly. The average Western spruce-pine-fir price for two-by-fours had dropped to US\$232 by the end of June 1993.

Canadian companies took advantage of the increased demand for lumber in the latter half of 1992 and the first quarter of 1993. Overall, lumber exports to the United States in 1992 increased by 14 percent over 1991. The market for the remainder of 1993 is uncertain. The U.S. Administration's plan to resolve the Pacific Northwest timber supply problems has been announced. There will be significant reductions in timber sales from this region. The U.S. Forest Service announced on July 16, 1993 that annual federal timber sales in the region must be limited to between 200 million and 1.7 billion board feet over the next two decades to protect threatened species. In addition, the allowable cut on some major British Columbia timber management areas was reduced during 1992, with further reductions expected by the mid-1990s. The anticipated increase in housing construction has not yet materialized.

#### THE COUNTERVAILING DUTY INVESTIGATION

During the countervailing duty investigation, the U.S. Department of Commerce (DOC) investigated provincial stumpage programs and Canadian log export control measures.

An affirmative preliminary determination of injury was made on December 12, 1991, by the United States International Trade Commission (ITC).

On March 5, 1992, the DOC announced its affirmative preliminary determination that stumpage programs and log export restrictions in British Columbia conferred subsidies to softwood lumber exported to the United States at a national rate of 14.48 percent *ad valorem* (stumpage at 6.25 percent + log exports controls at 8.23 percent). Effective March 12, 1992, importers of softwood lumber from Canada were required to make cash deposits or post bonds of 14.48 percent on the value of the imported merchandise.

In its final affirmative determination on May 15, 1992, the DOC confirmed its March 5, 1992 decision that Canada's provincial stumpage mechanisms, and log export restrictions in British Columbia provided countervailable subsidies to softwood lumber imported from Canada. The overall country-wide subsidy rate was reduced to 6.51 percent *ad valorem* (stumpage at 2.91 percent + log export controls at 3.60 percent). The DOC also excluded 15 companies from the investigation.

On May 28, 1992, the Government of Canada, the provincial governments, and the Canadian industry appealed the final determination of subsidy to a binding binational review panel under Chapter 19 of the FTA. The panel reported its findings on May 6, 1993, unanimously instructing DOC to re-examine its determinations on the key issues in the case, reflecting in large part the arguments made by the Canadian government, provincial governments and industry.

On June 25, 1992 the United States ITC in a four-to-two vote, determined that subsidized imports of Canadian lumber materially injured U.S. lumber producers. This was the last of four decisions in the United States CVD investigation. On July 24, 1992, the Government of Canada, the affected provinces, and the Canadian industry appealed the final determination of injury to a binding binational review panel under Chapter 19 of the FTA.

#### ISSUES BEFORE THE FTA INJURY PANEL

The FTA Chapter 19 panel is reviewing whether U.S. trade law was correctly applied by the United States International Trade Commission in its final injury determination in the countervailing duty investigation of certain softwood lumber products from Canada. The issues before the injury panel include:

- whether the Commission fully took into account substantial record evidence presented by the Canadian parties and U.S. industry;
- whether the Commission's conclusions that imports of softwood lumber from Canada suppressed U.S. prices is supported by substantial record evidence;
- whether the Commission evaluated properly all relevant economic factors within the context of the business cycle;
- whether the Commission's conclusions with respect to the conditions of competition unique to the softwood lumber industry is supported by substantial record evidence; and
- whether the Commission's failure to consider other relevant economic factors when evaluating the effect of Canadian lumber imports on the domestic industry, including the nature and effect of the subsidies found by the DOC, is supported by substantial record evidence.

**THE GATT SUBSIDIES CODE PANEL**

A GATT Subsidies Code panel was established in December 1991 at Canada's request to determine whether the U.S. actions were consistent with U.S. international trade obligations. The panel found that the United States had violated its obligations when it imposed the Section 301 interim bonding requirements, but that the United States possessed sufficient evidence to initiate the CVD investigation. The panel report is under discussion in the GATT Subsidies Code Committee, of which both Canada and the United States are members.

July 1993



## Chronology

### SOFTWOOD LUMBER

- 1982-83** The United States conducts the first countervailing duty investigation of softwood lumber from Canada. The Department of Commerce (DOC) concludes that Canadian programs do not confer subsidies to Canadian lumber producers.
- 1986** The United States conducts the second countervailing duty investigation of softwood lumber from Canada. The DOC reverses itself and concludes that provincial stumpage programs confer subsidies of 15% to Canadian lumber producers.
- December 30** Canada and the United States resolve the bitter and highly political trade dispute by entering into the Softwood Lumber Memorandum of Understanding (MOU). Canada agrees to impose an export charge of 15% on softwood lumber exports to the United States in return for the U.S. industry withdrawing its countervailing duty petition and the U.S. Government terminating the investigation.
- 1987-1991** The MOU is amended on several occasions to exempt the Atlantic Provinces from the Canadian export charge and to reduce the export charge for British Columbia and Quebec as a result of replacement measures implemented by the provinces.
- 1991**
- September 3** The Government of Canada serves a Diplomatic Note on the Government of the United States, advising of Canada's intent to terminate the 1986 Softwood Lumber Memorandum of Understanding, effective October 4, 1991.
- October 4** Canada terminates the Softwood Lumber Memorandum of Understanding.
- The United States announces its intention to self-initiate the third countervailing duty investigation and to impose interim bonding requirement on imports of softwood lumber from Canada.
- October 31** The DOC self-initiates the third countervailing duty investigation.

December 16 The U.S. International Trade Commission (ITC) makes affirmative Preliminary Determination of Injury.

At Canada's request, the GATT Subsidies Code Committee establishes a panel to examine whether the U.S. imposition of interim bonding measures and the self-initiation of the countervailing duty investigation violated U.S. international trade obligations.

1992

March 5 The DOC makes the Preliminary Determination of Subsidy - 14.48%

May 28 The DOC publishes the Final Determination of Subsidy - 6.51%.

The Government of Canada, provincial governments and Canadian industry appeal the Final Subsidy Determination to binding binational panel review under Chapter 19 of the Canada-United States Free Trade Agreement.

June 25 The ITC makes a Final Determination of Injury - affirmative material injury.

July 13 The DOC publishes permanent countervailing duty order, imposing duty of 6.51%.

July 24 The Government of Canada, provincial governments and Canadian industry appeal the Final Injury Determination to binding binational panel review under FTA Chapter 19.

1993

February 19 The GATT Subsidies Code panel distributes final report to members of the Subsidies Code Committee. The panel concludes that the United States violated its international trade obligations when it used Section 301 of the Trade Act to impose an interim bonding requirement, but that it possessed sufficient evidence to initiate the countervailing duty investigation.

May 6 The FTA Chapter 19 Subsidy Panel reports its findings, instructing the DOC to re-examine its determination on the key issues in the case.

July 26 The FTA Chapter 19 Injury Panel reports its

## Questions and Answers

### SOFTWOOD LUMBER FTA INJURY PANEL

#### QUESTION

What happens now? Will Canadian exporters still be subject to duties?

#### ANSWER

The International Trade Commission (ITC) will have to respond to the panel by reviewing the injury determination in light of this panel's findings. The ITC has 90 days in which to provide a redetermination.

Until the remand process in both the subsidy and injury panels is over, Canadian exporters will continue to be subject to the duty. However, such duties will be refunded with interest if the countervailing duty is reduced or eliminated.

#### QUESTION

Is this the end of this dispute?

#### ANSWER

There could be further remands of either the subsidy or injury determinations.

#### QUESTION

How many remands can there be?

#### ANSWER

Panels are required to reach a final decision as expeditiously as possible. In all but three previous panel cases, a final panel decision was issued after the first remand. In the raspberry dumping case, the pork subsidy case and most recently, in the swine administrative review case, there were two remands, following which the panel rendered its final decision.

QUESTION

How can you be certain that the U.S. will honour this decision?

ANSWER

The United States has a legal obligation under the FTA to implement the decision. As well, the United States Trade Representative has assured Canadian authorities that the U.S. will live up to its FTA commitments and implement the panel decisions, whatever the outcome.

QUESTION

Will the panel's decision result in an extraordinary challenge?

ANSWER

We know of no basis for the establishment of an extraordinary challenge committee. Only the U.S. and Canadian governments have the right to invoke the extraordinary challenge procedure.

QUESTION

Will the outcome of this panel have any effect on the panel reviewing the final subsidy determination?

ANSWER

No. The FTA subsidy panel has reviewed separate issues and a separate record. The subsidy panel reported its findings on May 6, 1993, unanimously instructing the U.S. Department of Commerce (DOC) to re-examine every major part of its subsidy determination. The DOC is due to report back to the subsidy panel by August 4, 1993.

QUESTION

What happens after the ITC issues its remand determination? When will this process reach a conclusion?

ANSWER

After the ITC issues its remand determination, all parties have 40 days to comment on the results. The panel's

decision on the remand determination must be made not more than 90 days after the ITC has issued its remand determination. If the panel remands the proceeding to the ITC a second time, this process will be repeated.

QUESTION

Who were the parties involved in this case?

ANSWER

The Government of Canada, together with the provinces of Alberta, British Columbia, Ontario and Quebec, the Canadian Forest Industries Council and affiliated companies, the Quebec Lumber Manufacturers' Association, and the members of the Canadian Lumbermen's Association located in Quebec ("Canadian parties") challenged the ITC's determination that imports of softwood lumber from Canada were causing material injury to the U.S. domestic lumber industry.

QUESTION

What did the Canadian parties argue before the panel?

ANSWER

The Canadian parties argued that imports of Canadian softwood lumber were not injuring the U.S. domestic industry. More specifically, we argued that the ITC failed to demonstrate that imports of softwood lumber from Canada suppressed prices in the United States, that the ITC failed to evaluate all relevant economic factors within the context of the normal business cycle for this industry, that the ITC failed to take into consideration the conditions of competition that are unique to the softwood lumber industry, and that ITC failed to consider other relevant factors, including the nature and effect of the alleged subsidies found by the DOC.

QUESTION

What is the status of the GATT panel?

ANSWER

The GATT panel has reported its conclusions. The panel

ruled that the United States violated its international trade obligations when it imposed the interim Section 301 duties (October 1991 - March 1992). However, the panel ruled that the United States was entitled to initiate the countervailing duty investigation. The GATT panel report is now being considered by the GATT Subsidies Codes Committee.

QUESTION

What is the relation between the GATT panel and the FTA panels?

ANSWER

The GATT and FTA panels ruled on different issues. The GATT panel was asked to determine whether the U.S. had acted consistently with its GATT obligations when it self-initiated the countervailing duty investigation. The FTA panels determine whether U.S. law is applied correctly by the investigating authorities.

QUESTION

What is the volume of trade affected by the U.S. duty?

ANSWER

Canada's exports to the United States were roughly 13 billion board feet in 1992, worth C\$4 billion. Canada accounted for roughly 29 percent of U.S. consumption during the period 1990-92.

QUESTION

How are the FTA injury and subsidy panels related?

ANSWER

The two FTA panels originate from the same action, the imposition of countervailing duties on imports of Canadian softwood lumber. For a countervailing duty to be levied, both the elements of injury to a domestic industry and the subsidization of imports must be present. This panel dealt with the ITC's injury determination. The other panel deals with the subsidy determination made by the DOC based on the record of the subsidy investigation. The subsidy panel reported on May 6, 1993.

QUESTION

What is the relationship between this case and the Clinton Administration's efforts to develop a comprehensive forest-management/timber policy?

ANSWER

There is no direct relationship between the binational panel review process and the Clinton Administration's efforts to develop a comprehensive forest-management/timber policy.

However, we note that in the context of the Timber Summit that took place on April 2, 1993 in Portland, Oregon, the U.S. Home Builders' Association and the U.S. Lumber Dealers' Association argued that in light of escalating lumber prices and decreasing U.S. timber supply, the U.S. duty on Canadian lumber made little sense and was contributing to rapidly increasing housing costs.

We agree with the U.S. home builders' and lumber dealers' assessment that a countervailing duty on Canadian softwood lumber cannot be justified in light of current economic conditions in the North American market.

QUESTION

Can the United States terminate the countervailing duty?

ANSWER

Yes. The removal or reduction of the countervailing duty could result from the panel remand process.

QUESTION

How long will Canadian companies have to pay the duty?

ANSWER

Duties will continue to be assessed pending the outcome of the FTA panel remand process. Once the process is completed, any reduction or elimination of the countervailing duty will result in the refund of duties paid to date, with interest.

QUESTION

Why is Canada requesting an administrative review when the softwood lumber duty is being reviewed by the FTA panels?

ANSWER

U.S. countervailing duty regulations provide for administrative reviews of countervailing duties on an annual basis. A review must be requested in the anniversary month that the duty was imposed -- in this case, July 1993. If a review is not requested, the duty becomes permanent. To preserve the appeals before the panels, an administrative review will be requested. However, the DOC is not expected to begin the review until the results of the two FTA panel reviews are final.