

CENTRE FOR THE STUDY OF SECURITY AND DEVELOPMENT

POLICY PAPERS

Policy Options for the Softwood Lumber Dispute, Round 5

Steven Holloway, CSSD Research Fellow

June 2017

Canadian softwood lumber exports to the US have been a perennial trade irritant since at least the 1980s. But recently a “perfect storm” of factors, including a year of increased exports with the ending of the 2006 SLA (Softwood Lumber Agreement) restrictions in October 2015, the recent fall in the Canadian dollar and the unexpected election of the protectionist Donald Trump, all have conspired to make this fifth round of disputation, front-and-centre to the challenged US-Canada bilateral relationship.

Description of the Softwood Lumber (SL) sector

According to the US Department of Commerce (USDC), total Canadian SL imports to the US for 2015 were valued at US\$4.5 billion. With its huge territory and forest lands, one would expect Canada to have a comparative advantage in this US market and every Canadian province is involved in the trade. A recent *Globe and Mail* graphic shows BC dominates earning 65% of the total Cdn\$7.2 billion worth of SL exports for 2016 followed by Quebec 18% and Alberta and Ontario at 7% each.¹

This article also shows the difference in the source of these softwood exports with Canadian forestry lands primarily government-owned [Crown land] and the US primarily private. Also, the Canadian industry is heavily concentrated in the hands of a few large (BC-based) lumber firms whereas the US industry is somewhat less concentrated with many more small private owners. As a result, the price of much of the Canadian timber is determined by government-set “stumpage fees” whereas much more of the US timber price is determined by auctions and the market. The US industry (and many environmentalists on both sides of the border) has argued the stumpage fees are too low or below market value. This allows the US industry and government to argue the low fees represent an unfair subsidy. However, in recent disputes, the USDC has accepted some claims by Atlantic Canada and

¹ My calculations from figures provided on the graphic showing its data source as “Gov of Canada.” Adrain Morrow et al, “Canada braces for lengthy softwood battle as Trump gets tough on trade,” *Globe and Mail*, 26 Apr 2017, A1.

some Quebec and Ontario companies that their lumber is priced by the market and they have assessed either no or lower Countervail Duties and other restrictions.

The trade remedy process

Under the GATT and then WTO trade rules, states may seek “remedies” for unfair trade practices such as government subsidies (with Countervail Duties) and selling exports below market value (with Anti-dumping Duties.) Historically Canada pioneered (and the US quickly followed) in the development of domestic complaint procedures by which the domestic industry could file a petition to a government trade agency initiating an investigation which might lead to preliminary and then final assessment of Countervail and/or Anti-dumping Duties on the offending import. Given the greater openness to local interests and lobbying of the US government system, Canada demanded in the 1984 Free Trade Agreement the right to appeal such decisions to “Chapter 19” binational panels for legal review.

Though Canada hoped for an expeditious deliberation by independent arbitrators, in practice over the previous four rounds, the US has drawn out the process through appeals and delaying tactics even to the point of virtually ignoring the findings of NAFTA and WTO review panels. For example, the Round IV dispute dragged on from 2001 to 2006. And during those five years, hefty duties were collected, costing Canadian exporters market share, loss of production and layoffs resulting in some bankruptcies.

Indeed, from Round I to Round IV, the outcomes seem to have deteriorated for Canada. In Round IV, the USDC collected duties at an average rate of 27 % on the four largest provinces to a total of about \$4 billion but then, unlike the previous round, the 2006 agreement refunded only 80% of these collected duties to Canada (giving the rest to its own producers, in effect, giving them further incentives for future petitions.) Furthermore, in the 2006 SLA, Canada again accepted the idea of a cap (this time 34% of the US market) and a price support system with a progressive tax imposed when the US price dipped below a given threshold. Canadian production lagged under this agreement and our share of the diminished US market dropped to a low of about 25% in 2009 from a peak of about 35% in 2001 though factors other than the SLA must also be considered.²

Current softwood dispute

When the 2006 SLA expired in Oct 2013, the Obama and Harper governments agreed to a 2-year extension. Shortly thereafter the US real estate market took off, the Canadian dollar began its steady decline (lowering the price of Canadian imports in the US market) and the Canadian share of the US market grew, though not back to its 34% cap (until after the SLA extension had expired.) Perhaps for these reasons, a coalition of US producers (called the “Coalition”) refused to agree to a further

² Most importantly the 2008-9 Housing/Financial Crisis and the Canadian dollar near parity at the time. Data on US market share from Nick Szucs, “Softwood Lumber Dispute in Context,” 18 May 2017. <http://leithwheelerblog.sitcm.com/uncategorized/softwood-lumber-dispute-in-context/>

extension in Oct 2015. As by the terms of the 2006 SLA, a one year “cooling-off” period with no restrictions and petitions followed. As might be expected, the Canadian share of the US market grew through 2016 with the Coalition claiming that Canada took advantage of this period to create a “surge” and “critical circumstances” for them. The big four³ Canadian companies denied doing this (and as we’ll see, their argument at least was apparently accepted by the USDC). Other critics claim in hindsight that Trudeau squandered Canada’s last opportunity to negotiate a settlement with Obama before the Trump arrival. Canadian negotiators claimed US demands for a new 25% cap blocked a deal. In any case, no deal was reached.

So as expected, when the holding period end this past fall, the Coalition filed a petition against Canadian SL imports again starting both the US Countervail and Dumping determination processes. Unlike past rounds, the Coalition this time noticed a great increase in lumber from NB and demanded it (but not the rest of Atlantic Canada) also be investigated. J.D. Irving Ltd., of Saint John had the foresight to request to be a “voluntary” respondent to the USDC investigation along with the usual four “mandatory” (Big 4) respondents to supply further details. And also in November came the surprise Trump election victory and his threat to get tough with US trade partners even to the point of scrapping NAFTA.

On 24 April 2017, the USDC announced its preliminary subsidy findings. Based on differing rates of alleged subsidization, the five respondent companies were charged different Countervail Duties rates: West Fraser, 24.12%; Canfor, 20.26%; Tolko, 19.50%; Resolute, 12.82%; J.D. Irving, 3.02%. Apparently, an average of these rates was taken for a rate of 19.88% to be applied to all other Canadian SL imports to the US. Also, Commerce bought the big four’s argument that they hadn’t surged their exports in the past year so while Irving and all the others had to add on 90 days’ worth of retroactive duties at Irving’s rate of 3.02%, the Big 4 we exempted.

By late this June, preliminary Anti-dumping findings are to be announced and, based on past experience, should add another 10-15 percentage points to the overall duty rate at the US border. (In the past round, Atlantic Canada was not exempted from these AD duties and should expect the same this time.) But the comparative firm/regional advantages will be less likely to favour the Atlantic or smaller exporters. On top of the retroactive duties, all firms are expected to provide hefty deposits for further exports. Thus, further shut-downs, job losses and bankruptcies are expected.

Policy options

So what should Ottawa do? There appear to be no overwhelmingly good options. Already one has heard unusual calls for tough counteraction; for example, Premier Clarke’s threat for a retaliatory ban on thermal coal from the US seconded by the Prime Minister, or import taxes and restrictions targeting

³ The “Big 4” in softwood lumber as commonly used in the media are three BC firms—West Fraser Timber Co. Ltd. (largest Canadian producer), Canfor Corp. (2nd largest) and Tolko Industries Ltd and Resolute Forest Products Inc. of Montreal with properties mainly in Quebec and Ontario.

goods from Oregon to pressure a protectionist Senator and the industry there. Most such threats have been shown to have negative backlashes for Canada and provoking the volatile Mr. Trump seems a bad idea especially with the NAFTA renegotiation looming. The President after all thrives on conflict, diversion and rallying his bellicose core. Given the basic size asymmetry in the US-Canada economic relationship, any trade threat and loss will hurt Canada more. Traditional "Quiet Diplomacy" would seem preferable.

One such quieter tactic might be to seek allies and lobbying from American industries using Canadian lumber imports such as house construction and furniture. But many such importers, foreseeing the dispute have stocked up. Even if a lumber shortage raises the price of a new home by a few thousand dollars, this increase represents only a small percentage of the overall sales price in the current booming US market. And finally, many individual US firms (with the encouragement of the US Coalition and Trudeau government!) are already splitting and running to the USDC to beg a special exemption from duties for their product.

Another tactic is to seek an alternate market especially in the huge Chinese construction market. To a large extent BC exporters have already been pursuing this over the past decade. But there are limitations too beyond the recent Chinese economic slowdown. Eastern Canada is too far away and small mills are unwilling to bear the costs to retool their saws from feet to meters for the Chinese or European markets (where the Scandinavians are entrenched.)

Or we could repeat the pattern of past SL disputes, following the well-worn, legal, and institutional tracks of USDC trade remedy determinations and NAFTA chapter 19 panels and appeals (and hopefully victories again for Canada) over the next several years. In the past, this path only lead to a negotiated settlement on whatever terms Canada could extract. Panel victories might help the negotiations. One obvious change or concession would be to offer up the archaic BC lumber export tax especially since the USDC finding specifically mentions it.

But the gravest danger this time is the unfortunate coincidence of the SL dispute and broader NAFTA negotiations and the encouragement a Canadian panel victory might give for Mr. Trump to demand to end the Chapter 19 panels altogether. These panels were after all a requirement for our acceptance of the original deal and their loss would be a major Canadian setback going well beyond softwood.

Dr. Steven Holloway recently after a distinguished career at St. Francis Xavier University, and is now an adjunct professor with the Political Science department at Dalhousie. He is the author of numerous books and articles on international politics and Canadian foreign policy, including Canadian Foreign Policy: Defining the National Interest (Broadview, 2006).