Seeing the Forest for the Trees: The Softwood Lumber Dispute as Managed Trade

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The softwood lumber dispute between Canada and the United States is one of the longest running trade disputes in history, and possibly the longest running trade dispute ever relating to a single topic. In one form or another, the dispute has been underway for nearly four decades. Notwithstanding its legal and economic significance, the softwood lumber dispute is not widely followed or understood outside of Canada and the United States. After reviewing the origins and history of the softwood lumber dispute, this article seeks to identify some of the broader implications of the dispute as they may affect governments and industries in other parts of the world. The article contends that existing subsidy disciplines as set forth in the WTO's Agreement on Subsidies and Countervailing Measures have an uneasy and uncertain relationship to disputes concerning access to natural resources and international trade in goods derived from natural resources, such as softwood lumber. The SCM Agreement's concepts of "financial contribution", benefit, and injury to the domestic industry of the importing country are particularly difficult to reconcile with sovereign natural resource arrangements. The softwood lumber dispute is best understood not as a traditional dispute about the injurious effects of subsidies, but as a form of managed trade effected through periodic trade remedy investigations and negotiated settlements of those investigations.

Key Words : Softwood Lumber, SCM agreement, Natural resource subsidies, Managed Trade

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Ⅰ. INTRODUCTION

The softwood lumber dispute between Canada and the United States is one of the longest running trade disputes in history, and possibly the longest running trade dispute ever relating to a single topic. In one form or another, the dispute has been underway for nearly four decades. The dispute has spawned more litigation before the World Trade Organization (WTO) than any other topic, with the WTO Dispute Settlement Body (DSB) having adopted 17 panel, Appellate Body, and arbitration reports relating to the topic over the course of more than 20 years.[1] It is also one of the highest-value trade disputes in history, with U.S. softwood lumber imports from Canada routinely valued at around $5 billion per year.

Notwithstanding its legal and economic significance, the U.S.-Canada softwood lumber dispute is not widely followed or understood outside of Canada and the United States. Compared, for example, to the *Aircraft* disputes between the United States and the European Union - another high-stakes, high-value trade dispute spanning the course of several decades - the softwood lumber dispute has not typically received the same level of attention from other WTO Member governments or from academic commentators. It is a peculiarly North American trade dispute.

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[1] The lumber-related WTO proceedings that have proceeded to the panel stage are: *US – Lumber CVDs Prelim* ("Lumber III") (WT/DS236); *US – Lumber CVDs Final* ("Lumber IV") (WT/DS257); *US – Final Lumber AD Determination* ("Lumber V") (WT/DS264); *US – Lumber ITC Investigation* ("Lumber VI") (WT/DS277); *US – Lumber CVDs* ("Lumber VII") (WT/DS533); *US – Differential Pricing Methodology* (WT/DS534). The panel reports in *US – Export Restraints* (WT/DS194) and *US – Section 129* (WT/DS221) are also related to the softwood lumber dispute.

This article seeks to explain the softwood lumber dispute to audiences outside of North America, i.e. outside the community of U.S. and Canadian trade officials and private sector lawyers whose careers the dispute has largely consumed. After reviewing the origins and history of the softwood lumber dispute, the article seeks to identify some of the broader implications of the dispute as they may affect governments and industries in other parts of the world. As a dispute that relates, most fundamentally, to the pricing of a natural resource (standing timber) and to cross-border trade in goods derived from that natural resource (softwood lumber), the softwood lumber dispute may have implications for other trade disputes and trade policy issues relating to natural resources and goods derived from natural resources.

This article will argue that existing subsidy disciplines as set forth in the WTO's Agreement on Subsidies and Countervailing Measures (SCM Agreement) have an uneasy and uncertain relationship to disputes concerning access to natural resources and international trade in goods derived from natural resources. The commonly understood economic rationale for anti-subsidy disciplines is that subsidies have the potential to increase the output of the subsidized product relative to market-determined levels and thereby cause competitive injury to non-subsidized producers of the same product. In the case of natural resources, however, the terms by which governments provide access to sovereign natural resources do not normally alter the quantity of the resource extracted or, for that reason, the quantity or price of downstream goods derived from that resource. Because natural resource pricing policies do not have the same potential to distort market outcomes, the application of anti-subsidy disciplines to these policies is harder to justify and can lead to results that are difficult to reconcile with the rationale for those disciplines. These incongruous results have been evident throughout the history of the softwood lumber dispute.

Given that Canadian softwood lumber policies do not have the same potential to distort market outcomes as the types of subsidies that the SCM Agreement was designed to address, one may reasonably wonder what the point of this multi-decade dispute has been. The softwood lumber dispute is an unusual example of an internecine trade dispute between two closely integrated economies. Even more unusually, it concerns a product - softwood lumber - that the United States *must* import from Canada in substantial volumes in order to satisfy its own domestic demand. Seen in this light, the softwood lumber dispute is best understood as a form of *de facto* managed trade, in which the petitioning U.S. industry has sought to use trade remedy investigations and negotiated settlements of those investigations as a means of regulating Canadian market share and increasing domestic softwood lumber prices.

Ⅱ. BACKGROUND

1. What is Softwood Lumber?

Softwood lumber is used principally as a framing material in the construction and renovation of residential homes and other types of low-rise buildings. Softwood lumber is milled from a variety of species of softwood conifers, such as Douglas fir and southern yellow pine. These are tree species that grow in forests throughout Canada and the United States, with particularly dense concentrations in western Canada, the U.S. Pacific Northwest, and the southern United States. Softwood species may be contrasted with hardwood species, such as maple and oak, the products of which are used more commonly for furniture and other non-framing applications.

As a building material, the market for softwood lumber is closely tied to the demand for new construction, especially the demand for new residential housing.[2] Compared to other parts of the world, where steel and masonry materials are more widely used in residential construction, "stick-built" homes remain the predominant form of low-rise residential construction in North America. For this reason, the North American market for softwood lumber has historically followed the cyclical pattern of new housing starts, which are heavily influenced by interest rates and the overall state of the economy.[3]

The manufacture of softwood lumber begins with the harvesting of trees in the forest, which become logs once felled. Logs are the input to lumber mills, which convert the logs into lumber of various pre-determined sizes (referred to as "dimension lumber") and into other wood by-products, such as wood chips. Because of the relatively low weight-to-value ratio of logs as compared to lumber, lumber mills are usually located in close proximity to the forests that supply their log input. As discussed in Part IV.A below, lumber mills can source logs from forestlands owned by the company itself, from forestlands owned by other companies or private individuals, or from publicly owned forestlands. At its most basic level, and as discussed in detail below, the

[2] *See*, *e.g.*, U.S. Department of Agriculture, "Projecting Lumber Demand in the U.S. and Abroad" (2 August 2021), available at: https://www.usda.gov/media/blog/2018/09/07/projecting-lumber-demand-us-and-abroad.

[3] *Softwood Lumber from Canada* (Investigation Nos. 701-TA-566 and 731-TA-1342 (Final), USITC Publication 4749, December 2017), pp. 27-28.

softwood lumber dispute concerns the compensation that Canadian lumber mills provide to Canadian provincial governments when the mills acquire logs from publicly owned forestlands.

The North American market for softwood lumber is closely integrated. Canadian softwood lumber producers have consistently supplied around one-quarter to as much as one-third of the United States' annual demand for softwood lumber products.[4] Canadian softwood lumber companies have invested heavily in the construction and acquisition of lumber mills in the United States, and U.S. softwood lumber companies have, to a lesser degree, acquired mill operations in Canada. But for the imposition of trade remedy duties by the United States, softwood lumber would move duty-free between the two countries.[5] Imports of logs and lumber from other countries are negligible, with the result that Canada and the United States effectively supply, on a combined basis, all of the softwood lumber that they consume.[6]

One of the unusual features of the U.S.-Canada softwood lumber dispute is that it concerns imports of a product that the complaining party, the United States, cannot do without.[7] While the U.S. softwood lumber industry has at times argued to the contrary, the fact that Canadian producers have consistently maintained a significant market share in the United States even when duties have been in place confirms that the United States needs Canadian softwood lumber to meet domestic demand.

The United States' dependence on Canadian softwood lumber imports was evidenced most recently when softwood lumber prices spiked dramatically in the first part of 2021 as the U.S. economy and U.S. housing starts began to recover from the impact of the Covid-19

4 Congressional Research Service, "Softwood Lumber Imports from Canada: Current Issues" (12 April 2018), pp. 3–4, available at: https://www.everycrsreport.com/files/20180412_R42789_9477a19fc7a8d8e638a5431242b9d3e6d8a98b62.pdf ("The Canadian share of the U.S. market peaked at more than 35% in 1995–1996 and fluctuated around 33% until 2005. Over the nine years the 2006 SLA was in place, the Canadian share of the U.S. market averaged 28% annually.").

5 *See* Harmonized Tariff Schedule of the United States, Basic Revision 8 (2021), Chapter 44, Tariff Code 4407 ("Wood sawn or chipped lengthwise, sliced or peeled, whether or not planed, sanded or end-jointed, of a thicknes s exceeding 6 mm"), available at: https://hts.usitc.gov/view/Chapter%2044?release=2021HTSABasicRev8.

6 Both countries, especially Canada, also export softwood lumber products to other countries. Since 2002, Canadian exports to South Korea, Southeast Asia and the United Kingdom have increased more than 200 percent to over $700 million. *See* Government of Canada, Softwood Lumber Fact Sheet, available at: https://www.nrcan.gc.ca/19605.

7 Government of Canada, Softwood Lumber Fact Sheet, available at: https://www.nrcan.gc.ca/19605 (90 percent of U.S. homes are built with softwood lumber, while the U.S. can only meet 70 percent of its softwood lumber needs); Congressional Research Service, "Softwood Lumber Imports from Canada: Current Issues" (12 April 2018), p. 3, , available at: https://www.everycrsreport.com/files/20180412_R42789_9477a19fc7a8d8e638a5431242b9d3e6d8a98b62.pdf ("Historically, Canada has been the largest foreign supplier of softwood lumber in the United States, accounting for 95% of imports since 1965.").

pandemic.[8] Unusually in the history of the softwood lumber dispute, some U.S. politicians and officials called for the removal or reduction of duties on imports of softwood lumber from Canada, effectively acknowledging that these duties are taxes paid by U.S. consumers that constrain supply and raise prices.[9] As this episode illustrates, and as discussed in Part III below, the U.S.-Canada softwood lumber dispute is best seen not as an effort to remediate import-related injury to a domestic industry (the traditional rationale for trade remedies), but rather as an effort by the petitioning U.S. industry to manage Canadian market share and raise market prices for softwood lumber.

2. The Historical Origins of the Softwood Lumber Dispute

The softwood lumber dispute is, at its highest level, a tale of two different natural resource systems co-existing within an integrated market. In Canada, around 85 percent of the timber used to produce softwood lumber is sourced from publicly owned lands.[10] In the United States, most timber used to produce softwood lumber is sourced from privately owned lands.[11] Timber sourced from publicly owned lands in the United States accounts for only 10 to 15 percent of the total timber supply, roughly the opposite of Canada.[12] The existence of these two different systems side by side - predominantly public ownership of a natural resource versus predominantly private ownership of a natural resource - is in many ways the root source of the softwood lumber dispute.

The differences in timberland ownership in the United States and Canada are the result of differences in the historical evolution of the two countries, especially in respect of the westward expansion of European settlers and how newly occupied lands were incorporated into the expanding nations. These historical differ-

8 *See*, *e.g.*, Lance Lambert, "'Pure panic': Lumber prices up a staggering 280% as builders scramble for supply" (5 May 2021), Fortune, available at: https://fortune.com/2021/05/05/lumber-prices-chart-2021-may-price-of-lumber-going-up-data-wood-shortage-why-so-expensive-to-buy-wood/.

9 *See*, *e.g.*, David Lawder and Jarrett Renshare, "U.S. trade chief pressured to lift duties on Canadian lumber" (16 May 2021), Reuters, available at: https://www.reuters.com/business/us-trade-chief-pressured-lift-duties-canadian-lumber-2021-05-16/; Payne Lubbers, "U.S. Commerce Chief Seeks Long-Term Lumber Solution With Canada" (26 May 2021), Bloomberg, available at: https://www.bloomberg.com/news/articles/2021-05-26/u-s-commerce-chief-seeks-long-term-lumber-solution-with-canada.

10 Natural Resources Canada, Forest Land Ownership, available at: http://www.nrcan.gc.ca/forests/canada/ownership/17495 ("The majority of Canada's forest land, about 94%, is publicly owned and managed by provincial, territorial and federal governments. Only 6% of Canada's forest lands is privately owned.").

11 Congressional Research Service, "Softwood Lumber Imports from Canada: Current Issues" (12 April 2018), p. 6, available at: https://www.everycrsreport.com/files/20180412_R42789_9477a19fc7a8d8e638a5431242b9d3e6d8a98b62.pdf.

12 United States Department of Agriculture, "Forest Resources of the United States, 2017" (March 2019), p. 9, available at: https://www.fs.fed.us/research/publications/gtr/gtr_wo97.pdf.

ences have influenced, in turn, how access to natural resources is governed today and how compensation for natural resource rights is typically provided.

In the United States, vast amounts of timberland in the American West were given away for free by the U.S. government as the nation expanded westward. The Homestead Acts of the 1800s and early 1900s sought to encourage European settlement in the American West by allowing individual settlers to claim ownership of government-controlled land.[13] In addition, the United States gave large amounts of timberland to railroad companies in the 1800s to promote the development of transcontinental railways.[14] These railroad land grants usually extended well beyond the land required for the railway itself and often included prime timberlands adjacent to the railway. Through these and other mechanisms, most of the timber-producing land in the United States ended up in private hands.

In Canada, by contrast, the government - usually in the form of the provincial governments - retained ownership of most timberlands as European settlers expanded westward. While Canada also had land grant programmes, including for railways, the amount of land given away by the government was not as extensive as in the United States, due in part to Canada's lower population density. As a result, most timberlands in Canada, especially in western Canada, remain owned by the provincial governments to this day.

These differences in land ownership between the United States and Canada affect the principal means by which lumber companies gain access to timber and logs in each country. In the United States, most timberlands are owned by integrated forest product companies (i.e. companies that own timberlands and produce wood products such as softwood lumber from those timberlands) or by private investors that sell timber harvesting rights to lumber producers and others.[15] In effect, land that the United States gave away for free earlier in its history has become a perpetual source of natural resource income for private interests, with no benefit to the government other than revenue from general taxation.

In Canada, lumber producers obtain most of their timber and log supply from public lands under various types of li-

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[13] *See* Greg Bradsher, "How the West Was Settled" (2012), Prologue Magazine, U.S. National Archives, available at: https://www.archives.gov/files/publications/prologue/2012/winter/homestead.pdf.

[14] *See id.*, p. 29 ("By 1871, almost 128 million acres had already been granted to the Union Pacific and Central Pacific Railroad Companies to aid construction of the nation's first transcontinental rail line.").

[15] Congressional Research Service, "Softwood Lumber Imports from Canada: Current Issues" (12 April 2018), p. 2, available at: https://www.everycrsreport.com/files/20180412_R42789_9477a19fc7a8d8e638a5431242b9d3e6d8a98b62.pdf.

cense arrangements with the government.[16] Many of these license arrangements, called "tenures", are long-term in nature (e.g. 25 years or more). Under these license arrangements, the license holder agrees to undertake an array of forest management responsibilities in exchange for the right to harvest standing timber from the licensed area. In addition, and critically for the softwood lumber disputes, license holders agree to pay a fee to the government for the timber that they cut and remove from the licensed area. This fee is usually volumetric in nature (i.e. tied to the volume of timber harvested) and is referred to as a "stumpage" charge. As discussed in Part IV.B below, the stumpage charge is a means of allocating the natural resource rent (profit) between the license holder and the government, akin to a royalty payment or a resource extraction tax.

The central issue in the softwood lumber dispute is whether these provincial licensing arrangements, including the levels at which stumpage charges are set, give rise to a countervailable subsidy. As discussed below, the basic allegation of the U.S. softwood lumber industry is that Canadian softwood lumber producers pay "less than adequate remuneration" for the timber that they harvest from provincially owned forestlands. The U.S. industry contends that Canadian softwood lumber producers thereby receive a subsidized input, logs, and that this input subsidy provides an unfair competitive advantage to the Canadian producers' manufacture and export of softwood lumber to the United States.[17]

Underlying the U.S. industry's allegations is a sentiment that there is something inherently unfair or suspicious about the widespread public ownership of forestlands in Canada, in contrast to what the U.S. industry considers to be the "normal" condition of private forestland ownership. Even though most forestlands in the United States were given away for free a long time ago, to the ongoing benefit of the U.S. softwood lumber industry and other users of wood fibre, the U.S. industry takes private forestland ownership as its "market" baseline and assumes that a system of public forestland ownership must involve the provision of a subsidy because of the government's continuing involvement in the management of the natural resource.

As discussed below, the allegation that provincial forest licensing arrangements amount to a "subsidy" is one that the U.S.

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[16] *See*, *e.g.*, Government of British Columbia, "Timber Harvesting Rights", available at: https://www2.gov.bc.ca/gov/content/industry/forestry/forest-tenures/timber-harvesting-rights.

The U.S. industry has also claimed that Canadian producers "dump" softwood lumber in the U.S. market (broadly speaking, sell softwood lumber at less than its cost of production), but this article focuses on the core claim of subsidization that has consistently been at the centre of the softwood lumber dispute.

investigating authorities and reviewing bodies such as the WTO have examined under U.S. and/or international law, as those laws have evolved over the course of the past 40 years (as influenced, at times, by the softwood lumber dispute itself). Those laws provide the formal legal framework for evaluating whether provincial forest licensing arrangements give rise to a subsidy. At its core, however, the softwood lumber dispute is a dispute arising from the co-existence of two different natural resource systems operating within a single, integrated market for the products of that resource. It is the misunderstandings and suspicions arising from these two different systems, as well as the opportunities that trade remedies present for rigging the market to the benefit of U.S. producers, that explain the unusual persistence of this dispute.

Ⅲ. A HISTORY OF THE SOFTWOOD LUMBER DISPUTE IN FIVE PARTS

Under the SCM Agreement, and also under U.S. law, a "subsidy" exists when a government provides a "financial contribution"[18] to a company or industry and that financial contribution confers a "benefit".[19] To be "actionable", including for the purpose of imposing countervailing duties, a subsidy must also be "specific" to certain enterprises or industries.[20] Broadly speaking, a subsidy is "specific" if it is not widely available to enterprises and industries throughout the economy. WTO Members may impose countervailing duties on an imported product (i.e. duties intended to offset the effects of foreign subsidization) when they determine, after due investigation, that foreign producers of that product obtained specific subsidies and that imports of the subsidized product are causing or threatening to cause injury to domestic producers of the same product.[21]

One of the types of "financial contributions" recognized by the SCM Agreement and U.S. law is where a government "provides goods" to the producers of a product. An example of a government "providing goods" would be where a government provides rubber to manufacturers of tyres. The government provision of a good confers a "benefit" when the government provides the good for "less than adequate remuneration". Under Article 14(d) of the SCM Agreement, the "adequacy of remuneration" for the provision of a good is to be

18 SCM Agreement, Article 1.1.
19 *Id.*, Article 1.2.
20 *Ibid.*
21 SCM Agreement, Articles 5 and 6.

determined "in relation to prevailing market conditions for the good … in the country of provision".

The essential allegation of the U.S. softwood lumber industry is that Canadian provinces provide timber harvesting rights to Canadian softwood lumber producers for less than adequate remuneration. The U.S. petitioners contend that the provision of timber harvesting rights under different types of provincial licensing arrangements amounts to the provision of a "good", because the companies that hold these rights are able to harvest standing timber from government-owned lands and thereby obtain logs, a tradable good that is the key input to the production of softwood lumber. The U.S. petitioners claim that Canadian provinces provide these "goods" for less than adequate remuneration because the levels at which the provinces set their stumpage charges (the charge, usually volumetric, that the licensee pays upon harvesting standing timber) are not "market-determined". The U.S. petitioners allege that imports of subsidized softwood lumber from Canada injure U.S. producers of softwood lumber products, for example by taking market share from U.S. producers and suppressing softwood lumber prices.

The United States has examined these allegations across five different countervailing duty investigations spanning nearly 40 years. Like movie sequels, these investigations are commonly referred to by their Roman number, e.g. "Lumber I", "Lumber II", and so on. The countervailing duty investigation and related proceedings currently underway, which began in 2016, is known as "Lumber V".[22] These countervailing duty investigations have spawned not only numerous WTO disputes, as discussed above, but also a large number of U.S. court challenges and challenges before binational U.S.-Canadian panels.

Beginning with the Canada-U.S. Free Trade Agreement in 1988, and following into the North American Free Trade Agreement (NAFTA) and now the United States-Mexico-Canada Agreement (USMCA), national trade remedy determinations have been subject to review by *ad hoc* binational panels.[23] These panels consist of five individuals with relevant trade remedy expertise who review the consistency of a trade remedy determination with the national law of the country imposing the measure (in this case, the United States).[24] Binational panel review is in lieu of

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Confusingly, the WTO also uses Roman numbers in its short-form captions for disputes relating to softwood lumber, but its numbering system relates to the order in which the dispute was initiated rather than the investigation to which the dispute pertains. For example, the dispute that the WTO refers to as "Lumber VII" (*United States – Countervailing Measures on Softwood Lumber from Canada,* WT/DS533) is a dispute arising from the countervailing duty investigation known in the United States and Canada as Lumber V.

23 *See*, *e.g.*, United States-Mexico-Canada Agreement (USMCA), Article 10.12.

the right to seek judicial review of a trade remedy determination before a national court (which, in the United States, would be the U.S. Court of International Trade with the right to appeal to the U.S. Court of Appeals for the Federal Circuit).[25] The system of binational panel review under these agreements arose in no small part from the history of the softwood lumber dispute between the United States and Canada. Canada's position was that there should be *no* trade remedies permitted between the United States and Canada (i.e. no countervailing or anti-dumping duties permitted on imports), but the two countries ultimately agreed that trade remedies would be permitted subject to review by binational panels instead of domestic courts.

Across five separate U.S. countervailing duty investigations of softwood lumber from Canada, there has never been a final affirmative determination of subsidization and injury that has withstood judicial or binational panel review. Instead, each investigation has either resulted in a negative determination of subsidization and/or injury by the U.S. investigating authorities, or has led to a negotiated agreement between Canada and the United States before definitive countervailing duties could be assessed. For all of the time and resources that the U.S. softwood lumber industry has put into pursuing its allegations of subsidized Canadian lumber, and for all of the time and resources that the U.S. investigating authorities have put into examining these allegations, there has never been a final and definitive finding that Canadian softwood lumber is in fact subsidized.

Before reviewing the history of these investigations, it is helpful to explain briefly how the U.S. countervailing duty process works. In the U.S. system, the U.S. Department of Commerce (USDOC) is responsible for investigating and determining the existence and extent of subsidization, while the U.S. International Trade Commission (USITC) is responsible for determining whether imports of the product under investigation are causing or threatening to cause injury to the domestic industry.[26] An affirmative determination of both subsidization and injury is required to impose countervailing duties.[27]

The United States operates an unusual "retrospective" system of trade remedy duties in which the initial investigation, if

[24] *Id.*, Annex 10-B.1.

[25] 19 U.S.C. § 1516a ("Judicial review in countervailing duty and antidumping duty proceedings").

[26] *See*, *e.g.*, USITC, Antidumping and Countervailing Duty Handbook (2015, Fourteenth Edition), available at: https://www.usitc.gov/trade_remedy/documents/handbook.pdf.

[27] *See*, *e.g.*, *id.*

affirmative, results only in the collection of preliminary import duties known as "cash deposits", while *actual* duty liability, if any, is determined in subsequent periodic (or "administrative") reviews carried out on a rolling basis after the initial investigation is concluded.[28] Because parties can challenge both the initial countervailing duty investigation and the results of the subsequent administrative reviews,[29] and enjoin the final collection of duties while those legal challenges are underway,[30] large amounts of preliminary cash deposits can accumulate in the U.S. treasury over the course of a countervailing duty investigation and subsequent litigation relating to that investigation. As will become evident, this feature of the U.S. retrospective system has proven consequential in the history of the softwood lumber dispute.

The first U.S. countervailing duty of investigation of softwood lumber from Canada ("Lumber I") was initiated in 1982 and resulted in a finding by the USDOC that Canadian lumber is not subsidized beyond a *de minimis* level.[31] The USDOC rejected the U.S. softwood lumber industry's core allegation that Canadian provincial stumpage programmes provide a countervailable subsidy. The USDOC found that provincial stumpage programmes were not limited to certain enterprises or industries (i.e. that they are not "specific"), and also found that provincial stumpage programmes did not confer a subsidy benefit.[32] As a result of these findings, no countervailing duties were applied.

The USDOC initiated Lumber II in 1986. In its preliminary countervailing duty determination, the USDOC reversed its prior findings from Lumber I and found that Canadian provincial stumpage programmes confer a subsidy benefit and are limited to certain enterprises (i.e. "specific").[33] This is an example of how the outcomes of the lumber investigations have been driven as much by changes in the law and/or the increasing politicization of the USDOC as opposed to any change in the underlying facts. Before the USDOC issued a final determination in the investigation, Canada and the United States entered into a memorandum of understanding (MOU) under which Canada agreed to collect a 15 percent charge on lumber exports to the United States.[34] This was the first occasion on which a U.S. countervailing duty investigation of softwood lumber resulted in a bilateral

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28 19 C.F.R § 351.221.

29 19 U.S.C. 1516a(a)(1).

30 *Id.*, 1516a(c)(2).

31 *See Certain Softwood Products From Canada*, 48 Fed. Reg. 24,159, 24,160 (31 May 1983).

32 *Ibid.*

33 *Certain Softwood Lumber Products from Canada*, 51 Fed. Reg. 37,453, 37,457-58 (22 October 1986).

"managed trade" agreement between Canada and the United States, a pattern that was to repeat itself.

In September 1991, Canada announced its intention to terminate the MOU that had resulted from Lumber II. The USDOC self-initiated a countervailing duty investigation ("Lumber III") in October 1991.[35] In its final determination, the USDOC found that Canadian provincial stumpage programmes confer a subsidy benefit and that the subsidy is limited to certain enterprises.[36] The Canadian parties challenged the USDOC's final determination before a binational panel. The binational panel found that the USDOC had failed to provide a rational basis for its finding of specificity, and that the USDOC had failed to evaluate whether Canadian provincial stumpage programmes result in market distortion (a topic discussed in Part IV.B below).[37] After a series of remands from the binational panel and re-determinations by the USDOC, in which the USDOC effectively refused to comply with the binational panel's rulings, the binational panel ordered the USDOC to terminate the countervailing duty order.[38]

In May 1996, following the conclusion of the proceedings in Lumber III, Canada and the United States entered into the first Softwood Lumber Agreement (SLA).[39] The SLA was a five-year agreement under which Canada agreed to impose fees on exports of softwood lumber from specified Canadian provinces when the volume of those exports exceeded certain quantitative limits (similar to a tariff-rate quota).[40] During this period, the United States agreed that it would not initiate countervailing duty investigations of softwood lumber.

The SLA expired on 31 March 2001 and, within a matter of days, the U.S. investigating authorities initiated a new countervailing duty investigation of softwood lumber from Canada ("Lumber IV").[41] The USDOC once again found that Canadian provincial stumpage programmes confer a countervailable subsidy, while the USITC found that imports of softwood lumber from Canada threatened injury to the U.S. industry.[42] The legal challenges to these determinations were multifaceted and com-

34 *Memorandum of Understanding between the Government of Canada and the Government*, 52 FR 1311 (30 December 1986); *Certain Softwood Products from Canada*, 52 Fed. Reg. 315 (5 January 1987) (reflecting the termination of the investigation).

35 *See Certain Softwood Lumber Products From Canada*, 56 Fed. Reg. 56,055, 56,055 (31 October 1991).

36 *Certain Softwood Lumber Products from Canada*, 57 Fed. Reg. 22,570, 22,570 (28 May 1992).

37 *Certain Softwood Lumber Products from Canada*, 59 Fed. Reg. 12,584 (17 March 1994).

38 *Certain Softwood Lumber Products From Canada*, 59 Fed. Reg. 42,029 (16 August 1994).

39 Canada–United States: Softwood Lumber Agreement, May 29, 1996, 35 I.L.M. 1195 (1996).

40 *Ibid.*

41 *Certain Softwood Lumber Products from Canada*, 66 Fed. Reg. 21,332 (30 April 2001) (notice of initiation).

plex, involving two binational panels (one each for the USDOC and USITC determinations), multiple WTO challenges, and various collateral proceedings in the U.S. courts (including a challenge by the U.S. petitioners to the constitutionality of the system of binational panel review). The USDOC and the USITC strongly resisted a series of rulings from the binational panels and the WTO finding that the two agencies' determinations were not in accordance with law.[43] The USDOC and USITC effectively refused to comply with these decisions, and in fact sought to use the existence of these legal challenges as an opportunity to impose even higher duties on Canadian imports.

With the extraordinarily complex and costly legal challenges to the Lumber IV determinations at a stalemate, Canada and the United States once again agreed to enter into a managed trade agreement to resolve the dispute. The Softwood Lumber Agreement 2006 ("SLA 2006") resulted in an even more complex system of export charges and volumetric quotas designed to limit Canadian market share in the U.S. market.[44] In addition, the SLA 2006 distributed over $4 billion in cash deposits that had accumulated in the U.S. treasury while the Lumber IV proceedings and legal challenges were underway.[45] Under the agreement, over $2 billion was paid out to Canadian softwood lumber producers, $500 million was paid out to the petitioning U.S. softwood lumber producers, and an additional $500 million was set aside to fund various research initiatives and projects for the benefit of the North American lumber industry.[46]

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42 *Certain Softwood Lumber Products from Canada*, 67 Fed. Reg. 36,070, 36,076 (22 May 2002).

43 *See*, *e.g.*, *Certain Softwood Lumber Products from Canada*, USA-CDA-2002-1904-03, Panel Decision (13 August 2003); *Certain Softwood Lumber from Canada: Final Affirmative Countervailing Duty Determination*, USA-CDA-2002-1904-03, First Remand Determination (12 January 2004); *Certain Softwood Lumber from Canada: Final Affirmative Countervailing Duty Determination*, USA-CDA-2002-1904-03, Second Remand Determination (30 July 2004); *Certain Softwood Lumber from Canada: Final Affirmative Countervailing Duty Determination*, USA-CDA-2002-1904-03, Third Remand Determination (24 January 2005); *Certain Softwood Lumber from Canada: Final Affirmative Countervailing Duty Determination*, USA-CDA-2002-1904-03, Fourth Remand Determination (7 July 2005); *Certain Softwood Lumber from Canada: Final Affirmative Countervailing Duty Determination*, USA-CDA-2002-1904-03, Fifth Remand Determination (22 November 2005). *See also* Panel Report, *United States - Preliminary Determinations with Respect to Certain Softwood Lumber from Canada*, WT/DS236/R (27 September 2002).

44 Softwood Lumber Agreement Between the Government of the United States of America and the Government of Canada (12 September 2006), State Dep't No. 07-222, available at: https://2009-2017.state.gov/documents/organization/107266.pdf.

45 *See id.*, Annex 2A ("Termination of Litigation Agreement").

46 The SLA 2006 also introduced an arbitration mechanism to adjudicate claims that Canadian provinces were "circumventing" the terms of the agreement. Canada and the United States agreed to have these claims adjudicated by the London Court of International Arbitration, using three-member arbitration panels composed of third-country nationals. This was an unusual use of a commercial arbitration forum to hear state-to-state disputes. Three such arbitrations were held during the period that the SLA 2006 was in effect. *See*, *e.g.*, Government of British Columbia, Dispute Resolution under the Softwood Lumber Agreement, available at: https://www2.gov.bc.ca/gov/content/industry/forestry/competitive-forest-industry/softwood-lumber-trade-wit

The SLA 2006 expired in October 2015 following an agreed two-year extension of its original seven-year term. Under the original agreement, the United States had agreed not to initiate a new countervailing duty investigation for a period of one year following its expiration.[47] Shortly after this "stand-still" period expired, the U.S. Lumber Coalition filed another countervailing duty petition against Canadian lumber imports in November 2016, commencing "Lumber V". In July 2017, the USDOC released the findings of its investigation and issued countervailing duty orders against Canadian companies.[48] In December 2017, the USITC ruled that the U.S. lumber industry was materially injured by softwood lumber imports from Canada.[49] As with the prior lumber appeals, the legal challenges to these determinations have been multifaceted, and remain ongoing.

In May 2020, a NAFTA binational review panel upheld the USITC's findings in Lumber V,[50] while in August 2020 a WTO dispute settlement panel issued a decision in which it identified multiple respects in which the USDOC's subsidy finding was contrary to law.[51] Further NAFTA binational panel reviews are ongoing with respect to the findings of the USDOC in the investigation phase and the first administrative review (the findings of which were released in November 2020, and reduced the amount of duties owed by Canadian companies).[52] Until these legal challenges are finalized, however, the U.S. government continues to collect and hold cash deposits paid upon the importation of Canadian softwood lumber into the United States. To date, the amount of duties paid by Canadian companies is in excess of $5 billion.

As can be seen from this historical summary, certain patterns and practices have emerged in the softwood lumber dispute over the course of the past forty years. After Lumber I, in which the USDOC found no stumpage subsidy and only a *de minimis* level of subsidization overall, the USDOC and USITC subsequently made affirmative determinations of subsidization and injury, respectively, in each investigation. Lumber II ended in

h-the-u-s/2006-sofwood-lumber-agreement/dispute-resolution.

47 Softwood Lumber Agreement Between the Government of the United States of America and the Government of Canada (12 September 2006), State Dep't No. 07-222, available at: https://2009-2017.state.gov/documents/organization/107266.pdf, Annex 2A ("Termination of Litigation Agreement").

48 *Certain Softwood Lumber Products From Canada*, 82 Fed. Reg. 51,814 (8 November 2017).

49 *Softwood Lumber from Canada* (Investigation Nos. 701-TA-566 and 731-TA-1342 (Final), USITC Publication 4749, December 2017).

50 *Softwood Lumber from Canada* (Softwood Lumber Injury), USA-CDA-2018-1904-03 (22 May 2020).

51 Panel Report, *US – Countervailing Measures on Softwood Lumber from Canada*, WT/DS533/R (24 August 2020).

52 *Certain Softwood Lumber Products from Canada: Final Results of the Countervailing duty Administrative Review*, 2017-2018, 85 Fed. Reg. 77,163 (1 December 2020).

a negotiated agreement between Canada and the United States before the investigations were complete. Lumbers III and IV ended in negotiated agreements between Canada and the United States following successful legal challenges by the Government of Canada and the Canadian parties before binational panels (Lumbers III and IV) and at the WTO (Lumber IV). This pattern of investigation-litigation-settlement seems likely to repeat itself in the case of Lumber V, although as of this writing there are no settlement discussions underway.

Several different factors seem to account for this pattern of investigation- litigation-settlement. Certainly one factor has been Canada's success in challenging the legality of the USDOC's and USITC's determinations before binational panels and the WTO. As noted above, there has never been an affirmative finding that Canadian softwood lumber is subsidized and causing injury to U.S. producers that has withstood subsequent legal challenges. The United States and the U.S. petitioners have therefore been forced to the negotiating table by their inability to defend the legality of countervailing duties on softwood lumber before binational panels and the WTO. Another factor that has contributed to the settlement dynamic is the fact that the softwood lumber trade between the two countries is economically significant to both sides - the United States is the principal export market for Canadian softwood lumber producers, and the United States, for its part, needs imports of Canadian lumber to satisfy domestic demand. Both sides have therefore had reason to prefer predictable terms of trade over endless litigation and uncertainty.

Perhaps the greatest driver of the investigation-litigation-settlement dynamic, however, has been the opportunity that the resulting settlement agreements have provided to the petitioning U.S. industry to shape market conditions in the United States. The MOU and the two Softwood Lumber Agreements between the United States and Canada have been, in effect, managed trade agreements between the two countries. The petitioning U.S. industry has used these agreements to restrict the domestic U.S. supply of softwood lumber products and raise market prices for these products. These higher prices are ultimately paid by U.S. consumers, primarily in the form of higher prices for new home construction and home remodelling. Especially in an integrated market in which the imported product is necessary to satisfy domestic demand, restricting imports through quota volumes and/or export charges has the effect of constricting supply relative to demand and raising prices for consumers.

This effect was apparent early in 2021, when U.S. softwood lumber prices increased dramatically in response to a surge in new housing starts as the U.S. economy began to recover from the Covid-19 pandemic. In the first quarter of 2021, the Random Lengths framing lumber composite index price skyrocketed to over $1000 per thousand board feet (the industry's standard unit of measurement), nearly three times the average price that had prevailed for many years.[53] It was estimated that increased lumber costs added as much as $36,000 to the price of a new home.[54] The sharp increase in prices occurred at a time when the United States was collecting cash deposits of around 10% on imported Canadian softwood lumber, a duty that constrains domestic supply and that is effectively passed on to consumers in the form of higher prices. In response to the surging prices, homebuilders' associations and some politicians called for the reduction or elimination of the cash deposits collected on imports of Canadian softwood lumber, effectively acknowledging that the consequence of these duties is to constrain supply and raise prices for U.S. consumers.[55]

Beginning with Lumber IV, the U.S. petitioners found another way to benefit from managed trade settlements - receiving significant cash payouts. As described previously, the design of the U.S. trade remedy system allows cash deposits to accumulate during the course of a countervailing duty investigation, subsequent administrative reviews, and legal challenges to those determinations. Given the volume and value of Canadian softwood lumber exports to the United States, those unliquidated cash deposits can total billions of dollars. Ordinarily, cash deposits would be returned to the Canadian exporters if no final countervailing duties were assessed. In Lumber IV, the U.S. petitioners received $500 million of those cash deposits as part of the negotiated settlement.[56] Because cash deposits are effectively paid by U.S. consumers in the form of higher softwood lumber prices, this amounted to a transfer of wealth from U.S. consumers to the U.S. softwood lumber industry. It seems likely that

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53 *See* National Association of Home Builders, "Framing Lumber Prices: Price Tracker", available at: https://www.nahb.org/news-and-economics/housing-economics/national-statistics/framing-lumber-prices.

54 *See* National Association of Home Builders, "Skyrocketing Lumber Prices Add Nearly $36,000 to New Home Prices" (28 April 2021), available at: https://www.nahb.org/news-and-economics/industry-news/press-releases/2021/04/skyrocketing-lumber-prices-add-nearly-36000-to-new-home-prices.

55 *See*, *e.g.*, David Lawder and Jarrett Renshare, "U.S. trade chief pressured to lift duties on Canadian lumber" (16 May 2021), Reuters, available at: https://www.reuters.com/business/us-trade-chief-pressured-lift-duties-canadian-lumber-2021-05-16/; Payne Lubbers, "U.S. Commerce Chief Seeks Long-Term Lumber Solution With Canada" (26 May 2021), Bloomberg, available at: https://www.bloomberg.com/news/articles/2021-05-26/u-s-commerce-chief-seeks-long-term-lumber-solution-with-canada.

56 Softwood Lumber Agreement Between the Government of the United States of America and the Government of Canada (12 September 2006), State Dep't No. 07-222, available at: https://2009-2017.state.gov/documents/organization/107266.pdf, Annex 2A ("Termination of Litigation Agreement").

the U.S. industry would demand a similar payout as part of any negotiated settlement of Lumber V.

In sum, the history of the softwood lumber investigations is best understood as a system of managed trade effected through countervailing duty investigations (and also parallel anti-dumping investigations). Instead of leading to the assessment and collection of definitive countervailing duties on imported Canadian softwood lumber, the lumber investigations have resulted in negotiated settlements that have allowed the U.S. industry to shape domestic market conditions to its advantage and receive significant cash payouts. The US-Canada softwood lumber dispute is, in effect, managed trade through litigation.

Ⅳ. BROADER IMPLICATIONS OF THE SOFTWOOD LUMBER DISPUTE

At first glance, it may appear that the U.S.-Canada softwood lumber dispute has no broader implications for the international trade community. As discussed in Part II above, the softwood lumber dispute is a trade dispute that arises from divergent patterns of forestland ownership in two adjacent countries that are closely integrated economically, including in respect of the product in question. Seen in this light, one might conclude that the softwood lumber dispute is peculiar to its facts and holds no lessons for the international trading system at large, notwithstanding its outsized significance in U.S.-Canada trade relations and the volume of international trade litigation that the dispute has spawned.

However, as a dispute relating to the terms and conditions under which governments grant access to sovereign natural resources, the softwood lumber dispute does, in fact, have broader significance to the international trading system. Over the course of four decades of litigation, the softwood lumber dispute has revealed that traditional anti-subsidy disciplines as set forth in the SCM Agreement do not fit well with trade disputes that concern access to natural resources. At the most fundamental level, this is because the economics of natural resources differ in important ways from the microeconomic assumptions that underlie the traditional rationale for imposing disciplines on industrial subsidies. As a result, there is often a disconnect between the disciplines imposed by the SCM Agreement and how these disciplines relate to the particular case of alleged natural resource subsidies.

This article will proceed to identify three respects in which the existing disciplines of the SCM Agreement have an uneasy relationship to the case of natural resources: (1) the treatment of the provision of natural resource rights as equivalent to the provision of a "good"; (2) the fact that government policies concerning access to sovereign natural resources do not ordinarily have the potential to distort market outcomes and therefore do not implicate the core rationale for imposing anti-subsidy measures; and (3) the challenge of determining what constitutes "adequate remuneration" for the provision of natural resource rights. Each one of these issues has arisen in connection with the softwood lumber dispute. These issues are worth examining because they may have implications for other trade disputes relating to access to natural resources, and to the negotiation of new international disciplines on subsidies.

1. Rights, not Goods

One of the first conceptual difficulties of treating natural resource arrangements as potential subsidies under the SCM Agreement is that many natural resource arrangements involve *rights,* not *goods.* Governments often do not provide commercial enterprises with natural resources in a directly useable form. Rather, governments frequently promote the development of sovereign natural resources by granting private interests or state-owned enterprises the right to exploit the natural resource and convert that resource into a form that can be used as an input to the production of other products. For example, governments often grant companies the right to extract crude oil from government-owned lands, which is not the same as providing companies with barrels of refined petroleum or other oil products that can be used directly in the manufacture of other products.

Canadian provincial governments do not provide softwood lumber producers with *logs,* an identifiable good that is the immediate input to the production of softwood lumber. Instead, as discussed in Part II.B above, provincial governments grant companies the *right* to harvest standing timber from government-owned lands in exchange for the licensee agreeing to undertake a variety of obligations, including the payment of stumpage charges at the time of harvest. The timber harvesting rights that licensees thereby obtain are interests in real property and have independent economic value. License holders are usually free to sell their timber harvesting rights to other companies, and many of the longer-term licenses in provinces such as British Columbia have been sold on at least one occasion, often for considerable sums of money.[57]

[57] *See*, *e.g.*, Canfor Corporation, "Canfor Signs Agreement with Peak Renewables to Sell Fort Nelson Tenure" (17 November 2020), available at: https://www.canfor.com/docs/default-source/news-2020/nr2020-11-17-canfor-fort-nelson-tenure-sale-news-release.pdf?sfvrsn=a832ee91_2 ("Canfor announced today it has reached multi-year $30-million agreements with Peak Renewables involving the sale of the Company's forest tenure in the Fort Nelson region of British Columbia.").

The threshold question under the SCM Agreement is whether the provision of natural resources pursuant to these types of license arrangements is a "financial contribution".[58] If there is no financial contribution, there can be no subsidy. Under Article 1.1(a)(1)(iii) of the SCM Agreement, a financial contribution exists when "a government *provides goods*" to an enterprise.[59] The USDOC has consistently taken the position that there is no difference between the provision of the right to harvest standing timber and the provision of logs, a tangible good that results from the *exercise* of that right. In other words, the USDOC treats the provision of the *right* to harvest standing timber as indistinguishable from the provision of a *good*, logs, that is used in the manufacture of softwood lumber.

Canada challenged the USDOC's position before the WTO in *US - Softwood Lumber IV,* arguing that the provision of a right is not the same as the provision of a good.[60] The Appellate Body agreed with the United States, ruling that the term "goods" in Article 1.1(a)(1)(iii) of the SCM Agreement includes tangible items of property that can be severed from land, such as timber, and that governments "provide" these "goods" when there is a "reasonably proximate relationship" between the provision of a natural resource right and the enjoyment of the natural resource in a useable form.[61] The panel and Appellate Body in that dispute considered that such a "reasonably proximate relationship" between the right and the good exists in the case of Canadian provincial timber harvesting rights.[62]

As a result of these findings, it seems clear that most, if not all natural resource rights provided by governments have the potential to be challenged as the provision of goods for less than adequate remuneration. While there is a certain intuition to the Appellate Body's interpretation of what it means to "provide goods" - one would not, after all, want to countenance circumvention of the SCM Agreement's disciplines by allowing governments to re-characterize the provision of a good as the provision of a "right" to that good - its interpretation nevertheless raises ques-

58 SCM Agreement, Article 1.1.

59 Article 1.1 of the SCM Agreement provides an exhaustive list of types of financial contributions, including: (a) direct transfers of funds such as grants, loans, and equity infusions as well as potential transfers of funds or liabilities such as loan guarantees; (b) revenue due that is forgone or not collected, for example through fiscal incentives such as tax credits; (c) the provision of goods or services (other than general infrastructure) or the purchase of goods; and (d) any form of income or price support in the sense of Article XVI of the GATT 1994.

60 Appellate Body Report, *United States –Softwood Lumber IV*, paras. 34-36.

61 *See* Appellate Body Report, *United States –Softwood Lumber IV*, paras. 59 and 71.

62 Appellate Body Report, *United States –Softwood Lumber IV*, para. 71; Panel Report, *United States –Softwood Lumber IV*, paras. 7.19-7.30.

tions about how different types of natural resource arrangements relate to the WTO's existing subsidy disciplines.

Consider fishing rights, for example. Under the United Nations Convention on the Law of the Sea (UNCLOS), coastal states have a sovereign right to natural resources, including fish, found within their territorial waters and within their 200-mile exclusive economic zone (EEZ).[63] Coastal states often provide companies and individuals with various forms of rights to fish within these waters, or they might allow fishing in these waters on an unlicensed basis (which can be seen as a *de facto* right to fish). Either way, there is a "reasonably proximate relationship" between a *right* conferred by the government and the use or enjoyment of a *good,* fish.

Curiously, however, the WTO's Agreement on Fisheries Subsidies, in draft form as of this writing, does not appear to contemplate that coastal governments provide a "subsidy" when they provide fishing rights for less than adequate remuneration. Nothing in the draft text requires coastal governments to collect *any* remuneration, much less "adequate remuneration", for the fish that companies and individuals take from waters that the government controls. The Appellate Body's conclusion in *US - Softwood Lumber IV* - that a *right* to a natural resource is equivalent to the *good* obtained through the exercise of that right - seems not to have occurred to the drafters of the Agreement on Fisheries Subsidies, even though there is no meaningful difference between extracting timber from government- controlled forests and extracting fish from government-controlled waters.

Indeed, the draft Agreement on Fisheries Subsidies implicitly acknowledges the relationship between fishing *rights* and obtaining a *good* (fish), but does not follow this insight to its logical conclusion. In international fisheries practice, governments sometimes enter into "fisheries access agreements", under which one government ("Country A") pays another government ("Country B") for the right to obtain access to Country B's coastal waters. Country A purchases these access rights on behalf of its national fishing vessels so that they may obtain fish from Country B's coastal waters. The draft Agreement on Fisheries Subsidies carves out from its definition of a subsidy the non-collection of payment by Country A when it extends to its national fishing vessels the right to fish in the coastal waters of Country B, a right that Country A has paid Country B to obtain.[64] This carve-out presupposes that, in the absence of the carve-out,

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63 United Nations Convention on the Law of the Sea (10 December1982), 1833 U.N.T.S. 397. Article 61.1 of UNCLOS provides that "[t]he coastal state shall determine the allowable catch of the living resources in its exclusive economic zone."

Country A's uncompensated provision of fishing rights in Country B's coastal waters *would* constitute a subsidy to Country A's fishing vessels.

By accepting the premise that fishing rights have economic value that can be transferred to operators or vessels, the draft agreement appears to recognize that fishing rights are equivalent to the provision of a good (fish) in the same way that the Appellate Body concluded in *US - Softwood Lumber IV* that timber harvesting rights are equivalent to the provision of logs.[65] But if this is true when Country A provides its fishing vessels with the right to fish in Country B's coastal waters, it should also be true when Country B provides *its* fishing vessels with the right to fish in *Country B's* waters. The provision of fishing rights is equivalent to the provision of fish regardless of whether the country conferring the rights is providing access to another country's coastal waters or to its own coastal waters. Logically, the provision of fishing rights for less than adequate remuneration should constitute a subsidy whenever a coastal state provides uncompensated access to its coastal waters, including when it provides uncompensated access to its own national fishing vessels.

One suspects that the drafters of the Agreement on Fisheries Subsidies chose not to address this implication of *US - Softwood Lumber IV* because of the dramatic restructuring of fishing access arrangements that it would require. Applying the logic of *US - Softwood Lumber IV* to fishing access arrangements would mean that every coastal government would be required to collect adequate remuneration from its own domestic fishing vessels in the same way that the Appellate Body has found that governments must collect adequate remuneration for timber harvested from government-controlled lands. The imposition of such a requirement would likely pose a significant financial hardship to the operators of fishing vessels, who in many cases are already engaged in an economically marginal activity. But if the objective of the Agreement on Fisheries Subsidies is to preserve fish stocks and reduce overfishing,[66] requiring governments to place a price on the natural resource would prob-

64 Negotiating Group on Rules – Fisheries Subsidies, Revised Draft Text (8 November 2021), WTO Doc. TN/RL/W/276/Rev.2, Article 5.2(b).

65 *See* Appellate Body Report, *United States –Softwood Lumber IV*, paras. 59 and 71.

66 *See* Sustainable Development Goal 14 (Conserve and Sustainably Use the Oceans, Sea and Marine Resources for Sustainable Development), available at: https://sdgs.un.org/goals/goal14. Sustainable Development Goal 14.6 pertains specifically to fisheries subsidies and provides: "by 2020, prohibit certain forms of fisheries subsidies which contribute to overcapacity and overfishing, and eliminate subsidies that contribute to IUU fishing, and refrain from introducing new such subsidies, recognizing that appropriate and effective special and differential treatment for developing and least developed countries should be an integral part of the WTO fisheries subsidies negotiation."

ably be one of the most effective ways of achieving that objective.[67]

As the example of fishing rights demonstrates, the conclusion that the provision of a right is equivalent to the provision of a good has implications that may not fit comfortably with common understandings of what constitutes a "subsidy", including common understandings of when governments should be expected to collect compensation for providing the right to access a natural resource. It is not evident that the Appellate Body fully considered these implications when it decided *US - Softwood Lumber IV*. As international law and practice surrounding natural resource arrangements continue to evolve, greater consistency in the treatment of this issue would be desirable.

2. The Allocation of Natural Resource Rents Will Not Ordinarily Distort Downstream Product Markets

Standing timber is what is known as a "Ricardian rent" resource.[68] Ricardian rent is the profit that returns to a resource that is fixed in supply, or at least fixed in supply in the near-term.[69] The supply of standing timber is effectively fixed in the near-term, given that most timber species take at least 25 years to come to maturity. Standing timber therefore has the same basic economic characteristics as other natural resources that are fixed in supply and that governments routinely manage, such as oil, natural gas, and underground ores and minerals.

The fact that standing timber is a Ricardian rent resource has important implications for the assessment of whether Canadian provincial stumpage programmes implicate the types of concerns that have traditionally motivated the imposition of legal disciplines on the provision of government subsidies. The classical rationale for anti-subsidy disciplines is that subsidies have the potential to distort the allocation of market resources. Subsidies have this effect by increasing the supply of a good relative to a non-subsidized market. In economics jargon, subsidies shift the supply

67 It is particularly troubling that the drafters carved out the provision of fishing rights in distant coastal waters (i.e. the circumstance in which Country A provides its national vessels with the right to fish in Country B's waters). This type of arrangement is likely equivalent to "negative stumpage" in the case of timber harvesting rights, i.e. the government paying the exploiter of the natural resource to harvest resources that would not otherwise be economic to harvest (discussed in Part IV.C below).

68 World Trade Report, Trade in Natural Resources (2010), p. 77 ("The classical notion of differential rent is related to land. The idea is that greater rent accrues to land of higher productivity and better quality (e.g. greater fertility), with marginal land receiving no rent. More generally, differential or Ricardian rents arise when producing firms operate under different conditions – that is, at production sites with more or less favourable characteristics. For example, there may be deposits from which it is easier and cheaper to extract oil or mineral resources; as a consequence, some firms face lower or higher costs than others and earn more or less than others, respectively.").

69 *See generally* "Ricardian Rent", The Palgrave Encyclopedia of Strategic Management (2018), available at: https://link.springer.com/referenceworkentry/10.1057%2F978-1-137-00772-8_514.

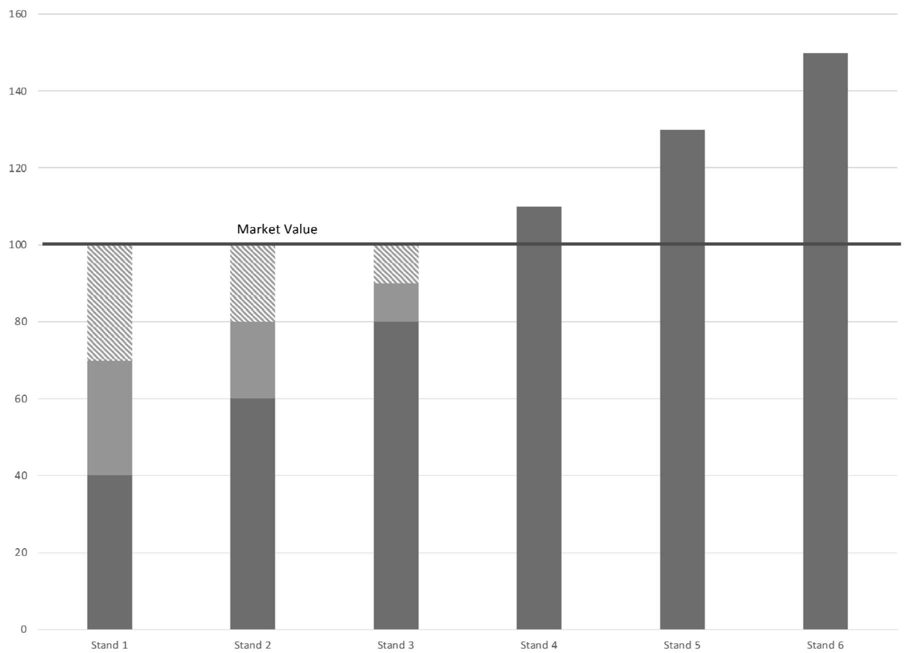
curve to the right, resulting in higher output and lower prices than those that would prevail in a non-subsidized market. The difference between the subsidized and non-subsidized market outcomes is considered a misallocation of economic resources, a deadweight loss compared to a market in which economic resources are allocated without government subsidies. The rationale for allowing WTO Members to impose countervailing duties on subsidized imports is to allow Members to counteract this market distortion when it is shown to cause injury to domestic producers of the like product.[70]

Under normal conditions, the level at which Canadian provincial governments set stumpage charges under forest licensing arrangements cannot have these market-distorting effects. This is because stumpage charges are not a "price of logs", as the petitioning U.S. producers characterize them, but rather a means of allocating the available natural resource rents between the landowner (the provincial government) and the exploiter of the natural resource (the license holder). As an allocation of profit, the level at which a provincial government sets it stumpage charges has no effect on the quantity of timber and logs supplied to the market. Stumpage charges, like other forms of resource taxes, therefore do not have the potential to distort market outcomes in the ways that have traditionally justified anti-subsidy disciplines such as the imposition of countervailing duties.

To illustrate the effect - or, more accurately, the lack of effect - of stumpage charges on market outcomes, consider a hypothetical forest consisting of six homogenous stands of trees. Each stand has a certain cost associated with harvesting the timber at that location and converting it into a marketable product (which, for simplicity, we will assume is limited to softwood lumber). The cost of production for each stand is affected by a variety of factors, such as the topography of the land, its proximity to existing roads, and its proximity to sawmills capable of milling the harvested logs into softwood lumber. The difference between the cost of production for each stand and the market value of the softwood lumber that can be produced from that stand is the amount of economic rent, if any, that is available from that stand. This situation can be depicted as follows:

It is apparent from Figure 1 that stands one through three have positive economic rent at the prevailing market price for softwood lumber. The orange segment represents the available rent, divided between the producer's share (solid) and the government's share (striped), shown here as divided equally between them. Stands

[70] *See*, *e.g.*, WTO, "Anti-dumping, subsidies, safeguards: contingencies", available at: https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm8_e.htm.



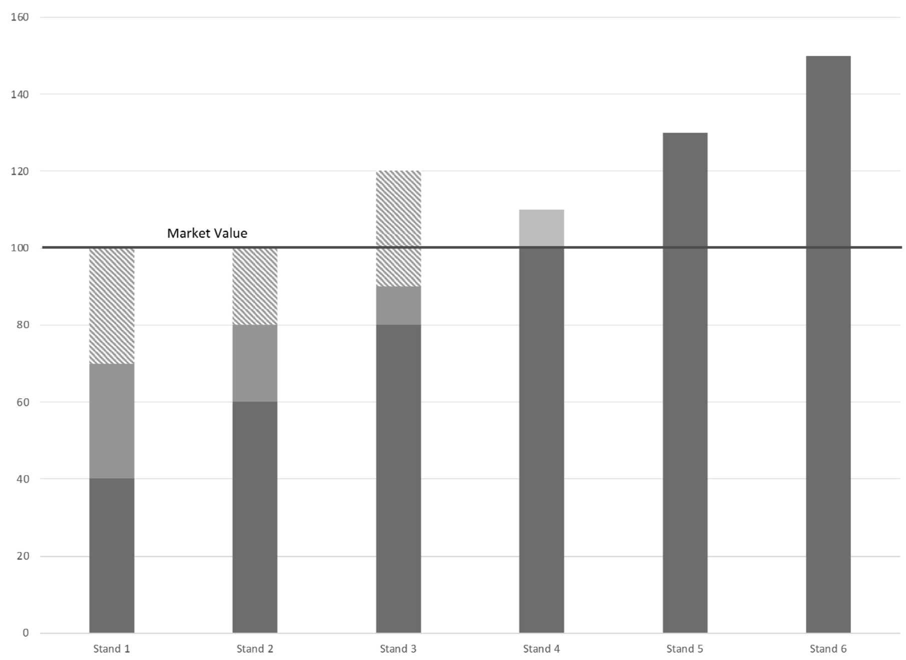
* Note: The configuration of each bar graph is blue, orange(solid) and orange(stripe) from the bottom.

Figure 1

four through six have no economic rent available under prevailing market conditions, as the cost of production for each stand exceeds the market price of the softwood lumber that can be produced from those stands. The level at which a province sets the stumpage charge will affect the allocation of the available economic rent, if any, between the province and the license holder. Certainly the license holder would prefer to receive more rather than less of the available rent. Critically, however, the license holder will harvest every stand that has positive economic rent *regardless of the allocation of rent between the province and the license holder*, i.e. regardless of the level at which the stumpage charge is set. In Figure 1, the license holder will harvest stands one through three, and it will not harvest stands four through six, provided that the stumpage charge is set at a level that allows the license holder to recover its cost of production for each stand (including its return on capital). Thus, for example, if the available rent for stands one through three were divided 90/10 in favour of the government, the licensee would still harvest those stands, just as it would if the available rent were divided 90/10 in the licensee's favour.

There are only two ways in which the level at which the stumpage charge is set could affect the quantity of logs and lumber supplied to the market. The first is where the province imposes what might be called "excess" stumpage, i.e. stumpage that renders uneconomic a stand that would otherwise be economic to harvest under prevailing market conditions. This scenario is depicted in stand 3 in Figure 2 below. This scenario is not of concern from an international trade point of view because its effect would be to *reduce* the supply of timber and logs to the market. The second way in which the level of the stumpage charge could affect the supply of timber and logs is if the government provided "negative" stumpage, i.e. if the government effectively *paid* the license holder to harvest stands that do not have positive economic rent under prevailing market conditions. This scenario is depicted in stand 4 in Figure 2 below (with the yellow portion representing a payment by the government to the producer). If a government were to provide "negative" stumpage, this *would* increase the supply of timber and logs relative to a market-determined outcome. However, there has never been any allegation, much less any evidence, that Canadian provincial governments provide "negative" stumpage, i.e. pay license holders to harvest uneconomic stands.

Thus, so long as a stumpage charge (or any other sort of resource tax) is set in the "normal" range, i.e. it allocates somewhere between zero and 100 percent of the available economic rent to the license



* Note: The configuration of each bar graph is blue, orange(solid) and orange(stripe) from the bottom.
** In stand 4, the bar consists of blue and yellow (from the bottom).

Figure 2

holder, the level at which that charge is set will not increase the supply of the natural resource to the market relative to a scenario in which the natural resource is entirely in private hands. This is true not only of standing timber, but also of other Ricardian rent resources such as oil and natural gas. Stumpage charges and other forms of resource taxes allocate the available profit between the government as the owner of the natural resource and the license holder as the exploiter of that resource. They do not, however, alter economic behaviour in ways that have the potential to distort market outcomes.

The conclusion that Canadian provincial stumpage programmes do not have the potential to distort market outcomes is one that several prominent natural resource economists have endorsed in expert submissions to the USDOC over the course of the past 40 years. These experts have included William Nordhaus, widely considered the world's leading natural resource economist and the 2018 recipient of the Nobel Memorial Prize in Economic Sciences.[71] While economists retained by the U.S. softwood lumber industry have tried to come up with theories of how the level of the stumpage charge could distort market outcomes notwithstanding its lack of impact on harvesting decisions, these theories have been speculative and unpersuasive.

The conclusion that stumpage charges do not have the potential to distort market outcomes in the ways that have traditionally justified the imposition of countervailing duties is one of the principal bases on which Lumber III was ultimately decided. The binational panel charged with reviewing the USDOC's countervailing duty determination in that investigation concluded that the USDOC had erred by not examining whether Canadian provincial stumpage programmes had market-distorting effects. The USDOC effectively refused to comply with the binational panel's finding, arguing that it was not required under U.S. law to evaluate whether subsidies have market-distorting effects. After a series of remands to the USDOC on this and other issues, the binational panel eventually instructed the USDOC to revoke the countervailing duty order.[72]

Following Lumber III, the U.S. Congress amended the Tariff Act of 1930 to provide that the USDOC is not required to consider the effects of a subsidy

[71] *See*, *e.g.*, William D. Nordhaus, "The Impact of Stumpage Charges on Prices and Trade Flows in Forest Products," (18 February 1992), Appendix A in "Memorandum Concerning Alleged Stumpage Subsidies and Preferentiality," submitted on behalf of the Government of Canada et al. University of British Columbia, Special Collections and University Archives Division, available at: https://rbscarchives.library.ubc.ca/impact-of-stumpage-on-prices-and-trade-flows-in-forest-products.

[72] *Certain Softwood Lumber Products From Canada*, 59 Fed. Reg. 42,029 (16 August 1994).

in determining whether a subsidy exists.[73] The express purpose of this amendment was to prevent a future binational panel from holding that the USDOC is required to examine whether provincial stumpage programmes cause market distortion. This amendment to U.S. law reduced the incentive for the Canadian parties to argue in subsequent lumber investigations that provincial stumpage programmes do not affect output or prices, even though this is true as a matter of economics. Because binational panels are required to review the USDOC's and USITC's determinations for consistency with U.S. law,[74] the amendment to the Tariff Act effectively foreclosed this line of argument.

An amendment to U.S. law, however, cannot change accepted principles of natural resource economics. While the United States has insulated its investigating authorities from having to consider whether subsidies have effects, no such obstacle would exist if the same or similar issue were to arise in WTO dispute settlement or in dispute settlement under other bilateral or regional trade agreements. The fact remains that natural resource rent-sharing arrangements - that is, the terms on which natural resource profits are allocated between the state and the exploiter of the natural resource - do not implicate the traditional rationale for the imposition of anti-subsidy measures such as countervailing duties. For natural resources that are fixed in supply or effectively fixed in supply, such as standing timber, the allocation of natural resource profits does not affect either output or prices and therefore does not have the potential to distort market outcomes in the ways that have traditionally justified subsidy disciplines.

3. What Constitutes "Adequate Remuneration" for a Natural Resource?

Assuming that the conferral of access rights to a sovereign natural resource constitutes the provision of a "good", the provision of that good constitutes a "subsidy" if the good is provided for "less than adequate remuneration".[75]

In the context of natural resource arrangements, the "remuneration" for the provision of a natural resource right is not a question of the "price" paid for that right, but rather a question of how the *profit* from the exploitation of the natural resource is divided between the government as the owner of the natural resource, on the one hand, and the commercial enterprise as the entity that extracts the nat-

73 19 U.S.C. § 1677(5)(C).
74 *See*, *e.g.*, USMCA, Article 10.12(2).
75 SCM Agreement, Article 14(d).

ural resource and brings it to market in a merchantable form, on the other. As discussed in Part IV.B above, the stumpage charges levied by Canadian provincial governments are not a "price of timber", but a means of allocating the available natural resource rents between the province and the license holder.

Governments obtain remuneration from the exploitation of sovereign natural resources in a wide variety of ways. To use oil and gas as an example, governments might obtain remuneration from the initial sale of the extraction rights (e.g. a bid payment), from royalties paid to the government at the time the resource is sold (e.g. a portion of the market value of each barrel of oil sold), from production sharing arrangements (e.g. allowing the government to market a portion of the resource for its own account), from resource taxes imposed upon the licensee's income or profits, or from some combination of these or other types of fiscal measures. The particular configuration of compensatory measures imposed by a government upon the exploitation of a natural resource is commonly referred to as the "fiscal regime" for that resource, and the portion of the available rents (profits) obtained by the government through a fiscal regime is commonly referred to as the "government take".[76]

By transposing the concept of "adequate remuneration" for the provision of a good to the context of natural resource profit-sharing arrangements, the question under Article 14(d) of the SCM Agreement becomes this: what portion of the available rents does a government need to collect for remuneration to be considered "adequate"? In other words, how large does the government take need to be to avoid a finding that the government has provided a subsidy to the commercial enterprise engaged in the exploitation of the natural resource?

Implicit in the USDOC's approach to the calculation of the subsidy benefit in the softwood lumber investigations is that a government must collect 100 percent of the available rents to avoid a finding of subsidization. This is because the USDOC calculates the subsidy "benefit" from provincial stumpage programmes by, in essence, deducting from the market value of logs (the downstream product) the full cost of harvesting the timber necessary to produce those logs and bring them to market, and treating the entire difference as the amount of "remuneration" that provincial governments are required to collect. As is evident from Figure 1 above, this method of calculating "adequate remuneration" for timber harvesting rights is essentially the

[76] *See*, *e.g.*, National Resource Governance Institute, "Fiscal Regime Design: What Revenues the Government Will be Entitled to Collect" (2015), available at: https://resourcegovernance.org/sites/default/files/nrgi_Fiscal-Regime-Design.pdf.

same as calculating the full amount of rent available from the natural resource and treating any shortfall in the collection of the available rent as a "subsidy". The USDOC's basic reasoning is that *private* owners of land would seek to recover 100 percent of the economic rent from their own natural resources, and therefore companies obtain a benefit when governments confer rights to sovereign natural resources for anything less than 100 percent of the economic rent.

There are at least two major problems with the assumption that "adequate remuneration" for a natural resource requires governments to collect 100 percent of the available resource rents. The first problem with this assumption is that it does not accord with the reality of how governments operate. Few, if any, governments have ever expected to recover 100 percent of the rents available from their sovereign natural resources. In the oil and gas sector, for example, estimates of the government take vary widely from one country to another, ranging from a low of around 25 percent to a high of around 90 percent.[77] The United States, for example, is estimated to recover only 67 percent of the available rents from government-owned oil and gas resources, meaning that the commercial enterprises licensed to extract those resources obtain the remaining 33 percent of the available rents.[78] As discussed above, there is no expectation that governments obtain *any* of the available rents from fish harvested from coastal waters. A standard of "full rent recovery" for natural resources simply is not realistic.

The other major problem with a standard of full rent recovery is that it does not comport with the text of Article 14(d) of the SCM Agreement. Article 14(d) requires "adequate" remuneration, not "maximum" or "full" remuneration, or even "fair market value". The SCM Agreement does not define the term "adequate remuneration", but the use of the term "adequate" as opposed to some of these other terms seems intentional. The term "adequate" can be understood to mean "sufficient for a purpose", which naturally raises the question of what that purpose is in the context of the SCM Agreement. Given that the purpose of the SCM Agreement is to discipline subsidies that have injurious effects upon the interests of other Members, the most natural understanding of the term "adequate remuneration" is that remuneration is "adequate" when it is set at a level that avoids these types of injurious effects.

As discussed in Part IV.B above, any al-

[77] Boston Consulting Group, "Government Take in Upstream Oil and Gas: Framing a More Balanced Dialogue" (9 December 2015), available at: https://www.bcg.com/publications/2015/government-take-in-upstream-oil-and-gas-framing-a-more-balanced-dialogue.

[78] *Ibid.*

location of natural resource rents that falls within the "normal" range, i.e. between zero and 100 percent of the available rents, will not affect a licensee's determination as to how much of the natural resource to exploit and bring to market. The licensee will, regardless of the allocation of rents, exploit those resources that have positive economic rent and it will not exploit those resources that have no economic rent. Any allocation of rent within the normal range therefore will not affect output or prices for the resource in question, or for products derived from that resource. Seen in this light, "adequate" remuneration for the provision of a natural resource right is any allocation of rents between zero and 100 percent. Governments would provide natural resource rights for *less* than adequate remuneration only when they pay licensees to exploit natural resources that would otherwise be uneconomic to exploit (e.g., in the case of timber harvesting rights, when governments provide "negative stumpage"). It is only this circumstance that a government's fiscal regime for a natural resource increases output and lowers prices relative to a baseline in which all natural resources are privately owned, i.e. in comparison to a purely "market-determined" outcome in which the government plays no role.

The reality, however, is that this understanding of "adequate remuneration" for the provision of a natural resource right does not comport with the commonly understood meaning of Article 14(d) of the SCM Agreement, or with the practice of national investigating authorities. If a government provides steel ingots to a company at $600/ton at a time when the market price for steel ingots is $1000/ton, few would question that the subsidy "benefit" in this situation is $400/ton. In practice, "adequate" remuneration is usually understood to mean "the market price", even though this is not how Article 14(d) is drafted. While this understanding may make sense when applied to fungible commodity goods like steel ingots, it makes considerably less sense when applied to the allocation of natural resource rents. This is because the allocation of natural resource rents is not comparable to any "price" that can be found in the market, but is instead an allocation of profit between two parties with an interest in the resource. No economic principle dictates that *all* of the available profit should go to one party or the other, unlike the common economic expectation that market actors will pay the prevailing market price for a good.

To the extent that issues relating to the allocation of natural resource rents continue to be evaluated within the framework of anti-subsidy disciplines, including the SCM Agreement, it may be more appropriate to evaluate the "adequacy of remuneration" by reference to the *process* by which governments allocate the available rents between the government and commercial licensees. For example, if governments use sealed bidding practices or use other types of auction mechanisms to confer natural resource rights, including the allocation of rents between the government and the licensee, the resulting "government take" should be considered "adequate remuneration" even if the government does not collect 100 percent of the resource rents. In addition, any evaluation of the "adequacy of remuneration" in this context should take into account all of the ways in which governments obtain revenue from the exploitation of sovereign natural resources, to include not only direct payments (such as stumpage charges or other types of royalty payments), but also indirect sources of revenue such as generally applicable corporate income taxes.

Ⅴ. CONCLUSION

The softwood lumber dispute has been a chronic irritant for four decades between two of the world's most closely integrated economies. For the reasons set forth in this article, it is a dispute that is difficult to justify or explain by reference to the traditional rationale for anti-subsidy disciplines. The terms under which governments provide access to sovereign natural resources do not fit comfortably with the SCM Agreement's rules for identifying subsidies that cause injury to the domestic industry of an importing country. This disconnect becomes especially apparent when one tries to apply the USDOC's framework - that provincial forest licensing arrangements involve the provision of "goods" for "less than adequate remuneration" - to other types of sovereign natural resource arrangements.

Rather than viewing the softwood lumber dispute as a traditional dispute about subsidies, albeit one that has been particularly long-running, the softwood lumber dispute is better understood as a form of managed trade, effected through successive countervailing duty investigations and negotiated settlements of those investigations. The petitioning U.S. industry has used the trade remedy mechanism to regulate competition in the U.S. market, by constraining the supply of Canadian softwood lumber and raising market prices for lumber products. These increased costs have been borne overwhelmingly by U.S. consumers. A more rational approach to resolving this perennial trade conflict would be for the United States and Canada to enter into a permanent negotiated solution.