



## Time to Draw a Line in the Sand: NAFTA and the Softwood Lumber Dispute

By Bruce Campbell

In a recent *Globe and Mail* commentary, Canada's deputy chief free trade negotiator, Gordon Ritchie, urged Prime Minister Martin to ask the US President George Bush to muzzle his trade pit bulls who are threatening to destroy the NAFTA dispute settlement system. Though it is naive to think that Bush would have committed any of his political capital at the March 23 NAFTA leaders meeting to settling the softwood lumber dispute, Ritchie's exasperation is understandable.

The dispute settlement mechanism was touted as the jewel-in-the-crown of the original Free Trade Agreement. Ritchie wrote in his memoir that without it the Canadian team would never have signed on to a deal. It was not the exemption from US trade law that Prime Minister Mulroney had promised, but it would, by constraining the US misapplication of its own laws, significantly reduce the problems Canadian exporters faced, and thereby greatly improve their security of access to the US market.

That was 17 years ago. The Canada-US softwood lumber dispute is now in its 23<sup>rd</sup> year. It has gone through four rounds, the last two with the FTA/NAFTA in place. The third round (Lumber III) ended in 1996 with a five-year negotiated settlement. The fourth round (Lumber IV), which began in 2001, is now in its fourth year. Each round has been more protracted and acrimonious than its predecessor.

Softwood lumber figures centrally in the free trade saga. It was the face of the gathering storm of US trade harassment that gave the Mulroney government its main rationale for seeking a free trade deal. The US Congress demanded a 15% duty on Canadian lumber exports as its price for allowing the negotiations to proceed. Canada challenged the US duty at the multi-

lateral trade body—GATT, but fearing it would poison the free trade negotiations, retracted and opted for a settlement that replaced the US duty with a 15% Canadian lumber export tax. When this five-year deal expired in 1991, it immediately triggered Lumber III.

On the surface the dispute is straightforward. The US lumber producers and the Administration's trade agencies—the Department of Commerce (DOC) and the US Trade Representative (USTR)—allege that the fee Canadian governments charge companies for cutting timber (stumpage) is below fair market price and is therefore an unfair subsidy to Canadian producers; and what's more, this unfair advantage hurts US producers. The solution, they argue, is for Canada to adopt the American-style market-based ownership and pricing practices.

Underlying it are profound differences in the ownership and management of forest resources. In Canada, 90% of timber cut is from public, or Crown land, while 95% of US timber cut is from privately owned land. In the US, private market auctions determine the price for cutting timber. In Canada, the price charged by government to companies to cut timber (stumpage fees) is based on a number of factors: production costs, market calculations, and company obligations regarding conservation, employment, and local processing.

Several other facts are important to understanding this dispute. Canada has 15 times as much forestland as the US and thus a huge supply advantage. Second, two-thirds of Canadian production is exported to the United States—60% from BC and 20% from Quebec. Canadian exports currently account for about one-third of American consumption. Third, the industry is not continentally integrated. US ownership of the Canadian

---

industry is low, and vice-versa, and unlike the auto industry, there is no strong US forestry lobby against US trade actions. Finally, Canadian companies have invested heavily in machinery and equipment and are on average much more productive than their American competitors.

At its core, the softwood lumber dispute is less about unfair Canadian subsidies and more about market share. When the Canadian dollar is low and/or the US demand (and prices) falls, competition from Canada threatens US companies' market share. What

US producers really want is a guaranteed no-less-than-70% share of their own market. Even if Canada were to comply completely with US pricing demands, it would not alter Canadian industry's comparative advantage, nor halt its capacity to increase US market share.

For two decades, Canadian governments and producers have fought these trade actions: in the World Trade Organization (WTO) since 2000 and in its predecessor the GATT. Since 1992, it has fought them under the NAFTA bi-national panel system, and it is now preparing to appeal a change to a US trade law declared illegal by the World Trade Organization—the Byrd

amendment—in the US domestic Court of International Trade (CIT). It opted for a negotiated settlement in 1986 to avoid aborting the free trade negotiations, and in 1996 to avoid changes to US trade law which neutralized Canada's victory in Lumber III and set the stage for a new round of duties. (The latter settlement also avoided a NAFTA constitutional challenge launched by the US lumber lobby.) Canada has won the legal battles thus far, but the question is: how far will the legal route overcome power politics in determining the outcome of the war and the terms of the eventual peace?

Legal maneuvering in the current round has become unusually rancorous. The US trade agencies have gone to extraordinary lengths to avoid complying with the legal rulings. They have employed dubious delay tactics and have attacked the integrity of panelists. They have refused to return the \$4.25 billion

(and growing by \$150 million a month) in tariff revenue collected from Canadian exporters since 2002. Senior American officials are saying they will not return this revenue, but rather will distribute it to their US competitors as directed by the Byrd amendment, even if the US loses its final legal appeal. They argue that because of an arcane legislative provision US law now trumps NAFTA panel decisions. The lumber lobby is again threatening a constitutional challenge against NAFTA if the latest extraordinary challenge appeal fails. Canadian exporters' legal fees are running at \$100 million annually and government legal costs are likely half that again.

The softwood lumber dispute highlights two fundamental truths about NAFTA: the deeply flawed FTA/NAFTA dispute system, and the pressure of NAFTA-driven integration to harmonize Canadian laws and regulations.

Although touted as a unique concession wrenched from the Americans and not extended in other US trade deals, less talked about is the fact that the FTA/NAFTA dispute system also served American objectives. As a Washington-based Center for Strategic and International Studies report noted, it legitimized US laws, standards and practices over international law with which it was often at odds.

The key feature of the dispute mechanism negotiated by Ritchie and his colleagues was the ad hoc bi-national panel system which replaced the US Court of International Trade's judicial review of the US trade agency decisions. The panels, comprised of nationals of both countries, did not judge the legality of US trade law, but only whether it was being properly applied. There was little to prevent the US Congress from changing its own law. A panel's final decision was binding only in the limited sense that it obliged the US trade agency to go back and review the case again. The process contained an extraordinary challenge appeal procedure that was only supposed to be used in extreme cases such as where a panelist had a conflict of interest or a panel had overstepped its authority. Finally, the FTA process was supposed to be much faster than the CIT review.

The softwood dispute has dramatically exposed NAFTA's flaws. The US invoked the Extraordinary Challenge Committee (ECC) procedure in Lumber III, and has invoked it again in the current round, with a ruling expected the coming months. (The US has used the ECC six times in all, making it a routine, not an unusual, part of the process). Some panel decisions

**The softwood  
lumber dispute  
highlights two  
fundamental  
truths about  
NAFTA: the  
deeply flawed  
FTA/NAFTA dis-  
pute system,  
and the pressure  
of NAFTA-driven  
integration to  
harmonize Ca-  
nadian laws and  
regulations.**

---

have split along national lines undermining their legitimacy. Despite NAFTA, the Congress has changed US law several times to reverse dispute losses. NAFTA panel disputes now take on average 700 days to resolve (Lumber IV is in its fourth year). This is more than twice as long as they were supposed to, and longer than those settled at the US Court of International Trade, the very process the NAFTA panels replaced.

Law professor Robert Howse argues persuasively in a CD Howe Institute paper that unless major improvements are made to the NAFTA system, complex cases with major stakes for the Canadian economy would be better dealt with at the WTO, and use of the NAFTA system should be confined to routine and politically uncontroversial cases.

Canadian companies have now taken their fight back to the US Court of International Trade, recognizing, as a report by US law firm, Baker and Hostetler concluded: "It is now arguable that Canadian private interests ensnared by anti-dumping and subsidies disputes with the United States would be better off in US courts than before binational panels." The bitter irony is that Canadian exporters have a chance in US court to have the duties held in escrow returned to them if they win, while under the NAFTA process, as US officials declare, they now have no chance at all of getting their money back. Hence, the perverse outcome that companies from Mexico and Canada going through the NAFTA dispute process get inferior treatment than say a French company going through the US court process. The final irony is that the Canadian government is also preparing to head back to the US domestic court, the very process it sought to replace under the FTA.

The second truth is that the NAFTA process has intensified pressure on Canadian governments to align their forest management policies with those of the US. In June 2003, the US Commerce department tabled a remarkable document outlining policy changes Canadian provinces would have to make to warrant the US removing its countervailing duties. They would, if implemented, foreclose decades of public policy linking company harvesting rights with obligations to maintain production, employment and stability in scores of communities, and weaken their capacity to undertake sustainable forestry conservation practices. US demands included the removal of the requirement to maintain a processing facility in the community where the timber was cut; removal of conditions for mill

closures; removal of minimum cut regulations that reduced production cutbacks and layoffs during economic downturns; adoption of what it called market-based reference prices and increased sale of timber at private auctions; and more privatization of Crown lands. The provinces, eager for an agreement, were prepared to move (in varying degrees) toward the US system, but talks broke off because the Americans wanted, in addition to this, a cap on Canadian market share at 30%.

In the intervening months the BC government, has unilaterally begun to implement some of the US demands, although other provinces have not. Recently, there have been talks to explore the possibility of resuming negotiations. The provinces have reportedly agreed to a federal proposal, part of which would involve the provinces bringing their timber management practices into line with the US system. Though vaguely worded, it would seem to disrupt the longstanding "social forest contract." Moreover, as inadequate as the provinces sustainable forestry practices may be, adopting the US free market system will only make them worse. Forestry policy must be made-in-Canada by Canadians, not directed out of Washington.

Ritchie noted in his autobiography that the FTA "reaches into the very core of government regulation of our society. Mishandled it can do great damage to our interests." He went on to express his dismay at government talk of harmonizing with US regulations because under FTA we were not under any obligation to harmonize. Maybe so, but Canadian officials, under intense pressure from their exporters to get a deal, are doing precisely this in order to secure access to the US market that we already paid dearly for and thought we had.

\* \* \*

The stakes in the softwood lumber dispute are very high—for the companies, the workers, and for dozens of resource-based communities across the country. However, this dispute is about much more than lumber. It is about the very integrity of the commitments the US government made under NAFTA and the

**As inadequate as the provinces sustainable forestry practices may be, adopting the US free market system will only make them worse. Forestry policy must be made-in-Canada by Canadians, not directed out of Washington.**

---

wisdom of the concessions Canada made to secure them.

Government and industry should continue to fight the legal battle through to its conclusion; and Lumber IV could last for a few more years. They should not cave in to US pressure for an early (and unfavourable) settlement. A legal win will not solve the problem, but it will help improve Canada's bargaining position in the negotiation that will inevitably follow. Government should provide adequate support to affected workers and communities, and assistance to the industry to help offset its enormous legal costs. The US is dragging

**If Canada continues to cave in, the Americans will continue to trample over us whenever they have an important interest to protect. Canada must draw a line in the sand. We do have alternatives to NAFTA in managing our bilateral economic relations.**

this out, trying to cripple the Canadian companies financially, and force them to settle on American terms. Any indication that we are anxious to settle will be interpreted as a sign of weakness and an incentive to continue their bully tactics.

If, as expected, Canada wins the legal battle and the US still refuses to remove the duty and return the duties collected from Canadian producers, if it persists in asserting that US law trumps NAFTA, then Canada should invoke a little-known, but powerful and as yet unused NAFTA provision: Article 1905. Article 1905 would allow Canada to trigger a bilateral consultation process on the grounds that the US is violating the Agreement. A win, which is likely, would give Canada the right to actually withdraw benefits it has extended the United States under NAFTA. The most obvious candidates for the withdrawal of benefits are the investment provisions—for example, national treatment for US investors or Chapter 11 investor-state privileges for US corporations—and the energy-sharing provisions.

Such an action would not be without consequence internationally. It would signal that Canada, the US' largest and closest trading partner, had lost confidence

in its willingness to live up to its international commitments. It would deal a blow to the US global economic strategy. Its bilateral trade negotiation initiative would be suspect, the hemispheric trade negotiation (FTAA) would formally collapse, and it would cast a shadow over current WTO negotiations.

An equitable and lasting solution to the softwood lumber dispute, if it is ever to be found, will be some form of managed trade agreement. Any negotiated settlement should not require Canadian governments to harmonize their forest management systems with that of the US. Canadian forest policy should be based on Canadian needs and priorities, including: sustainability, employment, and community stability. It should not be run out of Washington. Any negotiation should also involve all stakeholders, including affected communities and workers, who have been left out of previous negotiations.

Finally, the federal government should commission an independent assessment of the costs (and benefits) of getting out of NAFTA. Ritchie and others have been very clear that they would never have signed the Agreement in the first place if they thought that the Americans would treat its commitments with such contemptuous disregard. The US is out to destroy the dispute process, which, as Washington trade lawyer Elliot Feldman told a Commons committee, is now on "life support." They believe they can do this with impunity because Canada is so deeply integrated and dependent on the US, it would not walk away from the Agreement no matter what. If Canada continues to cave in, the Americans will continue to trample over us whenever they have an important interest to protect. Canada must draw a line in the sand. We do have alternatives to NAFTA in managing our bilateral economic relations. Despite the ongoing efforts of our elites, we still have the capacity to assert ourselves and flourish as an independent nation.

*Bruce Campbell is the Executive Director of the Canadian Centre for Policy Alternatives.*

*This paper was originally produced for the Centre for Research and Information on Canada.* 