



## Softwood lumber

# A trade dispute with the U.S. challenges Canadian federalism

BY STEVE MERTL

**Canada** and the United States enjoy the single biggest two-way trading relationship in the world. With almost \$2 billion CDN per day in goods moving back and forth across the border, there are bound to be a few hiccups.

But a long, bitter dispute over Canadian softwood lumber exports has been more like a sustained coughing spasm that abates for a while, then breaks out again — loud, painful and bringing no apparent relief.

It has also presented challenges for Canadian federalism, with the central government largely powerless in a battle that pits the American lumber industry against Canadian lumber-exporting provinces.

### **Dispute over alleged subsidies**

Canadian exports of lumber, used mainly for home building and renovation, have been under repeated attack from American lumber interests for 20 years. A politically influential coalition of U.S. producers claims Canadian lumber, which currently has about a one-third share of the American market, is subsidized through low stumpage fees — the royalties companies pay for logging timber in publicly owned forests.

At stake are lumber exports worth \$10 billion CDN in 2000, less than a week's worth of the total two-way trade between the two countries. But it's pivotal to several regions of Canada, especially British Columbia, the westernmost province where forestry remains the largest resource-based industry and major employer. Quebec and Ontario in central Canada, as well as Alberta (next door to British Columbia), are also big lumber producers. The four Atlantic provinces have increased their share of exports in recent years.

Under Canada's constitution, the 10 provinces have overriding authority in many areas. Perhaps none is more jealously guarded than provincial control

of natural resources, which remain important levers of regional economic development.

In forestry, that control is enhanced by the fact that most timber — in British Columbia it's 95 per cent — is located on Crown land, publicly owned and directly controlled by the provincial government. So besides regulating aspects such as safety and environmental standards, the province has a direct economic interest in logging through the issuing of timber licences to forest companies and collection of stumpage fees.

That's the crux of American criticisms. U.S. producers argue the provinces set stumpage rates and other licence requirements to extract maximum social benefits from the resource — such as employment and value-added processing — instead of pricing according to the true market value of the timber. That puts American lumber producers, whose domestic wood costs are based mostly on auction prices for logs from private tree farms, at a competitive disadvantage, they contend.

The provinces don't deny they want the benefits of a publicly owned resource to flow to their citizens but claim those goals aren't incompatible with stumpage fees that reflect the market value of the wood.

The American industry's response has been to file countervail complaints against Canadian lumber — four since 1982 — attempting to impose punitive duties on Canadian exports. They've been a boon for Washington trade lawyers but a headache for almost everyone else.

The latest, which added a complaint of dumping for good measure, was filed with the U.S. Commerce Department on April 2, 2001, two days after a five-year bilateral agreement that restricted Canadian lumber imports to the United States expired.

U.S. trade officials imposed provisional countervailing and anti-dumping duties totalling an average of 32 per cent.

Pending a final determination of duties this spring, Canadian exporters must post bonds covering their potential obligations. The anticipated cost of the duties, coupled with a slumping demand for lumber, caused many mills to shut down, especially in British Columbia, which accounts for more than half of Canadian export volume.

### **An intergovernmental conundrum**

The dispute has always left Ottawa in a politically awkward position. Foreign trade is clearly a federal responsibility but the policies that the Americans find egregious are within provincial jurisdiction.

To complicate things further, individual provinces and regions view the dispute differently, depending on the importance of forestry to their economies.

The Atlantic provinces, for instance, managed to avoid the latest countervail complaint because U.S. trade officials decided their auction-based timber-pricing system resembled the American ideal. However, they were still ensnared in the anti-dumping action, which targets individual companies with allegations of selling at below their cost of production or at prices lower than the domestic Canadian market.

British Columbia, which as late as the 1970s accounted for two-thirds of lumber exports, was the biggest player in this dispute and Ottawa was sometimes seen as catering to its interests at the expense of the other lumber-producing provinces.

To complicate things even more, federal officials have had to be mindful of the politics of Quebec sovereignty. The Parti Québécois, whose aim is to take the majority French-speaking province out of the Canadian federation, rarely misses an opportunity to exploit federalism's perceived shortcomings in terms of Quebec's interests.

And the past 20 years have seen the provinces gaining an increasing share of

decision-making power in formulating a Canadian response to US trade actions.

### **Feds fight the first rounds**

The first trade action in 1982 ended relatively quickly one year later with the U.S. Commerce Department concluding provincial forest-management programs did not constitute countervailable subsidies.

But three years later, the Americans were back with largely the same complaints. This time U.S. trade officials sided with their domestic producers, levying a 15 per cent countervailing duty against Canadian lumber.

Canadian priorities had changed too. The Progressive Conservative government in Ottawa was preparing to negotiate a comprehensive free-trade agreement with the United States. It didn't want lumber to potentially derail the treaty. Everyone got their own lawyers this time.

"This is not generally known, but B.C. itself had started its own talks secretly with the U.S. government," says a veteran of the lumber wars who has worked both for government and industry, who doesn't want to be named. "That certainly stimulated the federal government in Canada to do a deal, and they did."

Ottawa's response was to propose a memorandum of understanding with the United States. Canada would impose an export tax on lumber equivalent to the U.S. tariff, which would be lifted. The Canadian tax would be reduced as provincial stumpage fees were increased, although there was no admission of subsidy.

The advantage for Canada was that the export tax would be funnelled back to the producing provinces, whereas an American tariff went into the U.S. Treasury.

The federal initiative, accepted by the provinces and the Americans, allowed Ottawa to red-circle lumber and conclude the free-trade deal. Lumber trade wouldn't be free, though it would be covered by the new treaty's dispute-settlement rules.

A few years later, Ottawa pulled out of the memorandum of understanding, satisfied provincial policy changes had effectively raised wood costs. The U.S. Commerce Department apparently disagreed, self-initiating a third countervail case.

### **Increasing federal-provincial cooperation**

"The third lumber investigation is perhaps the most clear-cut case of how these things should go, as far as Canada's concerned at least," says an un-named source. "The federal-provincial co-operation at that time was quite good."

A 6.51 per cent duty imposed on the four main producing provinces, as well as Saskatchewan, Manitoba, the Yukon and Northwest Territories was successfully appealed under provisions of the now operative Canada-U.S. Free Trade Agreement and was quashed in 1994. Canadian producers eventually got back \$800 million CDN in duties.

But the victory proved hollow. The Americans served notice that they would be back again and Canada, backed by a weary lumber industry, opted to discuss a deal with the United States to forestall another costly legal battle.

"It was not unanimous," says an insider. "Many provinces were telling the feds, 'do not do this' because these consultations will inevitably turn into negotiations."

They did indeed become negotiations, resulting in the 1996 Canada-U.S. Softwood Lumber Agreement. The five-year deal, whose expiry last March triggered the latest countervail case, limited Canadian lumber exports into the United States to a percentage of 1995 sales, with an export charge levied on higher volumes. A quota system was set up, based on export levels by provinces and individual companies.

Provincial governments took a secondary role in the talks that led to the deal, said Jake Kerr, chairman of Lignum Corp., a Vancouver lumber company.

"Industry was in the front row, with the provincial governments in lockstep and the federal government sort of providing oversight but frankly not terribly active except when it came to winding it up and negotiating broader issues like access," said Kerr, a key industry negotiator in the agreement.

Manoeuvring began more than a year before the managed-trade deal expired.

Central Canadian lumber producers, with relatively smaller quotas to protect, wanted to take a hard line against the Americans, replaying the 1991 case that Canada had won.

British Columbia producers, fearful that amended U.S. trade legislation would make the case harder to win, initially

pushed for new negotiations towards a revised lumber agreement.

### **Provinces do the talking**

On the eve of the 1996 agreement's expiry, Ottawa moved pre-emptively to challenge aspects of U.S. trade law before the World Trade Organization.

The decision was to fight the countervail and dumping cases while holding "consultations" with the Americans to get at their core concerns and perhaps open the door to a real, long-term settlement. Central Canadian industry lobbyists were worried these would lead to another managed-trade deal to appease the Americans.

But the major producing provinces by all accounts showed surprising unity, at least in public. They tabled proposals aimed at making their stumpage systems appear more market sensitive but, led by British Columbia and Quebec, they rejected any solution that limited Canadian access to the U.S. market.

In face to face discussions with the Americans, the provincial delegations have taken the lead role.

Ottawa sees its role as a kind of facilitator, stepping in when it appears U.S. officials don't understand some point a province is making, or vice-versa.

The Canadian players so far appear to have maintained their united front. Quebec's Parti Quebecois government caused a brief stir in November when Natural Resources Minister Jacques Brassard seemed to suggest the province had reached its own accord with the Americans but needed Ottawa's approval to proceed.

The Canadian Minister of International Trade quickly vetoed the notion but the expected backlash never came. Federal officials now say the news media spun Brassard's comments.

And in British Columbia, where stakes are highest and pressure for a deal the strongest, Provincial Forests Minister Mike de Jong has taken on the province's traditional leadership role.

The federal government's balancing act has received good reviews in the West.

"There have been divisions in the country – talk now, talk later, don't talk, never talk," said John Allen, president of the B.C. Lumber Trade Council. "I think they've let it unfold as best they could, given the different interests in the country." 