

THE SOFTWOOD LUMBER CASE
EXPORT TAXES, QUOTAS AND TRADE RETALIATION

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The refusal of the United States to end dumping and countervailing duties on Canadian softwood lumber, in spite of a spate of NAFTA rulings, has led to demands for Canada to retaliate, including some suggestions that Canada should unilaterally restrict energy exports to the United States.

The prevailing view in Canada is that the U.S. has flagrantly disregarded the fundamental bargain in the agreement to settle these kinds of disputes through binational processes. Indeed, reflecting this commitment, Article 1904(9) of the NAFTA states in clear terms that decisions of panels “shall be binding” on the Parties.

The American position seems doubly disingenuous because, having lost its appeal to the Extraordinary Challenge Committee, the U.S. now says that it doesn’t matter because it had no intention of complying with the panel decision it was appealing from in the first place.

Even in the face of this kind of behavior, the immediate trade options are somewhat constrained. Canada can continue to seek recourse separately in the WTO, which it is doing, but this will take time. And unfortunately, nothing in the NAFTA allows for automatic retaliation either. The American lumber coalition knows this and so do their supporters in the Congress and the Bush administration.

LAWRENCE L. HERMAN

While some argue that Canada should ignore any limits imposed under NAFTA and just go ahead and apply countermeasures, it would be highly inadvisable for Canada to take steps that aren't allowed under the agreement. That would place Canada outside the NAFTA, following the ignominious example of the United States.

First, in terms of restricting energy trade, NAFTA Article 604 prohibits "any duty, tax or other charge" on the energy exports except under two limited conditions: first, any such tax has to apply to energy exports to all countries equally; second, the same tax has to apply to energy sales in Canada as well. So the idea of an immediate export tax is a non-starter.

Other kinds of export restrictions are similarly prohibited by the NAFTA. Under Article 605, Canada can only apply export restrictions on energy as permitted under the General Agreement on Tariffs and Trade, which means basically only in times of critical domestic shortages.

And there's a catch. Even where permitted, NAFTA says that export restrictions can't reduce exports to the U.S. below their pre-existing level as proportion as a percentage of total supply. In simple terms, this means that if the U.S. took 50% of Canadian supply before today, no export restrictions could cut them back from this percentage. So this is a non-starter as well.

That doesn't mean that Canada lacks trade-related options. Canada can and should continue to pursue retaliation under parallel proceedings in the WTO, as noted above. The difficulty here is that this will take another six to nine months to complete.

As well as using the WTO route, Canada should immediately take steps under NAFTA Article 1905, which permits retaliation where another Party's domestic law denies "binding force" to a panel decision. That's the situation we have here. The problem is

LAWRENCE L. HERMAN

that this route is also tortuous, legalistic and time-consuming. It requires Canada to initiate 45 days of consultations with the Americans. If this doesn't lead to a settlement – and it is unlikely that it would – Canada could proceed before a NAFTA “special committee”. The special committee would decide whether the U.S. breached its treaty obligations by not abiding by the panel decisions. That ruling must be made within 90 days, followed by yet another 60-days of consultations to again try to settle the dispute.

If the matter is not resolved after all this, and assuming the special committee upheld the Canadian case, the ultimate advantage under this provision is that Canada would have the right to immediately suspend trade benefits to the U.S. “as may be appropriate under the circumstances”.

A long, exhausting and rather frustrating process, especially after so many panel findings. But in the end, should Canada prevail, the right to suspend benefits “as may be appropriate” is virtually unlimited. It could include American benefits in the area of energy or any other sector that Canada might find fitting.

Some form of response is needed in the face of this latest U.S. tactic. A set of countermeasures would reinforce the outrage voiced at the political level. At the same time, in the highly unlikely event the Americans changed their tune, Canada should be open to returning to the negotiating table. After all this legal wrangling, long-term peace in the softwood lumber sector will only be achieved through a negotiated deal.



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