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MACLAREN CALLS FOR TERMINATION OF THE SOFTWOOD LUMBER CASE

The Honourable Roy MacLaren, Minister for International Trade, called for the termination of the softwood lumber case in light of the third unanimous decision of a Canada-U.S. Free Trade Agreement (FTA) binational panel that Canadian softwood lumber imports do not cause injury to the U.S. domestic industry.

"This is the third time the panel has ruled unanimously that the ITC injury determination is not supported by substantial evidence," Mr. MacLaren said. "This is enough. The harassment of Canadian softwood lumber exporters must end."

The Panel reaffirmed its July 26, 1993, and January 28, 1994, decisions that the ITC has failed to provide substantial evidence to support its original finding. The Panel has therefore remanded this determination to the ITC, which now has 30 days to reconsider.

The current cash deposit rate of 6.51 per cent remains in effect for Canadian softwood lumber exports to the United States. Cash deposits collected to date total approximately \$800 million. Canadian softwood lumber exports to the United States amounted to \$6.4 billion in 1993.

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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, and continues to be, an important and dependable supplier of quality lumber products. As a result of the U.S. 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 an area of trade friction 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 per cent on lumber producers. On December 30, 1986, to resolve a bitter and highly politicized trade dispute, Canada and the United States signed the Softwood Lumber Memorandum of Understanding (MOU), under which Canada imposed a temporary export tax of 15 per cent on certain softwood lumber entering the U.S. market from Canada. The agreement retained the export charge revenues in Canada rather than sending them to the United States in the form of countervailing duties. The U.S. lumber industry withdrew 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 zero per cent for exports of British Columbia lumber; and
- the export charge was gradually reduced for exports of Quebec lumber, to a rate of 3.1 per cent by late 1991.

In addition, Alberta and Ontario made various changes in their forest management regimes that would almost certainly have reduced the rate of export charge for these provinces. The MOU had not yet been amended to reflect these changes before it was terminated.

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 per cent 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 311 000 people in 1993 and contributed \$18.7 billion to Canada's gross domestic product in 1992. 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 19 per cent of employment in the forestry sector in 1991. Canada is one of the largest producers of softwood lumber in the world. In 1991, Canada accounted for 16 per cent of total world softwood lumber production, following only the United States (at 24 per cent) and the former Soviet Union (at 19 per cent). Within Canada, British Columbia is the principal producer of softwood lumber, accounting for 58 per cent (by volume) of production in 1993. The next largest producer was Quebec, accounting for 19.5 per cent of production by volume.

In 1991, Canada exported more softwood lumber than any other country, accounting for 36 per cent (by value) of total world exports. The principal destination for these exports was the United States. In 1992, Canada exported over 13 billion board feet of softwood lumber to the United States, valued at approximately \$4.2 billion. In 1993, Canadian exports of softwood lumber to the United States totalled nearly 15 billion board feet, valued at approximately \$6.4 billion.

NORTH AMERICAN LUMBER PRICES AND DEMAND

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 per cent 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. While the anticipated timber shortage in the Pacific Northwest has become a reality, mills in the southern United States and eastern Canada have been able to boost production to make up for losses in production elsewhere.

Between March and June 1993, lumber prices dropped significantly. Since June 1993, however, prices have recovered. The February 1994 average price for softwood lumber was US\$411.50 per MBF, an increase of 0.5 per cent over the previous month. This reflects a strengthening in U.S. demand. It is expected that continued

low mortgage rates will probably boost housing starts to 1.25 million units in 1994, exceeding the mid-1980s peak.

Lumber analysts suggest that high lumber prices have yet to impact significantly on mortgage affordability. In 1993, a \$3000-4000 increase in new home prices due to lumber was more than offset by declining mortgage rates. However, as a result of lower transportation costs, market demand is expected to shift to cheaper materials, such as oriented strand board, paperboards and plastics, in 1994. Otherwise, U.S. lumber demand would exceed available domestic and import supplies by a wide margin (at least several billion board feet).

Canadian companies were able to meet some, but not all, of the increased demand for lumber. Overall, lumber exports to the United States in 1992 increased by 14 per cent over 1991. The market remained relatively strong in 1993, and this trend is expected to continue.

FINAL PLAN FOR PACIFIC NORTHWEST

On February 23, 1994, the U.S. administration announced a plan to protect a host of endangered species by significantly reducing logging levels in the Pacific Northwest to 20 per cent of those in mid-1980s peak years (slightly more than one billion board feet vis-à-vis five billion). The new policy is largely similar to a draft that President Clinton presented last summer. The final plan further reduces logging and nearly doubles the draft's estimated number of jobs that will be lost from 5500 to 9500. The Government estimates that there are 2.2 million hectares of old-growth forest left in the Northwest, with about 600 000 of that protected in national parks or wilderness areas. The Administration would allow logging in 280 000 hectares, but would keep most of the remaining old-growth forest off limits. In Canada, increased restrictions on the allowable cut in some major British Columbia timber management areas have also been imposed by the province, with additional reductions expected in the coming years.

THE COUNTERVAILING DUTY INVESTIGATION

During the countervailing duty investigation, the DOC investigated provincial stumpage programs and Canadian log export restrictions.

A preliminary affirmative determination of injury was made on December 12, 1991, by the United States ITC.

On March 5, 1992, the DOC made an 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 per

cent *ad valorem* (stumpage at 6.25 per cent plus log export controls at 8.23 per cent). Effective March 12, 1992, importers of softwood lumber from Canada were required to make cash deposits or post bonds of 14.48 per cent 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 programs 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 per cent *ad valorem* (stumpage at 2.91 per cent plus log export controls at 3.60 per cent). The DOC also excluded 15 companies from the investigation.

On June 25, 1992, the ITC, in a four-to-two vote, determined that imports of Canadian lumber materially injured U.S. lumber producers. This was the last of four decisions in the United States CVD investigation.

FTA SUBSIDY PANEL

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

On September 17, 1993, the DOC responded to the FTA panel with a new subsidy determination, reaffirming its original conclusion. The new determination, in fact, sought to increase the subsidy rate. The panel reviewed the DOC's conclusions and ruled that the DOC, under U.S. trade law, should not have found a countervailable subsidy on either provincial stumpage programs or British Columbia log export restrictions.

On January 6, 1994, the DOC accepted the December 17, 1993, ruling by the Canada-United States Free Trade Agreement Subsidy Panel.

On February 23, 1994, the FTA Subsidy Panel affirmed the DOC's decision. As a result, on March 7 the FTA binational panel secretariat issued a Notice of Final Panel Action. (A Notice of Final Panel Action is a statement issued by the binational secretariat when a panel ruling has been adopted.) From the date that the Notice of Final Panel Action is issued, the FTA rules provide for a 30-day period in which an Extraordinary Challenge Committee can be requested either by Canada or the United States.

FTA INJURY PANEL

On July 24, 1992, the Government of Canada, the affected provinces and the Canadian industry appealed the final determination of injury by the ITC to a binding binational review panel under Chapter 19 of the FTA. The Injury Panel reported its findings on July 26, 1993, ruling that the ITC's conclusion that imports of lumber from Canada injured the U.S. industry was not supported by substantial evidence.

In response to the panel's ruling, the ITC reconsidered the information and again concluded, on October 25, 1993, that the U.S. lumber industry was injured by imports of Canadian lumber. On January 28, 1994, the FTA Injury Panel again concluded that the ITC decision was not sustainable.

On March 7, 1994, by a vote of 3 to 2, the ITC maintained its original determination that Canadian softwood lumber exports cause material injury to the U.S. lumber industry. The ITC submitted to the panel its redetermination to that effect on March 14, 1994.

On July 6, the FTA Injury Panel reaffirmed its January 28, 1994, ruling that the ITC has failed to provide substantial evidence to support its original finding.

EXTRAORDINARY CHALLENGE PROCEDURES UNDER THE CANADA-U.S. FTA

Article 1904.13 of the FTA allows for an extraordinary challenge to a panel ruling only in cases where a panel member is guilty of bias or a serious conflict of interest, or has materially violated the code of conduct; or where the panel seriously departs from a fundamental rule of procedure or manifestly exceeds its jurisdiction. In addition, the challenged action must have materially affected the panel's decision, and must threaten the integrity of the binational panel review.

An Extraordinary Challenge Committee must be established within 15 days of a request for such a committee. The Committee comprises three members, who are selected from a 10-person roster of judges or former judges of a federal court of the United States and a court of superior jurisdiction in Canada. Each country selects one panel member, and the third is chosen by both or by lot from the roster.

Written arguments must be filed with the Committee within 21 days after the request for a Committee has been filed.

The Committee was formed on April 25, 1994 and held oral hearings on June 13 and 14, 1994.

Annex 1904.13 of the FTA provides that the Committee must render its decision typically within 30 days of its establishment. The decision of the Committee is binding on both governments. The Committee can extend the time limits in the interest of fairness and justice, as was the case in the two previous Extraordinary Challenges launched in 1991 and 1993. The current Committee has indicated that it intends to render a decision by August 1, 1994.

In rendering its decision, the Committee can affirm the decision of the binational panel, vacate the decision, or remand the decision back to the panel for further consideration, accompanied by instructions from the Committee.

When the United States Trade Representative notified Canada of his intentions to request the challenge, he included a statement as to why the challenge was being launched.

REQUEST FOR ADMINISTRATIVE REVIEW

An administrative review may be conducted by the DOC at least once during each 12-month period, beginning on the anniversary date when a CVD order was issued. The review process is not automatic and must be requested in writing by an interested party during the anniversary month of the publication of the order. Such reviews are designed to determine the actual amount of subsidization during a particular period, and adjust the CVD accordingly.

An administrative review is essentially a replay of the original investigation, and therefore is an extensive procedure. It involves issuance of questionnaires, presentation of arguments by interested parties and publication of initial and final results of the review.

It also provides a new opportunity for scrutiny into governmental policies affecting the subject merchandise, besides those initially investigated. As a result, the DOC may determine that "new" programs are countervailable, and amend the order to include a duty that offsets the benefits of these additional programs.

If the deposits collected during the review period are greater than the actual margin found, the DOC will refund the overpayments with interest. If the reverse occurs, the DOC will collect the underpayment with interest.

If, after the completion of a review, the DOC determines that the subsidy margin is below 0.5 per cent, then the margin is considered *de minimis* (i.e. too low to act upon) and the DOC waives the duty deposit requirement.

Canada requested the first administrative review of the softwood lumber countervailing duty order on July 30, 1993. The review will cover the period March 1992 to April 1993, and is intended to fix a final duty for shipments during that period.

Should the current investigation be resolved in Canada's favour through the subsidy or injury investigations described above, including an Extraordinary Challenge, the administrative review would also be terminated. However, should the final outcome of the FTA panel process be in the United States favour, then Canadian exporters of softwood lumber to the United States would be liable to pay the countervailing duty once the DOC publishes final results of its administrative review in the U.S. Federal Register, either in the latter part of 1994 or early 1995. That notice would then finalize the countervailing duty payments between March 12, 1992 and March 31, 1993.

Due to statutory deadlines, and notwithstanding the ongoing legal appeals under the FTA, Canada will have to file a request for an administrative review for the period April 1, 1993 to March 31, 1994, with the DOC by August 1, 1994.

The results of final determinations of administrative reviews are subject to binational panel review under Chapter 19 of the North American Free Trade Agreement (NAFTA).

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 was adopted by the GATT Subsidies Code Committee on October 27, 1993. The United States has an obligation to implement the Panel's instructions to terminate the Section 301 interim bonding requirement, refund any cash deposits, and cancel any bonds resulting from the Section 301 action. The United States has yet to implement the Panel report.

Chronology

SOFTWOOD LUMBER

1982-83

The United States conducts the first countervailing duty investigation of softwood lumber from Canada. The U.S. 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 per cent 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 per cent 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.

1987-91

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 MOU, effective October 4, 1991.

October 4

Canada terminates the Softwood Lumber MOU.

The United States announces its intention to self-initiate the third countervailing duty investigation, and to impose an interim bonding requirement on imports of Canadian softwood lumber.

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 Subsidies Code Committee of the General Agreement on Tariffs and Trade (GATT) 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. trade obligations.

1992

March 5 The DOC makes the preliminary determination of subsidy — 14.48 per cent.

May 28 The DOC makes the final determination of subsidy — 6.51 per cent.

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 (FTA).

June 25 The ITC makes a final determination of injury — affirmative material injury.

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 its final report to the Subsidies Code Committee. The Panel concludes that the United States violated its trade obligations when it used Section 301 of the Trade Act to impose the 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 original determination on virtually all of the major issues.

July 26 The FTA Chapter 19 Injury Panel reports its findings, concluding that the ITC's determination of material injury was not supported by substantial evidence on the record.

- July 30 Government of Canada requests first administrative review.
- August 2 Government of Canada requests company-specific administrative review.
- August 24 The DOC initiates first administrative review.
- September 17 The DOC makes a new subsidy determination on remand as a result of review by the FTA Chapter 19 Subsidy Panel.
- October 14 Government of Canada files company-specific administrative review information as requested by the DOC.
- October 18 The ITC conducts a vote on injury as a result of the FTA Chapter 19 Injury Panel July 26 decision.
- October 19 The DOC issues questionnaires in first administrative review.
- October 25 The ITC submits a new injury determination on remand to the FTA Chapter 19 Injury Panel.
- October 27 The GATT Subsidies Code Committee formally adopts the panel report concerning the U.S. use of Section 301 of the Trade Act to impose an interim bonding requirement in October 1991 and self-initiation of the countervailing duty investigation.
- December 17 The FTA Chapter 19 Subsidy Panel rules that the DOC, under U.S. trade law, should not have found a countervailable subsidy on either provincial stumpage programs or British Columbia log export restrictions.
- 1994
- January 6 The DOC accepts the December 17 Panel ruling.
- January 28 The FTA Chapter 19 Injury Panel affirms its July 26, 1993, ruling that the ITC's determination of material injury was not supported by substantial evidence on the record.
- February 23 The FTA Subsidy Panel affirms the DOC's decision of January 6, 1994.
- February 24 The Office of the United States Trade Representative (USTR) announces that the United States will request the establishment of the Extraordinary Challenge

Committee to review the decision of the FTA Subsidy Panel.

- March 7 FTA Panel Secretariat issues Notice of Final Panel Action. From the date that the Notice of Final Panel Action is issued, the FTA rules provide for a 30-day period in which an Extraordinary Challenge Committee can be requested either by Canada or the United States.
- March 7 On March 7, 1994 by a vote of 3 to 2, the ITC maintains its original determination that Canadian softwood lumber exports cause material injury to the U.S. lumber industry.
- March 14 The ITC submits its most recent determination to the Panel.
- April 6 USTR formally requests the establishment of an Extraordinary Challenge Committee.
- April 25 Extraordinary Challenge Committee was formed.
- July 6 The FTA Chapter 19 Injury Panel reports its findings, concluding that the ITC's determination of material injury was not supported by substantial evidence on the record.
- August 1 Final day for Extraordinary Challenge Committee to issue its decision with respect to Subsidy Panel decision.
- August 5 The ITC to submit its new injury redetermination to the FTA Chapter 19 Injury Panel.