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America's Credibility Goes "Timber!"

By Daniel Ikenson, policy analyst, Center for Trade Policy Studies, Cato Institute

Introduction

The U.S.-Canada softwood lumber dispute is so long running that interested parties rely on dynastic nomenclature to catalog the sordid details. The present reign, "Lumber IV," began in April 2001 when the U.S. government initiated antidumping and countervailing duty investigations of Canadian imports. Final duties were imposed in May 2002.

After nearly three and a half years, duties approaching $5 billion have been collected. During the same period, a series of rebukes, remands, redeterminations, more rebukes, more remands, and more redeterminations from dispute settlement panels under the North American Free Trade Agreement were issued, finding the measures violative of U.S. law. Concurrently, the dispute settlement body of the World Trade Organization found those same measures to contravene U.S. international trade commitments. Yet the measures persist and, despite having exhausted its appeals under NAFTA, U.S. authorities have proclaimed that they will not repeal or refund the duties.

"This is nonsense," remarked Canadian prime minister Paul Martin in a speech before the Economic Club of New York. "More than that, it's a breach of faith. Countries must live up to their agreements. The duties must be refunded."[1] Our Canadian neighbors are rightly outraged by the U.S. position, as they consider retaliation and the propriety of Canada's future in NAFTA.

There is a familiar and meritorious economic argument against restricting trade in the first place. The wisdom of that argument is particularly obvious when the subject is a raw material that was already in short supply before a major hurricane, and the massive reconstruction it portends, exacerbated the gap between supply and demand. The fact that lumber-using industries account for a far greater share of U.S. economic output and employ about 25 workers for every one employed in lumber production further supports the argument for unfettered lumber trade.[2]

But the lumber dispute now transcends economics. Nothing less than America's credibility—a crucial asset to U.S. trade and foreign policy—is on the line. Even those inclined to believe that antidumping or antisubsidy protectionism has its place in trade policy must acknowledge the implications of U.S. intransigence on this particular issue.

The United States coauthored the rules of trade that govern NAFTA and the WTO. The United States has been found in violation of those rules as well as its own laws. The United States must comply with the NAFTA panels' instructions to repeal the measures and refund the duties collected if it expects the rules-based system of trade to function properly. Continued U.S. intransigence on lumber may prove to be the catalyst for a global retreat from the liberalization of trade that has characterized the post-WWII period. Nothing less is at stake.

Background (Lumber I-III)

Lumber trade between Canada and the United States has been a source of tension for many decades. But the primary issues at play in the current dispute trace back to 1982 (the beginning of "Lumber I"), when U.S. producers of softwood lumber sought to limit Canadian imports through countervailing duty measures. The focus of U.S. producers' complaints at that time and today has been the forest management practices of certain Canadian provinces. According to the U.S. industry, the fees charged by the Canadian national and provincial governments to harvest timber on government-owned lands—so-called stumpage fees—fall below market rates and thus bestow unfair subsidies on Canadian lumber producers. Other programs, such as log export controls in certain provinces, have been challenged as unfair subsidies by artificially inflating the supply and reducing the price of timber to Canadian mills.

The U.S. industry's first effort to convince the government to impose countervailing duties failed in May 1983, when the U.S. Department of Commerce (DOC) concluded that stumpage did not confer a countervailable subsidy to

Canadian lumber producers. Thus ended Lumber I.

"Lumber II" commenced in 1986, when the U.S. industry again petitioned the government for countervailing duties. This time DOC changed its tune. It found that the Canadian stumpage system conferred a subsidy to lumber producers averaging about 15 percent. But in lieu of imposing the duties, the two governments entered into a Memorandum of Understanding (MOU), which required that the Canadian government collect an export tax of 15 percent. A stipulation was included to allow for reduction of that rate if the stumpage fees or other provincial charges increased. The forest management policies of some provinces did change, and as a result their mandated export charges were reduced. But Canada terminated the MOU in September 1991, marking the conclusion of Lumber II.

The following month, October 1991, "Lumber III" began when DOC initiated a new countervailing duty investigation, which produced a finding that stumpage and log export controls conferred a subsidy of 6.51 percent on Canadian producers in all but the Atlantic provinces. After an affirmative determination by the U.S. International Trade Commission (ITC) that the U.S. industry was injured by subsidized Canadian imports, duties were imposed in July 1992.

Canada appealed the DOC subsidy and ITC injury findings to binational dispute settlement panels provided for under the U.S.-Canada Free Trade Agreement in August 1992. The panels agreed with Canada's claims that the subsidy and injury findings were based on insufficient evidence and had no legal bases and remanded the cases to DOC and ITC, respectively.

After finding the changes in the DOC analysis insufficient, the panel remanded the determination a second time. The panel hearing the injury case had to remand the analysis to ITC three times. Still, the United States was intent on keeping the litigation going. In April 1994, the U.S. government alleged conflicts of interest on the part of two Canadians who were on the panel that reviewed DOC's subsidy determination, and consequently requested the formation of an Extraordinary Challenge Committee (ECC) provided for under the agreement. Four months later, the ECC ruled against the United States and the CVD order was officially, but grudgingly, revoked.

Having been cleared of countervailable subsidy charges twice at this point, but facing the specter of new investigations and the burden of yet more legal costs, the Canadians entered into an agreement to limit their softwood exports to the United States. The Softwood Lumber Agreement (SLA), which was effectively a tariff rate quota system that allowed in finite imports duty free and then subjected imports above those limits to extremely high tariffs, went into effect in May 1996. It expired in March 2001, ending Lumber III.

Déjà vu ("Lumber IV")

Two days after expiration of the SLA, the U.S. industry filed a new CVD and an antidumping petition. ITC ruled that the domestic industry was "threatened" with material injury by reason of less than fair value (i.e., dumped) and subsidized Canadian imports of softwood lumber. Final countervailing duties of 18.79 percent and final antidumping duties ranging from 2.18 percent to 12.44 percent were imposed in May 2002.

Canada responded by challenging the legal and analytical propriety of those measures in the dispute settlement systems of NAFTA and the WTO. Under challenge were the threat of material injury determination rendered by ITC, and both DOC's subsidy and dumping findings. A total of six challenges were launched as all three claims were before NAFTA and the WTO.

The NAFTA panels found each of the U.S. determinations to contravene U.S. law, and the WTO—adopting either the panel report or the report of the Appellate Body—found all three determinations to violate U.S. obligations under the WTO.

Since the original investigation findings in May 2002, the three NAFTA panels have collectively issued 11 remand orders to the U.S. administering authorities: five in the subsidy case and three each in the dumping and injury cases.

At issue in the subsidy case through its five remands has been, not whether subsidies exist, but the proper methodology for calculating the benefits conferred by those subsidies. One thing that is clear is that the CVD rate has declined from the original 18.79 percent through each successive remand determination. It stands currently at 1.21 percent and is expected to become *de minimis* (less than 1 percent) if DOC follows the panel's instructions in the fifth remand.[3]

The NAFTA panel hearing the dumping case has issued three remands, each containing specific instructions for DOC to incorporate into its revised determinations. In its third remand, issued in June 2005, the panel instructed DOC to render a new determination that revokes the antidumping order with respect to West Fraser Mills, and that recalculates the rates for all the other respondents without relying on "zeroing." In other words, the DOC practice known as zeroing, which assigns a value of zero to price comparisons that yield negative dumping margins and has been found to violate U.S. WTO commitments, was expressly prohibited by the panel.[4]

But in July 2005, DOC issued its third remand redetermination, which disregarded the panel's instructions. Rather than forgo zeroing, DOC opted to change its price comparison methodology to one under which zeroing has not been explicitly rejected. By adopting the new methodology, DOC argues that it can continue to zero.

And under this methodology, the rate for West Fraser Mills increased above *de minimis*, so DOC refused to revoke the order with respect to this company, as instructed by the panel.

The panel hearing the injury case found the ITC determination to be flawed primarily because it failed to distinguish between the contribution to the threat of injury attributable to dumped or subsidized imports and other factors, such as other Canadian wood products, imports from other countries, domestic competition, and consequences related to past decisions of U.S. producers. The case was remanded to ITC in September 2003 with explicit instructions to consider certain factors and incorporate them into the remand determination.

When ITC's remand determination was published in

December 2003, again finding a threat-of-material-injury, Canada again challenged the finding. The panel concluded that most of the bases for the ITC's finding were "not supported by substantial evidence" on the record and remanded the case again with instructions to disregard assumptions that were not supported by substantial evidence.[5]

ITC published its second remand determination in June 2004, which concluded again that the industry was threatened with material injury. Again, Canada challenged the finding. And this time, the panel's conclusions were quite explicit:

> In its Second Remand Determination, the Commission has refused to follow the instructions in the First Panel Remand Decision. The Commission relies on the same record evidence that this Panel not once, but twice before, held insufficient as a matter of law to support the Commission's affirmative threat finding. By the Commission's so doing, this Panel can reasonably conclude that there is no other record evidence to support the Commission's affirmative threat determination. The Commission has made it abundantly clear to this Panel that it is simply unwilling to accept this Panel's review authority under Chapter 19 of the NAFTA and has consistently ignored the authority of this Panel in an effort to preserve its finding of threat of material injury.[6]

Likewise, the panel's instructions for a third remand could not have been clearer:

> This Panel remands this case to the Commission for the Commission to make a determination consistent with the decision of this Panel that the evidence on the record does not support a finding of threat of material injury and to make that determination within ten (10) days from the date of this Panel decision.[7]

In September 2004, pursuant to the panel's instructions, ITC published a determination that imports of Canadian lumber do not threaten injury to the domestic industry, thereby eliminating the justification for antidumping and countervailing duty measures.

But in November 2004, the United States again alleged a conflict of interest on the part of a panelist and requested the formation of an Extraordinary Challenge Committee. The ECC ruled unanimously in Canada's favor in a report issued in August 2005, marking what should have been the end of U.S. stalling tactics. Under NAFTA rules, the United States is obligated to revoke the duties prospectively and refund the duties—close to $5 billion—that have been collected in error since 2002.

Instead, the Bush administration announced that the lumber duties would remain in place and that there would be no refunds. U.S. officials cite a revised ITC threat-of-injury analysis, issued in November 2004 in response to the WTO Appellate Body's instructions, as their justification. Although the Appellate Body report has not been officially released to the participants, it is said to have found U.S. efforts to bring its threat-of-injury decision into conformity with the WTO Agreements (i.e., the November 2004 ITC Injury Redetermination) acceptable. The administration now claims that it has complied with the WTO's request and produced a new threat-of-injury finding, which justifies continuation of the measures.

But that revised analysis is invalid under NAFTA. It was rendered only after the record was re-opened and new information considered—contravening the NAFTA panel's instructions to render a negative threat-of-injury finding. Furthermore, the ITC's revised injury determination has no revised dumping or revised subsidy determinations from DOC to go with it. Antidumping and countervailing duties can be imposed only if there is dumping or subsidization that is causing or threatening material injury. There has been no report from the WTO as to whether the DOC's redeterminations on dumping and subsidization will bring the United States into conformity with the various agreements. Accordingly, there is no basis for the measures.

Furthermore, it is important to understand the distinctive role of the two dispute settlement processes. Under NAFTA, dispute settlement is tasked with determining solely "whether the relevant administrative agency [the ITC and/or the DOC in the case of U.S. actions] applied its national AD/CVD laws correctly."[8] The NAFTA panels are available as "an alternative to judicial review by domestic courts of final determinations in antidumping and countervailing duty cases."[9]

Under the WTO agreement, however, the dispute settlement mechanism serves a different function. Rather than determine whether the administering authorities' actions are consistent with that country's laws, the relevant question is whether those actions are in conformity with the various WTO agreements.

Whereas the WTO dispute settlement system can put pressure on members to bring their offending actions, regulations, or laws into conformity with the respective agreement, it has no authority to impose any remedial actions. At most, it can sanction retaliation from complainants that are victimized by the action found to be inconsistent with a member's obligations.

In contrast, the NAFTA process provides the equivalent of domestic judicial review and, as such, its verdicts are binding on the administering authorities. In the lumber case, those verdicts are quite clear. Under NAFTA rules, the United States is obligated to terminate the restrictions and refund the duties.

Polluted Politics

Intransigence on lumber is the latest instance in an emerging pattern of U.S. antipathy for the rules of trade. The United States has failed to comply with several other verdicts of the WTO dispute settlement body in recent years, including a 2003 indictment of the so-called Byrd Amendment.

A little digging reveals a scandalous relationship between the U.S. positions on Byrd and lumber. The Byrd Amendment, formally known as the Continued Dumping and Subsidy Offset Act, became law in 2000.[10] It mandates distribution of antidumping and countervailing duties collect-

ed at the border to the domestic industries that filed or supported the original petitions in the underlying cases. Previously, duties collected were commingled with funds in the general treasury.

Byrd was quickly challenged by several trade partners in the WTO and was ultimately found to violate U.S. trade obligations because it punishes foreign exporters twice—first, by imposing the duties as a remedy to dumping or subsidization (which is acceptable), and then by using those funds to directly subsidize the U.S. producers (which is not). Despite the ruling, the United States failed to repeal Byrd, and last year the WTO authorized retaliation by the complainants. Thus far, Europe, Canada, Japan, and Mexico have begun or announced that they will begin imposing retaliatory tariffs against various U.S. exports.

Still, Byrd enjoys broad bipartisan support in Congress. And why shouldn't it? Members have been able to dole out $1 billion to their corporate constituents between 2001 and 2004 without having to fight for the disbursements, as the funding is automatic and doesn't come directly from U.S. taxpayers. According to a recent study by the Government Accountability Office, however, most of those funds went to a select few companies in a few industries.

That $1 billion is modest relative to the $5 billion at stake in the lumber case. And there are many companies, geographically dispersed, lined up to receive Byrd lumber money. If the United States were to comply with the lumber rulings and refund the duties, Congress would lose the opportunity to bestow those massive subsidies on its constituents. Thus, U.S. willingness to blatantly ignore the outcomes in two major dispute settlement cases is being driven by the crassest of political considerations at the expense of the global trade rules that the United States coauthored to protect U.S. national interests.

So intent are some members of Congress to ensure preservation of the lumber restrictions that the issue became a central point of discussion in the confirmation hearings of Franklin Lavin, nominee for undersecretary of commerce, International Trade Administration. Lavin testified before the Senate that he would find a way to keep the countervailing duties in place, and that officials at DOC have assured him that there are ways to recalculate the duties to produce a rate above *de minimis*.[11] About Lavin's assertion there should be little doubt. The DOC has vast discretion to mix and match methodologies in order to find or inflate dumping and subsidy margins.[12]

Likewise, a group of Senators submitted a letter to Commerce Secretary Carlos Gutierrez on October 20 urging him to preserve the duties. Reflecting total disregard for the purpose and legitimacy of the NAFTA dispute settlement system, the Senators opined that "NAFTA panel decisions cannot and should not force the Department to deny legitimate relief under U.S. law to the domestic lumber industry and its workers."[13]

Conclusion

America's growing disdain for its international trade commitments is a troubling development. It will now be that much easier for U.S. trade partners to break the rules while citing U.S. precedents. Members of Congress who grandstand over "unfair" Chinese trade practices, for example, no longer preach from the moral high ground.

U.S. credibility on trade issues is waning at a time when strong leadership is desperately needed. With the Doha Round of WTO talks fast approaching what experts believe to be a do-or-die meeting in Hong Kong in December, U.S. mockery of the rules could not come at a worse time. There was already a perception in many countries that the rules of trade are stacked in favor of the larger economies. When the world's largest economy ignores those rules, perceptions can quickly become entrenched wisdom.

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1. Address by Prime Minister Paul Martin at the Economic Club of New York, October 6, 2005 (available at http://pm.gc.ca/eng/news.asp?id=603).
2. Brink Lindsey, Mark A. Groombridge, Prakash Loungani, "Nailing the Homeowner: The Economic Impact of Trade Protection of the Softwood Lumber Industry," Cato Trade Policy Analysis no. 11, July 6, 2000, p. 7.
3. The DOC's fifth remand determination is due to be published on October 28.
4. For a detailed examination of the zeroing methodology, see Dan Ikenson, "Zeroing In: Antidumping's Flawed Methodology Under Fire," Cato Free Trade Bulletin no. 11, April 27, 2004.
5. Remand Decision of the Panel, "Article 1904 Binational Panel Review Pursuant to the North American Free Trade Agreement in the matter of Certain Softwood Lumber Products from Canada," Final Affirmative Threat of Injury Determination (Secretariat File No.USA-CDA-2002-1904-07), April 19, 2004.
6. Second Remand Decision of the Panel, "Article 1904 Binational Panel Review Pursuant to the North American Free Trade Agreement in the matter of Certain Softwood Lumber Products from Canada," Final Affirmative Threat of Injury Determination (Secretariat File No.USA-CDA-2002-1904-07), August 31, 2004.
7. Ibid.
8. Website of the NAFTA Secretariat, "Overview of the Dispute Settlement Provisions of the North American Free Trade Agreement (NAFTA)," http://www.nafta-sec-alena.org.
9. Ibid.
10. For a detailed look at the Byrd Amendment, see Dan Ikenson, "Byrdening Relations: U.S. Trade Policies Continue to Flout the Rules," Cato Free Trade Bulletin no. 5, January 13, 2004.
11. "Commerce Nominee Pledges to Keep Lumber Duties in Place," *Inside U.S. Trade*, October 21, 2005.
12. For a detailed look at how the Commerce Department wields its discretion in antidumping cases, see Daniel Ikenson, "Abuse of Discretion: Time to Fix the Administration of the U.S. Antidumping Law," Cato Trade Policy Analysis no. 31, October 6, 2005.
13. Letter from 21 U.S. Senators to Commerce Secretary Carlos Gutierrez regarding lumber duties, October 20, 2005, available at http://www.insidetrade.com/secure/htmldata2/wto2005_6284_1.htm.