GENERAL AGREEMENT ON

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Committee on Subsidies and
Countervailing Measures

UNITED STATES - MEASURES AFFECTING IMPORTS OF SOFTWOOD LUMBER FROM CANADA

Report of the Panel

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I. INTRODUCTION

1. On 8 October 1991, Canada requested consultations with the United States under Article 3:1 of the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade (hereinafter: "the Agreement"). This request followed an announcement made by the United States on 4 October that the United States Department of Commerce intended to self-initiate a countervailing duty investigation of imports of softwood lumber from Canada and action taken on the same date by the United States Trade Representative (USTR) to withhold or extend liquidation of entries of softwood lumber products from Canada and to impose a bonding requirement. Consultations between Canada and the United States were held on 16 October 1991. On 31 October 1991, the United States self-initiated a countervailing duty investigation of import of softwood lumber products from Canada.

2. On 1 November 1991, Canada requested that a special meeting of the Committee on Subsidies and Countervailing Measures be convened for conciliation under Article 17 of the Agreement on the matter described by Canada in document SCM/128. On 7 November 1991, the Committee received a communication from the United States in response to this request for conciliation (SCM/131). The Committee held a meeting under the conciliation procedure of Article 17 in this matter on 15 and 18 November 1991 (SCM/M/55).

3. On 2 December 1991, Canada requested the Committee to establish a panel in this matter under Article 17:3 of the Agreement (SCM/133). The Committee met on 16 December 1991 and established a panel. The Committee authorized the Chairman to consult with the parties to the dispute on the terms of reference of this Panel and to decide the Panel's composition, in consultation with the parties (SCM/M/56, paragraph 8). The representative of Japan reserved his delegation's right to intervene in the Panel's proceedings.

4. On 21 February 1992, the Chairman of the Committee informed the signatories of the Agreement in SCM/141 of the Panel's terms of reference:

> "To review the facts of the matter referred to the Committee by Canada in document SCM/133 and, in light of such facts, to present to the Committee its findings concerning the rights and obligations of the signatories party to the dispute under the relevant provisions of the General Agreement as interpreted and applied by the Agreement on interpretation and Application of Articles VI, XVI and XXIII of the General Agreement."

In the same communication, signatories of the Agreement were informed of the Panel's composition:

Chairman: Mr. Michael D. Cartland

Members: Mr. Luzius Wasescha
Mr. David Hayes

5. The Panel met with the parties to the dispute on 18-19 March, 20-21 May and 15 June 1992. The Panel received a written submission from Japan as interested third party.

6. The Panel submitted its findings and conclusions to the parties on 7 December 1992.

II. FACTUAL ASPECTS

7. The dispute before the Panel concerned (i) the suspension of liquidation and imposition of bonding requirements by the United States on 4 October 1991 under Section 304 of the Trade Act 1974 with respect to imports of softwood lumber from Canada, and (ii) the initiation by the United States on 31 October 1991 of a countervailing duty investigation on imports of softwood lumber from Canada. In taking these actions, the United States referred to the termination by Canada on 4 October 1991 of a Memorandum of Understanding on trade in softwood lumber, concluded between Canada and the United States on 30 December 1986, a brief description of certain aspects of the conclusion and implementation of this Memorandum of Understanding is therefore appropriate.

8. On 5 June 1986, the United States Department of Commerce initiated a countervailing duty investigation on imports of softwood lumber from Canada.[1] An affirmative preliminary determination of the existence of injury was made in this investigation by the United States International Trade Commission (USITC) on 29 June 1986. On 16 October 1986, the Department of Commerce made an affirmative preliminary determination of the existence of subsidization, as a result of which the liquidation of entries of softwood lumber from Canada was suspended and a cash deposit or bond equal to 15 per cent ad valorem required for each entry of this product. The notice of this preliminary determination indicated that a final determination was expected to be made by 30 December 1986.

9. On 1 August 1986, the Committee on Subsidies and Countervailing Measures, acting at the request of Canada, established a panel in a dispute between Canada and the United States with respect to the initiation by the United States of the above-mentioned countervailing duty investigation.[2]

10. On 30 December 1986, Canada and the United States concluded a Memorandum of Understanding (hereinafter "MOU") "to resolve differences with respect to the conditions affecting trade in softwood lumber products". This MOU provided in Article 4 for the collection by Canada of an export charge on exports of softwood lumber to the United States; Article 5 provided for the possible reduction or elimination of these

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[1] 51 Fed.Reg., 11 June 1986, pp.21205-21208.

[2] Documents SCM/76 and SCM/M/Spec/12.

export charges upon introduction of "replacement measures". Article 3(b) of the MOU provided that the MOU was "without prejudice to the position of either Government as to whether the stumpage programmes and practices of Canadian governments constitute subsidies under United States law or any international agreement".

11. Three provisions of the MOU explicitly related to the countervailing duty investigation initiated in June 1986. First, Article 3(a) provided that the MOU would be implemented when the countervailing duty petition on certain softwood lumber products from Canada was withdrawn and a notice of termination of the investigation signed. Second, under Article 3(c), the United States undertook to release bonds and refund deposits made pursuant to the preliminary affirmative countervailing duty determination made in October 1986. Finally, under Article 3(d) the United States undertook to state in the notice of termination of the investigation that the affirmative preliminary countervailing duty determination on certain softwood lumber products from Canada was henceforth without legal force and effect.

12. In a side letter, the Government of Canada indicated that the objective of the MOU, "to resolve differences with respect to the conditions affecting trade in certain softwood lumber products", involved not only settlement of the dispute over the countervailing duty investigation initiated in June 1986, but also avoiding the enactment of legislated restrictions or further investigations under US trade law and that, in either eventuality, it might exercise its right to terminate the MOU. Article 9 of the MOU provided for the right of either party to terminate the MOU at any time upon thirty days written notice.

13. On 30 December 1986, immediately after signature of the MOU, the petitioner in the countervailing duty investigation, the Coalition for Fair Lumber Imports, withdrew its petition, "based upon the entry into force of the agreement between the Governments of Canada and the United States concerning trade in softwood lumber". At the same time, the petitioner indicated that this withdrawal was "without prejudice to the filing of another petition based upon the same Canadian acts and practices, should the Coalition determine at any time that it is in its interest to do so".[3]

14. On 5 January 1987, the Department of Commerce published in the Federal Register a notice of termination of the countervailing duty investigation on softwood lumber from Canada, based upon the withdrawal of the petition on 30 December 1986. The relevant part of the notice reads as follows:

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[3] Letter from Stanley Dennison, Chairman, Coalition for Fair Lumber Imports, to Gilbert Kaplan, Deputy Assistant Secretary for Import Administration, 30 December 1986.

> "In a letter dated December 30, 1986, petitioner notified the Department that it is withdrawing its May 19, 1986, petition. Under section 704(a) of the Act, as amended by section 604 of the Trade and Tariff Act of 1984, upon withdrawal of a petition, the administering authority may terminate an investigation after giving notice to all parties to the investigation and after assessing the public interest. We have determined that termination would be in the public interest. We have notified all parties to the investigation of petitioner's withdrawal and our intention to terminate. For these reasons, we are terminating our investigation."[4]

On 26 January 1987, this notice was amended to add the following sentence:

> "The preliminary affirmative countervailing duty determination on certain softwood lumber products from Canada is henceforth without legal force and effect."[5]

15. In an Agreed Minute to the MOU, Canada and the United States agreed that, promptly after implementation of the MOU, both parties would notify the GATT secretariat "that a mutually satisfactory settlement has been reached in the dispute concerning the countervailing duty proceeding by the United States of America on certain softwood lumber products from Canada". In letters dated 13 and 29 January 1987, Canada and the United States, respectively, informed the Chairman of the Panel established by the Committee on Subsidies and Countervailing Measures in August 1986 that a mutually satisfactory resolution of the dispute before the Panel had been reached. Canada provided the Panel with a copy of the MOU. The Report of the Panel contained a brief summary of the provisions of the MOU and noted that a copy of the MOU was available in the secretariat for consultation by interested delegations.[6]

16. In its semi-annual report submitted under Article 2:16 of the Subsidies Code on countervailing duty actions taken in the period 1 January-30 June 1987, the United States notified the Committee on Subsidies and Countervailing Measures that, in the investigation of certain softwood lumber products from Canada, the "case" had been "withdrawn" on 5 January 1987.[7]

17. In the exchange of Notes of 30 December 1986 effecting the MOU, the United States informed Canada that the MOU was "a trade agreement for purposes of United States law".[8] On the same date, the United States, by

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[4] 52 Fed.Reg., 5 January 1987, 315.

[5] 52 Fed.Reg., 26 January 1987, p.2751.

[6] BISD 34S/194.

[7] SCM/84/Add.4, page 5.

[8] Letter from the United States Trade Representative to the Embassy of Canada in the United States, 30 December 1986.

Presidential Proclamation 5595, imposed a temporary surcharge on imports of certain softwood lumber products from Canada, on the basis of a determination by the President under Section 301 of the Trade Act of 1974 that Canada's inability to collect an export charge on softwood lumber exported to the United States until at least 8 January 1987 was unjustifiable or unreasonable and constituted a burden or restriction of US commerce.[9] This temporary surcharge was suspended on 8 January 1987 when Canada began collecting the export tax. Also on 30 December 1986, the US President, acting under Section 301 of the Trade Act of 1974, instructed the Secretary of Commerce to determine periodically whether the Government of Canada and the Canadian provincial governments were fully imposing the export charge and any replacement measures therefor. The President announced that:

> "If the Secretary of Commerce determines that such export charges are not being fully imposed, I will take action (including the imposition of an increase in the tariff on softwood lumber imported from Canada) to offset any shortfall in the full imposition of the export charge or of the replacement measures therefor."[10]

18. On 17 January 1987, Canada submitted a diplomatic note to the United States in which it objected to the imposition of this duty under Section 301 as well as to the determination by the President to use Section 301 to offset any shortfall in the full imposition of the export charge or the replacement measures.

19. On 16 December 1987, Canada and the United States agreed to amend the MOU inter alia to exempt from the payment of export charges exports to the United States of certain softwood lumber products produced in New Brunswick, Newfoundland, Nova Scotia and Prince Edward Island. It was also agreed that replacement measures described in an Appendix to the amendments for the Province of British Columbia would constitute full replacement of the export charge upon the fulfilment of the conditions described in this Appendix. Provisions to monitor these replacement measures in British Columbia were also put in place. In a subsequent amendment to the MOU, Canada and the United States agreed to reduce the export charge with respect to exports of certain softwood lumber products produced in Quebec as of 1 April 1988, as a consequence of replacement measures instituted by that Province. Finally, Canada and the United States agreed to exempt 365 million board feet of lumber produced from logs of US-origin from the export charge annually.

20. In a diplomatic note dated 3 September 1991, Canada gave the United States formal notice of its intention to terminate the MOU, as provided for in Article 9 of the MOU, effective 4 October 1991. This

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[9] 52 Fed.Reg., 5 January 1987, pp.229-230.

[10] 52 Fed.Reg., 5 January 1987, p.233.

notice followed a series of informal ministerial discussions between Canada and the United States which occurred over a period of several months.

21. On 4 October 1991, following Canada's termination of the MOU, the USTR, acting under Section 304 of the Trade Act of 1974, determined "(a) That acts, policies, and practices of the Government of Canada regarding the exportation of softwood lumber to the United States, specifically the failure of the Government of Canada to ensure the continued collection of export charges of softwood lumber envisioned by the MOU, are unreasonable and burden or restrict US commerce; and (b) That expeditious action is required and that the appropriate action at this time is to impose contingent, temporary increased duties on the parties identified in appendix 1 ( ) that originate on those provinces and territories listed in appendix 2 ( )".[11]

22. The notice of imposition of these measures described the reasons for these measures as follows:

> "As a consequence [of the termination of the MOU], the United States, which in December 1986 terminated its countervailing duty investigation in reliance upon Canada's undertakings in the MOU, will be denied the offset that had been provided by Canadian export charges against possible injurious Canadian subsidies. Due to the limited notice provided by Canada in terminating the agreement and the amount of time required for the Department once again to make a preliminary subsidy determination, the Department is unable in the short period leading up to that determination to impose interim protective measures. Accordingly, action by the United States is required during this interim period in order to restore and maintain the status quo ante. Since the Government of Canada has refused to collect export charges to offset possible subsidies during this period, the United States is compelled to exercise its rights and to take enforcement measures arising out of the MOU by imposing temporary measures to safeguard against an influx of possible injurious subsidized Canadian softwood lumber."[12]

23. The measures decided upon in this determination took the form of bonding requirements, the imposition of a duty, contingent upon affirmative final determinations of subsidization and injury, and the withholding or extension of liquidation of entries of certain softwood lumber from Canada. These measures took into account the replacement measures instituted in certain Canadian provinces. Thus in the case of lumber production in British Columbia, no bonding requirements were imposed and the rate of the contingent duty was zero.[13]

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[11] 56 Fed.Reg., 8 October 1991, p.50739.

[12] 56 Fed.Reg., 8 October 1991, p.50739.

[13] 56 Fed.Reg., 8 October 1991, pp.50739-40.

24. On 16 October 1991, Canada held consultations with the United States under Article 3:1 of the Agreement. At these consultations on the basis of the provisions of Article 2:1 of the Agreement, Canada requested from the United States evidence of the existence of a subsidy, of injury and of a causal link between the alleged subsidy and the alleged injury on which the United States justified its intent to self-initiate a countervailing duty investigation.

25. On 31 October 1991, the United States Department of Commerce self-initiated a countervailing duty investigation on imports of certain softwood lumber products from Canada.[14] In the notice of the self-initiation of this investigation, the Department stated that:

> "Canada's unilateral termination of the MOU, which was the basis for the withdrawal of the CVD petition and the termination of the CVD investigation in 1986, constitutes special circumstances within the meaning of Article 2.1 of the Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade (Subsidies Code)."[15]

The notice further explained that the practices subject to the investigation were "stumpage programmes, which are government programmes through which individuals and companies acquire the rights to cut and remove standing timber from provincial forest lands"[16] and that the information available to the Department indicated that the provisions of stumpage was specific, that discretion was exercized in the awarding of stumpage rights and the setting of stumpage prices, and that stumpage was preferentially priced.[17] The notice of initiation also indicated that, while the Department had information on restrictions applied by Canadian (federal and provincial) authorities on exports of logs, this information was not considered to be sufficient to warrant the inclusion of these export restrictions within the scope of the investigation:

> "In the Final Affirmative Countervailing Duty Determination and Countervailing Duty Order; Leather from Argentina (55 FR 40212 (1990), the Department determined that programmes that restrict exports are countervailable. In Leather from Argentina, the Department determined that export restrictions prohibiting the export of cattle hides caused prices to be lower than they would have been absent the restrictions, and provided a countervailing benefit to leather tanners as the specific users of cattle hides. Although economic theory would indicate that log export restrictions in Canada artificially lower domestic log prices, the Department requires

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[14] 56 Fed.Reg., 31 October 1991, pp.56056-56058.

[15] 56 Fed.Reg., 31 October 1991, p.56056.

[16] 56 Fed.Reg., 31 October 1991, p.56056.

[17] 56 Fed.Reg., 31 October 1991, p.56057.

> evidence demonstrating that the restrictions had measurable downward effect on log prices in order to meet the threshold for initiation ... Presently, the Department does not have sufficient evidence to ascertain the extent to which the log export restrictions artificially lower domestic prices for logs, the major input into the product under investigation. However, if an interested party submits such evidence during the course of the proceeding, the Department remains willing to investigate these programmes."[18]

26. The notice of the self-initiation of a countervailing duty investigation on imports of softwood lumber from Canada further contained a discussion of evidence available to the Department of Commerce which demonstrated "that the US softwood lumber industry is currently suffering material injury as a result of subsidized softwood lumber imports from Canada, and faces the threat of further, more extensive, material injury."[19]

27. Finally, the notice of self-initiation of the investigation exempted from the scope of the investigation softwood lumber products produced in New Brunswick, Newfoundland, Nova Scotia and Prince Edward Island, on the ground that, because these Provinces had been exempted from payment of the export charges under the MOU, the termination of the MOU by Canada could not be considered to constitute "special circumstances" with respect to these Provinces.[20]

28. A detailed description of the evidence relied upon by the Department of Commerce as a basis for the self-initiation of the countervailing duty investigation on imports of softwood lumber from Canada appears in a Department of Commerce Memorandum.[21]

29. On 3 and 13 December 1991, the Department of Commerce received information from interested parties in the investigation with respect to the price effects of the export restrictions maintained by British Columbia, Alberta, Ontario and Quebec. The Department found that this information provided sufficient evidence demonstrating that these export restrictions had a measurable downward effect on prices of logs in these provinces and therefore decided on 23 December 1991 to investigate these export restrictions as part of the countervailing duty investigation on imports of certain softwood lumber products from Canada.

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[18] 56 Fed.Reg., 31 October 1991, p.56057.

[19] 56 Fed.Reg., 31 October 1991, p.56057.

[20] 56 Fed.Reg., 31 October 1991, p.56058.

[21] Basis for Self-Initiating the Countervailing Duty Investigation on Certain Softwood Lumber Products from Canada, hereinafter "Initiation Memorandum".

III. FINDINGS REQUESTED

30. **Canada** requested the Panel to find that the measures taken by the United States on 4 October 1991 in the form of a suspension of liquidation of entries of softwood lumber products from Canada and the imposition of bonding requirements on such entries were inconsistent with the obligations of the United States under Article 5:1, and were not justifiable as a form of "expeditious action" under Article 4:6 of the Agreement.

31. The **United States** requested the Panel to find that the measures taken on 4 October 1991 with respect to entries of softwood lumber products from Canada were fully consistent with Article 4:6 of the Agreement.

32. **Canada** requested the Panel to find that the self-initiation by the United States on 31 October 1991 of a countervailing duty investigation on imports of softwood lumber products from Canada was inconsistent with the obligations of the United States under Article 2:1 of the Agreement.

33. The **United States** requested the Panel to find that the self-initiation on 31 October 1991 of a countervailing duty investigation of imports of softwood lumber products from Canada was fully consistent with the obligations of the United States under Article 2:1 of the Agreement.

34. **Canada** requested the Panel to recommend that the Committee on Subsidies and Countervailing Measures request the United States (1) to withdraw the bonding requirements imposed on 4 October 1991, release the bonds, refund with interest any cash deposits and amounts collected, and terminate the suspension of liquidation of entries of softwood lumber from Canada ordered on 4 October 1991, and (2) to terminate the countervailing duty investigation initiated on 31 October 1991 with respect to imports of softwood lumber from Canada.

IV. ARGUMENTS OF THE PARTIES

1. MEASURES TAKEN BY THE UNITED STATES ON 4 OCTOBER 1991

35. **Canada** submitted that the interim bonding requirement and suspension of liquidation of entries imposed by the United States on 4 October 1991 on softwood lumber products from Canada were contrary to the requirements of Article 5:1 of the Agreement. Article 5:1 sets out the conditions for the imposition of provisional measures as follows:

> "Provisional measures may be taken only after a preliminary affirmative finding has been made that a subsidy exists and that there is sufficient evidence of injury as provided for in Article 2, paragraph 1(a) to (c). Provisional measures shall not be applied unless the authorities concerned judge that they are necessary to prevent injury during the period of investigation."

The types of provisional measure that could be imposed by a signatory were defined in Article 5:2:

> "Provisional measures may take the form of provisional countervailing duties guaranteed by cash deposits or bonds equal to the amount of the provisionally calculated amount of subsidy."

The bonding requirement and the suspension of liquidation of entries of softwood lumber from Canada had been imposed by the United States not only prior to a preliminary determination of the existence of a subsidy, but even prior to the self-initiation of a countervailing duty investigation on 31 October 1991. The introduction of these measures by the United States absent a preliminary determination of the existence of a subsidy and injury was prima facie inconsistent with the obligations of the United States under Article 5:1 of the Agreement.

36. **Canada** considered that the imposition of provisional measures by the United States on 4 October 1991 could not be justified under Article 4:6 of the Agreement which allowed for "expeditious actions" under very narrowly defined circumstances:

> "In the event of violation of undertakings, the authorities of the importing signatory may take expeditious actions under this agreement in conformity with its provisions which may constitute immediate application of provisional measures using the best information available."

Any action taken under this provision must be "in conformity with" the provisions of the Agreement. One such provision was Article 4:2 which stipulated that no countervailing duty shall be levied on any imported product in excess of the amount of the subsidy found to exist. No such determination of subsidy had been made by the United States; the only final determination on the existence of a subsidy (made in 1983) had concluded that imports of softwood lumber products from Canada were not subsidized.

37. **Canada** also pointed out in this respect that a signatory could only take action under Article 4:6 in the form of immediate application of provisional measures if an undertaking had been violated. As the MOU concluded between Canada and the United States on 30 December 1986 had been negotiated outside the framework of the countervailing duty legislation of the United States, no "undertaking" within the meaning of Article 4:5 existed and no "violation" within the meaning of Article 4:6 had occurred. One of the provisions of the MOU had allowed for either party to terminate the Understanding at any time upon thirty days written notice. Canada had acted in accordance with this provision when on 3 September 1991 it had given notice of its intention to terminate the MOU, effective 4 October 1991. Canada could not be construed in any way of violating the MOU by adhering to its terms and conditions.

38. The **United States** argued that the measures taken on 4 October 1991 with respect to entries of softwood lumber products from Canada found their legal basis in Article 4:6 of the Agreement. The **United States** considered that (1) the MOU concluded between Canada and the United States on 30 December 1986 constituted an undertaking within the meaning of Article 4:5(a) of the Agreement; (2) Canada's withdrawal from the MOU provided a basis for expeditious action under Article 4:6 of the Agreement and, (3) the suspension of liquidation and imposition of bonding requirements were specifically recognized in the Agreement as forms of "provisional measures" authorized under Article 4:6.

1.1 Status of the MOU under Article 4:5 of the Agreement

39. The **United States** argued that the MOU by its terms constituted an undertaking within the meaning of Article 4:5 of the Agreement. An undertaking under Article 4:5 existed if (1) a signatory agreed to eliminate or limit a subsidy or to take other measures concerning its effects and (2) a countervailing duty investigation was suspended or terminated as a consequence. In the case of the MOU on softwood lumber, both these elements of an Article 4:5 undertaking were expressly met in the actions taken by the United States and Canada in concluding and implementing the MOU and were explicitly reflected in the text of the MOU itself. First, the United States had terminated the countervailing duty investigation upon implementation of the MOU: Article 3(a) of the MOU expressly provided that termination of the countervailing duty investigation was a condition precedent on implementation of the MOU. Second, Canada had imposed an export charge in the precise amount of the margin preliminarily established in October 1986 in an investigation conducted under US law in accordance with the provisions of the Agreement: Article 4(b) of the MOU established an export charge in the amount of 15 per cent to be collected by Canadian federal authorities or offset through the implementation of replacement measures by Canadian provincial authorities under the MOU. This rate was identical to that established in the preliminary determination of subsidization in the countervailing duty investigation. The provisions in Article 7 of the MOU, which served the monitoring function contemplated in Article 4:6 of the Agreement, reinforced the conclusion that the MOU constituted an undertaking within the meaning of Article 4:5 of the Agreement.

40. **Canada** argued that it had never considered the MOU to be an undertaking and had not treated it as such. Canada had specifically sought and obtained the termination by the United States of the investigation initiated in June 1986 (Articles 3(a) and 3(d) of the MOU). In addition, Article 4:5(a)(i) of the Agreement described undertakings as actions whereby "the government of the exporting country agrees to eliminate or limit the subsidy or take other measures concerning its effects". Since Canada per Article 3(b) of the MOU had not accepted that there was a subsidy, it could not have agreed "to eliminate or limit the subsidy or take other measures concerning its effects". The MOU therefore could not have been an undertaking within the meaning of Article 4:5(a)(i).

41. The **United States** observed, in response to Canada's argument that it had specifically sought and obtained the termination of the countervailing duty investigation, that the Agreement expressly recognized that both suspension and termination agreements could serve as undertakings between signatories. In response to Canada's argument based on Article 3(b) of the MOU, the United States argued that Canada's reasoning that an undertaking within the meaning of Article 4:5 could exist only if the signatory alleged to be providing a subsidy expressly agreed that the practice in question was a subsidy under the Agreement would eliminate the prospect of concluding an undertaking in most cases, thus undermining the purpose of Article 4. Canada's argument ignored the fact that most undertakings arose because a country wanted to avoid an express finding of subsidization. The United States furthermore observed that it was disingenuous now for Canada to assert that its decision to enter into the undertaking was tantamount to the two parties agreeing that Canada's stumpage pricing practices did not constitute subsidies. Had Canada so believed, it could have pursued its complaint referred to the Panel established in August 1986 through to completion. The United States, referring to Article 58 of the Vienna Convention on the Law of Treaties (1969), also argued that the Canadian argument that Article 3(b) of the MOU meant that the United States had somehow implicitly waived its rights to enforce the MOU under Article 4:6 of the Agreement was contrary to the established principle of international law that a bilateral agreement would not waive the rights of the parties to that agreement under an existing multilateral agreement unless such a waiver was explicit and the parties to the multilateral agreement had been notified of the waiver. In the case of the MOU, there was no such express waiver of rights under the Agreement.

42. **Canada** pointed out that it was not disputing that the Agreement provided for undertakings involving either the termination or the suspension of a countervailing duty investigation. While the Agreement allowed signatories to use suspension and termination agreements as undertakings, the Agreement did not require signatories to use either form of agreement (or to allow undertakings at all). The countervailing duty legislation of the United States provided in section 704 (i) of the Tariff Act of 1930, as amended, for the authority to take action in respect of violation of suspension agreements concluded pursuant to sections 704 (b) or (c), but not in respect of termination agreements, as this phrase was used in Article 4:5 of the Agreement. The fact that the United States had availed itself of the authority to use suspension agreements as "undertakings" did not allow it to transform separate and substantively different trade agreements into "undertakings" ex post facto by calling such agreements "termination agreements". The action taken by the United States in instituting the bonding requirements had been taken under the authority of section 301 of the United States Trade Act of 1974, outside the countervailing duty legislation of the United States. The EEC, in contrast, had specifically provided for the acceptance of "termination agreements" as "undertakings" in Article 10:6 of the Regulation providing for the authority to apply countervailing duty measures, and for the imposition of provisional measures upon withdrawal from such agreements, as provided under the Agreement.

43. In response to the argument of the United States that, if the MOU had been intended by the parties to be outside of the provisions of the Agreement, there should have been an expressed intention of the parties to suspend inter se the operation of Article 4, **Canada** argued that the principal fallacy in this argument was that the "right" that was supposedly being "waived" simply did not exist in the context of the MOU. The United States had no rights under Article 4:6 of the Agreement with respect to the MOU because the MOU was not an undertaking under Article 4:5 of the Agreement. No "waiver" of rights under Article 4:6 had therefore been necessary and, accordingly, there had been no obligation to notify the signatories of the Agreement of such a "waiver". The termination of the countervailing duty investigation in January 1987 had extinguished any right of the United States to use the investigation initiated in June 1986 as a basis for the imposition of provisional measures. The fact that an independent trade agreement, outside the provisions of the countervailing duty law of the United States, was concluded at the same time a countervailing duty investigation was terminated did not make that agreement an undertaking for purposes of Article 4:5 of the Agreement and did not lead to the accrual of rights under the Agreement as a result of the conclusion of that independent agreement. This was confirmed by Article 4:8 of the Agreement which through the use of the word "shall" set out mandatory notification requirements whenever a countervailing duty investigation was suspended or terminated, pursuant to Article 4:5. Thus the rights and procedures of Articles 4:5 and 4:6 had to be invoked; they were not automatic.

44. In light of the statement of the United States that in the case of the MOU Canada and the United States had not expressed an intention to suspend obligations under the Agreement, the Panel asked the United States to comment on the fact that in its semi-annual report of countervailing duty actions in the first half of 1987 the United States had indicated with respect to the investigation of softwood lumber from Canada that "the case" had been "withdrawn". In response, the **United States** pointed out that this notification indicated the disposition of the case or investigation and did not in any way state or imply that the United States was waiving its rights under Article 4. This notification, like the notification of the MOU to the Panel established in August 1986 and to the Committee on Subsidies and Countervailing Measures and the notification by the United States in its semi-annual report for the second half of 1991 all contradicted Canada's position that the MOU had existed outside the parameters of the Agreement.

45. **Canada** noted that there was no explicit provision in the MOU which precluded the United States from taking countervailing duty action on the softwood lumber products covered in the MOU. Canada had considered the purpose of the MOU to avoid "the enactment of legislated restrictions or further investigation under US trade law", and to this effect, an agreed side letter was included in the MOU stating that "in the event of further investigations under US law, Canada may exercise its right to terminate the agreement".

46. The **United States** observed that the text of the MOU itself did not address the issue of whether, as long as the MOU remained in force, there would be no new countervailing duty investigations initiated on softwood lumber from Canada. However, it was clear that the MOU was dependent upon the withdrawal of the existing countervailing duty case and that the filing of a new countervailing duty petition would have led to the prompt termination of the MOU. In a side letter Canada had stated its view that "the objective of the MOU ... involves ... avoiding ... further investigations under US trade law". This would be a prime objective for any country (or the country's exporters) in concluding a termination undertaking within the meaning of Article 4:5. Indeed, it would be inconsistent with Article VI to impose countervailing duties on a product already subject to a suspension or termination undertaking in connection with the same practice or programme.

47. **Canada** considered that the term "undertaking" in the title to paragraph 6 of the MOU had meaning only in the context of the MOU. It had no relevance under the Agreement.

48. The **United States** considered that the fact that paragraph 6 of the MOU is entitled "Additional undertaking" was of significance in that under the Agreement the MOU could not have been anything else.

49. **Canada** also argued that the fact that the MOU had not been treated by the United States as an undertaking supported its view that the MOU had not constituted an undertaking within the meaning of Article 4:5 of the Agreement. First, the United States had not notified the MOU as an undertaking in its semi-annual report of countervailing duty actions covering the period 1 July-31 December 1986 (SCM/84(Add.4), as required by Article 2:16 of the Agreement. Second, the MOU had not been notified as an undertaking in the Federal Register notice of the termination of the investigation initiated in June 1986, as required by Article 4:8 of the Agreement. Indeed, the United States had terminated the investigation, stating that the petition had been withdrawn and that the preliminary determination was without legal force or effect. In the exchange of letters accompanying the MOU, the United States had expressly advised Canada that it considered the MOU to be a "trade agreement" for the purposes of US law. This was intended to bring the MOU under the authority of Section 301 of the Trade Act of 1974 precisely because the United States would not be able to enforce the MOU under the "suspension agreement" provisions of its countervailing duty law. Third, the bonding requirement and suspension of liquidation of entries on 4 October 1991 were imposed by the United States under the provisions of Section 304 of the United States Trade Act of 1974. These provisions were not part of the legislation notified by the United States to the Committee on Subsidies and Countervailing Measures in document SCM/1/Add.3 of 30 April 1980 (Tariff Act 1930, as amended). The United States Trade Representative (USTR) had not been notified to the Committee as the responsible agency for dealing with the initiation and conduct of countervailing duty investigations.

50. **Canada** further pointed out in this context that during the life of the MOU, no steps had been taken by either party with respect to the notification of the GATT or the Committee on Subsidies and Countervailing Measures regarding the characterization of the MOU as an undertaking. This lack of action was not an omission. Both sides had been well aware of the obligations to notify an undertaking under the Agreement. Canada noted in this regard that the Agreement did not distinguish between substantive and procedural requirements of undertakings. While the text of the MOU had been provided to the Chairman of the Panel established by the Committee in July 1986, this had been done solely for the purpose of informing the Panel that a mutually satisfactory solution had been reached in the dispute examined by that Panel. In the Federal Register notice of the imposition of interim measures on 4 October 1991 the United States had not referred to any violation of an undertaking. In introducing these measures, the United States had not made any reference to the application of the provisions of the Agreement. These omissions were further evidence that the United States had not considered the MOU to be an undertaking within the meaning of the Agreement. The United States had considered the MOU to be outside its countervailing duty law until after the termination of the MOU. It was only on 16 October 1991 that the United States had stated in bilateral consultations with Canada that it considered the MOU to be an undertaking under Article 4:5 of the Agreement.

51. In response to Canada's argument that the United States had not treated the MOU as an undertaking within the meaning of Article 4:5 of the Agreement, the **United States** argued that the MOU was treated precisely as any 'termination undertaking' under Article 4 would be treated under US law. Moreover, Canada's argument ignored that under international law the subjective intent of the parties to an agreement was irrelevant for purposes of interpreting the agreement: what mattered was the intention of the parties as expressed in the text. This was confirmed both by the jurisprudence of the ICJ and by Article 31 of the Vienna Convention on the Law of Treaties (1969). Thus, the purpose of an international agreement was not determined by the unexpressed intent of one of the parties to the agreement. In addition, Canada was factually incorrect in claiming that the United States had not treated the MOU as an undertaking within the meaning of Article 4:5 of the Agreement. The record demonstrated that the United States had considered the MOU as a termination undertaking within the meaning of Article 4:5 of the Agreement. For example, in the context of the United States-Canada FTA Chapter 19 bilateral Working Group the suspension agreement on raspberries and the MOU on softwood lumber were treated identically as "bilateral agreements" arising out of countervailing duty investigations but not covered by countervailing duty orders. Similarly, the United States had explicitly indicated to Canada that it planned to enforce the MOU as a trade agreement, which showed that the United States saw the MOU as an enforceable undertaking, as this would be the only means of enforcing a termination undertaking under US law.

52. The **United States** also considered that the record did not support Canada's contention that Canada all along considered the MOU to be a bilateral agreement concluded, implemented and terminated completely

outside the Agreement. To the contrary, the record demonstrated that Canada considered the MOU to be fully consistent with its obligations under the General Agreement. In view of this, the position urged by Canada in this proceeding strained credulity. Canada would have the Panel believe that (1) the MOU bore no relation to the countervailing duty investigation conducted in 1986, notwithstanding that implementation of the MOU was expressly contingent on the termination of that case; (2) the MOU bore no relation to the obligations of the United States and Canada under the Agreement, notwithstanding that the proceedings of a dispute settlement Panel under the Agreement had also been terminated upon the implementation of the MOU, and the MOU had been specifically notified in connection therewith; and (3) the MOU bore no relation to the obligations of the United States and Canada under the General Agreement, notwithstanding that Canada had taken care to emphasize that the MOU was fully consistent with those obligations. In the face of the record, Canada's post hoc contentions simply did not stand. Both Canada and the United States had considered the MOU to fall within their obligations under the General Agreement. In any event, even if Canada could so demonstrate, its view would not overcome the basic fact that the MOU on its face constituted a termination undertaking within the meaning of the Agreement.

53. The Panel asked the United States to explain its view on how the fact that Canada had considered the MOU to be consistent with its obligations under the General Agreement indicated that Canada had treated the MOU as an undertaking within the meaning of Article 4:5 of the Agreement. In response, the **United States** observed that the only manner in which a countervailing duty investigation could be terminated by agreement was Article 4 of the Agreement. Accordingly, the MOU could only have been a termination undertaking within the meaning of Article 4 of the Agreement.

54. The **United States** argued that it had twice notified the GATT of the termination of the countervailing duty investigation and the conclusion of the undertaking: (1) jointly with Canada through the "Agreed Minute appended to the MOU", and (2) by letter dated 29 January 1987, from Ambassador Samuels to the Chairman of the 1986 Panel. The terms of the MOU had been outlined in the Panel Report (SCM/83) and a copy of the MOU had been made available in the secretariat for consultation by interested signatories. Even if the United States had not complied with the notification requirements of Article 4:8 of the Agreement, this non-compliance with a procedural requirement could not have prejudiced substantive rights of the United States under the Agreement. In addition, for its part Canada had done nothing to demonstrate that it had taken any action making clear that it did not consider the MOU to be a termination undertaking within the meaning of the Agreement.

55. In response to Canada's argument that it was only on 16 October 1991 that the United States had for the first time indicated to Canada that it considered the MOU to be an undertaking within the meaning of Article 4:5 of the Agreement, the **United States** observed that the record of this proceeding demonstrated that Canada had not implicitly or explicitly informed the United States that it considered the MOU to be outside the

scope of Canada's obligations under the Agreement. During the pre-initiation consultations held between Canada and the United States in October 1991 under Article 3:1 of the Agreement the United States had mentioned, in response to a question from Canada and almost in passing, that the interim measures derived from the rights of the United States under Article 4:6 of the Agreement. The United States was at that time and remained surprised that Canada would challenge that basic fact. Thus it was not until these pre-initiation consultations that the United States realized that Canada questioned that the United States and Canada both had rights and obligations under the Agreement with respect to the MOU. Accordingly, prior to that time, the United States had not deliberately employed language identical to that found in the Agreement, since the Agreement did not require particular language to be used in taking actions under its provisions. Nonetheless, the United States had clarified this matter, including by notifying the action taken following Canada's withdrawal from the MOU to the Committee on Subsidies and Countervailing Measures in its semi-annual report[22] covering countervailing duty actions taken in the second half of 1991.

56. The Panel asked the United States to explain its views on how the fact that the United States had informed Canada that it considered the MOU to be a trade agreement for purposes of its domestic trade laws indicated that the United States had treated the MOU as an undertaking under Article 4:5 of the Agreement. In response, the **United States** observed that the Agreement expressly suggested that the proper form for an undertaking was a trade agreement because Article 4:5 provided that an essential condition of an undertaking was that "the government of the exporting country agrees to eliminate or limit the subsidy ...". In addition, at the time of the entry into force of the MOU the United States had indicated that it would enforce its rights under the MOU. It had been understood that the designation of the MOU as a trade agreement was intended to have that effect. It should be presumed, absent strong evidence to the contrary, that the United States had planned enforcement actions consistent with the Agreement. The United States also noted in this context that, immediately after the MOU had come into effect, it had exercized its right to enforce the MOU as an agreement. Until the proceeding before this Panel, Canada had not complained that this enforcement action by the United States was improper on the ground that the United States had not notified the provisions of section 301 of the Trade Act of 1974 to the Committee on Subsidies and Countervailing Measures. Canada's silence with respect to this enforcement action therefor undercut the position taken by Canada in the proceedings before this Panel.

57. In response to Canada's argument that the Agreement did not distinguish between substantive and non-substantive requirements for undertakings, the **United States** observed that the MOU had been notified in

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[22]SCM/136/Add.4, 26 March 1992, p.4 and p.8.

accordance with the requirements of the Agreement. In addition, the fact was that the MOU was a termination undertaking by definition (under Article 4:5 of the Agreement). Even if the MOU had not been properly notified (a contention of Canada with which the United States did not agree), this fact would not defeat nor in any way detract from the substantive essence of the MOU as an undertaking. Finally, the Agreement in fact did make a distinction between procedural and substantive requirements. The substantive requirements for undertakings were laid down in Article 4:5 whereas the procedural requirements relating, inter alia, to notification, were contained in a separate provision, Article 4:8.

58. The **United States** denied that the fact that the bonding requirements were imposed under the authority of the USTR was probative of the question of whether the MOU constituted an undertaking within the meaning of Article 4:5 of the Agreement. Canada incorrectly asserted that the USTR was conducting the countervailing duty investigation. In fact, the investigation was conducted by the Department of Commerce and the USITC. The USTR had imposed the suspension of liquidation and the bonding requirements because, under US law, the Department of Commerce did not have the authority to do so. Nothing in the US notifications to the Committee did or could limit the USTR's authority to take this limited action and similar action had been taken in 1987 without protest. The case of the MOU was unique in that, prior to the termination of the MOU, the United States had never had to act in the context of a country violating a termination undertaking under Article 4:6. As soon as it had become evident that the United States would take action, it had promptly notified the Committee on Subsidies and Countervailing Measures. In any event, even if (assuming arguendo) the United States had been unaware of its rights under the Agreement to act as it did, and even if it had not properly notified the Committee of a specific manner of implementation of those rights prior to taking such action, the failure to meet a procedural requirement could no more defeat rights of the United States than the failure to notify a subsidy could be taken as congruent with a violation of the Agreement based on providing that subsidy.

59. In response to a question by the Panel as to how the United States had informed the Committee on Subsidies and Countervailing Measures of the interim measures taken on 4 October 1991 with respect to imports of softwood lumber from Canada, the **United States** indicated that these measures had been notified to the Committee in the semi-annual report of the United States on countervailing duty actions taken in the second half of 1991.[23]

60. Responding to a question by the Panel as to how the nature of the US measures taken on 4 October 1991 as a form of "expeditious action" within the meaning of Article 4:5 of the Agreement was reflected in the text of

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[23]SCM/136/Add.4, 26 March 1992.

the Federal Register Notice announcing these measures, the **United States** argued that under Article 4:6 "expeditious actions" could include "immediate application of provisional measures using the best information available". Provisional measures were defined in the Agreement as "provisional countervailing duties guaranteed by cash deposits or bonds equal to the amount of the provisionally calculated amount of subsidization". The Federal Register Notice of 8 October 1991 had established a bonding requirement in the amount of the export charge established by the MOU less an amount reflecting replacement measures agreed to and implemented as of that date. Accordingly, the Federal Register Notice expressly described actions explicitly authorized by Article 4:6 of the Agreement. Significantly, in the case of a suspension agreement, the provisional measures would not have reflected the replacement measures introduced by some Canadian Provinces.

61. **Canada** also argued that the fact that the MOU was outside the framework of the countervailing duty legislation of the United States supported the view that the MOU had not constituted an undertaking within the meaning of Article 4:5(a)(i) of the Agreement. The Agreement required in Article 2:2 that the relevant authorities and procedures be notified to the Committee on Subsidies and Countervailing Measures. In the case of the United States, the legislative procedures notified to the Committee were those of the Tariff Act of 1930, as amended. The United States had concluded the MOU outside these procedures and could therefore not claim any rights under Articles 4:5 and 4:6 of the Agreement in relation to the MOU. In addition, the status of the MOU under US domestic law was relevant insofar as it provided an indication of the intention of the parties at the time they had negotiated the MOU. It was quite clear that Canada could assume that the United States would act in accordance with its own law when conducting its affairs. At the time the MOU had been negotiated, the United States had not acted in accordance with its own internal law regarding undertakings. This indicated that the intention of the United States was not to create an "undertaking" but, rather, to enter into an independent bilateral agreement with Canada.

62. In light of Canada's statement that the United States had concluded the MOU outside the procedures of the Tariff Act of 1930 and therefore could not claim rights under Articles 4:5 and 4:6 of the Agreement in relation to the MOU, the Panel asked Canada to explain whether it considered that the procedure for the termination of a countervailing duty investigation upon withdrawal of a petition was outside the procedures notified by the United States to the Committee on Subsidies and Countervailing Measures. **Canada** responded that the termination of a countervailing duty investigation upon withdrawal of a petition was provided for in section 704(a) of the Tariff Act of 1930 and, as such, within the procedures notified to the Committee by the United States. However, provisions for undertakings based on agreements to eliminate or offset completely a subsidy fell under section 704(b) of the Tariff Act of 1930, as amended, which were not the procedures followed in this case. What was outside of the procedures notified by the United States to the Committee was the reinstitution of a previously terminated countervailing

duty investigation, or the imposition of interim measures following the termination of a countervailing duty investigation. Neither of these procedures was found in the Tariff Act of 1930, as amended.

63. In characterizing the MOU as being outside the framework of the domestic countervailing duty legislation of the United States, **Canada** made the following points.

64. First, the countervailing duty legislation of the United States distinguished between the procedures for termination of investigations and the procedures for suspension of investigations. Termination of a countervailing duty investigation could be the result of the withdrawal of the petition which had caused the initiation of an investigation or of negative determinations by the Department of Commerce or the USITC. Termination of an investigation could also result from an agreement between the United States and the foreign government concerned regarding quantitative export restrictions and the withdrawal of the petition. Once terminated, neither investigations nor proceedings could be resumed. There was no provision in the countervailing duty law of the United States for the imposition of any measures subsequent to termination of an investigation upon the withdrawal of the petition. In contrast, investigations could be suspended under the countervailing duty law of the United States when an agreement was reached between the United States and a foreign government, under which such government agreed to offset the subsidy in question, cease the export of the product in question or eliminate the injurious effects of the subsidized import. Investigations and proceedings continued in existence even following suspension agreements, subject to annual review. The investigation was required to be resumed if the suspension agreement was violated, or if the exporting party withdrew from the agreement. Enforcement of suspension agreements was provided for under Section 704 of the Tariff Act of 1930, as amended. The undertakings notified by the United States to the Committee on Subsidies and Countervailing Measures had been of this type. In the case of the MOU, Canada had not wanted to conclude a suspension agreement under the US countervailing duty law. Such an agreement would have had no termination clause and could have left countervailing duties in place for an indefinite and lengthy period, while subjecting Provinces and industry to annual reviews.

65. Second, Article 3(a) of the MOU had stipulated that its terms would be implemented when the petition in the countervailing duty investigation initiated in June 1986 had been withdrawn and the notice of termination of the investigation signed. As the United States had been required to declare that the preliminary determination issued in October 1986 no longer had legal force of effect under US domestic law, the MOU had stood by itself.

66. Third, the notice published in the Federal Register in January 1987 of the termination of the investigation initiated in June 1986 had not mentioned the existence of a bilateral agreement between Canada and the United States concerning softwood lumber. This was at variance with the

practice of the United States of publishing detailed texts of suspension notices for the purposes of undertakings. Three notices had been published in the Federal Register referring to the MOU. None of these notices had described the MOU as a suspension or termination agreement under the countervailing duty legislation of the United States.

67. The Panel asked Canada to comment on the following passage in the Presidential Memorandum of 30 December 1986 under Section 301 of the US Trade Act of 1974:

> "This agreement [the MOU] successfully addresses the problems that led the US softwood lumber industry to file a petition under the countervailing duty law with the Department of Commerce. As a result, the US industry is withdrawing its petition and the Department of Commerce will terminate its investigation."[24]

Canada observed that this statement indicated that the MOU had addressed issues sufficiently that the petitioning industry decided to withdraw its case under the US countervailing duty law. Upon withdrawal of the petition, the Department of Commerce was authorized to terminate the investigation and had done so. These facts, however, had not made the MOU an undertaking under Article 4:5 of the Agreement. Under the countervailing duty law of the United States, a suspension agreement resulting from a countervailing duty case fell under section 704 of the Tariff Act of 1930, as amended. The document referred to in the quotation was a notification under section 301 of the United States Trade Act of 1974; this Act had not been notified to the Committee on Subsidies and Countervailing Measures under Articles 2:2 or 19:5(b) of the Agreement. The three notices published in January 1987 in the Federal Register with respect to the MOU nowhere referred to section 704 of the Tariff Act of 1930, as amended.

68. The Panel asked Canada to explain whether it was of the view that in the case of the United States only "suspension agreements" could be considered as "undertakings" within the meaning of Article 4:5 of the Agreement. In response, **Canada** pointed out that the United States had implemented the Agreement only in the Tariff Act of 1930, as amended, and that this legislation did not contain p[rovisions for undertakings other than "suspension agreements". Thus, only suspension agreements could be considered to be "undertakings" within the meaning of the Agreement. The only type of agreement envisaged by the relevant provisions of the Tariff Act of 1930 in the context of the termination of an investigation was a quantitative restrain agreement (section 704 (a) (2), as amended). However, that statute addressed only the procedures and considerations to be used in determining whether to enter a quantitative restraint agreement, and neither that statute nor the general US countervailing duty scheme

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[24] 52 Fed.Reg., 5 January 1987, p.233.

provided any mechanism for the enforcement of such a quantitative restraint agreement. In the only instance of which Canada was aware in which the United States had entered a quantitative restraint agreement in the context of the termination of a countervailing duty investigation, the United States had enacted specific statutory authority in order to provide enforcement authority, and that authority had not been connected in any way to the Agreement or to the US countervailing duty legislation.[25]

69. **Canada** further noted in this context that the Agreement did not require a signatory to impose a countervailing duty even where all the requirements for the imposition of such a duty had been met. This discretion available under the Agreement included the ability to withdraw or terminate a countervailing duty proceeding using procedures other than those set out in Article 4:5 of the Agreement. This was what the United States had done in this case. Article 4:5 was but one method to terminate a proceeding. Its express inclusion in the Agreement had been necessary because of the additional rights which flowed from the use of undertakings - the right to impose provisional measures under Article 4:6 when an undertaking was violated. The fact that the statement linking the MOU and the withdrawal of the petition occurred in the section 301 notice underscored Canada's point that the MOU was not an undertaking under the Agreement or under US countervailing duty law. Rather, it was a trade agreement over which the United States had asserted unilateral 'enforcement' rights under section 301 of the Trade Act of 1974.

70. In response to Canada's argument that the MOU had not constituted an undertaking under Article 4:5(a) of the Agreement because the domestic countervailing duty legislation of the United States did not specifically provide for the acceptance of undertakings as a basis for termination (as opposed to suspension) of investigations, the **United States** argued that Section 704 of the Tariff Act 1930, as amended, did contemplate termination of cases through agreements when in the public interest - i.e. a termination undertaking as in this case. Further, the scope of its domestic law could not circumscribe rights of the United States under an international agreement. Although the provisions of domestic law on which the United States had relied to maintain the status quo following Canada's withdrawal from the MOU were different from the provisions of US law relating to the reinstatement of a suspended countervailing duty investigation, the manner in which the United States chose to implement its rights and obligations under the Agreement in its domestic law did not implicate any other signatory's rights under the Agreement. The manner in which the United States had chosen to enter into this termination agreement (the MOU) did not implicate a substantive concern because the Agreement, unlike US law, did not distinguish between suspension and termination agreements.

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[25] Steel Import Stabilisation Act of 1984, 19 U.S.C. S 2253 note.

71. In response to the argument of Canada that the affirmative preliminary determination of subsidization made by the Department of Commerce in October 1986 had been declared to be without legal force or effect under US law, the **United States** noted that this preliminary determination had been given no effect as res judicata or as binding precedent concerning natural resource subsidies. On the other hand, the decision had been consistently relied upon by the US courts, the Department of Commerce, and dispute panels established under the Canada-United States FTA Agreement as strong authority on matters involving analysis of preferentiality and specificity standards under US countervailing duty law.

72. **Canada** considered that the argument of the United States that the scope of its domestic law could not circumscribe rights of the United States under an international agreement would, if sustained by the Panel, mean that the United States could impose actions under any trade law and still be in conformity with the Agreement. This would mean that the obligations of Article 2:2 of the Agreement were without any meaning and that signatories had no way of knowing when they were entering into a bilateral agreement with the United States whether it would be considered by the United States as an "undertaking" for the purposes of the Agreement.

1.2 Termination of the MOU as a "violation" of an undertaking

73. The **United States** considered that the argument of Canada that the termination by Canada of the MOU in accordance with the termination clause of the MOU could not be considered to be a violation within the meaning of Article 4:5 of the Agreement would effectively nullify the remedy provided in Article 4:6. Canada's proffered distinction between withdrawal from an undertaking and its violation was illogical on its face. Canada argued in essence that provisional measures could not be applied under Article 4:6 if an exporting country decided to take an action inconsistent with the terms of an undertaking, so long as the exporting country notified the importing signatory of its intention to do so. Under such an interpretation, no country would ever choose to violate the terms of an undertaking; it would simply withdraw one day before taking such action and thereby escape the reach of the remedy provided for in Article 4:6. Canada's argument would also undermine the Agreement's support for the conclusion of termination or suspension agreements. The considerable detail provided in Article 4:5, 4:6 and 4:7 of the Agreement concerning the conclusion and treatment of such agreements indicted a policy in favour of permitting, if not promoting such agreements in lieu of the imposition of definitive countervailing duties. To permit a signatory to such an agreement to defeat the remedy provided at Article 4:6 simply on the basis that it had "withdrawn" from an undertaking prior to violating the undertaking would undermine that policy. Thus, both US and EEC cases had consistently found "violation" to include unilateral termination of undertakings.

74. **Canada**, responding to the argument of the United States that Canada's "withdrawal" from the MOU provided grounds for claiming a "violation" of the MOU, rejected the characterization of the termination of the MOU as a "withdrawal". The term "termination" was specifically used in the MOU and

Canada's action was a termination fully consistent with its negotiated rights under the MOU. An action specifically provided for in a bilateral agreement could not be construed as a violation of that agreement. Were the position of the United States to be accepted, the lawful termination of any agreement which settled a trade dispute could be considered grounds for an expedited self-initiation of an anti-dumping or countervailing duty investigation.

75. The **United States** pointed out that it did not contest that Canada had acted within its rights under the MOU by terminating the MOU on 4 October 1991. However, the United States too was acting within its rights under Article 4:6 of the Agreement to respond to Canada's action. The termination clause of the MOU could not be used to defeat rights of the United States under Article 4:6 of the Agreement. The termination clause in the MOU had served the same function as a termination clause in other types of bilateral agreement: providing an explicit right for either country to withdraw from the agreement. The consequence of invoking a termination clause was that a country could cease abiding by the terms of that agreement and not be in violation of an international treaty obligation on the basis of the bilateral agreement. Thus, it was not the position of the United States that Canada had violated the MOU by exercizing its right of termination. However, there was no support for Canada's argument that the termination clause in a bilateral agreement concluded in accordance with the provisions of a multilateral agreement also served to defeat the rights of the United States under that multilateral agreement. Canada's argument was contradicted by the terms of Article 4:6 which, inter alia, expressly reserved to the importing country the right to determine whether the terms of an undertaking were being fulfilled and related the concept of "violation" to the fulfilment of the objectives of the undertaking. Since the agreement of the importing country was necessary in order for a countervailing duty investigation to be suspended or terminated, the continued acquiescence of the importing country was required to maintain the undertaking. Certainly, either party had the right to withdraw from the undertaking; however, each must bear the consequences of doing so. In sum, Canada's right to withdraw from the MOU and the right of the United States to the remedy under Article 4:6 stood side by side; neither did (nor should be construed to) defeat the other. To do otherwise would discourage settlement of countervailing duty cases by making inclusion of a termination clause (a common clause in undertaking) unacceptable to the importing country.

76. The **United States** pointed out that the language in Article 4:6, which required that a "violation" of an undertaking occur prior to provisional action, was immediately preceded by the following language:

> "Authorities of an importing signatory may require any government or exporter from whom undertakings have been accepted to provide periodically information relevant to the fulfilment of such undertakings, and to permit verification of pertinent data." (emphasis by the United States)

Thus, the Agreement directly linked the ability of the importing country to respond expeditiously to the failure to fulfil the substantive terms of the undertaking. The term "violation" had to be interpreted in this light. Moreover, the Agreement expressly left a determination of the continued need for an undertaking to the importing country:

> "The authorities of an importing signatory shall review the need for the continuation of any undertaking, where warranted, on their own initiative, or if interested exporters or importers of the product in question so request and submit positive information substantiating the need for such review." (emphasis by the United States)

In this respect, the right of an importing country to review the continued need for an undertaking parallelled the right of the importing country to review the continued need for a countervailing duty order. Although Canada could have requested a formal review pursuant to Article 4:7, it had chosen to act unilaterally. While this was Canada's right, it carried certain potential consequences under the Agreement which Canada sought in this proceeding to avoid. Canada's ability to have requested a review of the undertaking under Article 4 was certainly relevant in determining whether a unilateral withdrawal from the undertaking should be dealt with under Article 4:6.

77. In response to a question by the Panel on whether a legal procedure had existed in the case of the MOU to ensure that, as an undertaking, the MOU would "not remain in force any longer than countervailing duties could remain force under this Agreement" (Article 4:7), the **United States** pointed out that the MOU had included explicit consultation provisions which would have permitted Canada to seek a review of any provisions or of the Understanding as a whole. Since Canada had not fully replaced the export tax on over one-third of Canadian lumber production, this opportunity had never seriously materialized. It was worth noting, however, that Canada had refused to engage in the required quarterly consultations in the second quarter of 1991.

78. In response to a question by the Panel on whether a legal procedure had been available to the Government of Canada and to interested exporters or importers to request a review of the need for the continuation of the MOU, the **United States** stated that a petition to that effect could have been filed at any time with either the Department of Commerce or the USTR. Such a request would have been given due consideration.

79. The **United States** further argued in this context that in the practice of both the EEC and the United States a withdrawal from an undertaking was treated in the same manner as a violation of an undertaking. This practice made sense because the effect of a violation and a withdrawal was identical: the exporting country signalled its intention not to abide by the terms of the undertaking, on the basis of which the underlying countervailing duty proceeding had been suspended or terminated. Thus, the United States had included termination clauses in a number of suspension agreements concluded in countervailing duty proceedings. Thereafter, if

the agreement was terminated or the exporting country withdrew from the agreement, the Department of Commerce acted to reinstate the suspended investigation and imposed provisional measures pending the outcome of the completed investigation. Similarly, in the EEC, if it appeared that a price undertaking had been violated, or if such an undertaking was withdrawn, the EEC Commission gave the exporter an opportunity to comment and could then immediately, upon consultation with the advisory committee, impose a provisional duty.

80. **Canada** noted that the suspension agreements referred to by the United States had specifically allowed the United States to reopen the countervailing duty investigation. The underlying determinations for these agreements had not been expressly declared "of no legal force or effect", as had been the case with the MOU. The MOU had come into effect only after the investigation had been terminated. Thus, in the Certain Red Raspberries from Canada case, cited by the United States, Section IV.b of the suspension agreement had provided that:

> "The provisions of section 704(i)1 of the Act shall apply if: (1) Canada withdraws from this Agreement; or (2) the Department determines that the Agreement is being or has been violated or no longer meets the requirements of section 704 of the Act."

Such a provision had not existed in the MOU, which in Article 9 had only provided for the right to terminate the agreement. This confirmed that the MOU had not been an undertaking within the meaning of Article 4:5 of the Agreement.

81. In response to a question by the Panel on whether Canada made a distinction between a "withdrawal" from an undertaking and a "violation" of an undertaking, **Canada** argued that there were important distinctions between a withdrawal from, violation of, and termination of an agreement. To say that a country had withdrawn from an agreement implied that the agreement continued to have some viability, either because it actually continued to exist or because the withdrawing country had continuing obligations thereunder. This also was true in the case of a violation of an agreement since the agreement continued to exist and there were continuing obligations thereunder. However, when a country terminated an agreement, in accord with the express terms of that agreement, there was no further obligation to comply with the terms of the agreement. The agreement no longer existed and, accordingly, the non-terminating party had no right to take action based on the act of termination, unless provided for in the agreement. No such rights existed in the case of the MOU, since the only condition of termination of the MOU was the provision of 30 days notice. Both Canada and the United States agreed that Canada had complied with this condition.

82. The **United States** observed that if Canada's interpretation was accepted, Canada could have terminated the agreement 30 days after it was signed with no effects - obviously a ridiculous result. Further, the United States pointed out that the distinction Canada was showing - between

suspension and a termination agreement - was valid as a matter of US law, but irrelevant under the Agreement.

1.3 Other requirements of Article 4:6

83. The **United States** considered that Canada's argument that the application of the interim measures was unwarranted because there had been no prior determination of the amount of a subsidy was based on a misstatement of fact and ignored the plain language of Article 4:6. An affirmative preliminary determination of subsidization had been made by the United States in October 1986 and the rate established in that determination had been the basis for the level of the export tax established under the MOU. In addition, Article 4:6 of the Agreement explicitly authorized the importing country to use "the best information available" ("BIA") in establishing the amount of provisional measures. In providing for the use of BIA, the drafters had clearly understood that it might not be possible in the immediate wake of a country's withdrawal from an undertaking, to obtain and apply new information on the rate of subsidization. The bonding requirements imposed by the United States explicitly limited the amount of potential liability of an importer to the rate established in the prior preliminary determination of subsidization: 15 per cent. Moreover, the Agreement in no way limited action under Article 4:6 to instances in which there had been a final subsidy finding. Such an interpretation contradicted the express permission to exporters to seek final subsidy and injury determinations if they chose and would undercut the purposes of encouraging undertakings in settlement of actions. At the same time, read together, Article 4:6 and Articles 5:1 and 5:2 clearly contemplated that the preliminary findings necessary before imposition of provisional measures could, in the case of enforcement of an undertaking, occur prior to the adoption of the undertaking. Any other reading would essentially make Article 4:6 superfluous.

84. **Canada** argued that Articles 4:2 and 5:1 of the Agreement provided that provisional measures "may only be taken after a preliminary finding has been made that a subsidy exists". The logic of Article 4:6 coupled with Article 5:1 restricted the immediate application of provisional measures under Article 4:6 to cases where a preliminary determination existed. In the case before the Panel, the preliminary determination made by the United States in October 1986 regarding imports of softwood lumber from Canada had been declared by the United States without legal force and effect, i.e., it did not exist in US law.

85. The **United States** argued that, whatever the status under US law of the preliminary determination made in October 1986, it did not have the ability to circumscribe the rights of the United States under the Agreement "to take expeditious actions using the best information available". Moreover, the MOU's limitation of the effects of the 1986 preliminary determination was terminated along with the MOU.

86. The **United States** considered that the measures taken on 4 October 1991 with respect to entries of softwood lumber from Canada fell

well short of what the Agreement explicitly authorized. The Agreement expressly permitted the imposition of "provisional measures" in the event of a violation of an undertaking. Provisional measures in turn were defined in Article 5:2 as "cash deposits or bonds equal to the amount of the provisionally calculated amount of subsidization". Accordingly, under the Agreement, as soon as there was a violation of a suspension or termination agreement, authorities of an importing country were authorized to impose cash deposits in the amount of the estimated margin of subsidization. In the case of the interim action of the United States, there were two simple elements: a bonding requirement and a withholding or extension of liquidation. The result of these measures would be - at most - collection of a duty (contingent upon final affirmative determinations of subsidization and injury in the ongoing investigation) in the amount agreed between Canada and the United States in the termination agreement (15 per cent), less the amount of any replacement measures taken. These actions fell well within the scope of action permitted under the Agreement.

87. The Panel asked the United States to explain how in its view under the Agreement the termination by Canada of the MOU was a ground for the application of interim measures under Article 4:6 and at the same time constituted a "special circumstance" within the meaning of Article 2:1 justifying the self-initiation of a countervailing duty investigation. In response, the **United States** argued that Canada's abrupt withdrawal from the MOU had been based upon a unilateral claim that all subsidy practices in Canada had ceased to exist. The United States had asked Canada to maintain the status quo to allow the United States to investigate Canada's claim. Canada had refused this request, which had given rise to the need for the United States to protect itself in the short term by imposing the interim measures as well as to a "special circumstance" namely, the need to commence an investigation as quickly as possible to verify Canada's claim.

2. SELF-INITIATION BY THE UNITED STATES OF A COUNTERVAILING DUTY INVESTIGATION ON 31 OCTOBER 1991

88. **Canada** submitted that, in self-initiating a countervailing duty investigation on 31 October 1991 with respect to imports of softwood lumber products from Canada, the United States had acted inconsistently with its obligations under Article 2:1 of the Agreement. There had been no "special circumstances" to justify the self-initiation of this investigation. In addition, the United States had initiated this investigation absent sufficient evidence of the existence of a subsidy and sufficient evidence of injury and causality.

89. The **United States** submitted that Canada's withdrawal from the MOU had constituted "special circumstances" within the meaning of the Agreement, justifying self-initiation of the countervailing duty investigation. Furthermore, the United States had possessed sufficient evidence of the existence of Canadian provincial subsidies to softwood lumber producers, injury and a causal link between the subsidized imports and the alleged injury as required by Article 2:1 of the Agreement. Accordingly, the self-initiation by the United States of the investigation on softwood

lumber products was consistent with the obligations of the United States under Article 2:1 of the Agreement.

2.1 Special circumstances to justify the self-initiation of a countervailing duty investigation

90. **Canada** argued that, while in the Notice of Initiation of the countervailing duty investigation of imports of softwood lumber from Canada the United States had acknowledged that Article 2:1 of the Agreement required that there be "special circumstances" to allow for the self-initiation of a countervailing duty investigation, the factors identified in this Notice as a basis for the self-initiation of the investigation did not constitute "special circumstances" for purposes of Article 2:1. The Notice had made the following statements regarding the alleged special circumstances:

> "We also determine that Canada's unilateral termination of the MOU...constitutes special circumstances within the meaning of Article 2:1 of the ... Subsidies Code."[26]

and:

> "As a consequence of Canada's termination of the MOU, the U.S. lumber industry will be denied the offset that had been provided by Canadian export charges against what in 1986 preliminarily had been found to be injurious Canadian subsidies. Furthermore, the U.S. Government and the U.S. industry will no longer have the ability to determine whether the timber fee increases instituted in some provinces to replace or reduce the export charge will remain in place because there will no longer be the exchange of information that occurred under the MOU."[27]

In the view of **Canada**, the reasons advanced by the Department of Commerce in the Notice of Initiation did not constitute special circumstances justifying the self-initiation of an investigation. If the US softwood lumber industry could be injured by the termination of the MOU, there was ample provision within the Agreement for this well-organized industry (which had already submitted petitions in two previous cases) to request the initiation of a countervailing duty investigation. As well, the claimed lack of information and the hypothetical supposition that provincial legislation might change were not special circumstances.

91. **Canada** noted that in the Notice of Initiation mention had been made of "the special circumstances resulting from Canada's breach of the agreement between the two governments which had resulted in execution of

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[26] 56 Fed.Reg., 31 October 1991, p.56056.

[27] 56 Fed.Reg., 31 October 1991, p.56056.

the MOU and termination of the CVD investigation."[28] However, the MOU had constituted the whole of the agreement and had not referred to any previous agreement. The MOU had been terminated by Canada in full compliance with its provisions.

92. **Canada** further argued that, while the Department of Commerce had explained in the Notice of Initiation that special circumstances warranting the self-initiation of a countervailing duty investigation did not exist with respect to the Maritime Provinces because these Provinces had not been subject to the export charge, under the MOU since 1987 British Columbia had also been exempted from the payment of the export charge on softwood lumber products. On that basis, the same logic should apply to British Columbia as to the Maritime Provinces for purposes of defining whether "special circumstances" warranting self-initiation of a countervailing duty investigation existed. Yet, the United States had capriciously decided that "special circumstances" existed for British Columbia but not for the Maritime Provinces.

93. Finally, **Canada** argued that the claim of the United States that "special circumstances" existed warranting the self-initiation of the entire countervailing duty investigation could not apply to measures affecting the export of logs. Such measures had not been subject to the MOU concluded in December 1986 and the alleged "violation" of this MOU therefore could not justify the invocation of "special circumstances" to allow for the self-initiation of a countervailing duty investigation with regard to these measures.

94. The **United States** argued that the unilateral termination by Canada of the MOU on softwood lumber had constituted "special circumstances" within the meaning of Article 2:1 of the Agreement. The Notice of Initiation of the countervailing duty investigation had specified that this termination would deny the US softwood lumber industry the offset against injurious subsidies and would deny both the United States Government and the US industry the ability to determine whether the timber fee increases instituted in some Canadian Provinces to replace or reduce the export charge would remain in place, because the exchange of information provided for under the Memorandum of Understanding would be terminated. In fact, the consultations had proven an important aspect of the MOU, particularly with respect to British Columbia, in the five years of the MOU. Canada's argument that the US industry itself could have filed a countervailing duty petition ignored the extremely short lead time that would have been available to the industry to prepare a petition in a situation where subsidised imports had already been preliminarily determined to be causing material injury. Also, unlike the typical countervailing duty case, in this case the Department of Commerce already had in its possession sufficient information concerning the subsidy and injury factors. Also,

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[28] 56 Fed.Reg., 31 October 1991, p.56056.

unlike in the typical situation, requiring the industry to present such information would have been unnecessary and would merely have delayed the initiation of the proceedings for no reason. Moreover, the industry already had presented a petition; imposing the burden of a new petition on the industry when the Department had possessed sufficient evidence to initiate an investigation would have been absurd. In short, in this special situation, the Department of Commerce had been in the best position to seek expeditious initiation of a countervailing duty investigation.

95. In response to Canada's argument that no "special circumstances" could have existed to warrant self-initiation of an investigation with respect to imports from British Columbia, the **United States** argued that Canada was incorrect in arguing that British Columbia and the Maritime Provinces should have been treated identically. The Maritime Provinces had never been subject to obligations under the MOU, while exports from British Columbia initially had been subject to export charges under the Memorandum and subsequently had been subject to replacement measures. These replacement measures were instituted under the terms of the MOU, were subject to the monitoring and enforcement provisions of the MOU and could be removed or offset following Canada's termination of the MOU. The United States also noted that it had not self-initiated a case against Canadian log export restrictions. The MOU explicitly treated the provinces differently.

96. **Canada** noted that, during the negotiations on the Agreement on Implementation of Article VI of the General Agreement (1967) the United States had taken the position that the "special circumstances" under which self-initiation of an anti-dumping duty investigation could take place existed when the domestic industry lacked sufficient knowledge or sufficient resources and organization to acquire the knowledge that dumping was the cause of its difficulties.[29] In the proceedings before this Panel the United States had argued that "special circumstances" existed for self-initiation because termination of the MOU on softwood lumber would deny US producers the "offset against injurious subsidies" under the Memorandum, and would deny the US Government the information to determine whether British Columbia and Quebec would roll back their replacement measures under the Memorandum of Understanding. Additionally, the United States had provided several purported reasons why US domestic producers were not in a position to submit a petition for the initiation of a countervailing duty investigation. Canada considered that the first two stated reasons were not pertinent since they did not address why the US Government, rather than the US domestic producers, should be responsible for preparing the basis on which to initiate an investigation into any injurious subsidies which might exist. By the reasoning followed by the

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[29] Anti-Dumping Checklist: Comments by the United States (Sub-Committee on Non-tariff Barriers Group on Anti-Dumping Policies) TN.64/NTB/10/Add.3 (28 April 1966) p.7.

United States - that there must be immediate protection against any possible subsidies which might exist currently or in the future - the rule on "special circumstances" would completely overwhelm the normative rule under the General Agreement that countervailing duty investigations would be initiated only upon industry petition.

97. The **United States** observed that the rationale for self-initiation that an industry lacked resources was not a sole basis for 'special circumstances' and could not be such. In addition, the Agreement did not require 'special circumstances' which prevented effective filing of a petition by domestic producers, although such circumstances did exist in this case.

98. **Canada** further argued in this context that there had been no "special circumstances" which prevented US domestic producers from filing a countervailing duty petition. First, US lumber producers were very well organized, and had access to a wide array of information maintained in the ordinary course by numerous government agencies and trade associations. US producers had twice previously submitted petitions sufficient to launch countervailing duty investigations. The provision in the MOU requiring advance notice of termination had provided an opportunity for US domestic producers to prepare a petition, Second, while the United States had referred to the fact that there had been an affirmative preliminary determination of subsidisation in October 1986, following the conclusion of the MOU the United States had declared this determination to be without legal force and effect. To attempt to resuscitate this determination after the MOU had been executed and relied upon by the parties and then faithfully terminated according to its provisions, was to ignore common principles regarding the interpretation and application of treaties. Third, the argument that US domestic producers already had submitted a petition was unavailing. The domestic producers had withdrawn their petition on 30 December 1986. The letter in which this withdrawal had been announced was expressly without prejudice to the petitioner's right to file another petition in respect of the same Canadian acts and practices at any time. Finally, the United States' self-serving declaration that it already had in its possession information concerning the subsidy and injury factors presumed the answer to questions which Canada had requested the Panel to address and could not provide an independent basis for ignoring the petition requirements of the Agreement.

99. The **United States** submitted that the Agreement did not define the term "special circumstances". Furthermore, the position adopted by the United States during the negotiations in the Kennedy Round simply provided one example concerning 'special circumstances' in an anti-dumping proceeding. Because no universally accepted definition of the phrase 'special circumstances' existed, a signatory's interpretation of that term was necessarily subject to a case-by-case analysis based upon a standard of reasonableness. In this regard, Canada had failed to demonstrate that the interpretation espoused by the United States in this case somehow was unreasonable or otherwise conflicted with an express provision of the GATT texts. For these reasons, Canada's arguments necessarily failed.

2.2 Standard of "sufficient evidence"

100. **Canada** noted that the last sentence of Article 2:1 of the Agreement set out the conditions for the self-initiation of a countervailing duty investigation as follows:

> "If in special circumstances the authorities concerned decide to initiate an investigation without having received such a request, they shall proceed only if they have sufficient evidence on all points under (a) to (c) above."

While there was no definition in the Agreement of what constituted "sufficient evidence" in countervailing duty investigations undertaken in response to petitions from industry, logically a higher standard of "sufficient evidence" was required for self-initiated investigations. This was reflected in the exceptional nature of self-initiation, which could take place only "in special circumstances" and "only if" sufficient evidence was possessed. Article 2:1 required that a self-initiating government could proceed only if it had "sufficient evidence". The standard of "sufficient" was its plain language meaning of "that amount of proof which ordinarily satisfies an unprejudiced mind".[30] **Canada** considered that "evidence" in the context of Article 2:1 must be relevant, i.e. bear a logical relationship to the existence of (a) subsidy, (b) injury and (c) causality according to the meanings found in the Agreement.

101. The **United States** considered that the plain language of Article 2:1 did not support the view that a higher standard of "sufficient evidence" applied to cases of self-initiation of countervailing duty investigations. This provision allowed for self-initiation of an investigation subject to two conditions: the existence of "sufficient evidence" of the existence of a subsidy, injury and causality and the existence of "special circumstances". While the terms "sufficient evidence" and "special circumstances" had not been defined and thus remained ambiguous, what was not ambiguous was that the first requirement for self-initiation was that there be "sufficient evidence". Elementary rules of legal construction indicated that the drafters of the Agreement would not have used the term "sufficient evidence" to mean one thing in the third sentence of Article 2:1 and something entirely different in the fourth sentence of that provision. There was no support for the proposition that the "special circumstances" referenced in Article 2:1 of the Agreement in fact established a higher "sufficient evidence" standard for self-initiation. The plain meaning of the "special circumstances" prong of the rule regarding self-initiation was that the self-initiation option was one that could be applied only in "abnormal" circumstances. Thus, this term related to the circumstances surrounding the initiation of an investigation, not to

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[30] Black's Law Dictionary.

the standard of evidence. Once the "special circumstances" criteria were met, there was no reason for a higher standard of "sufficient evidence".

102. The **United States** noted that, while the term "sufficient evidence" had been left undefined in Article 2:1, the context of the term indicated that the drafters intended it to mean evidence sufficient to establish a basis for investigation: in other words, evidence which provided "a reason to believe" that subsidies were being provided which were causing threatening injury to a domestic industry.[31] This standard was also applied by Canada in initiations of countervailing duty cases. A similar standard had been applied around the world. In any case, the US initiation easily satisfied Canada's proposed higher standard.

103. **Canada** pointed out that self-initiation of a countervailing duty investigation was limited to cases of special circumstances. In such cases, the investigating authorities could proceed only if they had sufficient evidence on all three elements mentioned in Article 2:1. The use of the words "only if" implied that there was an especially strong onus of the authorities to ensure the criteria of sufficient evidence were met as this involved action by investigating authorities acting both as plaintiff and judge. It was in this sense that Canada considered a higher standard to be set in cases of self-initiation.

104. **Canada** disagreed that the "sufficient evidence" standard of Article 2:1 was met whenever there was "reason to believe" that the three elements of Article 2:1 existed. The concept of "belief" was fundamentally subjective. It would allow an investigation to be conducted on the basis of mere allegation. Such a standard was incapable of multilateral scrutiny as provided for by the Agreement and the General Agreement. The modifier "sufficient" was more than mere allegation. The evidence required under Article 2:1 had to be of an objective, not subjective, nature, capable of multilateral scrutiny. Canada rejected the argument of the United States that Canada's standard was similar to that of the United States, stating that Canada's law and practice on initiation was consistent with this evidentiary standard.

105. **Canada** considered that the countervailing duty legislation of the United States provided for a presumption of the existence of evidence of a subsidy unless previous countervailing duty investigations had ruled the measure in question not to be a subsidy (although even this was not certain, as illustrated by the fact that in the case of softwood lumber from Canada the only final ruling made by the Department of Commerce in 1983 had found that Canadian stumpage programmes were not subsidies). Article 2:1 of the Agreement clearly obliged investigating authorities to have evidence of the existence of a subsidy. The standard applied by the United States was to presume the existence of a subsidy unless the measure

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[31] 19 US Code of Federal Regulations, Section 355.12.

in question had been declared not to be a subsidy. To allow this standard to be the deciding factor for evidence of a subsidy was to leave open for investigation potentially all government measures.

106. **Canada** also argued in this context that under US countervailing duty legislation the standard of evidence applied in cases of self-initiation of investigations was lower than the standard applied in cases of initiation upon receipt of a petition. The latter standard was already insufficient to meet the requirements of the Agreement. Thus, the US legislation allowed any interested party to file a countervailing duty petition if that party had "reason to believe" that a subsidy was being provided and the industry was being injured by the imports in question.[32] The law required the Department of Commerce to determine whether the petition was "sufficient" and accompanied by information "reasonably available" to the petitioner, without making any judgement as to the veracity of the information provided by the petitioner. The Report of the Senate Finance Committee on the Trade Agreements Act of 1979 indicated that an investigation was to be initiated unless there was strong evidence to the contrary:

> "The committee intends section 702(c)(1) to result in investigations being initiated unless the authority is convinced that the petition and supporting information fail to state a claim upon which relief can be granted under section 701 or the petitioner does not provide information supporting the allegations which is reasonably available to him. Under this standard, it may be proper to refuse to commence a proceeding if the specific practice alleged has been determined not to be a subsidy, as a matter of law, in a prior investigation. However, the authority could not refuse to commence a proceeding merely because of conjecture that the practice is not a subsidy."[33]

For the purposes of self-initiation of a countervailing duty investigation by the Department of Commerce, the US law and regulations[34] only required that the Department "... determines, from information available to it that a formal investigation is warranted ...". While the United States had argued in the proceedings before this Panel that the standard of evidence in cases of self-initiation was identical to the standard of evidence in cases of initiation upon receipt of a petition, a plain reading of the quoted language of the US legislation and legislative history suggested that the United States applied a lower standard for self-initiation than the already insufficient standard for initiation on the basis of a petition.

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[32] 19 CFR 355.12.

[33] Senate Report (Finance Committee) No. 96-249, 17 July 1979, p.47.

[34] 19 CFR 355.11.

107. The **United States** contested that the use of the words "only if" in the last sentence of Article 2:1 of the Agreement indicated that a higher standard of evidence applied in cases of self-initiation of a countervailing duty investigation. In fact, those words were commonly used to denote a necessary precondition for an action and it was in this sense that they were used in Article 2:1. Indeed, the word "only" was used in that manner also in the first sentence of that paragraph.

108. The **United States** considered as unfounded Canada's assertion that in the US countervailing duty legislation the existence of a subsidy was presumed unless the measure in question had been declared not to be a subsidy. US countervailing duty law provided that an investigation could be initiated only if there was information that the investigation was warranted on the basis of all elements specified in both the Agreement and US legislation: the existence of subsidies provided to imports which were causing material injury to a domestic industry. The language in the Senate Finance Committee Report referred to by Canada provided that an investigation should be initiated unless the petition and supporting information "fail to state a claim upon which relief can be granted or the petitioner does not provide information supporting the allegations which is reasonably available to him". This language was fully consistent with both the Agreement and US countervailing duty law. Indeed, the language made it clear that under certain circumstances even a properly filed petition could be rejected. In fact, this language articulated the standard from the US Federal Rules of Civil Procedure. It was the standard applied by civil courts in the United States to determine whether a complaint was sufficiently well-founded to support a full judicial inquiry. It was appropriate for the Senate Finance Committee to refer to this standard in offering its interpretation of an appropriate threshold of sufficient evidence; this threshold in no way defeated the standard established by Article 2:1 of the Agreement.

109. The **United States** provided to the Panel a description of a number of recent anti-dumping and countervailing duty investigations initiated by Canada which demonstrated that the evidentiary standard applied by the Canadian authorities for the initiation of investigations was met if there was "a reasonable indication" of the existence of dumping or subsidization and of injury. This standard, as applied by the Canadian authorities, was not a particularly stringent standard to meet.

110. The **United States** also considered as unfounded Canada's argument that under the US countervailing duty legislation the standard of evidence in cases of self-initiation was lower than the standard of evidence in cases of initiation upon receipt of a petition. The legislation provided that "A countervailing duty proceeding shall be commenced whenever an interested party ... files a petition with the administering authority ... which alleges the elements necessary for the imposition of the duty imposed by section 701(a), and which is accompanied by information reasonably available to the petitioner supporting these allegations". With respect to the self-initiation of countervailing duty investigations, the legislation provided that "A countervailing duty investigation shall be commenced

whenever the administering authority determines, from information available to it, that a formal investigation is warranted into the question of whether the elements necessary for the imposition of a duty under section 701(a) exist". The standards as written and as applied in practice for initiation upon receipt of a petition and for self-initiation were thus virtually identical. There was no discernible difference.

111. The **United States** considered that Canada's approach to this case was unprecedented. Under the guise of a challenge to the initiation of a countervailing duty investigation, Canada had sought essentially as full an adjudication of the essential issues of the countervailing duty investigation at issue as Canada would have received had it challenged a final determination made pursuant to this investigation. Canada had offered the Panel virtually no basis to distinguish its challenge of the decision by the United States to initiate this investigation from a challenge which it might present to a final determination. This was illustrated by the argument of Canada that the United States had an obligation to weigh different possible causes of injury before commencing the investigation, by the argument of Canada that the United States should have determined that the Canadian stumpage practices were subsidies before initiating this investigation, and by Canada's arguments concerning log export restrictions, which had not been self-initiated upon. It was telling that Canada's only attempt to offer a definition of the standard of "sufficient evidence" provided for in Article 2:1 had been to raise that standard so that it more closely approximated a "positive evidence" standard. In the proceedings before the Panel, Canada had had every opportunity to make out a case that the United States did not have sufficient evidence to investigate Canada's stumpage pricing and log export restriction practices and whether subsidized Canadian imports caused injury to the domestic industry in the United States. Canada's complaint on its face failed to provide a basis - on either factual or legal grounds - to overturn the decision of the United States to initiate a countervailing duty investigation in this case. The **United States** noted in this connection that, in the context of a domestic juridical proceeding in the United States, it would request a panel of judges to issue a summary judgement that the United States had acted within its rights and obligations under the Agreement in self-initiating the countervailing duty investigation. While such a procedure did not <u>per se</u> exist in a dispute settlement process under the Agreement, the analogy was nonetheless helpful. The United States noted that the only issue in this case was whether Canada's alleged subsidy programmes should be investigated.

112. **Canada** considered that the United States incorrectly characterized the nature of Canada's challenge. It was clear from Article 2:1 of the Agreement that a countervailing duty investigation could be initiated only where the investigating authorities had sufficient evidence of the existence of a subsidy, of the existence of injury within the meaning of Article VI of the general Agreement as interpreted by the Agreement, and of a causal relationship between the subsidized imports and the alleged injury to the domestic industry. Article 2:3 reiterated the requirement that sufficient evidence must form the basis for a decision to initiate an

investigation. The requirement that there be sufficient evidence went to the heart of Canada's complaint. To leave matters about whether a measure was or was not a subsidy, or whether or not the evidence of injury used was sufficient, without challenging it from the initiation of the investigation, would expose exporters to needless harassment and loss of economic opportunity for the additional time that it took the US domestic procedure to run its course. The very purpose of the initiation obligations in Article 2:1 of the Agreement was to avoid these unjustified costs. The position of the United States would, if accepted, completely frustrate this objective and effectively render the initiation obligations in Article 2:1 null and void.

2.3 Evidence of the Existence of a Subsidy

2.3.1 Evidence of discretion exercized by Canadian authorities in the awarding of stumpage rights and in the setting of stumpage fees

113. **Canada** noted the following statement made by the Department of Commerce in its notice of the self-initiation of a countervailing duty investigation of softwood lumber products from Canada:

> "The Department has current information indicating that discretion is exercized in the awarding of stumpage rights and the setting of stumpage prices. The exercise of discretion in the awarding of stumpage rights is an indication of specificity, and as such, sufficient to meet the threshold for initiation."[35]

The Memorandum which had been the basis for the self-initiation described this information on the exercise of discretion as follows:

> "The provinces manage their timber resources by prescribing the manner in which they are utilized. Forest Tenures, p.2. Forest tenures, as explained above, are arrangements between government and industry that govern harvest rights and management responsibilities. Tenure arrangements regulate and administer the forest resource in accordance with specific guidelines. These guidelines are designed to meet a variety of provincial objectives which include social as well as economic goals. Forest Tenures, p.14. The provinces consider many non-economic criteria in their evaluation of applications for various arrangements allocating stumpage rights. Among the factors that may be considered are employment, integration, and utilization guidelines. For example, "[p]rocessing stipulations commonly require the tenure holder to build, or maintain in operation, a timber processing facility of a certain capacity or type". Forest Tenures, p.6. The fact that specific economic, as well as non-economic criteria, are considered indicates that the

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[35] 56 Fed.Reg., 31 October 1991, 56057.

government may be trying to develop specific regions or sectors within the province."[36]

Canada argued that, in considering the exercise of discretion as evidence of the existence of a subsidy, the United States had acted contrary to Article 2:1 of the Agreement. The concept of discretion in the context of specificity under the Agreement related to the targeting of an action towards a specific enterprise or industry. "Discretion" in this context had a narrow and particular meaning, namely, governmental action which discriminated between enterprises. The United States, however, had given this term an entirely different and far more expansive meaning in its notice of self-initiation of the investigation of softwood lumber from Canada. The examples of discretion given by the United States were inherent in the normal function of government. In the management of a natural resource governments needed to take account of a broad range of competing and potentially inconsistent objectives as well as the nature of the natural resource being exploited. In the case of timber, its inherent characteristics dictated the use of stumpage and logs and the nature of the industries dependent upon the resource. The forests products industries, which represented some 27 industries under the Canadian system of industrial classification, used stumpage. Stumpage was of interest only to such firms as were equipped to exploit it. It was of no use in its natural form to computer companies, banks or aircraft manufacturers. The exercise of discretion based on the inherent characteristics of the resource in its allocation for exploitation did not, therefore, constitute discrimination. A distinction had to be drawn between the general discretion exercized by governments and the particular kind of discretion which provided certain advantages to specific industries within the meaning of Article VI of the General Agreement. Only when the effect of the exercise of discretion was discriminatory and thus conferred a benefit was there evidence of a subsidy under Article VI.

114. In response to a request by the Panel for a clarification of the statement that in the case of timber its inherent characteristics dictated the use of stumpage and logs and the nature of the industries dependent upon the resource, Canada observed that the Canadian Provinces exercized their discretion only in the sense that they administered their natural resources in a manner designed to promote rational resource management, in a company- and industry-neutral manner and to serve numerous interests (which focused not only on resource extraction but also, for example, on aesthetics and recreation, preservation of fish and wild life, protection of vital watershed, environmental stewardship, and the like). Tenure holders and timber uses were not determined by these government actions, but were limited solely by the inherent characteristics of standing timber. Those who could not use timber would not become tenure holders. The inherent characteristics of standing timber required that the timber be

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[36] Initiation Memorandum, p.18.

harvested and processed before it had economic value; any company that harvested and processed the logs - regardless of the intended use of the fibre - was engaged in primary timber processing. By determining that the primary processors of a particular natural resource were a specific group, the United States allowed itself to find that specificity automatically existed in the government disposition of any natural resource. Such tautological reasoning could not be sufficient evidence of the existence of a subsidy. Where there were numerous users of a programme - in this case, some twenty-seven industries under Canada's industrial classification system - whose identities were limited only by the inherent characteristics of the programme at issue, specificity did not exist. Indeed, in the negative final determination made in 1983 in its countervailing duty investigation of imports of softwood lumber from Canada, the Department of Commerce had found that Canadian stumpage programmes were not specific because:

> "The only limitations as to the types of industries that use stumpage reflected the inherent characteristics of this natural resource and the current level of technology."[37]

115. The **United States** pointed out that the Department of Commerce had in its notice of initiation described the programme subject to investigation as "the selective provision of a government resource, provincially owned timber, at administratively-set prices which were determined to be at preferential rates".[38] The two key elements in this definition (the selective provision of the resource and the establishment of prices at preferential rates) reflected specific requirements of the countervailing duty legislation of the United States; the Agreement did not establish these elements as prerequisites for a finding of subsidization, let alone for a finding as to the sufficiency of evidence for the initiation of an investigation. In fact, Canada acknowledged that specificity per se was not a requirement under the Agreement.

116. Regarding the first of the above-mentioned two elements (the selective provision of a resource), the **United States** argued that the first defining characteristic of the Canadian provincial stumpage programmes was that the resource was provided selectively to certain users only: i.e., the benefits of the practice were not generally available to all users but rather limited to a specific industry or group of industries. The "specificity test", as it had come to be known, was straightforward. A domestic subsidy was specific if it was limited, in law or in fact, to a specific enterprise or industry or group of enterprises or industries. Canada applied the same standard in application of its law. In assessing whether a domestic subsidy was specific in fact, the United States authorities had found it useful to consider, inter alia, the following

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[37] 48 Fed.Reg., 31 May 1983, p.24167.

[38] 56 Fed.Reg., 31 October 1991, 56058.

factors: (1) the extent to which a government acts to limit the availability of a programme; (2) the number of enterprises or industries or groups thereof that actually use a programme; (3) whether there are dominant users of a programme, or whether certain industries or groups thereof receive disproportionately large benefits under a programme; and (4) the extent to which a government exercises discretion in conferring benefits under a programme.

117. The **United States** explained that, information obtained after the termination of the MOU on 4 October 1991, information available based on bilateral consultations under the MOU, information from the 1986 investigation as well as information in the public domain, had revealed the following. In Alberta, British Columbia, Manitoba, Ontario, Quebec, and Saskatchewan, over 90 per cent of the forest land was owned by the provincial governments. The provincial governments sold the right to cut standing timber, or "stumpage", and in awarding stumpage rights, each provincial government continued to exercise discretion in a manner which favoured the production of softwood lumber. For example, each province maintained local processing requirements as a criteria of eligibility to purchase timber. Thus, in order to buy timber, the purchaser must have a sawmill, plywood mill or pulp mill. In other words, subsidized stumpage could be of use to computer companies, banks, aircraft companies and others, if they were permitted to buy it and resell it at a profit. Canadian laws prevented that by allowing only forest product companies to obtain timber rights. Canada's argument that stumpage pricing was not specific because the use of the product was limited by its inherent characteristics ignored the fact that, if permitted, many industries would buy a subsidized input and resell it despite its inherent characteristics. Canada's argument would allow a government to find an input predominantly used by one sector and subsidize it with impunity. Indeed, softwood lumber producers were also the dominant beneficiaries of stumpage rights.[39] More important, Canada's argument would produce the absurd result that a foreign government could select a particular industry based upon its unique inherent characteristics (e.g. aircraft industry), selectively subsidize that industry in a manner unique to that industry (e.g. preferential provision of aircraft engines) and escape altogether any countervailing duty liability. For this precise reason, the United States Congress specifically abolished the "inherent characteristics" test from the US countervailing duty legislation when amending that legislation in 1988. There was thus more than ample information before the Department of Commerce at the time of initiation of the countervailing duty investigation that strongly supported the conclusion that the provinces managed their timber resources by prescribing the manner in which they were utilized. For example, as noted in the Initiation Memorandum:

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[39] Initiation Memorandum, p.17.

> "The fact that specific economic, as well as non-economic, criteria are considered indicates that the government may be trying to develop specific regions or sectors within the province."[40]

Certainly, this information justified investigation of this issue. Thus, Canada's argument that the United States had no evidence of discrimination with the effect of granting an advantage to certain companies in the allocation of stumpage rights was factually incorrect.

118. The **United States** further argued in this respect that the specificity of Canada's stumpage policies was manifest in the specific tenure fee systems established in the provinces, as explained in the Initiation Memorandum. Each of the major lumber producing provinces maintained forest tenure arrangements. While these tenure arrangements varied from province to province, they shared the essential characteristic of setting the price for stumpage. Although the Agreement established no requirement for province by province information, the Department of Commerce nonetheless had extensive information on the tenure arrangements in each province. After describing each province's tenure arrangement, the Initiation Memorandum had elaborated extensive evidence as to why these stumpage programmes were limited to a specific enterprise or industry, or group of enterprises or industries. In particular, the evidence before the Department of Commerce on specificity demonstrated that the provincial governments managed their timber resources by prescribing the manner in which they were utilized and which firms could utilize the timber. In addition, the provinces considered many non-economic criteria in their evaluation of applications for various arrangements allocating stumpage rights. As detailed in the Initiation Memorandum:

> "Among the factors that may be considered are employment, integration and utilization guidelines. For example, [p]rocessing stipulations commonly require the tenure holder to build, or maintain in operation, a timber processing facility of a certain capacity and/or type."[41]

The evidence before the Department also indicated that the provinces specified allotment type and placed size specifications restricting the area or volume which could be granted under a particular tenure arrangement. Furthermore, in some cases, tenures may be reserved for small forestry companies or private individuals. Accordingly, the Department had concluded that "although a final ruling concerning the specificity of stumpage programmes must await a complete investigation, there is sufficient evidence of specificity at this time to warrant the initiation of an investigation".[42]

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[40] Initiation Memorandum, p.18.

[41] Initiation Memorandum, p.18.

[42] Initiation Memorandum, p.18.

119. In response to Canada's argument that the Agreement required sufficient evidence of specificity under Article 2:1 and that discretion under the Agreement had a narrow meaning, the **United States** argued that neither the General Agreement nor the Agreement required the investigating authorities to make a finding as to specificity. Since the Agreement did not contain a specificity requirement, per force it could not contain restrictions on how the specificity requirement was to be applied. Canada had also not provided any citation to the Agreement or other authority for its proposition that the exercise of discretion based on the inherent characteristics of a natural resource did not constitute discrimination. Such an "inherent characteristics" test had been specifically rejected during the Uruguay Round negotiations. In response to the argument of Canada that discretion did not in and of itself constitute a subsidy, the **United States** pointed out that it had never maintained that discretion, in and of itself, constituted a subsidy. Rather, discretion was an indicator of specificity. In this case, the Department of Commerce had had ample evidence at initiation that the exercise of discretion skewed the use of the resource.

120. **Canada** considered that the assertion of the United States that softwood lumber producers were favoured by the exercise of discretion on the part of Canadian provincial governments was unsupported by any statement or evidence in the Initiation Memorandum. The principle in paragraph 4.4 in the report of the Panel in "New Zealand - Imports of Electrical Transformers from New Zealand"[43] indicated that the obligation existed on the contracting party imposing an anti-dumping or countervailing duty to establish the existence of the evidence to support its action when challenged.

121. In response to the argument of the United States that the specificity test was not an obligation under the Agreement, **Canada** argued that Article 11:3 of the Agreement established a criteria of specificity for subsidies which might cause injury to a domestic industry. This was supported by the Draft Guidelines for the Application of the Concept of Specificity in the Calculation of the Amount of a Subsidy other than an Export Subsidy.[44] These draft Guidelines, which were before the Committee on Subsidies and Countervailing Measures for adoption and had been developed by a Group of Experts established pursuant to footnote 15 of the Agreement, explicitly derived from Article 11:3 and recognized the existence of the concept of specificity in the Agreement as a test of the existence of a subsidy for the purpose of imposing countervailing duties. **Canada** also observed that the claim by the United States that there was no specificity requirement in the Agreement was in contradiction with the testimony of former USTR Yeutter in 1986 in hearings before the United States Congress. In this testimony Ambassador Yeutter had rejected

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[43] BISD 32S/55 at 68.

[44] Document SCM/W/89, 25 April 1985.

a proposal to remove the specificity criteria in the legislation of the United States in order to make natural resource pricing practices actionable as countervailable subsidies and had observed that this proposal would involve a departure from the obligations of the United States under the Agreement.[45]

122. **Canada** also considered that the specificity test, as applied under US practice, was so broad and discretionary as to be meaningless in and of itself. The history of US countervailing duty actions with respect to imports of softwood lumber from Canada underlined the reality that the US countervailing duty laws and regulations could be used to find a subsidy where none existed. In 1979 Congress had, in section 771 (5) (B) of the Tariff Act of 1930, as amended, defined domestic subsidies as those provided to a "specific enterprise on industry or group of enterprises or industries". In 1983, in a countervailing duty investigation of imports of softwood lumber from Canada, the Department of Commerce had found that Canadian stumpage programmes were not specific because (i) the programmes were available within Canada on similar terms regardless of the industry or enterprise of the recipient; (ii) the only limitations on the type of industries which could use stumpage resulted from the "inherent characteristics" of standing timber and the "current level of technology" and were "not due to activities of the Canadian governments", and (iii) stumpage was used by several groups of industries.[46] However, in 1986, in examining the same stumpage programmes the Department of Commerce had used a different interpretation of the same provision of the US countervailing duty law and had found that Canadian stumpage programmes were specific, turning its previous decision on its head. The rationale for the new approach had been explained as follows. First, Congress had provided no guidance on how the specificity test should be applied and this gave the Department the discretion to "develop the test through its experience in actual cases". Second, the Department had pointed out that three factors had to be considered in determining the existence of specificity: the extent to which a government acted to limit the availability of a programme, the number of actual users of a programme (which could involve an examination of whether there were dominant users of the programme), and the extent to which a government exercized discretion.

123. **Canada** noted that the reasons given for the reversal of the finding made in 1983 were almost exclusively based on the new factor of discretion (which in 1983 the Department had considered irrelevant) and on the changed view that pulp and paper and lumber producers tended to be horizontally integrated. As a result, in October 1986 the Department had

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[45]Statement of Hon. Clayton Yeutter, US Trade Representative, in Hearings before the Sub-Committee on Trade of the Committee on Ways and Means, House of Representatives, 99th Congress, Second Session, Part I, March 20, 21; April 8 and 10, 1986, Serial 99-78.

[46]48 Fed.Reg., 31 May 1983, p.24167.

found in a preliminary determination that stumpage programmes were provided to a specific group of enterprises. Since the concept of specificity was now subject to an "actual use" test, based on variable definitions of what constituted industries, the concept of discretion (which caught up almost any government programme) was virtually open-ended. Thus, the fact that governments exercised some discretion in managing a complex resource for a variety of reasons, plus the fact that the number of users of standing timber was perforce limited, were taken as evidence on its face that there was a subsidy. Such a test, if accepted as legitimate, was almost impervious to any objective review, besides being contrary to the Agreement.

124. **Canada** noted that this new administrative practice to determine the existence of specificity based on actual use of a programme had been incorporated into US countervailing duty law in 1988 by the following amendment:

> "Nominal general availability, under the terms of the law, regulation, program, or rule establishing a bounty or grant, or subsidy, of the benefits thereunder is not a basis for determining that the bounty, grant or subsidy is not, or has not been, in fact, provided to a specific enterprise or industry, or group thereof."[47]

Observers had noted that under this new provision the Department of Commerce would be free to find, or could be compelled to find by a court decision, as countervailable the fact that some firms benefited more from a given government programme than other firms, which would effectively nullify the specificity test and remove what limits might remain on the application of US countervailing duty laws to government programmes, none of which could guarantee an equal take-up. For example, even though the United States seemed to accept that general tax systems were not subsidies, the law and practice of the United States with respect to the specificity concept left open the possibility to argue that the effect of a given general corporate income tax was somehow to favour a particular group of industries, e.g. those involved in high technology products. As no system of taxation would fall equally on all in the real world, this might well be the case. Under GATT rules, this fact of less than perfect distribution of a tax burden would not be evidence of a subsidy, but under US law it would seem to qualify, at least for the purpose of initiating a countervailing duty investigation.

125. **Canada** noted that in 1991, in initiating its third countervailing duty investigation on imports of softwood lumber from Canada, the Department of Commerce had again relied on the discretion test, citing evidence from the 1986 preliminary determination. However, the Department

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[47] Omnibus Trade and Competitiveness Act of 1988, Public Law 100-418, Section 1312.

had changed the measurement standard from that used in 1986, although nothing had changed substantially in the administration of the stumpage programmes other than the large stumpage fee increases and/or the addition of new forest management responsibilities for the bulk of users of forest lands.

126. The **United States** rejected Canada's criticism of the application by the United States of the concepts of specificity and preferentiality. First, contrary to Canada's interpretation of the administration of the US countervailing duty law, an affirmative determination based upon a domestic subsidy practice required a showing of both (1) specificity (i.e. a benefit conferred upon a discrete class of citizens) and (2) preferentiality, i.e. price discrimination within the same political jurisdiction. Second both standards were well-established and rigorous and in the case before the Panel the supporting documentation on, and analysis of, the existence of specificity and preferentiality were extensive. Canada's contention was simply an overstatement concerning the application by the United States of the specificity and preferentiality tests. If, as Canada had asserted, these tests were meaningless, the United States would countervail every foreign government domestic programme subject to investigation. That this was not the case was demonstrated by a recent decision of the United States Court of Appeals for the Federal Circuit in PPG Industries, Inc. v. United States[48] involving an investigation in which the United States had declined to countervail the sale by a foreign government of natural gas at controlled prices and exchange-risk programmes, based upon absence of specificity and lack of preferential pricing. Thus, contrary to Canada's sweeping assertion, the United States administered its specificity test in a rigorous manner: only if a foreign government programme was not de jure limited to a specific class of recipients did the Department of Commerce undertake its de facto analysis. Notably, Canada conveniently ignored that a binational panel established under the provisions of the Canada-United States FTA Agreement had recently upheld the application by the Department of Commerce of its specificity test.[49] Finally, it was notable that the US standards criticized by Canada in this case had been relied upon by Canada in its own initiation of countervailing duty investigations. Moreover, Canada misstated the distinction between the 1986 and 1983 cases. First, the "inherent characteristics" test of the 1983 case was effectively overruled in a 1985 court case involving another product. Second, the 1986 case found that as a matter of fact the users of timber were narrower than had been asserted by the Department of Commerce in 1983 and that these users were a tightly knit industry. Third, in 1986 the Department of Commerce found in its preliminary determination that discretion was exercized in a manner favouring this industry.

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[48] 928 F. 2d 1568 (Fed.Cir. 1991).

[49] Fresh, Chilled and Frozen Pork from Canada, USA-89-1904-06, 8 March 1991.

2.3.2 Evidence of the existence of "preferentiality"

127. As noted in paragraph 17, in initiating the countervailing duty investigation on softwood lumber from Canada, the United States relied, in addition to evidence on discretion as an indication of specificity, on evidence that stumpage was "preferentially" priced:

> "We also have evidence that stumpage is preferentially priced. Relying on information from a variety of public sources, we estimate that subsidies exist, based on comparisons of administratively set stumpage prices to either competitive or private stumpages prices within Canada."

The manner in which the Department of Commerce determined that under the Canadian programmes stumpage was provided at a preferential rate is described on pp.19-28 of the Initiation Memorandum.

128. **Canada** contested the sufficiency of the evidence on preferential pricing both as a matter of law and as a matter of fact. As a matter of law, the preferentiality test as applied by the United States was irrelevant in identifying the existence of a subsidy when the measure in question was the setting of a price for the access to a natural resource.[50] As a matter of fact, the evidence of preferentiality relied upon by the United States in initiating this investigation was insufficient for the following reasons.

British Columbia[51]

129. **Canada** argued that the claim of the Department of Commerce that there was preferential stumpage pricing in British Columbia was inconsistent with testimony of the United States Deputy Assistant Secretary for Commerce before the US congress. The evidence of the measure of subsidies in British Columbia presented by the Department of Commerce was based on data from the year April 1989 to 31 March 1990.[52] In 1987, British Columbia had made changes to its forest policies which had resulted in increases fees and costs to the industry. The United States had agreed that these charges, as set forth in Appendix 1 to the MOU, had fully replaced the export charge. Thus, in February 1991 the Deputy Assistant Secretary of Commerce had stated in sworn testimony before the US Congress that:

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[50] See infra, paragraph 160 et seq.

[51] Initiation Memorandum, pp.19-22.

[52] Initiation Memorandum, Annex 6 tables C-1 and C-1-A.

> "To date, replacement measures have been adopted in British Columbia, which accounts for 75 per cent of all lumber imports from Canada ...".[53]

The fact that the replacement measures had offset the export charge had been implicitly recognized by the USTR when it had excepted the application of a bonding rate to softwood lumber products exported from British Columbia in the measures taken on 4 October 1991. The United States had thus two publicly stated contradictory positions on the existence of "subsidies" in British Columbia. First, replacement measures enacted in British Columbia fully offset any alleged subsidy and British Columbia had not imposed any new measures which would offset such an effect. Second, provincial stumpage fees conferred "subsidies" of at least 7 per cent in British Columbia during the same time period. These conclusions had been based on the same evidence. These contradictory conclusions undermined the assertion of the United States that it had evidence of a subsidy meeting the higher standard required for self-initiation.

130. The **United States** argued that the Department of Commerce had possessed sufficient evidence that stumpage was provided at preferential rates in British Columbia. To determine the amount of the subsidy, the Department had compared sales under the Forest Licenses and Tree Farm Licenses (the two principal tenure arrangements in British Columbia) with minor timber sales licenses offered through the Small Business Forest Enterprise Programme (SBFEP), accounting for approximately 12 to 15 per cent of the timber harvest in British Columbia. Under this programme, most timber was sold competitively.[54] This comparison had led to the following conclusion:

> "Based on quarterly stumpage price information submitted to [Commerce] under the MOU, we note that the average price of stumpage sold competitively in FY 1989-1990 was C$17.60 per m^3, and the average price of stumpage sold in the non-competitive programs was C$8.02 per m^3".[55]

The Department had made adjustments to account for the fact that the responsibilities of stumpage harvesters under the competitive programme were less than under the non-competitive programme and to account for differences in species of trees and quality of stumpage. After making these adjustments, it had found that, using the adjusted competitive price of C$13.29 per m^3 as a benchmark, there was a 7.17 per cent ad valorem subsidy on lumber produced in British Columbia.[56]

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[53] "Hearing on the 1986 United States - Canada Memorandum of Understanding on Softwood Lumber", 22 February 1991, p.49.

[54] Initiation Memorandum, p.14.

[55] Initiation Memorandum, p.20 and Table C-1.

[56] Initiation Memorandum, p.21.

131. In response to Canada's argument that no evidence of subsidization British Columbia could have existed given that, as recognized by the United States, replacement measures enacted by British Columbia had fully replaced the export charge, the United States argued the following. First, the Deputy Assistant Secretary of Commerce had testified as to whether Canada was abiding by the MOU and the subsidy offset provided for in the MOU, not as to the subject in general of Canadian subsidies to softwood lumber and their effects on the US market. Second, the MOU itself was a compromise agreement reached as a way to settle a trade dispute. Once Canada had withdrawn from the MOU, there was no reason why the United States should be banned by the now-defunct compromise in its enquiry into subsidies and trade effects. Finally, the terms of the compromise had been fixed a number of years earlier; there was nothing to say that market circumstances had not changed, thereby rendering the terms of the compromise irrelevant to actual subsidization and trade effects. In fact, the gap between competitive and non-competitive prices in British Columbia had grown dramatically since 1986: in particular when British Columbia in its MOU replacement measures increased substantially the relative volume of timber sold competitively, providing an adequate benchmark that had not existed in 1986. In addition, there was a contradiction in the Canadian position in that it, in its argument on the alleged lack of evidence of subsidization in British Columbia, Canada appeared to treat the 15 per cent export tax which had formed the basis for the replacement measures under the MOU as a rate of subsidization, whereas in its arguments on the alleged inconsistency with the Agreement of the interim measures taken on 4 October 1991 Canada had emphasized that the 15 per cent rate of subsidization preliminarily determined in October 1986 was irrelevant. Finally, the Department of Commerce had specifically explained in its Initiation Memorandum why its calculation of the rate of subsidy did not need to be adjusted for the effect of the replacement measures.[57]

132. Canada noted that the Deputy Assistant Secretary of Commerce had stated that "the MOU has been effective in offsetting the subsidies which distorted fair trade in lumber between the United States and Canada", and that no further action was necessary with respect thereto as of 22 February 1991. The argument of the United States that the Deputy Assistant Secretary had been testifying "as to whether Canada was abiding by the MOU, not as to the subject in general of Canadian subsidies to softwood lumber and their effects on the US market" was therefore unsupportable.

133. Canada also argued that, on the basis of information available to the United States under the MOU relating to the replacement by British Columbia of the export charge with new policies and practices, and subsequent monitoring by the United States of these measures, the US authorities were aware that the Small Business Forest Enterprise Programme (SBFEP) and the

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[57] Initiation Memorandum, pp.21-22.

long term forest tenures were so fundamentally different that they could not be compared. For instance, a company under the SBFEP was not required to undertake silviculture, build as many roads or provide the management planning which were required of long term tenure holders.

Quebec and Alberta[58]

134. **Canada** noted that, for Quebec and Alberta, the Department of Commerce had found evidence of preferential pricing of stumpage on the basis of a comparison of prices charged in these provinces with prices in other provinces. Factually, cross-jurisdictional comparisons must account not only for differences in stumpage fees, but also for the detailed non-financial differences including properties of the timber and the complex package of the rights and obligations of the different tenure holders. The difficulties in measuring the value of standing timber between jurisdictions were well recognized. For example, in 1983 the Department of Commerce had observed that:

> "Each individual stand of timber is unique due to a variety of factors, such as species combination, density, quality, size, age, accessibility, and terrain and climate. Stumpage prices vary substantially both regionally and locally within Canada and the United States, even within a mill's timber supply area.... We believe that a comparison of stumpage prices with U.S. prices would be arbitrary and capricious".[59]

135. **Canada** observed that the Department of Commerce had possessed no current, accurate or appropriate evidence to allege the existence of a subsidy in Quebec.[60] The evidence relied upon was six-year old evidence, based on a comparison of average prices in Quebec and New Brunswick. Except for the pricing system, there were major differences between these two provinces regarding their forests, climate, logging conditions, roads and distances. Stumpage prices in Quebec were based on provincial market prices within Quebec and reflected competitive market conditions. Consequently these prices produced no market distortion and did not constitute a subsidy.

136. Regarding the evidence of subsidization in Alberta, **Canada** noted that this evidence was based on the fact that Alberta charged a different price for its timber than did British Columbia in its interior region. However, there were virtually no similarities between these provinces: their forests, climate, logging conditions, road, distances and pricing systems. In addition, changes had been made in March 1991 to the Timber Management

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[58] Initiation Memorandum, pp.23-26.

[59] Final Negative Countervailing Duty Determinations: Certain Softwood Products from Canada, 48 Fed.Reg., 31 May 1983, p.24159.

[60] Initiation Memorandum, pp.23-24.

Regulations under the Forest Act of Alberta which had increased reforestation obligations. The difference in stumpage prices between Alberta and British Columbia was not evidence of the existence of a subsidy but only evidence that prices were different between these jurisdictions. This did not meet the higher standard of evidence required for self-initiation of an investigation.

137. The **United States** explained that the Department of Commerce had been unable to apply the first alternative benchmark to measure the degree of preferentiality to stumpage prices in Quebec and Alberta because no evidence had been available regarding the price for similar goods or services being sold by provincial governments. In the absence of data on competitively-bid stumpage or similar merchandise in Quebec and Alberta, the Department had relied on the second alternative benchmark: the price charged by other sellers to buyers within the same political jurisdiction for an identical good or service. Provincial timber was not sold competitively in Quebec. With respect to Quebec the Department had used private timber stumpage prices in New Brunswick as a benchmark to evaluate whether stumpage was being sold at a preferential rate. It had explained why this benchmark was appropriate by pointing out that the provinces were geographically contiguous, the type and quality of timber available from these provinces were similar, and reliable information on private stumpage fees was available for New Brunswick.[61] In comparing the cost of stumpage in Quebec with the price of stumpage in New Brunswick, the Department had made adjustments to the price in New Brunswick for road building costs because harvesters in Quebec were reimbursed for road costs. The Department had found that there was no need to make adjustments for differences in costs of silviculture. The adjusted private price in New Brunswick of C$8.05 had been compared to the average stumpage price of C$5.04 in Quebec, yielding a 5.10 per cent ad valorem estimated subsidy on lumber in Quebec. As explained by the Department, the price used as the basis for the initiation had reflected any replacement measures introduced by the Government of Quebec.[62]

138. The **United States** explained that, with respect to Alberta, the Department of Commerce had compared the stumpage price with the competitively bid price for the interior of British Columbia; this benchmark was used based on the fact that the species mix of the interior of British Columbia was similar to that of Alberta. Adjustments had been made to the competitive price for silviculture and road building costs and for differences in species and quality of mix of stumpage. Based on its comparison between the competitive price in British Columbia and the price in Alberta, the Department had estimated a subsidy of 21.58 per cent ad valorem. This evidence provided the basis - at a minimum for investigation.

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[61] Initiation Memorandum, p.23.

[62] Initiation Memorandum, p.24.

139. The **United States** noted that Canada's argument that stumpage prices in Quebec were based on provincial market prices within Quebec and reflected competitive market conditions was not consistent with the facts of record. Regardless of whether this statement was correct, this was not the evidence in the possession of the Department of Commerce which had led it to believe that a subsidy existed. At the time of initiation of the investigation, the Department had information on Quebec's administratively set stumpage prices, but it did not have complete knowledge of how these prices were established. What the Department did know, based upon Forest Tenures in Canada: A Framework for Policy Analysis, (a publication by the Government of Canada) was that tenure holders in Quebec were reimbursed for 50 to 80 per cent of their costs for private roads and that, although these tenure holders must perform silviculture, they were allowed to credit the costs of such silviculture treatments against stumpage fees. The Department had also lacked sufficient information about private or any competitively bid stumpage in Quebec to believe that it could make a reasonable assessment on the basis of that information. However, the Department had possessed information about private stumpage prices in a neighbouring province whose forests abutted those of Quebec. The Department had used these prices, making several adjustments to the price comparison to reflect what knowledge it had about the relevant differences between the two stumpage pricing systems. While the 1983 case, which was effectively reversed in 1985, had disfavoured comparisons from different countries, cross-provincial comparisons did not pose as great a problem and had been utilized in 1986.

140. **Canada** argued that under its constitution the provinces had independent authority to establish conditions, including pricing systems and other obligations, for access to their natural resources. Regardless of how the United States defined its preferentiality benchmark, there was no reason why revenue collection systems of different jurisdictions need be the same. The comparison of prices of stumpage in Alberta with prices in British Columbia, and the comparison of stumpage prices in Quebec with prices in New Brunswick were therefore unsupportable. Even if the stumpage prices being compared had been for tenures within the same jurisdiction, there were such substantial physical differences in the timber being compared that any price differences could not be evidence of a subsidy. For example, in comparing the forests of Alberta and British Columbia (which fell on opposite sides of the Continental Divide), the Department had ignored radical differences in these resources of which it had been aware, such as differences in species composition, tree and fibre quality, and accessibility - which rendered any price comparison unsound. The Department had made similar errors in its analysis of Quebec, overlooking important differences between the forests of Quebec and New Brunswick. Finally, the calculations of the Department were faulty since they were based on unreliable or outdated data, credited Quebec's tenure holders with government reimbursements under programmes which had been discontinued several years earlier, and failed to account for numerous other adjustments which should have been made.

Ontario[63]

141. **Canada** argued that the evidence presented by the Department of Commerce of price differences in Ontario was prima facie incorrect. This evidence[64] was based on data for stumpage prices limited to the period April-June 1989 which showed that a higher stumpage price was charged to "integrated" companies for coniferous timber than charged to "non-integrated" companies for coniferous timber. Reliance on data for a three-month period did not meet the standard of sufficient evidence. The United States had not established that this was a representatie period. The United States had compared the level of stumpage fees charged to "integrated" firms between April and June 1989 (for softwood only) with the average stumpage fee paid on softwood and hardwood by all firms during the period 1 April 1989-30 March 1990. Since 1988 the Ontario Crown Timber Regulations had provided that one method of calculating stumpage rates should be applied to all companies for softwood timber processed into lumber. This information had been in the public domain since 1988. Either the United States had not considered widely available evidence or it had chosen to disregard evidence which would directly contradict its case. Canada submitted that the evidence of the United States did not meet the higher standard for self-initiation.

142. The **United States** argued that Ontario had a two-tiered pricing structure composed of integrated and non-integrated licenses. In theory, integrated licenses were provided if a production operation contained more than one processing plant at a single location. The regulations in force in Ontario stated, however, that all sawmills (regardless of whether or not they were actually integrated) would be charged the non-integrated rate and all pulp mills (regardless of whether they were in fact integrated) would be charged the integrated rate. Integrated licenses (i.e., pulp mills) were charged C$7.00 per m^3. The Department of Commerce had used the price charged by the Government of Ontario to integrated mills (pulp mills) for stumpage as a benchmark for stumpage charged lumber mills. The same benchmark had been applied in 1983. The fact that the Government was charging different prices for the same good to different buyers had constituted sufficient evidence that it was selling stumpage to lumber producers at preferential rates. Given that, as stated in the Initiation Memorandum it was unclear whether the price charged to the non-integrated licenses captured the full value of stumpage, there would have been a subsidy on those lumber mills charged the lower "non-integrated" rates even absent such a price difference. Finally, it had not been necessary to make adjustments for silviculture or road costs because the harvests were under identical tenure arrangements. Based on its comparison, the Department had derived an estimated subsidy for Ontario of 7.1 per cent ad valorem.

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[63] Initiation Memorandum, p.26.

[64] Initiation Memorandum, Annex table C-47.

143. Canada argued that the choice of the system that a government used to determine the stumpage rate of timber was the exercise of the normal function of government. It was not a subsidy. Nor, for the same reason, was the stumpage rate that resulted from the use of that particular system a subsidy. Citing differences of stumpage rates between or within jursdictions did not meet the test of evidence of the existence of a subsidy. There was not a single right price for a resource.

144. The **United States** considered as misleading Canada's comment that, since 1988, the Ontario Crown Timber Regulations had provided that one method of calculating stumpage rates should be applied to all companies for softwood timber processed into lumber because it did not address the fact that Ontario had two different rates for stumpage, the integrated rate, generally charged to pulp mills, and the non-integrated rate generally charged to sawmills (i.e. "softwood timber processed into timber"). This was a clear case of price discrimination. In response to a question by the Panel, the United States explained that its statement that there would have been a subsidy on those lumber mills charged the lower non-integrated rates referred to the fact that since the benchmark integrated rate, as stated in the Notice of Initiation, "may not capture the full value of stumpage", it was likely that the lower non-integrated rate did not capture the full value of stumpage either. Therefore, even if there was no difference between the two stumpage rates, there still could be a countervailable subsidy.

Saskatchewan, Manitoba, the Northwest Territories and the Yukon[65]

145. **Canada** argued that the existence of subsidies in Saskatchewan and Manitoba had been assumed by the Department of Commerce in its Initiation Memorandum:

> "... we believe that the administratively set, low stumpage rates in these provinces also indicate that the provincial governments in these provinces may be providing subsidies."[66]

This evidence was based on the "belief" that the administrative setting of stumpage rates "may" confer a subsidy. It also was based on the notion that "low" (neither defined nor compared) stumpage rates conferred a subsidy. The mere difference of a rate of stumpage between one jurisdiction and another could not be considered to be a subsidy within the meaning of the Agreement. The approach of the Department was both speculative and conjectural. The United States had provided no evidence in support of this statement. Equally unsupported by evidence was the statement made in the Initiation Memorandum regarding alleged subsidies in the Northwest Territories and in the Yukon:

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[65] Initiation Memorandum, pp.27-28.

[66] Initiation Memorandum, p.28.

"We believe that stumpage rates in these territories are administratively set at price levels consistent with provincial stumpage rates preliminarily determined to have been subsidized in 1986."[67]

146. The **United States** noted that prices in both Saskatchewan and Manitoba were set administratively at levels well below benchmark prices elsewhere in Canada or the United States.[68] Although the Department of Commerce had been unable to conduct an in-depth analysis of subsidy programmes in these provinces, it had concluded that, for purposes of initiation, "the administratively set, low stumpage rates in these provinces ... indicate that the provincial governments in these provinces may be providing subsidies."[69] While Canada had argued that the mere difference of a rate of stumpage between one jurisdiction and another could not be considered to be a subsidy, there was no support in the Agreement for the proposition that cross-jurisdiction comparisons could not be utilized to determine whether stumpage was being provided at preferential rates, at least to permit investigation. Article 2:1 merely required sufficient evidence of subsidization; it did not specify that cross-border comparison could not form the basis for an investigation, much less an initiation. Comparisons of the administratively set prices in Manitoba and Saskatchewan - with all of the possible competitive benchmarks in Canada available at the time of initiation - constituted sufficient evidence for purposes of initiation. The Department had actually included in its Initiation Memorandum estimated amounts of subsidization for these two provinces, even though there was no requirement in Article 2:1 of the Agreement that for purposes of initiation the amount of the subsidy be calculated.

147. Regarding the Northwest Territories and the Yukon Territory, the **United States** argued that the majority of timber harvested in these Territories was from federally-owned land. Given that stumpage rates were set administratively in all of the other Canadian provinces (with the exception of the Maritime provinces which had been specifically excluded from the investigation), the Department of Commerce had reasonable grounds to believe or suspect that stumpage rates in the Northwest Territories and in the Yukon Territory were also administratively set at price levels consistent with the provincial stumpage rates preliminarily determined to have been subsidized in 1986 to warrant initiation.

148. **Canada** also argued more generally that the preferentiality test as applied by the United States was so vague as to be open to any number of interpretations and application in a given case. There was no confidence that the same test, applied twice to the same situation, would give the sale result. In 1986, in the affirmative preliminary determination, the

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[67] Initiation Memorandum, p.16.

[68] Initiation Memorandum, pp.15-16.

[69] Initiation Memorandum, pp.27-28.

Department of Commerce had determined the existence of preferentiality based on a comparison of stumpage fees with the governments' costs of producing the good. This "cost of producing" standing timber had included the "intrinsic value" of the standing timber, which had been treated as an "indirect or inputed cost" to the government. However, in 1991 the cost to government benchmark had no longer been considered appropriate, no doubt because the increase in stumpage fees since 1986 would have provided little or no benefit under this approach. **Canada** noted in this connection that in the consultations held on 13 September 1991 regarding Canada's termination of the MOU, Canada had provided the United States with the results of an assessment utilizing the method used in 1986 by the United States of valuing timber to demonstrate that Canada was more than adequately recovering costs. Canada now found that the US countervailing duty law had shifted again and that cost-to-government was not the relevant test to determine if a subsidy was being provided. With this sort of flexibility of application, the preferentiality test could hardly serve as an objective measure and could be seen to be used to achieve whatever result was desired at the moment.

149. The **United States** pointed out that the United States had consistently applied the preferentiality test under its countervailing duty legislation. Specifically, the Department of Commerce had not used a methodology in 1991 for purposes of initiation different from that used for purposes of the affirmative preliminary determination of subsidization made in October 1986 with respect to imports of softwood lumber from Canada. In both cases the Department had applied its preferentiality hierarchy. With respect to the application of the methodology, the Department had in 1991 collected new evidence and new information from that used in 1986 and was able to utilize a benchmark which was clearly preferred as a matter of law and economies to the cost benchmark. In several cases, data were available that supported a better comparison than had been possible in 1986. In this connection, the **United States** explained that in the 1986 investigation both parties had made arguments against application of the preferred measures of preferentiality. As a result of these arguments and the lack of adequate data for comparison purposes, the Department of Commerce had had to evaluate the cost benchmark. The Department had explicitly noted that, given the nature of the subsidy, the cost of timber per se was an inappropriate measure of preferentiality. Thus, the Department had considered an additional imputed value which was intended to measure the extent to which costs did not reflect the full competitive benefit provided as a result of the subsidy. Cost alone had not been used as a benchmark. In the 1991 initiation decision, the cost benchmark had not been applied because adequate data existed for use of the price discrimination benchmark (which was the benchmark applied in the investigation of imports of Canadian softwood lumber in 1983 and which was the Department's preferred benchmark) and because of the infirmities with the cost benchmark. The fact that in 1991 new data were available which allowed for a better comparison than in 1986 should not be surprising. The availability of this new data was attributable in large measure to the replacement measures negotiated by the United States and the Province of British Columbia in 1987. Canada had contended throughout the proceedings before the Panel

that circumstances in Canada had changed between 1986 and 1991. The evidence before the Department of Commerce at the time of initiation of this investigation suggested that that was true to an extent.

2.3.3 Arguments on whether the setting of stumpage fees can be a subsidy within the meaning of the General Agreement and the Agreement

150. In support of its claim that there had been insufficient evidence of the existence of a subsidy to warrant the initiation by the United States of a countervailing duty investigation on imports of softwood lumber from Canada, **Canada** also submitted that the stumpage pricing practices in question were not per se subsidies within the meaning of the Agreement and within the meaning of Articles XVI and VI of the General Agreement. In support of this view, **Canada** presented the following arguments.

151. First, the levying of a charge in the form of a stumpage fee for access to standing timber did not involve a financial contribution to producers but was part of a government's collection of revenue function. The exercise of such a function in and of itself did not constitute a subsidy. In order to realize the gain inherent in its ownership of forest lands, the government must take direct action to capture what would otherwise accrue to the person or persons who were granted use of the land. This was akin to royalties charged by governments for the use of land for mineral and energy exploration and development. The stumpage fee levied did not constitute the sale of logs, but was rather the collection of some or all of the gain accruing to those who were granted the right of access to government land to extract a natural resource (in this case standing trees) and to perform economic activity to turn them into logs. The government could choose to collect this extra profit in a number of ways, but whatever method it chose did not change the fact that it was a means of revenue generation and not a subsidy.

152. Second, no form of natural resource charge, including stumpage fees, had ever been required to have been notified under Article XVI:1 of the General Agreement, nor had any governments done so, despite various reviews which indicated that governments should err on the side of notifying all subsidy measures with potential trade effects even when these were not clearly known.

153. Third, even if one accepted that stumpage fees fell within the meaning of the term subsidy, they would not normally be the type of measure that could be considered per se to have a trade effect and, thus, be subject either to the notification obligation of Article XVI:1 or the disciplines of the Agreement. Article XVI of the General Agreement did not cover all subsidies but was limited to "any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into its territory". The focus of this provision was on the trade effects of the measure. This emphasis on trade effects was a further indication that natural resource pricing was not meant to be included under Article XVI, inasmuch as basic economic theory held that the collection of economic rent

for natural resources had no impact on the price or quantity of products produced from those resources.[70]

154. Fourth, Article VI of the General Agreement was narrower in scope than Article XVI of the General Agreement. This was confirmed in paragraph 4.6 of the Panel Report in the dispute between Canada and the United States on countervailing duties on fresh, chilled and frozen pork from Canada. Whereas in Article XVI subsidies were considered from the point of view of the trade effects caused by the particular measure, Article VI limited the scope of the application of countervailing duties to bounties or subsidies "bestowed, directly or indirectly, on the manufacture, production, or export of any merchandise". Not all subsidies were countervailable within the provisions of Article VI and the Agreement. Countervailable subsidies formed a subset of the subsidies to be notified under Article XVI. Article VI action also required the demonstration of injury. To the extent that a measure did not fall under Article XVI, it was clear that it did not fall under Article VI. Conversely, it could not have been the intent of the drafters of the General Agreement to provide a unilateral remedy under Article VI which went beyond the scope of the remedy requiring the active rôle of the CONTRACTING PARTIES found in Article XVI.

155. With respect to Canada's arguments on the scope of Article VI of the General Agreement relative to the scope of Article XVI, the Panel asked Canada to comment on the statement made in the Second Report on Anti-Dumping and Countervailing Duties that:

> "The fact that the granting of certain subsidies was authorized by the provisions of Article XVI of the General Agreement clearly did not debar importing countries from imposing, under the terms of Article VI, a countervailing duty on the products on which subsidies had been paid."[71]

Canada observed that this quotation merely stated that the scope of Article XVI was not narrower than that of Article VI. This was entirely consistent with the argument of Canada that the scope of Article VI was narrower than that of Article XVI. The pricing of natural resources *in situ* did not fall under Article XVI of the General Agreement and therefore was not covered by Article VI of the General Agreement. Moreover, the first sentence of the paragraph in which this quoted statement appeared noted that:

> "Article VI of the General Agreement provided that an importing country could impose countervailing duties on the products which had received, directly or indirectly, an export or production subsidy,

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[70] See *infra*, paragraphs 167 and 168.

[71] BISD 9S/194, paragraph 32.

the importation of which caused, or threatened to cause, material injury to a domestic industry."

This indicated that the intention behind the statement was to make it clear that references in Article XVI to certain types of subsidies did not preclude that these subsidies could be subject to countervailing duties. This was again entirely consistent with Canada's argument that Article VI did not extend beyond subsidies mentioned in Article XVI of the General Agreement.

156. In support of its view that a financial contribution by a government was a necessary condition for the existence of a subsidy under the General Agreement, **Canada** referred to the comprehensive review of the operation of Article XVI of the General Agreement undertaken in the period 1960-61.[72] The Report of the Panel on this review provided specific evidence that the term subsidy was not all-inclusive and set out clearly the characteristics that a measure must possess to be considered as falling within the scope of Article XVI. First, the Panel found that, while the fixing of domestic prices to producers at above the world price level was a subsidy when this higher price was maintained by purchases and resale at a loss, there were clearly other cases where this action could not be considered a subsidy. In this regard, the Panel had cited one example of the maintenance of the higher domestic price by "quantitative restrictions or a flexible tariff or similar charges", concluding there "would be no loss to the government, and the measure would be governed not by Article XVI, but by other relevant Articles of the General Agreement".[73] Second, the Panel also considered that "levy/subsidy" schemes were notifiable to the extent that "the government took part either by making payments into the common fund or by entrusting to a private body the functions of taxation and subsidization". Here there was a distinction drawn between the function of taxation and the more specific act of subsidization.[74] Third, the Panel, in examining the question of what constituted a subsidy, determined that some measures did not fall under the term subsidy because it worried about the impossibility of arriving at a precise definition of subsidy that would include "all measures within the intended meaning of the term in Article XVI without including others not so intended". The Panel further noted that this lack of a precise definition "had not, in practice, interfered with the operation of Article XVI".[75] Canada noted its agreement with the view of Japan that the United States had not demonstrated the existence of sufficient evidence of a financial contribution by a government or by a public body.

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[72]"Review Pursuant to Article XVI:5", Report by the Panel, adopted on 24 May 1960, BISD 9S/188 and "Subsidies - Operation of the Provisions of Article XVI, Report adopted on 21 November 1961, BISD 10S/201.

[73]BISD 9S/191, paragraph 11, (emphasis added by Canada).

[74]BISD 9S/191, paragraph 12.

[75]BISD 10S/208, paragraph 23.

157. **Canada** concluded from this review of the Report of the Panel that the Panel accepted that there were limits to the term subsidy, that the lack of a precise definition could not be taken as meaning that no limits existed, and that a subsidy had to exhibit certain characteristics. Subsidies under the General Agreement were measures which involved a fiscal transfer by governments, such as in the sale or resale of goods at a loss; the making of payments into a common fund, or the transfer of similar taxation and subsidization powers to a private body. In other words, the term subsidy presupposed a financial contribution to an enterprise from a government action. It did not, however, involve the decision by a government to levy a tax or similar charge on all relevant enterprises, or, in other words, the raising of revenues through the exercise of its authority to tax. **Canada** noted in this context that Article 11:3 of the Agreement, which represented an interpretation of Articles XVI and VI of the General Agreement, provided an enumeration of "possible forms" of subsidies which all involved activities which could lead to a financial loss to the government and conversely a financial contribution to an enterprise.

158. In response to a question by the Panel as to whether Canada was of the view that the pricing of stumpage could never be considered to confer a subsidy, **Canada** observed that while, as a revenue collection measure, the granting of access to crown lands and the levying of a charge related to the right of access and use of the forest resource could not <u>per se</u> be considered to constitute a subsidy within the meaning of Articles XVI of VI of the General Agreement, certain aspects of revenue collection measures could be altered in such a way as to confer subsidies. In this respect, **Canada** pointed to two basic criteria. First, in all the examples dealt with by the 1960 Panel in its review of the operation of Article XVI, reference was made in one form or another to a direct or indirect fiscal or financial contribution. There was nothing in the General Agreement to sustain a country's argument that another government should be collecting a certain level of revenue. Thus, the "failure" to collect a presumed level of revenue in itself could not be argued to constitute such a financial contribution, otherwise the concept of financial contribution would not have any meaning and there would have been no reason for the Panel to have drawn a distinction between the revenue collection function of government and the act of subsidization. Second, Article 11:3 of the Agreement provided further guidance as to the types of subsidies which could possibly give rise to injury to a domestic industry in that it identified a certain class of subsidies which might give rise to injury, namely those "granted with the aim of giving an advantage to certain enterprises" and provides an enumeration of "possible forms of such subsidies." Article 11:3 established a criteria of "specificity" for subsidies which might cause injury to a domestic industry. This was supported by the Draft Guidelines for the Application of the Concept of Specificity in the calculation of the Amount of a Subsidy other than an Export Subsidy.[76] These Guidelines

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[76]Document SCM/W/89, 25 April 1985.

explicitly derived from Article 11:3 of the Agreement and recognized the existence of the concept of specificity in the Agreement as a test of subsidy for the purpose of imposing countervailing duties. The identification in Article 11:3 of the type of subsidy which might give rise to injury to a domestic industry (among other adverse effects) was also perforce the type of subsidy which could give rise to the right to take countervailing duty action, which was the unilateral track provided elsewhere in the Agreement for dealing with injury to a domestic industry.

159. **Canada** further noted that, given that stumpage fees could not per se be considered to constitute subsidies within the meaning of Articles XVI and VI of the General Agreement, any allegation that some aspect of such practices and policies did in fact constitute subsidies had to provide certain evidence in order to meet the test of sufficient evidence under Article 2:1. In the case of a government measure which was not per se a subsidy, the requirement of sufficient evidence of the existence of a subsidy implied that there must be at minimum evidence that the action provided a transfer of revenue, a financial contribution, directly or indirectly to producers. The simple act of revenue collection could not be considered to be a subsidy. Thus, it was not sufficient to have evidence that the level of revenue collection varied between jurisdictions, which was normally to be expected of revenue collection measures. In addition, there had to be evidence that the measure provided a benefit in the form of an advantage to certain producers over other producers in similar situations. In this case, given that the level of economic rent could vary by tract of land, it was not sufficient to have evidence that the stumpage fees varied nominally between producers. It had to be shown why this difference constituted an advantage. The collection of differing levels of a charge might actually leave two producers with similar levels of additional profit (i.e., the economic rent not collected or captured by the government stumpage fee).[77] The evidence relied upon by the Department of Commerce in initiating its countervailing duty investigation of imports of softwood lumber from Canada did not meet these requirements that there be a financial contribution by a government which was separate from the general levying of a tax, and specific action by the government to direct this financial benefit to certain firms over others in similar situations.

160. In this connection, **Canada** noted that in the notice of initiation of the investigation the Department of Commerce had only mentioned the action by provincial governments in Canada to grant the right of access to companies to harvest standing timber to produce logs. The Department had not alleged the provision of any goods or services by provincial governments or of financial contributions such as grants and loans to lumber producers. The tests of specificity and preferentiality applied by the Department in its analysis of the Canadian stumpage programmes did not meet the criteria of the General Agreement and of the Agreement for

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[77] See infra, paragraphs 167 and 168.

identifying measures which could legitimately be included in a countervailing duty action. It was clear from the language of the General Agreement and the Agreement that the government measure challenged first had to be determined to be a subsidy; it was only once this determination had been made that the question of countervailability became relevant. The approach of the United States was first to test a measure for specificity, and then to consider whether a benefit was granted through a test of preferentiality. By going straight to specificity without first determining the existence of a subsidy, the United States was placing the cart before the horse. This approach failed to distinguish between those measures that were subsidies and those that were not, as it failed to provide a test of financial contribution as identified by the 1960 Panel. This approach also applied a specificity test which, to the extent it could be considered to meet the terms of Article 11:3 of the Agreement, should be applied only to those measures which were considered subsidies, i.e., measures involving a financial contribution by a government. The application to non-subsidy measures of a test which was intended in the Agreement to identify a sub-set of subsidy measures would necessarily give rise to absurd results. A tariff or quantitative restriction on cane sugar could be considered to be "specific" to domestic sugar beet producers. While such measures could have a subsidy-like effect, they failed to meet the test of financial contribution in the sense set out by the General Agreement and by the Agreement. The concept of preferentiality used by the United States to measure the benefit from a "specific" measure also had no meaning when applied to measures which were not subsidies. There might well be benefits from a tariff, for example, but tariffs were not subsidies.

161. In response to a question by the Panel as to whether Canada considered that a difference between an administratively set price for access to a natural resource and a price set by the market for the access to a natural resource could not be considered to involve a subsidy, Canada noted that in the Initiation memorandum the Department of Commerce had not compared the administratively set price charged by a government for access to a natural resource in situ to a "market price" set by a private land owner within the same jurisdiction. Assuming that by "prices set by the market" was meant the price of access to private lands containing in situ natural resources, and that the Panel's question related to pricing within a jurisdiction, i.e. in this case within a province, there was no basis to compare what was a revenue collection measure with what was a market mechanism for transferring economic rent to the land owner. The levying of a stumpage fee did not relate to the sale of a good or service. If by "market prices" was meant a fee set by an auction or tender system for access to certain lands compared to other ways of setting the fees for access to other public lands, there was again no reason, in cases involving in situ natural resources, that the level of a fee or a charge could be considered a subsidy since the principle of economic rent established that such differences did not increase output or decrease prices of products made from the natural resources.

162. In response to a question by the Panel as to whether Canada considered that a revenue collection measure by a government could entail a financial contribution by that government if the measure involved the levying of different rates or charges to enterprises within the same jurisdiction, **Canada** argued that the concept of a financial contribution by a government, in the sense of 1960 Panel report, covered those situations in which a government made a fiscal transfer or conferred a benefit which potentially affected output and prices (i.e. which influenced a firm's marginal costs of production). Revenue collection measures which could distort a firm's marginal costs of production could be a financial contribution to the extent that there was discrimination between enterprises in similar circumstances. However, different rates of stumpage did not affect the marginal costs of production and were thus not distortive. Therefore, in this situation differences in stumpage rates were not an appropriate measure of the existence of a financial contribution.

163. The Panel asked Canada to explain whether in its view a revenue collection measure could involve a financial contribution by a government if the revenues collected did not cover government expenditures. **Canada** noted in response that a comparison of revenue collected to government expenditures had not been the basis for the self-initiation of the countervailing duty investigation by the United States. A government could provide a good or service in connection with access to natural resources, and not charge sufficient fees to cover the cost of providing such goods and services. In such circumstances the government would be providing financial transfers to its tenure holders and could be causing a countervailable market distortion (i.e. an increase in the amount of output and, therefore, an increase in the amount, or decrease in the price, of products made from the resource. However, Canada had provided the United States prior to 4 October 1991 with evidence that expenditures in the forest sector did not exceed revenues when the MOU was terminated. There were no allegations or evidence in this investigation that Canada provided any such goods and services to its tenure holders.

164. **Canada** emphasized that its position that the setting of natural resource prices did not involve a financial contribution by a government and was therefore not a subsidy only covered natural resource policies relating to the granting of access to a natural resource and the levying of a fee or charge for that right of access. This was fundamentally different from cases in which governments set the prices of resources which had been exploited or removed from their natural state. In such cases, the natural resource was no longer <u>in situ</u> but had been transformed into a good. There was no comparison between stumpage and the fixing of the price of natural gas which was in a state to be sold as an energy source or input to consumers. Such pricing was not related to the right of access to an <u>in situ</u> (i.e. non-exploited) resource.

165. The Panel asked Canada to further explain its view that Article 11:3 of the Agreement provided criteria for the application of countervailing measures under Part I of the Agreement. In response, **Canada** argued first

that the term subsidy as described in Article 11:3 was the same as the term subsidy in Part I of the Agreement and, thus, the provisions of Article 11:1-11:3 relating to those subsidies which could cause injury to a domestic industry of another signatory also applied to actions taken pursuant to Part I. The text of the Agreement supported the view that Parts I and II were interrelated, particularly as regards the term subsidy. First, the provisions in Part II were not qualified by the words "for the purposes of this Part..." or any similar language which would expressly limit the definitions used in Articles 7 to 13 to Part II of the Agreement. If the signatories had wished all the provisions of Part II to be limited in their application, it was likely that they would have expressly stated this. Second, although certain provisions in Part II (e.g. Articles 7:1 and 3, 10:1 and 2) appeared to be limited in application to Article XVI of the General Agreement, there was no restrictive language in Article XVI preventing its elaborations on the term subsidy from being applied in other Articles of the general Agreement, such as Article VI (and, therefore, indirectly to Part I of the Agreement, which interpreted and elaborated on Article VI). Third, Article 11, which set out examples of possible forms of subsidies other than export subsidies, was not specifically qualified by "for the purposes of Article XVI ..." (although there was a reference to Article XVI:5 in the context of reviewing the enumeration of possible forms of subsidies). If the reference to Article XVI in other provisions was restrictive in effect, this implied that Article 11 was meant to have a broader scope.

166. Fifth, Article 8:3 (a) of the Agreement noted that signatories agreed that they shall seek to avoid causing, through the use of any subsidy, injury to the domestic industry of another signatory. A footnote to this provision noted that injury to a domestic industry was used in this provision in the same sense as it was used in Part I. If the definition of a subsidy in Part I and Part II was not the same, the injury caused to a domestic industry could not be the same. Fifth, there were numerous references in Part I and Part II of the Agreement which expressly applied to "this Agreement". Thus, note 22 ad Article 7 (found in Part II) stated, in part, that "In this Agreement the term subsidies shall be deemed to include... "These examples were evidence that the provisions in Part II of the Agreement were relevant to those in Part I. Finally, Article 19 of the Agreement stated that no specific action could be taken against a subsidy of another signatory except in accordance with the provisions of the General Agreement, as interpreted by the Agreement. This Article made no distinction between subsidies under Part I and subsidies under Part II; it merely referred to "a subsidy", implying that the definition of a subsidy was the same in Part I and in Part II. In addition, the Article noted that action could be taken only in accordance with the General Agreement. If Part I and Part II were considered to be completely separate, then Article VI and XVI of the General Agreement must be argued to be separate and distinct. This would mean that the term "subsidy" as used in Article XVI did not mean the same as the term "subsidy" as used in Article VI of the General Agreement. However, for purposes of unilateral countervailing duties, countervailable subsidies (under Article VI) were a subset of

subsidies covered by Article XVI, subject to the additional requirements of specificity and injury.

167. **Canada** responded as follows to a question from the Panel as to whether Canada was arguing that a log was a good and that the stumpage fee did not influence the cost of production of lumber products. A standing tree was a natural resource much like a mineral or an energy source (oil or gas) in the ground. It was neither a log nor a good. The granting of the right of access to the land on which the trees stood and the collection of revenue (stumpage fees) from those granted the right of access was not the sale of a good. The tree became a good when it was cut down and its branches removed, i.e. turned into a log. A log was a good which could be sold for immediate use or as an input into other products, e.g. lumber, which was also a good. Were the government to cut down the tree and then offer the log for sale, this would constitute the sale of a good. Stumpage fees were not part of the extraction costs but the fee for the right to harvest that resource. Extraction costs were the costs of transforming the tree into a log, i.e. a good. Stumpage fees were a component of the total cost of making logs but they were not part of the per unit production cost or variable cost of producing the log. The stumpage fee did not influence the marginal cost of production of producing the next unit of product. This was determined by the cost of the factors (labour, energy, capital equipment and capital - in the sense of a return on investment or profit) needed to get to the tree, cut it down, de-branch it and ship it to a processing facility, none of which are affected by the level of the stumpage fee charged. If the marginal cost of producing the next log was equal to or less than the market price for the log, the log would be cut. The level of the stumpage fee, so long as it did not collect more than the economic rent, would only determine whether the producer would get a normal profit, or also, an additional profit.

168. In this context, **Canada** also argued that the GATT rules on subsidies reflected basic economic principles and concepts. In the case of subsidies, the 1960 Panel on subsidies clarified that for a measure to be considered a subsidy, there must be a financial contribution by a government. The attribute of financial contribution involved either directly paying or contributing to a firm or relieving a firm of a financial burden that it would otherwise be expected to carry. It was assumed, based on economic principles, that this would distort production costs and economic efficiency, and thus, adversely affect the normal conditions of competition. Stumpage policies involved the granting of access to public lands and the timber thereon and the charging of a fee for this right based on the economic rent or inherent value of the land. These policies were a form of revenue collection, separate from the act of financial transfer identified by the 1960 Panel Report. The theory of economic rent in economics emphasized that the collection or non-collection of this economic rent did not affect output or price, which underpinned the logic of the criteria identified by the panel in examining the rights and obligations relating to subsidies in the General Agreement. The theory of economic rent accorded strongly with the GATT rules and reinforced the position that stumpage, being the collection of economic rent related to

the use of public lands for the cutting of standing timber, was not per se a subsidy.

169. The **United States** argued that nothing in the General Agreement or the Agreement stated or suggested that in situ (i.e., non-exploited) natural resource subsidy practices per se were non-actionable pursuant to GATT law. It would be inconsistent with Article 11 as well as with the intent of the drafters of the Agreement to exclude per se such a broad category of subsidies from actionability under the Agreement. Such a finding would inter alia encourage the adoption of ever more complex natural resource subsidies, which could adversely affect the conditions of normal competition. Moreover, the actionability of natural resource subsidies was nothing new, as confirmed by the allegation of the EEC in the late 1970's that US natural gas pricing practices provided countervailable subsidies and by the practice of the EEC in the implementation of the rules on state aids in Article 92 of the Treaty of Rome. Thus, the EEC had found that the provision of natural resources to a specific industry at preferential rates was market distorting.

170. The **United States** considered that the text of Article 11 of the Agreement contradicted Canada's claim that subsidies provided to natural resource products could not be the subject of countervailing duty actions. Article 11:1 of the Agreement listed a half-dozen "important policy objectives" in respect of which governments might wish to provide subsidies but did not contain any reference to subsidies provided to natural resource products. Moreover, even subsidies expressly referenced on the list were not considered non-actionable under either the General Agreement or the Agreement. Article 11:2 indicated that a wide variety of domestic subsidies might be countervailed if they caused or threatened to cause injury to a domestic industry. Under Article 11:2, countervailability was particularly likely when a programme "would adversely affect the conditions of normal competition". In self-initiating the investigation on softwood lumber from Canada, the Department of Commerce had possessed ample evidence that Canadian stumpage pricing practices were preferential and had historically and again recently adversely affected competitors in the United States. Moreover, under the rationale of Canada's argument, even if Canada sold a natural resource (such as iron ore) to specific industries at 50 or even 95 per cent below the cost of extracting the ore, such action would not be countervailable even if it caused adverse trade effects within the meaning of Article 11. There was no support in the Agreement for this position. Finally, Article 11 recognized that subsidies bestowed by a government for "social and economic policy objectives" might be actionable by an importing country. Moreover, stumpage was not collected as a fee for access to timber (i.e., a flat fee) but rather as a price per unit volume. If not timber was harvested, no stumpage was paid, and the amount paid increased proportionately with the amount harvested.

171. The **United States** further pointed out that Articles XVI and VI of the General Agreement and the Agreement plainly did not provide a definition of

the term subsidy.[78] However, to the extent that certain subsidy practices were specifically identified, for example in the Illustrative List of Export Subsidies annexed to the Agreement, these practices supported the view that the natural resource pricing practices at issue in this proceeding might, in fact, constitute countervailable practices. The General Agreement recognized that when a government paid a price above world market prices for a product (selling off what it bought at a loss), a subsidy was provided to the producer of the product.[79] Logically, the same should hold true when, rather than increasing the sales price of the end product by entering the market in a non-commercial manner, the government reduced the cost of the input product to a user industry by entering the market in a non-commercial manner. In this regard, one definition of subsidy offered in the literature was "any government action which causes a firm's, or a particular industry's, total net private cost of production to be below the level of cost that would have been incurred in the course of producing the same level of output in the absence of government action".[80] Further, narrowing the definition of what might constitute a countervailable practice or exempting entire categories of subsidies "may encourage countries to substitute hidden forms of subsidization for the transparent forms included in the narrow definition".[81]

172. In response to the argument of Canada that the notice of initiation of the countervailing duty investigation on imports of softwood lumber from Canada had not alleged the provision of any goods or services by provincial governments or of financial contributions such as grants and loans, the **United States** observed that, contrary to Canada's argument, the notice of initiation of the investigation had alleged the provision of a government-owned resource - namely, provincially owned timber - to a limited number of producers at administratively set, preferential prices. Canada had argued that, according to an economic theory, allowing lumber companies access to land to cut down trees did not constitute the provision of a good or service (with the good being timber that was then processed into lumber), notwithstanding the fact that the provinces in Canada maintained processing requirements. This argument was a clear example of theory being divorced from reality. Granting lumber companies the right to cut down trees clearly constituted a provision of a good or service, as had

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[78]BISD 10S/208, paragraph 23.

[79]BISD 9S/191, paragraph 11.

[80]H. Malmgren, "Subsidies and Trade Policy", quoted in C. Pestieau, Subsidies and Countervailing Duties, Canadian Economic Policy Committee, C.D. Howe Research Institute, 1977, p.9.

[81]N. Bruce, Measuring Industrial Subsidies: Some Conceptual Issues, OECD, 1990, p.2.

been made clear in the notice of initiation of the countervailing duty investigation and in the Initiation Memorandum the United States had always considered that Canada's timber pricing practices constituted the provision of a good. Evidence cited in the context of the initiation of the countervailing duty investigation provided ample support for this conclusion. For example, the British Columbia Forest Act defined stumpage as a payment for a good. In any case, the relevant provision for identification of a subsidy under US countervailing duty law was whether a programme provided a "bounty or a grant." This was fully consistent with the General Agreement. Canada's timber pricing practices met this definition.

173. The **United States** also noted in this context that neither the Agreement nor the General Agreement required, either explicitly or implicitly, the showing of a financial contribution or revenue foregone by a foreign government to trigger the initiation of a countervailing duty investigation.[82] Even assuming, arguendo, that the Agreement and the General Agreement could somehow be read to contain such a requirement, the Department of Commerce still had had sufficient evidence to self-initiate a countervailing duty investigation in this matter. The current administration of the Canadian stumpage system - administratively set prices that were lower than the non-preferential benchmark prices calculated by the Department of Commerce required the Canadian provincial governments to forego revenue in the form of lower stumpage fees. The **United States** observed that in the proceedings before this Panel Canada had conceded that government pricing policies could constitute subsidies if a government failed to collect sufficient revenue to offset its costs. Even using Canada's financial contribution criterion, there were a number of issues at initiation that merited investigation. Thus, there was the question of how to define the governments' "costs" in this case and whether these costs included the opportunity costs of selling to customers at a market rate of remuneration. These were the types of analytical, legal and factual issues which the Agreement expressly reserved to national investigating authorities the right to investigate.

174. The **United States** rejected the view that, as a basic function of a sovereign nation, natural resource pricing was not the kind of government activity the drafters of the General Agreement and the Agreement had intended to address elevated form over substance. The power of taxation was one of the pre-eminent sovereign functions; yet, a tax scheme which provided a competitive advantage to a specific industry and resulted in injury was clearly countervailable. The subsidy disciplines under the General Agreement were aimed at discouraging and offsetting the entry of a government with the market in a manner which injured a foreign industry. It was irrelevant whether that entry into the market was in the form of a

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[82] See also infra, paragraphs 199 and 200.

cash grant, under-valuation of an input when used only in products destined for export; or the under-valuation of an input not only used in products destined for export (at issue in this case). The Agreement and past GATT practice recognized that subsidies could serve important objectives and might involve sovereign functions but can still be actionable if injurious. A government system of regulating access to a natural resource was countervailable if it resulted in the provision of a benefit to a specific industry and such action resulted in injury to a domestic industry in an importing country.

175. The **United States** noted that Article VI:3 of the General Agreement permitted the imposition of a countervailing duty to offset "any bounty or subsidy bestowed, directly or indirectly, upon the manufacture, production or export of any merchandise" and identical language was used in Article 1 of the Agreement. Neither the General Agreement nor the Agreement circumscribed the type of subsidies which might be countervailed, much less alleged subsidies which might be subject to a countervailing duty investigation. To the contrary, the plain language of each expressly authorized a countervail proceeding against any subsidy. There was similarly, no express or implied limitation imposed by Article XVI to the right to impose countervailing duties under Article VI of the General Agreement. Article XVI did not address countervailing duties at all but rather established, inter alia, a mechanism under which a party whose interests were experiencing or were threatened with serious prejudice might seek to limit the subsidies. Article VI, by contrast, expressly authorized the imposition of countervailing duties on injurious imports of subsidized merchandise. There was no indication that the Article XVI remedy limited the scope of the Article VI remedy. Indeed, the Agreement, whose Parts I and II reflected the respective rôles of Articles XVI and VI of the General Agreement, recognized that the two options were coextensive in note 3 ad Article 1. Canada had attempted to carve out the subsidies under investigation from the set of remediable subsidies under the Agreement on the ground that the programmes at issue implicated Canada's sovereignty and constituted a normal government function. However, no such distinction existed under the Agreement. The subsidies under investigation concerned the bestowing of commercial advantages by the Canadian government, not as Canada attempted to portray it, the mere exercise of a state's police power. Canada had argued that the normal government function included the taxing authority. However, there was no doubt that beneficial and specific tax provisions were countervailable under the Agreement. Thus, it was apparent that Canada's interpretation of Article 11 of the Agreement as providing a "safe harbour" for certain types of subsidies was without merit. Article 11 addressed the right of signatories to provide certain subsidies but provided no restrictions on the rights of other signatories to impose offsetting duties. By the same token, the imposition of such duties by an importing signatory did not restrict the right of another signatory to provide subsidies; the two rights were independent of each other. Although Article 11:3 set out examples of possible forms of subsidies other than export subsidies, the Agreement specifically stated that this list was "illustrative and non-exhaustive". Accordingly, rather than providing a precise definition of countervailing domestic subsidies,

the Agreement in effect recognized a body of practices which might be determined to be countervailable subsidies depending on the circumstances of a given case. The **United States** noted in this connection that numerous commentators had recognized that the Agreement gave extremely broad latitude in the definition of countervailable domestic subsidies.

176. The **United States** considered that there was no basis for arguing that the supposedly "narrower" coverage of Article VI should be subordinated to the "broader" terms of Article XVI. The coverage of Article VI was not narrower than that of Article XVI. Article VI concerned "any bounty or subsidy bestowed, directly or indirectly, upon the manufacture, production, or export of any merchandise". Article XVI covered "any subsidy ... which operates directly or indirectly to increase exports of any product ...". As the 1961 Group of Experts on anti-dumping and countervailing duties commented:

> "The fact that the granting of certain subsidies was authorized by the provisions of Article XVI of the General Agreement clearly did not debar importing countries from imposing, under the terms of Article VI, a countervailing duty on the products on which subsidies had been paid."[83]

Canada argued that because Article XVI was not limited to subsidies bestowed on the manufacture, production or export of any merchandise, it was more extensive than Article VI. However, the language of the two provisions indicated that they were intended as "stand alone" provisions with respect to each other. Moreover, it was difficult to imagine subsidies which are not bestowed upon the manufacture, production or export of merchandise.

177. The **United States** observed in this connection that Canada also mistakenly relied on the Panel Report in "United States - Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada" to support its view that the scope of Article VI is narrower than that of Article XVI. The Panel in this dispute had never addressed the issue of whether subsidies actionable under Article VI were somehow less extensive than those under Article XVI. Rather, it had simply noted the different remedies available under the two Articles. The Panel's characterization of Article VI as an exception to basic GATT principles was in error. Additionally, Canada's argument that Article VI should be read more narrowly than Article XVI because the former expressly authorizes unilateral action whereas the latter involved multilateral action ignored the text and interpretative history of Articles XVI and VI.

178. The **United States** considered that Canada's argument on the nature of stumpage programmes as the collection of economic rent should appropriately

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[83] BISD 8S/194, 200, paragraph 32.

be considered during the course of the investigation by the Department of Commerce. Given Canada's position that economic rent theory conclusively established that provincial stumpage programmes did not confer a benefit and, therefore, could not be countervailed, the existence of any alternative theory in the literature suggesting that a benefit was in fact conferred was sufficient to warrant initiation of an investigation. In this regard, several economists and Canadian resource experts suggest that Canada's economic rent argument is wrong. Thus, leading forestry economics textbooks noted that timber supply/demand was affected by the same factors as other inputs. Volume was affected by price. In fact, one leading textbook explicitly explained why the "economic rent" theory might be a useful appraisal construct but did not describe real world supply and demand.[84] Moreover, numerous empirical studies showed a negative correlation between stumpage price and volume of timber harvested.[85] Even if one ignored that alternative theories existed, it would be difficult, if not impossible, for Canada to demonstrate conclusively for purposes of initiation that stumpage programmes could not, in any conceivable circumstances, confer a benefit. Given the conflicting theories regarding economic rent, this issue was appropriate for consideration during the course of the Department's investigation and should not serve as a bar to initiation.

179. The **United States** also argued that Article 2 of the Agreement reserved the right to conduct a countervailing duty investigation exclusively to national investigating authorities. The theory of economic rent raised numerous questions which required empirical evaluation. First, one assumption on which the theory was based was that all productive factors were perfectly elastic. Whether this assumption applied in the case of the forestry sector in Canada needed to be further investigated. Second, the theory was also based on the assumption that the supply of timber offered for sale was perfectly inelastic with respect to price. In light of empirical evidence that the supply of timber within Canada in fact fluctuated the validity of this assumption in the case under consideration was questionable even at the initiation stage. Third, a basic condition of

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[84] G.R. Gregory, Resource Economics for the Forester, (1987) pp.214-215.

[85] See, e.g., Adams, Darius M., Forest Products Prices and Prices and National Forest Timber Supply in the Douglas-Fir Region, 20 Forest Science 243-259 (1974). Adams, Darius M., Effects of National Forest Timber Harvest on Softwood Stumpage, Lumber, and Plywood Markets, Research Bulletin 15, School of Forestry, Oregon State University, Corvallis (1977). Connaughton, Kent p., Gerard A. Majerus and David H. Jackson, Deriving Local Demand for Stumpage from Estimates of Regional Supply and Demand, U.S.D.A., Forest Service Pacific Northwest Research station, Research Paper PNW-RP-406 (1989). McKillop, William, Thomas W. Stuart and Peter J. Geissler, Competition Between Wood Products and Substitute Structural Products; an Econometric Analysis, 26 Forest Science 134-148 (1980).

the economic rent theory was that it was a static model; if the model was not equally valid when applied to a dynamic market such as the lumber market it was not clear if the theory was relevant to the issues raised in the investigation at issue. Finally, the theory discussed prices and output in a so-called "normal range." Based on the conditions in the marketplace, the question arose of whether prices and output were in fact in this "normal range". Thus, the most that might be concluded at the initiation stage of an investigation was that the theory of economic rent might potentially be applicable to the circumstances of this case and that its applicability must be tested based on evidence obtained through investigation.

180. The **United States** further pointed out that objective source materials demonstrated that Canada's position was not only not the only correct position but in fact was wrong. As one World Bank study had noted in regard to Indonesia's timber pricing policies:

> "As with any natural resource, there is an economic rent relating to the standing stock of trees. The rent is the difference between the sale value of the timber and the costs of harvesting it, including a reasonable profit margin to the concessionaire. This rent approximates the maximum amount a forest concessionaire would be willing to pay for the concession. Low rates of rent "capture" have several important effects. The first is to limit Government revenues. Since such revenues should be available for development purposes, there is a cost to the public in terms of the foregone benefits. The second is to leave the rent available to other parties, giving rise to "rent seeking" by concessionaires. This means that there is pressure to harvest large areas in order to obtain quick profits. The net result is an acceleration in the rate of forest depletion as concessionaires rush to secure their share of high profits. Finally, high profits permit concessionaires to sell good timber products at low prices, even though the practice may not be economically sound."[86]

181. In response to the argument of the United States that several economists and Canadian resource experts had contested that the theory of economic rent was correct, **Canada** observed that economic rent was a fundamental principle of economics accepted in all economic textbooks. The textbook referred to by the United States[87] simply pointed out the limits to the theory, but did not question the theory's validity. This was similar to economists pointing out limits to the free trade model. To the

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[86]International Bank for Reconstruction and Development, Indonesian Forest Land and Water: Issues in Sustainable Development, IBRD Report No. 7822-IND (5 June 1989), paragraph 1.38 (emphasis added by the United States).

[87]G.R. Gregory, Resource Economics for the Forester, 1987.

extent that Gregory did question anything, it was the use of appraisal models using rent as a basis. The other authors cited by the United States were more forestry practitioners and econometricians who were used to dealing with the technical aspects of appraisal systems, not economic theory and its applications to natural resources. In fact, economic rent had not even been addressed as an issue by the United States in initiating the investigation of softwood lumber from Canada but only after the fact. The argument of the United States that the issue of economic rent was a matter to be addressed during the course of the investigation was simply a post hoc rationalization.

182. In light of Canada's statement that the theory of economic rent demonstrated that the rent not collected by a government might lead to higher profits of producers but that these higher profits would not lead to increased output, the Panel asked Canada whether it considered that such higher profits could not by themselves be considered to constitute benefits, even if not reinvested. **Canada** responded that, if by "benefits" was meant a financial contribution which increased output, any economic rent which accumulated to a producer was not a benefit, in the sense in which this term was commonly understood in the context of countervailing duty cases. While a producer might obtain higher than normal revenue and profit depending on the level of a government's collection of economic rent, this would not lead to increased output. For a producer to use any increased revenue to cut down trees which were not otherwise economic would be irrational and uneconomic behaviour. While the producer might reinvest this additional revenue elsewhere, this would not affect the level of output of logs which was determined by the marginal costs of production.

183. The **United States** argued that, as illustrated by the World Bank document relating to Indonesia's stumpage pricing practices[88], the question of higher profits was central to the fact that even if the economic rent theory was otherwise correct - that is, even if timber pricing did not in a given year affect the volume of timber harvested - a distortive timber subsidy could still be provided. In any given year in North America, the total volume of timber harvested would be less than the total amount of timber available for harvest and in any given year there would be some investments made in the United States. The provision of excess profits to Canadian lumber operations certainly could shift both the locus of the harvest and the locus of investment. In fact, since the mid-1970s (except for the period during which the MOU had been in effect) Canada's softwood lumber production had increased more rapidly (or fallen more slowly) than production in the United States partially as a result of the availability of cheap timber in Canada.

184. In response to a question by the Panel as to whether the argument regarding the nature of the Canadian stumpage fees as reflecting the

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[88] Supra, paragraph 180.

collection of economic rent had been considered by the Department of Commerce in its decision to initiate the investigation on imports of softwood lumber from Canada, the United States observed that the Department had been aware of the existence of the theory of economic rent in relation to the Canadian stumpage programmes based on the investigation conducted in 1986. In that investigation the department had considered but rejected the application of this theory to the facts found. At the time of initiation of the investigation in October 1991, the Department had reasonably decided that it would be inappropriate, in the absence of additional analysis and information, to decline to self-initiate the countervailing duty investigation based upon economic theory alone. In other words, whether the theory of economic rent was at all applicable to, or had any validity in, the softwood lumber market was a question appropriately addressed during the course of an investigation, rather than addressed a priori during the initiation stage. Thus, while the extensive evidence before the Department of Commerce at initiation had suggested that the facts of the Canadian timber practices did not comport with the theory of economic rent, the Department had stood prepared to investigate this matter.

2.3.4 Measures relating to the export of logs

185. In support of its claim that the United States had acted inconsistently with the requirement of Article 2:1 of the Agreement that there be sufficient evidence of the existence of a subsidy, **Canada** also referred to the steps taken by the Department of Commerce with respect to the inclusion in the scope of the countervailing duty investigation on imports of softwood lumber from Canada of certain measures applied by Canadian authorities relating to exports of logs. At the time of the initiation of the countervailing duty investigation, the Department of Commerce had made the following statement regarding the available evidence on these measures:

> "... the Department requires evidence demonstrating that the restrictions had measurable downward effect on log prices in order to meet the threshold for initiation ... Presently, the Department does not have sufficient evidence to ascertain the extent to which the log export restrictions artificially lower domestic prices for logs, the major input into the product under investigation."[89]

Article 2:1 of the Agreement obliged investigating authorities to proceed only if they had sufficient evidence of the existence of a subsidy at the time of self-initiation. By its own admission, the United States had not possessed sufficient evidence of the existence of a subsidy with regard to the measures relating to the export of logs on 31 October 1991. The receipt of evidence after the self-initiation of the investigation could not provide the basis of evidence needed for self-initiation of an

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[89] 56 Fed.Reg., 31 October 1991, p.56057.

investigation. The Agreement did not provide for an exemption to allow a signatory to provisionally initiate an investigation pending information. The admission by the Department of Commerce of absence of sufficient evidence of the existence of a subsidy was prima facie evidence that the United States had not met the "sufficient evidence" requirement in Article 2:1 when it had initiated the investigation on measures affecting the exports of logs.

186. **Canada** further noted that in its notice of self-initiation of the countervailing duty investigation the United States had left open the possibility of including in the investigation measures affecting the exports of logs. The United States had admitted in the same notice that there was not sufficient evidence of the existence of a subsidy to warrant including these measures in the investigation at the time of initiation, and had invited third parties to submit further information on this matter. **Canada** recalled that it had raised concerns over the potential inclusion of such measures in the investigation in its request for conciliation under Article 17 of the Agreement. Given that at the time of the initiation of the investigation the Department of Commerce, by its own admission, had not possessed sufficient evidence to initiate an investigation with respect to the measures affecting exports of logs, it should not have invited interested parties to submit information on these measures.

187. **Canada** also argued in this context that the measures applied in Canada relating to exports of logs were not subsidies within the meaning of the General Agreement and the Agreement. Measures such as export taxes and export permits were subject to specific provisions of the General Agreement and as such could not be included in the meaning of the term subsidy as found in Article XVI of the General Agreement or in the Agreement. An export charge was a tariff by another name, and was subject to other provisions in the General Agreement and did not fall under the meaning of the term subsidy as found in the Agreement. Although government measures such as export permits could, theoretically, have an effect on the price of products, the possibility of the existence of a price effect alone could not, within the rules of the General Agreement, establish these measures as subsidies. The Report on the Review Pursuant to Article XVI:5, adopted on 24 May 1960, had addressed the question in terms of government schemes which supported domestic policies through non-financial measures:

> "One such case might be that in which a government fixes by law a minimum price to producers which is maintained by quantitative restrictions or a flexible tariff or similar charges. In such a case, there would be no loss to the government, and the measures would not be governed by Article XVI, but by other relevant articles of the General Agreement."[90]

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[90] BISD 9S/188, paragraph 11.

The contention of the United States that quantitative export restrictions and export taxes provided a subsidy because of alleged price effects would include in the notion of subsidies a wide variety of government measures which only shared the common attribute of having alleged price effects. The acceptance of this argument would legitimise countervailing duty actions for any governmental measure which could have a price effect, such as the lowering of individual tariffs or a reduction in sales taxes on certain items. Such an interpretation would achieve precisely the result which the Contracting Parties to the General Agreement had consistently sought to avoid - the abuse of the exceptional nature of countervailing duties provided for under Article VI of the General Agreement. The provisions of this Article had never been intended to permit the imposition of a countervailing duty to offset the effect of all forms of government action.

188. **Canada** reiterated in this respect that under the General Agreement, not every government intervention having an effect on trade and competition could be qualified as a subsidy. The General Agreement clearly distinguished between subsidies and other measures having an effect on trade and international competition. This distinction was important because Article VI of the General Agreement enabled contracting parties to unilaterally take protective action against subsidised imports, whereas the General Agreement did not permit such action against other foreign practices, such as quantitative restrictions, import or export licences, even if these practices could lead to trade distortions. Under the General Agreement, export restrictions were regulated by Articles XI, XIII, and XX. Any violation of these provisions could be addressed only by means of the dispute settlement provisions of the General Agreement.

189. **Canada** argued that, even if it accepted that the log export restrictions were a subsidy, which it did not, the United States had not provided sufficient evidence to justify the inclusion of these restrictions within the scope of the countervailing duty investigation. The Department of Commerce had asserted that such export measures could "artificially lower domestic prices for logs, the major input into the product under investigation". Yet, in arguing that stumpage rights were mostly held by softwood lumber producers and pulp and paper manufacturers, the United States had implicitly acknowledged that these industries did not purchase their logs through a log market, but harvest them directly, irrespective of the domestic price of logs. The logic of the United States did not lead to the conclusion that measures affecting the exports of logs could affect the quantity or price of lumber exported to the United States.

190. The **United States** argued that the inclusion of the measures relating to exports of logs in the countervailing duty investigation was consistent with the obligations of the United States under Article 2:1 of the Agreement. In the Initiation Memorandum the Department of Commerce had discussed Canada's export restrictions on logs but did not initiate an investigation into this programme. The Department had noted that there was

clear evidence that such restrictions operated in Canada.[91] The Department had also observed that economic theory offered strong support for the proposition that such restrictions artificially lowered prices for domestic logs, the major input of softwood lumber, by artificially increasing the domestic supply of logs. As such, Canada's export restrictions potentially provided a countervailable benefit to those who incorporated the input product into the softwood lumber exported to the United States.[92] Notwithstanding this evidence of a subsidy, the Department had observed that evidence was required demonstrating that the restrictions had a measurable downward effect on log prices in order to meet the threshold for initiation. Accordingly, the Department had concluded:

> "Presently, the Department does not have sufficient evidence to ascertain the extent to which the log export restrictions artificially lower domestic prices for logs, the major input into the product under investigation. However, if an interested party submits such evidence during the course of the proceeding, the Department remains willing to investigate these programmes."[93]

On 3 December 1991, the Department of Commerce had received a documented allegation from an interested party to the investigation, the US Coalition for Fair Lumber Imports, that export restrictions applied in British Columbia constituted countervailable subsidies within the meaning of the US countervailing duty legislation. Similar allegations with respect to export restrictions applied by Alberta, Ontario and Quebec had been received on 13 December 1991. On 23 December 1991, after considering the allegations and the supporting documentation, as well as additional information before it, the Department had included the export restrictions in the countervailing duty investigation on imports of softwood lumber. In so doing, the Department had concluded that it had a sufficient basis to investigate the export restrictions.

191. The **United States** provided the Panel with a summary of the background document containing the evidence relied upon by the Department of Commerce in its decision to include the export restrictions within the scope of the countervailing duty investigation on imports of softwood lumber from Canada. This evidence related to the type of export restrictions maintained by the Canadian Federal Government and by the provincial Governments of British Columbia, Alberta, Quebec and Ontario, and to the price effects of these restrictions. In this latter respect, the evidence suggested that in the case of British Columbia for various species, when adjusted for quality differences, log export prices were on average between 53 per cent and 65 per cent higher than domestic log prices. At certain times and for certain species during 1984-1990 export prices had been over

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[91] Initiation Memorandum, pp.7-9.

[92] Initiation Memorandum, p.8.

[93] Initiation Memorandum, p.9.

100 per cent higher than domestic prices. For the six-year period examined, domestic prices had consistently been well below export prices. Based on the range of data examined, the pronounced differences between export prices and domestic prices did not appear to be caused by differences in species or quality. Rather, these differences were likely due to the export restrictions. These circumstances had constituted sufficient evidence that the export restrictions on logs might have a significant effect on the domestic price of logs. Since logs were the major input into softwood lumber, the export restrictions might provide countervailable benefits to the product under investigation.

192. The **United States** argued that, on its face, the decision to investigate log export restrictions was fully consistent with Article 2:1 of the Agreement. On 23 October 1991, the Department of Commerce had properly initiated a countervailing duty investigation on imports of softwood lumber from Canada. In the Notice of Initiation of the investigation, the Department had identified Canadian federal and provincial log export restrictions as potential subsidies but had stated that it had insufficient evidence to initiate an investigation of those restrictions. The Department had also stated that, if it received additional information showing the extent to which the restrictions artificially lowered the domestic price of logs, it would consider investigating the export restrictions. On 23 December 1991, based on the submission of new information, the Department had determined to include log export restrictions in its investigation. Accordingly, the Department had begun analysing the export restrictions in its ongoing investigation of subsidies provided to imports of softwood lumber from Canada. Moreover, at the same time as it had included the export restrictions in its investigation, the Department had decided to extend the investigatory period to accommodate any additional information and/or documentation that might be required by inclusion of the export restrictions in the investigation.

193. The **United States** considered that, by taking the formal step to include an additional potential subsidy practice in an ongoing countervailing duty investigation, the Department of Commerce had gone beyond what the Agreement required in terms of providing notice to Canada. In particular, the decision to delay commencement of the export restriction portion of its inquiry demonstrated the importance the United States attached to the need to have sufficient evidence to investigate each and every programme. Article 2:1 of the Agreement only required sufficient evidence of the existence of a subsidy, not each and every subsidy programme. Therefore, the Department's action in this case had exceeded the "sufficient evidence" standard of Article 2:1. Moreover, the provisions of the Agreement throughout Part I were oriented toward the investigation of whether subsidized imports were causing material injury to a domestic industry, not the number of individual subsidy programmes or whether such programmes had certain effects. This issue had recently been decided by a Panel in a dispute between Canada and the United States concerning the imposition by Canada of countervailing duties on imports of

grain corn from the United States.[94] Canada's argument that the United States could not have included the export restrictions in the ongoing countervailing duty investigation on imports of softwood lumber would also have the illogical result that, if investigating authorities initiated an investigation with respect to one programme and then discovered during the course of that investigation other subsidy programmes, these other programmes would have to be ignored or an entirely new investigation would have to be initiated, to the detriment of all parties. Indeed, the purpose of an investigation was to discover information about known as well as other potential subsidies. The Notice of Initiation of the countervailing duty investigation of imports of softwood lumber from Canada had expressly provided for obtaining such information. Thus, Canada's argument was premised on an erroneous understanding of the facts.

194. In support of its view that the steps taken by the Department of Commerce with regard to the inclusion of the log export restrictions in the investigation had involved a self-imposed standard, the **United States** noted that the Department had accepted comments on the evidence before it on the basis of which it intended to commence an investigation of the log export restrictions. Comments on this evidence had been made by the Government of Canada and by one Canadian exporter. The Department had reviewed these comments and concluded that they were insufficient to discredit the accuracy or reliability of the pricing data for purposes of initiating an investigation. Moreover, the US domestic industry had also submitted several econometric studies showing a large price effect of the log export restrictions. With respect to Canada's argument that the United States did not consider whether log experts restrictions could affect integrated producers, the United States pointed out that this issue was addressed in the material submitted by the US Coalition.

195. In response to Canada's argument that the Department of Commerce had improperly included the log export restrictions in the investigation because the Department had not possessed sufficient evidence as to these potential subsidies at the time of the initiation of the overall investigation, the **United States** argued that it was unclear on what legal basis in the Agreement Canada was suggesting that investigating authorities should ignore additional subsidy programmes discovered during the course of an investigation. The **United States** also noted that Canada had not challenged the sufficiency of the evidence before the Department of Commerce at the time it actually included the export restrictions in its investigation. Thus, the only issue presented was whether the Agreement permitted the inclusion of additional subsidy programmes in an investigation once properly commenced. Not only did the Agreement permit investigation of multiple subsidy programmes in a single investigation

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[94] SCM/140, adopted on 26 March 1992.

(even when the existence of some programmes might become apparent only after inquiry) but in fact was oriented toward such investigation.

196. In response to the argument of the United States that Canada had not identified a specific requirement of the Agreement which would preclude authorities from including in a countervailing duty investigation an additional programme discovered during the course of the investigation, **Canada** submitted that it had challenged the inclusion in the investigation of the log export measures as part of its argument that the United States did not have sufficient evidence of the existence of a subsidy at the time of the self-initiation of the countervailing duty investigation of imports of softwood lumber from Canada. The United States had acknowledged in the proceedings before the Panel that it had identified the log export measures as potential subsidies at the time of self-initiation and had admitted that there had been insufficient evidence to include such measures in the investigation. This was prima facie evidence that the United States had not met the requirements of Article 2:1 of the Agreement at the time of the self-initiation of the countervailing duty investigation. By subsequently including a measure in an investigation based on evidence provided by industry, the United States could not be permitted to deny Canada the right to challenge whether the United States had met its obligations under Article 2:1. Canada had the right to have examined, and wished the Panel also to rule on, the question of log export measures as not being a subsidy and that the United States did not have sufficient evidence of a subsidy as required under Article 2:1. Export restrictions had been mentioned explicitly in the Initiation Memorandum which was at the heart of the dispute referred to the Panel and formed part of Canada's request for conciliation which was the basis for the Panel's terms of reference.

197. The **United States** argued that to require a new investigation to be begun when additional information came to light regarding additional subsidies would be burdensome both to respondents and to investigating authorities. In fact, respondents might suffer most from such a requirement. On the other hand, to prevent undue burden on respondents in the ongoing investigation, the United States required that new subsidy allegations be introduced early in the proceeding. In this case Canada had had notice of this issue from the outset, the United States had taken the formal step of including log export restrictions in the countervailing duty investigation only after a large volume of information had been submitted to satisfy the "sufficient evidence" standard, and the investigation had been extended to give Canada additional time to respond. Under these circumstances it would be absurd, if not inconsistent with the terms of the Agreement, to require the United States to self-initiate a separate investigation with respect to the log export restrictions.

198. In response to a question by the Panel as to whether the possible inclusion in the countervailing duty investigation of the Canadian measures relating to exports of logs had been discussed in the bilateral consultations held between Canada and the United States in October 1991, prior to the initiation of the countervailing duty investigation, the **United States** noted that during the bilateral consultations, the

United States had informed the Government of Canada that programmes other than stumpage might be included within the scope of the prospective countervailing duty investigation.

199. The **United States** considered that there was no basis in the text, drafting history and interpretative history of the Agreement and of the General Agreement for Canada's argument that the United States could not lawfully have initiated an investigation of the log export restrictions because these export restrictions were not subsidies within the meaning of the Agreement and the General Agreement. First, the logical result of this argument would defeat the purpose of countervailing duty investigations; the very function of such investigations was to provide a basis for a determination as to whether a programme or practice did, in fact, constitute a subsidy within the meaning of the Agreement. The final determination by the Department of Commerce on this issue would require gathering and evaluating facts and conducting an analysis of legal and economic issues. This process by its nature must take place during an investigation and could not be addressed prior to initiation. The initiation standard in Article 2:1 was a threshold, used to determine whether an investigation should go forward. By contrast, the investigation provisions governed the actual collection of information and analysis. Canada treated the "sufficient evidence" standard of Article 2:1 as though it were the "positive evidence" standard of Article 6 and the decision to initiate an investigation as though it were a final determination, criticizing this decision on the basis of standards applicable only to a final determination. Second, there was no basis in the Agreement or in the General Agreement for Canada's argument that export restrictions could not be subject to countervailing duty investigations because they did not involve a financial contribution by a government. Neither the General Agreement nor the Agreement established a definition of what might or might not constitute a subsidy. Accordingly, Canada could not point to any support in the Agreement or in the General Agreement for its argument that there was an express or implied "financial contribution" limitation on the definition of a subsidy. Finally, although neither the Agreement nor the General Agreement provided a universally accepted definition of the term "subsidy", a careful reading of the GATT texts demonstrated that harder measures, such as export restrictions, could constitute a "subsidy" within the meaning of Articles VI or XVI of the General Agreement, as implemented by the Agreement. Just as the doctrine of ejusdem generis applied as an aid to statutory construction, so this doctrine was equally applicable when interpreting an international agreement, such as the General Agreement or the Agreement. In this regard, Article 11:3 of the Agreement set forth a non-exhaustive list of illustrative domestic practices, fiscal incentives. The export restraints on logs imposed by the Province of British Columbia were based in part upon a complex fiscal system (i.e., 100 per cent export tax) that taxed logs destined for the export market, but exempted from the tax logs sold in British Columbia. The net result of this fiscal régime was a partial reduction of the production costs of the softwood lumber manufacturers in British Columbia. Because these export restraints were based in part upon a fiscal tax régime, this measure was similar in nature or was at least analogous to one of the illustrative examples of an

internationally recongized domestic subsidy. Application of the maxim of ejusdem generis, therefore, supported the conclusion that the export log restrictions in British Columbia constituted another type or kind of illustrative "domestic subsidy" within the meaning of the Agreement.

200. In this latter respect, the **United States** contested Canada's argument that the Report on the Review Pursuant to Article XVI:5 supported the view that export restrictions could not be subsidies within the meaning of the General Agreement. First, the issued addressed in this Report had nothing to do with export restrictions. The Group's discussion had centred exclusively on "cases in which a government maintained a fixed price above the world price".[95] The conclusion of that portion of the Group's Report cited by Canada was that a government did not provide a countervailable subsidy when it fixed a minimum price through a quantitative restriction on imports as part of "a system which fixes prices to producers at above the world price level" and the programme did not cost the government financial resources. The comment was inapposite to the case before this Panel. The evidence before the Department of commerce had demonstrated that the log export restrictions had reduced prices of logs in British Columbia. These restrictions did not even remotely resemble, let alone constitute, the type of minimum price scheme which had been the subject of the Report of the Group of Experts. Second, the Report did not establish a financial contribution or cost to government criterion as a necessary condition for the existence of a subsidy. To the contrary, the Report had expressly recognized that a subsidy did not require a financial contribution as long as a benefit was provided, if the benefit was provided by the government. For example, in discussing the question of levy/subsidy schemes, the Group had recognized that such schemes were not countervailable if purely voluntary, but were covered by Article XVI of the General Agreement when they were "dependent for their enforcement on some form of government action" even though no financial contribution would be necessary in that case.[96] Similarly, the paragraph of the report following that cited by Canada noted that a subsidy could be countervailed when a government regulation turned over to a private body the function of subsidization, even though no financial cost to the government occurred. Obviously, such schemes would not necessarily involve a government financial contribution. Notwithstanding that a financial contribution by the government was not a universal requirement to establishing the existence of a countervailable subsidy, evidence had been presented to the Department of Commerce that the log export restrictions did curtail government revenues, at least in the provinces which permitted any competition for timber and (to the extent that private logs were affected and the loss of tax revenue was considered) perhaps in all provinces. Canadian log export restrictions could be seen in two lights. First, in one sense there was a direct government revenue foregone as a result of the fact that the export restrictions lowered the

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[95]BISD 9S/191, emphasis supplied by the United States.

[96]BISD 9S/192.

value of logs. The governments would collect higher timber fees (at least for the 10 per cent of competitive sales which provided one of the benchmarks for measuring the stumpage subsidy) absent the restrictions. Second, the "private" log industry was forced to forego revenues in order to benefit lumber manufacturers.

201. The **United States** considered that the Report of the Group of Experts clearly indicated that potential subsidy practices should be investigated and determined on a case-by-case basis. Fourth, the report of the Group of Experts had concluded that an evaluation of whether a subsidy had been provided depended on the facts of each case, which in turn, could be established only after an investigation had taken place.[97] Canada's request for a ruling that the Canadian export restrictions did not or could not constitute subsidies was therefore premature. The Agreement required that a factual record be established prior to evaluating this question. By definition, such a factual record had not been established at initiation and could not be compiled until after an investigation had taken place.

202. On the view expressed by the United States that the Report on the Review Pursuant to Article XVI:5 of the General Agreement provided no guidance on the question of whether export restrictions could be subsidies, **Canada** argued that the principal guidance provided by this Report was its finding that subsidies might have effects similar to government measures which were not subsidies for the purposes of the General Agreement. The 1961 Report of the same Group of Experts had also noted that "subsidies often closely resemble tariffs and quantitative restrictions in their purpose and effect". Export taxes and export restrictions were equivalent in effect to import tariffs, after all. Therefore, it was not sufficient to point to subsidy-like effects (such as the alleged price effects of the log export restrictions) as evidence of the existence of a subsidy. The arguments advanced by the United States had not addressed this fundamental point. Furthermore, the 1960 Report had considered two different types of government programmes, only one of which had been found to entail a subsidy. Thus, the Report had concluded that where a government maintained a domestic price by purchases and sales at a loss to the government, such measures constituted a subsidy. Such government action bore no relationship to the export regulations at issue in the case before the Panel. However, the Report had gone on to consider government action which fixed "a minimum price" and maintained such measures by import measures such as "quantitative restrictions or flexible tariffs or similar charges". Unlike the first situation considered in the Report, these latter measures were analogous to Canada's export regulations. To the extent that export regulations might have any effect on domestic prices of logs in Canada, it was not through government purchases and resales at a loss (which the Report had found to be a subsidy) but, rather, through export restrictions and/or tariffs. The Report had explicitly acknowledged that under such

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[97] BISD 9S/190.

latter circumstances "there would be no loss to the government" and the desired effect would be achieved "without resort to a subsidy".

203. **Canada** further argued in this context that the fact that the 1960 Report had discussed import restrictions was of no moment, since Article XVI of the General Agreement applied equally to programmes affecting imports and to those affecting exports. Thus, the 1960 Report provided direct support for Canada's position that export restrictions and/or tariffs, even if they might have a domestic price effect, could not considered to be subsidies under the General Agreement. The Reports adopted in 1960 and 1961 had formed the staring point for the discussions in the Uruguay Round on the issue of the definition of a subsidy. In those discussions, the issue of export restrictions had been raised by the United States but had been soundly rejected by all other participants in the negotiations. As a result, this issue had found no expression in the final Uruguay Round text on subsidies and countervailing measures.

204. In response to the argument of the United States that, even if one assumed that a financial contribution by a government was a necessary condition of the existence of a subsidy, the Canadian export measures could be considered to meet that condition, **Canada** argued that a financial contribution by a government was a necessary but not a sufficient condition of the existence of a subsidy. The comments of the United States regarding the possibility that export restrictions could involve a financial contribution by a government ignored the fact that export restrictions were not subsidies for purposes of the General Agreement in the first place, as demonstrated by the Reports on subsidies adopted in 1960 and 1961. Export restrictions were just that - export restrictions, not subsidies.

205. The **United States** contested that the potential applicability of other provisions of the General Agreement implied that export restrictions could not be subject to countervailing duty investigations. This argument was in direct contradiction with the text of Article VI:3 of the General Agreement which provided that countervailing duties could be levied to offset <u>any</u> bounty or subsidy. In addition, the Agreement, which constituted the agreed interpretation of Article VI, specifically envisioned in note 38 <u>ad</u> Article 19 that Articles VI and/or XVI might be invoked in addition to "other relevant provisions of the General Agreement, where appropriate". The scope of Article VI and its potential relevance to practices which might also be addressed by other Articles of the General Agreement had been addressed in the past. One commentator had noted in this respect that:

> "It is irrelevant, for the purposes of [countervailing a subsidy], whether or not practices which can be qualified as subsidies are

> prohibited under the GATT, or the Code on Subsidies and Countervailing Duties."[98]

Another commentator had observed that:

> "A GATT Contracting Party has the right to impose unilaterally a countervailing duty on imports of subsidized products (whatever the nature of the subsidy) ..."[99]

Canada's assertion that Article VI did not extend to practices which might be covered by other provisions of the General Agreement was therefore incorrect. Similarly, Canada's argument that other provisions of the General Agreement restrained the application of Article VI in the manner suggested by Canada was unsupported.

206. The **United States** contested in this context the view that Article XI of the General Agreement provided expressly or implied that it was the exclusive remedy concerning all aspects of import or export restrictions or prohibitions. In conducting a countervailing duty investigation with respect to the log export restrictions the United States was not challenging these export restrictions themselves as a violation of Article XI. Rather, the purpose of the investigation was to determine whether these export restrictions constituted a subsidy practice which might warrant the imposition of countervailing duties (assuming the appropriate findings with respect to injury and causation were made). Similarly, there was no general GATT precept that coverage of a particular practice under one Article of the General Agreement somehow supplanted or pre-empted a proceeding against that practice under another, equally applicable Article. To the contrary, the General Agreement envisioned that different Articles might cover the same practice, and that a complaining party might choose to proceed against the practice under one or more of the applicable provisions of the General Agreement. Thus, a subsidy was actionable under both Article VI or Article XVI of the General Agreement and there was no requirement that a contracting party proceed against the subsidy under one Article rather than another. Indeed, the Agreement envisioned in note 3 to Article 1 that a signatory could invoke one or the other. The only instance in which the General Agreement did not permit the imposition of a countervailing duty on the ground that the same situation could be addressed by another remedy under the General Agreement was provided for in Article VI:5 of the General Agreement. This provision demonstrated that, when the drafters of the General Agreement wanted to impose a restriction on the availability of the countervailing duty remedy because the same situation was remedied by another provision of the General

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[98] J.F. Beseler and A.N. Williams, Anti-Dumping and Anti-Subsidy Law: The European Communities, 118 (1986) footnotes omitted.

[99] Subsidies and Countervailing Duties: The Negotiating Issues, Canadian Economic Policy Committee, C.D. Howe Research Institute, 6 (1977).

Agreement, they had specifically provided for such a restriction. No such limitation appeared in the General Agreement in connection with countervailing duties vis-à-vis potential remedies under Article XI. The absence of such a restriction further demonstrated that Article VI remedies might be applied without reference to Article XI.

207. The **United States** also pointed out that the terms of Articles VI and XI of the General Agreement were not in conflict. Thus, it was not the case that one Article authorized export restrictions while the other would undercut that right. Since the General Agreement specifically envisioned that different articles might be invoked to remedy the same situation, there was no basis for creating a conflict between Articles VI and XI. Moreover, even if there was a potential conflict between these Articles, the General Agreement should be construed in such a manner as to avoid finding that such a conflict existed. It was well settled that, when interpreting an international treaty, a provision of the treaty should not be read so as to deprive another provision of the treaty of effect. The treaty should be read as a whole and interpreted to be consistent. Therefore, if there was a possible conflict between two provisions, the treaty should be interpreted so as to give full meaning to both of the provisions. The **United States** also noted that the question of a potential conflict between Articles VI and XI would not even arise unless and until the Department of Commerce had reached an affirmative final determination in its investigation of the log export restrictions and the USITC had issued an affirmative final determination of injury. If one or both of these determinations were negative, the issue of the potential countervailability of the log export restrictions, and with it any potential conflict between Articles VI and XI of the General Agreement, would be rendered moot. It would therefore not be appropriate to speculate on the mere possibility of a conflict between these provisions.

208. **Canada** contested that Article 19 of the Agreement could be interpreted to support the view expressed by the United States that the applicability of other provisions of the General Agreement did not mean that a measure could not be subject to countervailing duty proceedings. Article 19 and footnote 38 had to be interpreted together. Article 19 ensured that any countervailing duty action was taken only in accordance with the General Agreement and the Agreement. Footnote 38 then provided that that this stricture did not "preclude action under other relevant provisions of the General Agreement, where appropriate". This was the reverse of the spin the United States was attempting to put on this. Thus, for example, although a country might countervail a subsidy, this did not preclude its right to challenge the same subsidy on the ground that it was inconsistent with Article II of the General Agreement in nullifying or impairing a tariff concession. However, it did not mean that measures treated in other aspects of the General Agreement, such as tariffs and quantitative restrictions, could be considered subsidies under Article VI of the General Agreement. In short, the point was that the practice to be investigated under Article 2 of the Agreement had to be a subsidy in the sense in which that term was used in the General Agreement.

209. **Canada** considered that the basic structure of the General Agreement supported its position that export restrictions were not subsidies. Export regulations were not mentioned in Articles VI and XVI of the General Agreement or in the Agreement. However, quantitative restrictions were explicitly addressed in Article XI of the General Agreement. This explicit treatment of export regulations in one section of the General Agreement but not in another provided strong evidence that the Contracting Parties to the General Agreement had intended quantitative restrictions to be governed by Article XI, and not by the provisions on subsidies and countervailing measures. The Contracting Parties had not intended the rules on subsidies to be a residual means for dealing with any trade complaint, thereby rendering other Articles of the General Agreement superfluous.

2.4 Evidence of the existence of injury and causality

210. **Canada** submitted that the self-initiation by the United States on 23 October 1991 of a countervailing duty investigation of softwood lumber products from Canada was contrary to the requirements of Article 2:1 of the Agreement in that this investigation had been initiated absent sufficient evidence of material injury and of the existence of a causal relationship between the alleged injury and imports of softwood lumber from Canada.

211. The **United States** submitted that evidence before the Department of Commerce had demonstrated that the softwood lumber industry in the United States was currently suffering material injury as a result of subsidized softwood lumber imports from Canada sufficient to warrant initiation of an investigation, consistent with Article 2:1.

Arguments relating to the operation of the MOU

212. **Canada** noted that the evidence presented by the Department of Commerce in its Initiation Memorandum (see Annex 1) regarding injury and causality covered the years 1988-1990 and the first half of 1991. This period coincided with the operation of the MOU, the purpose of which was to offset "subsidies" either through the application of an export charge on softwood lumber products from Canada, or through provincial measures which replaced all or part of the export charge. As admitted by the testimony of the Deputy Assistant Secretary of Commerce before the US Congress in February 1991, the export tax had been adequate to offset the effect of the "subsidized" Canadian lumber at the time of the signing of the MOU and no measures had been introduced since that time by the Provinces or by the Government of Canada which would have offset the effect of the MOU. The claim of the United States that products entering the United States under the terms of the MOU had caused injury to the softwood lumber industry in the United States was thus contradictory to the testimony of the Department of Commerce that the United States had no evidence that exports of softwood lumber from Canada were causing injury to United States producers of softwood lumber.

213. The **United States** pointed out that the testimony of the Deputy Assistant Secretary of Commerce was that the MOU was designed to offset the

subsidies. The Assistant Secretary had stated that the MOU had worked as an offset to the subsidies. It was clear throughout her testimony that her description of the MOU's purpose and effect was to act as such an offset. The countervailing duty investigation, by contrast, was to determine whether the subsidized imports were materially injuring or threatening to materially injury a domestic industry. Articles 6:1, 6:2 and 6:4 of the Agreement directed investigating authorities to examine whether the subject imports were causing material injury. The testimony of the Assistant Secretary did not address the question of injury by reason of the imports and Canada's characterization of her statement as being relevant to this issue was mistaken.

Arguments on the applicable standard

214. **Canada** argued that, although the standard of evidence for initiation of an investigation was less strict than for a determination of the existence of material injury, Article 2:1 of the Agreement would be without meaning if a signatory were permitted to launch an investigation on the basis of evidence which was not relevant to an eventual determination which would meet the requirements of Article 6. A self-initiation of a countervailing duty investigation required higher standards of "sufficient evidence".[100] Article 6 directed that a determination of injury be based on positive evidence and include an objective examination of (a) the volume of subsidized imports and their effect on prices of the like product in the domestic market and (b) the consequent impact of these subsidized imports on the domestic industry. Article 6:2 noted that signatories should examine whether there had been a "significant increase in subsidized imports, either in absolute terms or relative to production or consumption in the importing signatory." Article 6:3 specified the factors which might be relevant in examining the impact of the subsidized imports on the domestic industry. Article 6:4 required that injury be caused by the subsidized imports, through the effects of the subsidy, and that injury caused by "other factors" must not be attributed to the subsidized imports. For the purposes of Article 2:1, sufficient evidence of both injury and causality had to be presented.

215. The **United States** emphasized that the issue before the Department of Commerce at the time of the initiation of the investigation was not whether imports of softwood lumber from Canada were causing material injury to the domestic industry in the United States, but rather, whether the Department had a reasoned basis to allow the case to proceed for a fuller analysis by the USITC. The evidence before the Department had met this requirement. The alternative explanations proffered by Canada of the evidence relied upon by the Department of Commerce in the initiation of this investigation were to be properly weighed and determined following a full investigation by the USITC. Canada's approach to the injury issues ignored the threshold

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[100] See also supra, section 2.2.

standard for initiation set forth in Article 2:1 of the Agreement and instead treated the decision that there was sufficient evidence of injury to initiate an investigation as if it were a final determination of injury.

Arguments on specific indicators of injury and causality

216. The **United States**, referring to the Initiation Memorandum, pp.30-36, provided the following summary of the evidence before the Department of Commerce at the time of the initiation of the investigation of injury to the domestic softwood lumber industry and the rôle of Canadian imports in causing that injury. As described on pp.30-31 of the Initiation Memorandum, over the period 1988-1990 the domestic industry was experiencing injury in the form of declines in production, shipments, exports, apparent domestic consumption; the domestic softwood lumber price index had risen by well under half the wholesale inflation rate; costs had increased dramatically; capacity utilization, employment and net income had fallen.[101] Many of these unfavourable economic trends had accelerated in the first half of 1991.[102] In addition, even when US producers were cutting back on production and lowering prices they were having an increasingly difficult time selling their inventories.[103] On the basis of the above mentioned indicators the Department of Commerce had concluded that a strong indication existed that the domestic industry was currently experiencing material injury.

217. Regarding the evidence of the rôle of imports from Canada in causing injury to the domestic softwood lumber industry, the **United States** pointed out that the analysis by the Department of the market and product characteristics in the United States had indicated that subsidized imports of lumber from Canada had suppressed domestic prices and taken sales from unsubsidized United States producers. First, Canadian softwood lumber imports over the period 1988-1990 had consistently commanded a significant share of the US market and, at the time of initiation, this market share was increasing.[104] In value terms, Canada's share of the US market increased throughout the period. Second, softwood lumber was a commodity product sold on the basis of price and thus was highly price sensitive.[105] Third, Canadian and US softwood lumber were fungible products which directly competed with one another in the North American market.[106] Finally, the demand for softwood lumber was highly inelastic, such that a change in price would result in a less than proportional change in demand.[107] Accordingly, price decreases would result in lower total

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[101] See also Initiation Memorandum, Tables E-1 through E-4.

[102] Initiation Memorandum, pp.31-32.

[103] Initiation Memorandum, p.32.

[104] Initiation Memorandum, p.33 and Table E-2.

[105] Initiation Memorandum, p.33.

[106] Initiation Memorandum. p.33.

[107] Initiation Memorandum, p.33.

revenue for US softwood lumber producers because the quantity of lumber sold would remain static. In light of these market and product characteristics the Department of Commerce had concluded that:

> "... it is likely that the existence of subsidized Canadian imports, which account for a significant share of the U.S. domestic market, suppressed domestic prices to a point significantly below the level they would have been had it not been for the subsidized imports. In addition, prices can drop significantly with little effect on the quantity of softwood lumber consumed, thereby depressing revenues and profits for U.S. softwood lumber manufacturers."[108]

An examination of price trends in the US softwood lumber market had substantiated that domestic prices had been suppressed as a result of imports from Canada.[109] Finally, the Department had possessed evidence of revenue and sales lost by the domestic industry to imports from Canada. This evidence indicated the existence of price depression clearly identified as resulting from Canadian imports.

(i) Volume of imports and market share

218. **Canada** observed that, in discussing the issue of the causal relationship between imports from Canada and injury to the domestic industry, the Department of Commerce had claimed that the Canadian imports were likely the cause of price suppression[110] on the ground that Canada had a significant share of the United States market and that there had been an increase in the second quarter of 1991. **Canada** considered that the fact that the market share of Canadian imports was significant was not evidence that such imports were the cause of injury to the domestic industry in the United States. As well, by using a three year average, the United States gave the impression of a constant Canadian share of the United States market during 1988-1990. In fact, the data presented in the Initiation Memorandum (Table E-2) showed that the annual Canadian market share of the US domestic market had declined from 28.2 to 26.8 per cent and that the absolute volume of imports from Canada had declined by 8.8 per cent during that period. Furthermore the same source showed that the volume of Canadian imports had been falling since 1987 and that market share had been falling since 1985.

219. With respect to the increase in the Canadian market share in the second quarter in 1991, **Canada** considered that this was not evidence of causality for three reasons. First, the United States had considered a market share increase in only one quarter to support its contention of increasing Canadian lumber market share and had ignored the fact that the

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[108] Initiation Memorandum, p.34.

[109] Initiation Memorandum, pp.34-35.

[110] Initiation Memorandum, p.34.

trend over the three-year period was a declining Canadian market share. It had ignored the fact that within the trend there had been quarters when the Canadian market share had also risen. For example, Table E-2 of the Initiation Memorandum showed that in 1989 and 1990 Canadian market share had increased in three out of eight quarters, while annual Canadian market share averages had fallen. Second, the volume of Canadian lumber exports to the United States increased regularly in the second quarter due to the seasonal increase in housing starts which use framing lumber, Canada's main export. Third, the argument of the United States regarding the existence of price suppression in the second quarter of 1991 was contradicted by evidence showing the domestic softwood lumber price index and the imported softwood lumber price index had increased more rapidly in this quarter than in any quarter since 1988.[111]

220. Canada also argued in this connection that the Department of Commerce had juxtaposed the increase in the Canadian market share from the first to the second quarter of 1991 with the performance of the US domestic industry, as based on a comparison of six industry indicators for the first half of 1991 with those of the first half of 1990.[112] On this basis, the increase in the Canadian market share had been used by the United States as evidence that Canadian imports had caused the injury to the domestic industry in the United States. If the Department of Commerce had been consistent in its method, it would have compared Canadian market share for the first half of 1990 with Canadian market share for the first half of 1991. This showed that Canadian market share was static at 26.7 per cent, based on semi-annual data in the column entitled "Canadian import penetration rate" in Table E-2 of the Initiation Memorandum. By using different time periods, the Department of Commerce had selectively used its data to give the impression that Canadian market share was rising at the time that the alleged injury was occurring, and had avoided having to address how injury could be caused during the same time that the market share of Canadian imports had remained the same. In fact, the Department of Commerce had used seven different time periods in considering injury and causality in order to construct its case. Alternatively, had the Department examined the changes in its industry indicators in the same period when the Canadian market share had risen (i.e. comparing the data for the first quarter of 1991 with that of the second quarter of 1991) there would have been no evidence of injury at all. Apparent in the data in Tables E-1-4 in the Initiation Memorandum but not addressed in the text of this document was that, between the first and the second quarter of 1991, there had been a reversal in the very indexes of injury identified by the United States for the period 1988 to 1990. Thus, during this period there had been increases in domestic production (10.3 per cent), domestic shipments (18.2 per cent), exports (9.1 per cent), consumption (20.6 per cent), domestic softwood lumber prices (11.2 per cent), capacity

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[111] Table E-4 of the Initiation Memorandum.

[112] Initiation Memorandum, pp.31-32.

utilization (6.9 percent), production employment in sawmills and planing mills (1.3 per cent), and total employment in sawmills and planing mills (1.4 per cent).

221. The **United States** argued that Canadian softwood lumber imports had commanded a significant share of the United States market and that, at the time of initiation, that market share had been increasing. From 1988 through 1990, Canadian softwood lumber imports had accounted, on average, for 27.8 per cent of domestic consumption in the United States. More importantly, the Department of Commerce had found that the Canadian import penetration rate had risen from 26.2 per cent in the first quarter of 1991 to 27.1 per cent in the second quarter. Recent information gathered by the Department indicated that import penetration had continued to increase in July and August 1991, climbing to 28.6 per cent of the United States market.[113] This import penetration rate of 28.6 was the highest since 1987 (with the exception of the third quarter of 1989, which had been only 0.1 per cent higher, at 28.7 per cent). This information alone constituted sufficient evidence with respect to the volume of imports and contradicted Canada's argument that there had been no evidence of increased Canadian imports.

222. The **United States** contested that, as contended by Canada, during the period 1988-1990 imports of softwood lumber from Canada had been decreasing. Canada's market share had fluctuated during this period and had showed increases in six of the twelve quarters in this three-year period. Therefore, Canada's assertion that its imports were declining and could not have injured the domestic industry in the United States rested on a flawed premise.

223. With respect to the argument of Canada that the increase in the market share of Canadian softwood lumber in 1991 was a fluctuation not outside the normal fluctuation inherent in the softwood lumber trade, the **United States** observed that the Department of Commerce had specifically rejected this explanation. Import penetration data for the third quarter of 1991 had shown a marked increase over the corresponding period in 1990. The rise in the third quarter of 1991 over the third quarter of 1990 import penetration comparisons undercut the argument that the increase in 1991 had been a seasonal fluctuation. Second, the increase in 1991 had occurred even while the MOU had been in effect, suggesting the likelihood of even greater future increases following the termination of the MOU. Third, Canada considered the data on import penetration in a vacuum, without regard to the price-sensitive nature of the product. The increase in the import penetration rate had to be considered in light of the nature of the industry in order to determine its significance. The price of Canadian imports had declined from 1989 to 1990, forcing down prices of the domestic product. The increase in import penetration would likely cause further

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[113] Initiation Memorandum, p.33, Table E-2.

declines in the price of the Canadian and, consequently, the domestic product and was therefore significant. Finally, Canada's argument also ignored the directive in Article 6:2 of the Agreement that, with regard to the volume and price effects of imports, "[n]o one or several of these factors can necessarily give decisive guidance." Canada assumed, in the context of a decision to initiate an investigation, that the increased import penetration was not significant, and next assumed that this conclusion was dispositive of the entire decision to initiate the investigation. The express words of the Agreement, which explicitly directed that no one factor could give decisive guidance, undercut Canada's argument.

224. **Canada** considered that the United States had presented no evidence to show that at the time of self-initiation of the countervailing duty investigation, the Department of Commerce had considered and "specifically rejected" seasonal fluctuations as an explanation of increased imports from Canada. With respect to the statement of the United States that third quarter import penetration data for 1991 showed a marked increase over the corresponding period in 1990, **Canada** argued that the United States had not presented any evidence that it had data at the time of self-initiation for other than July and August for the third quarter of 1991. A comparison of a two-month period with a three-month period was statistically unsupportable.

225. The **United States** argued that the evidence presented, considered and relied upon the self-initiation of the investigation indicated that the United States had recognized that seasonal fluctuations might be a consideration in an injury analysis of any industry. The data evaluated by the Department of Commerce for the self-initiation spoke for themselves: second quarter data for the years 1989, 1990 and 1991 showed more robust economic activity, reflecting peak demand for lumber products in the spring. For example, domestic and import prices, capacity utilization, and Canadian imports had tended to experience the highest percentage increase in the second quarter.[114] To account for this apparent seasonal fluctuation, the Department of Commerce had relied upon yearly averages. Any seasonal fluctuations would average out over the course of a year. Regardless of the within-year fluctuations, the economic factors examined in the Initiation Memorandum (e.g., production, shipments, apparent consumption, capacity utilization, costs, prices and the like) showed an average annual downward trend from 1988 to 1990, and many of these trends had continued in the first half of 1991. Seasonal fluctuations could not account for these declining annual trends. Moreover, the cause of an increase in imports was not a factor which was required to be considered under the Agreement in determining whether imports were a cause of injury in making either preliminary or final injury determinations, not to mention at the time of initiation. There was consequently no reason why the

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[114] Initiation Memorandum, Tables E-2, E-3 and E-4.

Department of Commerce should have "considered and specifically rejected" any particular reason underlying increased imports in self-initiating.

226. **Canada** considered that the argument of the United States that the Department of Commerce had recognized seasonality and that this factor had been accounted for by the use of annual averages was an argument made ex post facto. In response to the argument of the United States that the Agreement did not require that the cause of increased imports be considered, **Canada** argued that the Agreement required investigating authorities to demonstrate a causal link between injury and the subsidized imports. The imports which were alleged to be subsidized in this case were also alleged to have increased. Merely because a particular factor, such as seasonality, might be both the cause of increased imports as well as a factor relevant to the question of injury was no excuse for the United States to ignore it. This factor should have been taken into consideration because it was directly relevant to the question of injury.

227. In response to the argument of the United States regarding the price-sensitivity of the product under consideration, **Canada** explained that it was not disputing the contention regarding the price elasticity of demand for softwood lumber in North America, but its relevance to the injury issue. The nature of the demand for softwood lumber did not deny the fact that the United States had not established any evidence that imports from Canada were causing injury to the domestic industry in the United States. Given that the data in the Initiation Memorandum showed that during the period in question imports from Canada had actually declined, there was no basis to argue that the increase in import penetration had forced prices in the United States down.

228. With respect to the reference made by the United States to the provision in Article 6:2 of the Agreement that no one or several of the factors in that paragraph could necessarily give decisive guidance, **Canada** considered that it had demonstrated the insufficiency of all of the evidence of injury relied upon by the United States in initiating this investigation. In the absence of increased imports, investigating authorities must still show that there was injury due to price suppression, price depression or price undercutting.

229. **Canada** also argued that the Department of Commerce had ignored available evidence showing that the market share of domestic producers of softwood lumber had risen during the period examined by the Department of Commerce. There was no evidence in the Initiation Memorandum that the Department of Commerce had analysed the share of the US market held by domestic producers during the period 1988-1990, in spite of having the requisite data in Table E-2. This Table presented annual and quarterly data on the market share held by imports from all sources. Subtracting this figure from 100 per cent would give the market share held by domestic suppliers. Using data derived in this manner, it was clear that US market share had fallen from 71.4 per cent in 1981 to a low 67 per cent in 1985,

and had risen continuously to 73 per cent in 1990.[115] By not examining domestic market share (and finding that it had increased) the Department of Commerce had avoided having to explain how injury could occur while the domestic suppliers were increasing their market share. Any consideration of market share in the United States had to take into account the strong inverse link between shares held by United States and Canadian suppliers. As Canada supplied almost all the imports to the United States, any change in Canadian share would have an opposite effect on the share held by US suppliers.

230. The **United States** argued that the Department of Commerce had not ignored the data on market shares of domestic producers. In referring to the second quarter of 1991, the Department was relying on the most recent observable trends: US producers had experienced a decline, while Canadian producers had experienced an increase in market share during the second quarter of 1991. A relevant comparison was the first quarter of 1991 with the first quarter of 1990 (a slight decrease in Canadian import penetration) and the second quarter of 1991 with the second quarter of 1990 (a slight increase in Canadian import penetration). By contrast, a comparison of the first two quarters of 1989 and 1990 showed a very significant decrease in Canadian import penetration in 1990. The Department of Commerce had considered this change in direction against a backdrop, evident in Table E-2 of the Initiation Memorandum of Canadian import penetration hovering between 30 and 32 per cent before the signing of the MOU, and an import penetration level between 26 and 28 per cent in the years leading up to the termination of the MOU by Canada.

231. **Canada** considered that the United States continued to ignore market share trends since 1985. Nothing in the annual market share data as found in the Tables in the Initiation Memorandum used as evidence of increasing market penetration was inconsistent with overall trends or variations within the data for the past few years. The reference to the MOU made no sense because Canadian market share had started to decline a full year before the MOU and had continued during the period covered by the data used for the self-initiation.

232. The **United States** argued that data presented in Table E-2 of the Initiation Memorandum demonstrated that the market share of Canadian imports in the United States had peaked during calendar year 1985 and had begun to decline during calendar year 1986. There were two principal reasons for this declining market share. First, there had been a major strike by lumber workers in British Columbia during July-August of 1986 which had sharply cut into production and exports. Second, the USITC had issued a preliminary affirmative determination of injury in July, and the

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[115]Canada provided to the Panel a figure showing annual market shares of Canadian and United States domestic producers in the US softwood lumber market for the period 1981-1990.

bonding requirement pursuant to the affirmative preliminary determination made by the Department of Commerce in its investigation of imports of softwood lumber from Canada had gone into effect in October 1986. It had therefore been appropriate for the Department to analyse the evolution of the volume of imports from Canada against the backdrop of the MOU for purposes of its initiation decision.

233. **Canada** noted that the United States had admitted that the market share of Canadian imports into the United States had fallen continuously from 1985 to 1987. The United States had attributed the decline in 1986 and 1987 to the bonding requirement pursuant to the preliminary determination made by the Department of Commerce in October 1986. This decline and the reasons for it were ex post facto arguments, not found in the Initiation Memorandum. As well, the United States had provided no evidence that the MOU had had this effect.

(ii) Price effects of the imports

234. **Canada** noted that the Department of Commerce had claimed that imports of certain softwood lumber products from Canada had "... suppressed domestic prices to a point significantly below the level they would have been had it not been in the subsidized imports."[116] However, the Department had failed to present any evidence of what the domestic price level would have been in the absence of the allegedly subsidized imports or whether any supposed difference in prices was "significant".

235. In response to Canada's argument that the Department of Commerce had presented no evidence of what the domestic price level would have been in the absence of subsidized imports or whether any supposed difference in prices was significant, the **United States** argued that the Agreement did not require a consideration of what the domestic price level would have been in the absence of the imports under investigation. The price data relied upon by the Department of Commerce were sufficient evidence of the adverse price import attributable to the imports.

236. **Canada** noted that in support of its contention that domestic prices were being suppressed by imports from Canada, the Department of Commerce had in its Initiation Memorandum pointed to the following factors: (i) domestic softwood lumber prices had increased more slowly than the all-commodity producer price index; (ii) the price performance occurred during historically high levels of domestic softwood lumber consumption; (iii) the import price index for softwood lumber had been static while the producer price index for softwood lumber had risen slowly; (iv) the average annual f.o.b. price for composite framing lumber had been higher than the unit values for Canadian softwood lumber exports; and (v) the f.o.b. mill price of Douglas fir 2x4's in Vancouver (British Columbia) had

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[116] Initiation Memorandum, pp.33-34.

been lower than the f.o.b. mill prices in Portland (Oregan) for the same product. **Canada** argued that this evidence of alleged price suppression was insufficient for purposes of Article 2:1 of the Agreement for the following reasons.

237. First, **Canada** considered that there was no reason to expect that the domestic softwood lumber price index should be equal to the all-commodity producer price index, which was after all an average of a number of commodity indices. The United States had ignored that a more relevant explanation of low price increases for domestic softwood lumber was that the reduction in the number of US housing starts had resulted in the general drop in economic indicators in the industry. The fact that the price performance had occurred during historically high levels of domestic softwood lumber consumption[117] was immaterial. The key point was that the demand for softwood lumber had declined during the period under investigation, which the Department of Commerce had failed to consider.

238. **Canada** also argued that it would be expected from the proposition of the United States that the increase in market share of Canadian imports from the first to the second quarter of 1991 would be linked with increased price suppression and that the domestic softwood producer price index would fall faster than the all-commodity producer price index. In reality, however, the domestic softwood price index had increased by 13.1 index points between the first and second quarters of 1991.[118] This increase was greater than the fall of 1.2 index points in the all-commodity producer price index[119] during the same period. Thus, by the logic of the United States, there would be no evidence of price suppression for that period. The largest quarterly increase in the domestic softwood lumber producer price index since 1988 had occurred during this period. In general, the department of Commerce had failed to explain how imports could suppress domestic prices during the period 1988-1990, while losing market share. Nor had the United States explained how price suppression during the first half of 1991 could be present in the face of the reversal of all the indexes used as evidence of injury during 1988-1990.

239. The **United States** argued that the Department of Commerce had recognized that the reduction in US housing starts might have contributed to the low price increases for domestic softwood lumber. Nonetheless, this factor was just one of the many factors which could have an effect upon price increases. For example, at the same time that housing starts had been declining, demand for repairs and remodelling had risen. Despite these offsetting trends, US domestic consumption had declined slightly during the period analysed by the Department of Commerce (1988 to 1990). Canada, however, had ignored the final observation made by the Department

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[117] Initiation Memorandum, p.34.

[118] Initiation Memorandum, Table E-4.

[119] Initiation Memorandum, Exhibit E-2.

of Commerce in the relevant paragraph of the Initiation Memorandum: prices of imported softwood lumber (already substantially lower than US price levels) had remained unchanged during this same period, while domestic prices had risen only minimally.[120] Therefore, regardless of such factors as the reduction in US housing starts or the rise in demand for repairs and remodelling (factors which would affect both imported and domestic prices equally) the price of imported lumber had remained constant while the price of domestic lumber had risen slightly. If, at a minimum, the price of imports had kept pace with domestic prices and, as a result, had risen with US prices, the overall increase in the price of lumber in the United States would have been higher. That the import price did not keep pace with the slight rise in domestic prices had provided "sufficient evidence" suggesting that imports of Canadian lumber contributed to price suppression in the United States market.

240. **Canada** considered that the United States tried to downplay the overall decrease in lumber consumption by alluding to an increase in repair and remodelling. In fact, between 1988 and 1990, overall consumption of lumber had fallen by 3.5 billion board feet or 7 per cent even taking into account repair and remodelling. The argument of the United States that Canadian prices were not increasing as fast as domestic prices was irrelevant. As well, the USITC was required by statute to consider the business cycle in its assessment of injury. It was difficult to understand why the Department of Commerce was not required to make a similar consideration at the time of self-initiation.

241. Second, **Canada** argued that the difference between the import price index for softwood lumber and the producer price index for softwood lumber[121] did not indicate the existence of price suppression. The composition of imports of softwood lumber products in terms of species, grades, sizes and prices was different than the composition of the US domestic production. Therefore, one would expect to find differences between an import price index and a domestic price index for softwood lumber products. Furthermore, there was no substance to the claim of the United States that a slight rise in the Canadian market share in the second quarter of 1991 had been the result of price undercutting. US data for that quarter showed that the domestic softwood lumber price index had risen faster than at any time since 1988, and the import softwood price index had risen faster than the domestic softwood price index.[122] **Canada** also argued that the Department of Commerce had made an invalid comparison between indexes of prices of imported and domestic lumber which were based in different years.

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[120] Initiation Memorandum, p.34 and Table E-4.

[121] Initiation Memorandum, p.34.

[122] Initiation Memorandum, Table E-4.

242. The **United States** argued that two previous findings of the USITC in proceedings involving softwood lumber from Canada squarely contradicted the argument that the composition of imported lumber was different from the composition of domestic lumber and that this different composition explained the different movements in the two price indices. As stated in the Initiation Memorandum, the USITC had found that Canadian imports of softwood lumber were generally interchangeable and fungible with US-produced softwood lumber and that this substitutability was not dependent on the products being fabricated from the same species of tree.[123]

243. The **United States** argued that Canada's argument on the rise of domestic and import prices in the second quarter of 1991 was based on the erroneous assumption that price suppression could not occur if prices were increasing. However, price suppression could include instances in which prices were increasing but not as much as they would in the absence of subsidized imports. Thus, the fact that the US softwood lumber price and the Canadian imported softwood lumber price had increased more rapidly in the second quarter of 1991 than in any other quarter since 1988 did not contradict that there had been evidence of price suppression. Even in the second quarter of 1991, despite the sharp price increases, the price of imported Canadian lumber had been 8.5 per cent lower than the domestic price[124] Table E-6 in the Initiation Memorandum showed that for Douglas Fir green 2x4s the British Columbia price had been consistently lower than the Portland price between 1987 and the first half of 1991. In fact, out of the 54 months examined during that period, the British Columbia price had been higher than the domestic price in only eight months, and had never been higher by more than 4.2 per cent. In the remaining 46 months, the British Columbia price had been considerably lower, by as much as 21 per cent. This was not to say that movements in both the British Columbia and Portland prices, as well as domestic prices and import prices in general, did not follow the same pattern. In fact, they did. Both domestic and import prices responded to the same conditions prevalent in the United States market and therefore moved in the same direction. Price movements over time in and of themselves did not provide any indication of price suppression; for this reason, the Department of Commerce had never made such an assertion in this proceeding. Rather, it was the differential between import prices and domestic prices over time, and the fact that import prices had been consistently lower than domestic prices, which constituted evidence of both price undercutting and price suppression. It was this pattern that the Department of Commerce had relied upon in its self-initiation. Furthermore, increases in price indices in and of themselves did not demonstrate that price suppression was not occurring in an import market. Price suppression simply meant that the domestic price

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[123] Initiation Memorandum, p.33.

[124] Initiation Memorandum, Table E-4.

was lower than what it otherwise would have been in the absence of the lower-priced, subsidized imports. Price suppression could occur even if price indices were rising and the evidence on the record provided a reasonable basis for investigation.

244. **Canada** noted that it did not contest the theoretical point that price suppression could occur while prices were rising. However, the United States had relied on differences between imported and domestic lumber prices based on a comparison of the index of imported lumber prices and the index of US domestic lumber prices based in different years (import price index, 1985=100, and domestic price index, 1982=100) which made the comparison meaningless. The reference to Douglas Fir prices between Portland and Vancouver was meaningless; the British Columbia price was not an import price because it did not include transportation costs.

245. The **United States** considered that the comparison made by the Department of Commerce of price indices with different base years in Table E-4 of the Initiation Memorandum constituted nothing more than, at worst, harmless error. Accordingly, this error did not undermine in any manner the Department's finding of price suppression for initiation purposes. Using 1987 as the base year for purposes of recalculating the domestic and import price indices (the first year in which the MOU had been in effect) yielded results which were entirely consistent with the Department's findings regarding price suppression[125]: US softwood lumber prices had risen only 3.2 per cent during 1989 and 1990 and prices for imported softwood lumber were unchanged over the same period.[126] Moreover, the data also demonstrated that the revised domestic price index tumbled downwards from 109.47 in 1989 to 106.63 in 1990 partly as a result of the lower-priced Canadian imports. By the second quarter of 1991, the price undercutting and suppression effects of Canadian softwood lumber imports had become clear: Canadian imports were underselling US softwood lumber by a percentage rate of 5.64 per cent during that period.

246. **Canada** noted that the United States had admitted that it had made a second error in its analysis of the price index system. The United States had created new price index information which had not been part of the Initiation Memorandum and had introduced this new information to support its self-initiation ex post facto. **Canada** reiterated that there was no a priori reason for two such broadly based indexes to be equal or even move in the same direction.

247. Third, **Canada** considered that the comparison of average annual f.o.b. prices for composite framing lumber with unit values for Canadian softwood

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[125]The United States provided the Panel with a table showing the results of this recalculation.

[126] Initiation Memorandum, p.34.

lumber exports[127] was insufficient in that the Department of Commerce had compared a single f.o.b. price series in the United States with a concocted figure for Canada derived from data developed for purposes of administering the export charge under the MOU. In fact, the United States had not compared prices with prices. Furthermore, if the Canadian figures had indeed been f.o.b. prices, comparing these with US f.o.b. prices would not have given evidence of price suppression in the market. Only a comparison of prices in the market could be used to consider the possibility of price suppression.

248. The **United States** argued that the "single" f.o.b. price series in the United States referred to by Canada was a composite index for framing lumber. Canada itself had pointed out that framing lumber constituted Canada's major export. Furthermore, the so-called "concocted figure" for Canada's prices was, in fact, derived from Canada's own data - Canadian export notice submitted to the United States Customs Service in accordance with the terms and conditions of the MOU. Canada had repeatedly stood by the accuracy of the information in those export notices during the administration of the MOU. Finally, the export notices contained the f.o.b. price of the lumber as sold in the United States. Therefore, the prices in these notices were, in fact, US prices, and a comparison with domestic US prices was altogether reasonable. An f.o.b. advantage, as the USITC had previously found, could permit a subsidized exporter to undercut US prices or to absorb shipping costs into markets which, in the absence of subsidies, would be inaccessible.

249. **Canada** noted that on page 35 of the Initiation Memorandum the Department of Commerce had compared a Random Lengths composite framing lumber price series with what it called average Canadian f.o.b. export prices to the United States and had concluded that the fact that the so-called Canadian prices were lower after adjustment for exchange rates was evidence of price suppression. **Canada** contested the appropriateness of this comparison on two grounds. First, the so-called Canadian prices were actually average value estimates derived from data collected by Revenue Canada for purposes of export charge collection under the MOU. Revenue Canada had provided estimates by month of the volume of lumber exported to the United States and the value for export charge payment purposes. For the purposes of self-initiation, the United States had divided total value by total volume to develop the average value per unit of exports and reported it as an f.o.b. mill price equivalent. Revenue Canada had not reconciled the volume and value data. The two sets of data had been presented as reported by companies. Where the audits showed error in either volume or value, no retrospective adjustments had been made to the data which had been previously reported. The adjusted numbers had been simply added to the next report, further confusing any comparison of volume and value. Errors in coding and transcribing data had been reported in

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[127] Initiation Memorandum, p.35.

subsequent months, when found. But no reconciliation between the volume and value data had ever been undertaken, as this was not the purpose for which the data were reported. In summary, the two sets of data had never been designed to be used to estimate average values. The Department of Commerce had been well aware of the limitations of these data through their dealings with Canada regarding the MOU and the export charge collection system. Second, the data used by the Department of Commerce did not reflect the US market value of softwood lumber products. The value for export charge purposes related to production costs and not to final sales prices. Therefore, these data could not be used as a legitimate basis for comparison with Random Lengths price data.

250. The **United States** reiterated that the price comparisons made on page 35 of the Initiation Memorandum were valid and accurate. This conclusion followed from the incontestable fact that these price comparisons were based in large measure upon official data compiled by the Government of Canada. In particular, Table E-5 of the Initiation Memorandum unambiguously demonstrated that the Department of Commerce had relied on export charge collection data (i.e. monthly volume and value data compiled by Canada) submitted directly by the Government of Canada to the Department of Commerce in accordance with the terms and conditions of the MOU. To arrive at the average US price of Canadian exports of softwood lumber to the United States, the Department of Commerce had divided the value of the exports by the volume of such products. Furthermore, the disputed export notices submitted to Revenue Canada, Customs and Excise Division ("Revenue Canada"), in accordance with the terms and conditions of the MOU contained f.o.b. mill prices. The relevant provisions of the MOU compelled this conclusion. Article 4(c) of the MOU had provided that "An 'Exporter Notice' will be required for each shipment and will identify inter alia the exporter's license number ... and the sales price of the product exported." The **United States** provided the Panel with a copy of an actual export notice submitted by the Government of Canada to the United States under the MOU. This notice expressly required, inter alia that the Canadian manufacturer in question provide the "unit f.o.b. mill price" and the "total f.o.b. mill price" to the appropriate customs authorities. For Canada now to call prices derived from such notices "concocted" was disingenuous. In fact, such an assertion amounted to a tacit admission of a violation of the express terms of the MOU. Therefore, the Canadian prices relied upon by the Department of Commerce for injury purposes were, by Canada's own admission, based upon actual Canadian price data. It followed that the price comparisons made by the Department of Commerce in its Initiation Memorandum were altogether reasonable and, accordingly, satisfied the "sufficient evidence" standard arising under the Agreement.

251. **Canada** reiterated that the export notices referred to by the United States did not provide the basis for a price series for Canadian lumber. The export notices contained f.o.b. price data at the insistence of the United States. F.o.b. prices had not been used by Revenue Canada for reporting purposes. Rather, each month, the tax payer filed a return to Revenue Canada showing volumes of exports, value subject to charges, tax

due, etc. The export notice did not comprise part of this system. The United States had not used the export notices for its calculations in the Initiation Memorandum. Rather, it had used data developed by Revenue Canada based upon the tax collection system and transmitted to the United States by the Department of External Affairs.

252. Fourth, **Canada** argued that the alleged difference between the f.o.b. mill price of Douglas fir 2x4's in Vancouver and f.o.b. mill prices in Portland for the same wood[128] was the result of a comparison of a f.o.b. mill price in Portland to an arbitrarily constructed f.o.b. price for the same Canadian product, allegedly f.o.b. Vancouver. However, the actual Canadian price was a delivered price to the US northeast, adjusted for costs of transportation. No evidence had been provided that the adjustment made for transportation costs was relevant to transporting lumber originating in British Columbia to the northeast market. The Department of Commerce had also used this comparison on a product accounting for, at most, 3.1 per cent of annual Canadian softwood lumber exports to the United States and had described this as evidence for the purpose of establishing that Canadian softwood lumber imports caused price suppression in the United States market. The Department had ignored more relevant price comparisons, such as a comparison of published prices of Canadian SPF (a major component of Canadian exports) with published prices of US southern yellow pines, both in the same south-east US market.

253. The Panel asked Canada to explain its statement that "the actual Canadian price was a delivered price to the US northeast ..." In response, **Canada** noted that the Department of Commerce had used Random Lengths price series which estimated the f.o.b. British Columbia price using a delivered price to the United States Northeast and had reduced the published data by $82 to adjust for transportation costs.[129] The adjustment factor had been estimated and had not reflected actual costs of transportation. Thus, it was unclear just what "prices" had been compared. The Department of Commerce had assumed that transportation costs had remained unchanged for over two years.

254. The **United States** argued that with respect to the price of Douglas Fir 2x4s, it was not accurate that the Department of Commerce had compared a f.o.b. mill price in Portland with an "arbitrarily constructed" f.o.b. price for the same Canadian product. Rather, the data evaluated in Table E-6 of the Initiation Memorandum were based on data from Random Lengths Yearbook. In March 1989, prices for the Douglas Fir 2x4s from mills in British Columbia had begun to be reported "delivered Northeast United States", instead of "net f.o.b. mill" as they had been previously reported. For one of the early months when both prices had been available, the Department of Commerce had simply taken the difference between the two

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[128] Initiation Memorandum, p.35.

[129] Initiation Memorandum, Table E-6.

prices ($82.00) and had subtracted that amount from all future monthly prices which had been reported "delivered Northeast United States". Current information from Random Lengths demonstrated that current freight charges to Northeast United States from British Columbia were approximately $100.00 per thousand board feet. Subtracting this amount would result in an even greater differential between domestic and imported prices. Because the Department of Commerce had not been aware of any c.i.f. prices of domestic lumber at the time of initiation, the Department had reasonably made an adjustment to the Canadian c.i.f. prices after March 1989 to achieve a fair and symmetrical comparison. Further, assuming that by c.i.f. prices Canada meant delivered prices, there was no public source of delivered prices for US mills. The trade publication Random Lengths published "delivered prices" without differentiating the source; these prices were a guide to prices for the specified dimensions of lumber from all sources in a given market. Therefore, these data did not provide a basis for comparisons of US and Canadian prices. In addition, where Random Lengths published f.o.b. prices for Canadian lumber, it was acknowledged that those prices were derived by Canadian mills from their quoted delivered prices, minus published freight rates. It was also acknowledged that published freight rates did not represent actual payments for transportation to the market. Thus, Canadian "f.o.b." prices were not accurate for purposes of comparison to US f.o.b. prices. Price analysis had turned out to be one of the most difficult issues in the investigation currently conducted by the USITC, as these various quirks had become evident.

255. In response to a question by the Panel as to why the suggested alternative price comparisons would have been more relevant, **Canada** argued that a comparison between US southern yellow pine (SYP) and Canadian spruce pine fir (SPF) would have been more relevant because these two species competed in the same markets and could be used in the same applications. Furthermore, price data for the Southeast United States was available from Random Lengths f.o.b. Atlanta for SYP and for delivered costs for SPF. This region accounted for approximately 20 per cent of total United States consumption by volume. Canadian imports accounted for approximately 30 per cent of the supply used in the consumption in this region. Thus, a comparison of SPF and SYP in this region was a better comparison of their prices and would provide a better indication of the competitiveness of the two industries. **Canada** provided to the Panel a figure representing a comparison of the price series of these two species in Atlanta, Georgia, during the period 1987-1991.[130]

256. The **United States** considered as unfounded Canada's argument that the Department of Commerce should have compared f.o.b. mill prices of Canadian SPF to US prices of southern yellow pine. First, f.o.b. mill price

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[130]The source of these data was the National Forest Products Association and Random Lengths.

comparisons were relevant for the same or similar products originating from the same or similar markets. Southern yellow pine production was generally more than a thousand miles from SPF production. Second, a relevant comparison, US Engelmann Spruce - Lodgepole Pine (which would be called SPF if processed in Canada) cut in the Inland West of the United States was consistently undersold by SPF cut in the Interior of British Columbia. That is, this comparison comported precisely with the Douglas Fir comparison relied upon in part for initiation.

257. **Canada** reiterated that f.o.b. prices told one little about the market behaviour of a product. What mattered was where the lumber was sold and what it was used for. The United States ignored the fact that the relevant factor was not species but end use. In fact, the major competition between Canadian and US lumber was in the area of construction grade where SYP and SPF were the major competing species.

258. In response to a question by the Panel on whether at the time of the initiation of the investigation the Department of Commerce had before it data enabling it to make the price comparisons suggested by Canada, the **United States** explained that the Department of Commerce had chosen to compare the US and Canadian green Douglas Firs 2x4's was that this product was the only one made from the same species for which the Department had been able to find a clear and precise segregation of Canadian and US prices according to the Random Lengths Yearbook. All other product categories, including SPF (itself a mixture of various species of spruce pine and fir) and southern yellow pine (a species not grown in Canada), either contained a mix of US and Canadian products or contained no Canadian counterparts.

259. The **United States** noted that certain species-specific data examined by the Department of Commerce at the initiation stage demonstrated that the net f.o.b. mill price for the green Douglas Fir sold in Vancouver were, on average, six per cent lower than the net f.o.b. mill prices for the same species sold in Portland, Oregon during the relevant period.[131] Furthermore, based upon Random Lengths Yardstick, the species-specific price data for the Douglas Fir comported with aggregate price comparisons for other species.[132]

260. **Canada** argued that there was nowhere in the Initiation Memorandum any reference to comparisons between other species of softwood lumber. The Department of Commerce had made reference to "a composite framing lumber price". This composite covered all species sold as framing lumber, including SPF from Canada and SYP, and thus could not be taken to represent a price comparison for other species.

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[131] Initiation Memorandum, p.35.

[132] Initiation Memorandum, p.35.

(iii) Impact of the imports on domestic producers

261. **Canada** noted that, in discussing the rôle of imports of softwood lumber from Canada, the Department of Commerce had also referred to evidence of the existence of "lost revenue and sales due to Canadian imports":

> "There is also specific evidence of lost revenue and sales due to Canadian imports. It should be noted that such data are difficult to clearly identify because of the commodity nature of the product and the means of distribution. However, we were able to obtain limited data on lost sales and revenue which were clearly identified as resulting from Canadian imports. One indication of these data was price depression resulting from Canadian imports of 4.6 per cent over a three-year period (June 1988 through June 1991). See Exhibit E-3.[133]

Thus, the Department had admitted that this effect was difficult to identify and that it had only limited data. In fact, the referenced table (Exhibit E-3) gave no data on the existence of price depression. On page 31 of the Initiation Memorandum the Department had claimed that net income, as a percentage of sales, had declined steadily over the past three years, falling from 7.2 to 5.1, and finally to 0.9 per cent, respectively, but had not provided any evidence that this decline was due to imports from Canada. Moreover, these financial data accounted only for approximately 10 per cent of the domestic industry.[134] The United States had thus not provided sufficient evidence to support its claim that the allegedly subsidized imports from Canada had led to lost revenues and sales of domestic producers.

262. The **United States** argued that the Department of Commerce had relied on specific instances of sales which the domestic industry had lost to Canadian imports. The Department was thus presented with evidence which provided a sufficient basis for concluding that lost sales had occurred, and that a further investigation was warranted. The Agreement required no particular quantum of evidence of lost sales necessary to support a final determination of injury and, a fortiori, the Agreement did not require a particular quantum of evidence on this issue at the initiation stage. The fact that the Department of Commerce had observed that specific lost sales information was difficult to identify was no reason to conclude that the evidence was insufficient to initiate an investigation. To the contrary: the fact that the Department had been able to identify specific instances of lost sales prior to initiation should be weighed in light of the difficulty of obtaining that information. If the Department of Commerce was able to obtain such difficult information prior to initiation, it

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[133] Initiation Memorandum, pp.35-36.

[134] Initiation Memorandum, p.31.

certainly provided a sufficient basis to expect that more such information would be obtained in a full-fledged investigation.

263. **Canada** also contested the argument of the Department of Commerce that the price suppression caused by Canadian imports had injured the US domestic industry by decreasing net income[135] for the following reasons. The United States had claimed that for a small group of US domestic producers of softwood lumber annual net income, as a percentage of sales had declined from 7.2 to 0.9 per cent between 1988 and 1990.[136] This decline in net income had been attributed to a 4.6 per cent decline in the softwood lumber import price index. However, the number of companies surveyed was very small accounting for only about 10 per cent of the domestic industry. There was no reference to the source of the figures on declining net income (other than the "Coalition for Fair Lumber Imports") or whether they were representative of the industry. Thus, the Department had failed to establish a linkage between Canadian imports and changes in net income to US domestic producers. A decline in the import price index (a composite number) in itself was no evidence of price undercutting, nor that imports had caused net income declines in the industry. The United States had misrepresented its data and had used the third quarter of 1988 (index = 109.6) and the first quarter of 1991 (index = 105.0) to show the decline in import price index. This covered the period July 1988 to April 1991 (not to June 1991 as claimed) and purposefully left out the large increase in the import price index in the second quarter of 1991 (118.6). Had the stated time period been used, the import price index would have shown an increase of 8.2 per cent in that period.

264. The **United States** argued that as admitted by Canadian witnesses in the current proceedings before the USITC, the increase in the import price index in the second quarter of 1991 had been anomalous. Moreover, all of the price comparisons used by the Department of Commerce had shown similar results.

265. The Panel asked Canada to explain the factual basis of its argument that the Department of Commerce had misrepresented the data regarding the evolution of the import price index. In response, **Canada** pointed to the following statement in the Initiation Memorandum:

> "One indication of these data was price depression resulting from Canadian imports of 4.6 per cent over a three year period (June 1988 through June 1991)." See Exhibit E-3."[137]

The United States had misrepresented the period of analysis by claiming that it had used third quarter 1988 to second quarter 1991 when in fact it

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[135] Initiation Memorandum, pp.35-36.

[136] Initiation Memorandum, p.36, and Exhibit E-3.

[137] Initiation Memorandum, p.36.

had used third quarter 1988 to first quarter 1991. On the basis of actual data used, the United States had found a price decline of 4.6 per cent, where if the period claimed had been used, a price increase of 7.4 per cent would have been found.[138]

266. **The United States** noted that the parenthetical on page 36 of the Initiation Memorandum contained incorrect dates. The period of price depression to which the Department of Commerce had intended to refer had occurred between 1988 and the beginning of 1991. In the second quarter of 1991, prices had risen considerably. Regardless of the increase in the import price, the import price had still been 8.5 per cent lower than the domestic price in the second quarter of 1991.

267. **Canada** observed that the United States failed to note that the price trend for imports was up between the first and second quarters of 1991. Furthermore, the price indexes for domestic and imported softwood lumber were based in different years.

(iv) Injury caused by the imports from Canada, "through the effects of the subsidy"

268. **Canada** argued that Article 6:4 of the Agreement required that there be sufficient evidence that subsidized imports were causing injury "through the effects of the subsidy". In the Initiation Memorandum the Department of Commerce had stated that "Our analysis indicates that subsidies continue to be provided and that these subsidies are causing, or threatening, material injury to the U.S. lumber industry."[139] The Department had, however, not provided any evidence of how the alleged subsidy enabled the "subsidized" imports to cause injury to the domestic industry. The United States had not provided an explanation of how alleged subsidies on stumpage fees would result in injury to its domestic industry. In fact, it was a fundamental principle of economics that the level of fees charged for the right of access to a natural resource (like timber) could not cause any countervailable market distortion.

269. See supra, paragraphs ... for the views of the United States on the question of economic rent.

(v) Other factors allegedly injuring the domestic industry

270. **Canada** argued that Article 6:4 of the Agreement required that there be sufficient evidence that injuries caused by factors other than the allegedly subsidized imports not be attributed to the subsidized imports.

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[138] Canada provided to the Panel a table and a figure showing the quarterly price index for imported softwood lumber for the period 1988-second quarter of 1991.

[139] Initiation Memorandum, p.2.

In its Initiation Memorandum the Department of Commerce had described the evidence of injury to the domestic industry as including evidence of declining exports, rising costs and declining apparent consumption between 1988 and 1991. The Department had failed to demonstrate how declining exports, rising costs and declining apparent consumption could be the result of "subsidized imports" and had thereby attributed injury caused by other factors to the allegedly subsidized imports from Canada. This was particularly true for injury to the domestic industry between 1988 and 1990, when the evidence before the Department showed that imports of softwood lumber from Canada had been declining in volume and market share. The United States had not considered any causes other than imports which could have resulted in injury to the domestic industry.

271. The **United States** argued that Canada mis-stated the requirements of Article 2:1 of the Agreement. Article 2:1 required that the investigating authorities have sufficient evidence of "a causal link between the subsidized imports and the alleged injury". The Department of Commerce had had more than ample evidence that the subject Canadian imports were causing material injury to the domestic industry. The information before the Department was sufficient to demonstrate a significant increase in imports relative to consumption in the United States; significant price undercutting by the importers and that the imports had a materially injurious impact on the domestic industry. The requirements of Article 2:1 of the Agreement accordingly had been met by the Department. Canada's argument assumed that the investigating authorities must conduct an analysis of possible alternative causes of injury before commencing an investigation. Canada had pointed to no language in the Agreement to support this position. Nor could it, for Article 2:1 imposed no such requirement and did not even mention alternative causes as an initiation issue. The requirement that injury not be attributed to other factors appeared in Article 6:4 of the Agreement, which governed determinations of injury and had nothing to do with initiation requirements. Canada's attempted redrafting of the requirements of Article 2:1 also would make no practical sense. Canada would require authorities to gather evidence and reach conclusions concerning potential alternate causes of injury without being able to conduct an investigation to gather evidence and hear the views of the parties. Under this approach, authorities could not conduct an investigation because they had not conducted an investigation - a requirement which would never allow initiation of an investigation.

272. **Canada** considered that the argument of the United States that the obligation in Article 6:4 not to attribute injury caused by other factors to the subsidized imports did not apply at the initiation stage of an investigation filed in the face of the plain language of the Agreement. Article 2:1 required sufficient evidence of injury at initiation, and footnote 6 to that provision required that the term injury be interpreted in accordance with the provisions of Article 6. The United States apparently considered either that the footnote did not mean what it said, or that Article 6:4 was somehow implicitly excluded from the reference in the footnote to the whole of Article 6. The argument of the United States that the provisions of Article 6 did not govern the evidentiary threshold

that must be satisfied to trigger the initiation of an investigation was absurd. The footnote which contained the express obligation to interpret the term injury in accordance with Article 6 occurred in the same sentence of Article 2:1 which set out the sufficient evidence standard.

273. The **United States** noted that Article 2:1 of the Agreement required sufficient evidence of "(b) injury within the meaning of Article VI of the General Agreement as interpreted by [Article 6 of] this Agreement and (c) a causal link between the subsidized imports and the alleged injury" (emphasis added by the United States). Article 2:1 expressly did not require a causation analysis as provided for in Article 6. Canada had argued that clause (a) mandated the type of analysis contained in Article 6:4. However, Article 6:4 concerned causation, which was addressed by clause (b). That clause in turn made no mention of Article 6 but focused exclusively on evidence of a causal link between the imports and the alleged injury. The legal drafting of these clauses was no accident and was founded in the view that, if a plausible case of causation existed based on the evidence presented (as it clearly did in this case), that case provided a basis for initiation and investigation (including a consideration of alternative causation explanations if provided). If it did not exist, an investigation should not be initiated. There was no basis within the confines of an initiation to evaluate the relative merits of possible alternative causes of injury, as argued by Canada. Such an evaluation would, at a minimum have to include a three-part analysis: (a) an inquiry into whether such alternative causes existed; (b) an inquiry into what, if any, impact such causes might have on the industry; and (c) an analysis sufficient to comply with the direction in Article 6:4 that "any injuries caused by other factors must not be attributed to the subsidized imports." The analysis suggested by Canada would be complex enough in the context of a final determination. It was inconceivable (and inconsistent with the text of the Agreement) that the drafters could have intended that such an analysis occur at the initiation stage of an investigation. Moreover, the relative comparisons of Canadian and US prices, both affected by the same business cycle, provided an adequate consideration of alternative causes at initiation.

274. **Canada** considered that the United States had provided a novel interpretation of the obligations of Article 2:1, which eliminated the reference to Article 6:4. Contrary to the interpretation advanced by the United States, the requirements of Article 6:4 were expressly linked, by the text of footnote 6, to those of Article 2:1. Investigating authorities were under an obligation, at initiation and at the stage of a final determination, to ensure that injury caused by factors other than the subsidized imports was not attributed to the subsidized imports. The view of the United States was that this obligation should be truncated so as to permit initiation of an investigation in the face of overwhelming evidence that any injury being experienced was actually due to something other than allegedly subsidized imports. This interpretation was not supported by the plain language of the Agreement. Moreover, Article 1 made it clear that this obligation, like all other obligations under the Agreement, required active observance in that it stated that "Signatories shall take all

necessary steps to ensure that the imposition of a countervailing duty ... is in accordance with ... the terms of this Agreement." It was not sufficient to passively ignore this obligation, while ensuring that other obligations were not violated.

275. **Canada** also argued in this context that, in its analysis of injury and causation, the Department of Commerce had completely disregarded the cyclical nature of the softwood lumber industry and the effect of the economic recession on the industry. The North American softwood lumber market was a market in which a large number of producers produced a wide range of products differentiated by species, grades, dryness and prices. Within a grade and species grouping, a competitive market existed with each producer being a price taker. The market for softwood lumber in the United States was highly cyclical, and was strongly responsive to changes in housing starts. Over the past thirty years, there had been five periods of expansion and contraction in the demand for softwood lumber.[140] At the time of initiation of the countervailing duty investigation, consumption and production of softwood lumber in the United States had fallen since 1988. The unusually severe recession had the predictable economic effects on the domestic industry, including declining production, mill closures, reduction in employment, declining shipments, and declining capacity utilization. While the softwood lumber industry on both sides of the Canada- United States border was facing difficult economic conditions at the time of initiation, these difficulties were not due to alleged subsidies provided to Canadian lumber producers, but were a direct consequence of the deep economic recession which the North American softwood lumber industries were caught in. While the Department of Commerce had found a large number of factors indicating that the softwood lumber industry in the United States was performing poorly[141] the Department had made no attempt to determine if the industry was performing any differently than could be expected in the cyclical downturn in the softwood lumber market.

276. The **United States** argued in response that Canada mischaracterized the basic tenet of injury analysis. Material injury existed if subsidized imports were a cause, albeit not the only cause, of injury. The Department of commerce had recognized that the recession had affected the condition of the US industry. One relevant question was whether the industry would be doing materially better but for the subsidized imports. This question had been appropriately addressed.

277. The **United States** pointed out in this context that the presence of large volumes of heavily subsidized Canadian lumber in this commodity market had been considered, for purposes of initiation, to demonstrate that

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[140] Canada provided to the Panel a figure showing this pattern of expansion and contraction.

[141] Initiation Memorandum, pp.30-32.

these imports were at least a cause of injury. Evidence of price suppression and lost sales buttressed this conclusion Additional evidence had indicated that lumber prices were not even keeping pace with inflation. Moreover, strong evidence of a threat of injury had been present, a threat to which the US industry had been particularly susceptible given the then-current market conditions. The data upon which the Department of Commerce had relied when initiating the investigation refuted the argument that the cyclical downturn had been ignored, because these data had included the cyclical downturn experienced by the US domestic industry. Accordingly, the cyclical downturn had de facto been taken into consideration in the analysis of the relevant data.

278. **The United States** considered that Canada's argument based on the cyclical nature of the industry was an attempt to shift the focus of the Panel away from a critical reality governing this case: subsidized imports still could be a cause of material injury, or threat thereof, even when a domestic industry was experiencing a cyclical downturn. In fact, the data analysed by the Department of Commerce at the initiation stage had provided the investigating authority with a reasonable basis to believe that subsidized imports of softwood lumber from Canada were, at a minimum, a cause of material injury. In particular, these data demonstrated that Canadian imports had increased relative to US consumption, during a period of declining consumption in the United States market. Furthermore, Canada's unilateral termination of the Memorandum of Understanding, together with the excess production capacity in the Canadian softwood lumber industry and the increasing import penetration rate had provided the Department of Commerce with a reasonable basis to believe that the US domestic industry was vulnerable to lower-priced import competition from Canada.

279. **Canada** noted that the terms "recession" or "cyclical downturn" were nowhere to be found in the text of the Initiation Memorandum. There was no consideration in this document that injury to the domestic industry was attributable to a cyclical downturn or to any cause other than the imports of lumber from Canada. This was confirmed by the following statement:

> "There is strong evidence that imports of subsidized Canadian softwood lumber are causing the afore-mentioned material injury to US softwood lumber producers."[142]

This statement did not reflect any consideration of other possible factors of injury and clearly placed the blame for the injury solely on Canadian imports. The claim of the United States that the cyclical downturn in the softwood lumber industry had not been ignored was therefore a post facto claim.

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[142] Initiation Memorandum, p.32, (emphasis added by Canada).

280. The **United States** further argued that while individual Canadian lumber producers might have no power to affect prices within the US market insofar as that market was universally recognized to be a competitive one, Canadian lumber producers as a whole accounted for more than a quarter of the US lumber market and as a unified whole possessed a great deal of price setting power within that market. While cost components peculiar to individual Canadian firms might not be passed on to the market as a whole, cost components experienced by all or most Canadian producers were likely to be passed on to the market. As the Department of Commerce had determined, depressed domestic log prices had resulted from imports benefiting from cheap stumpage payments and log export restrictions. The issue was not whether ever individual Canadian exporter had the power to affect the price within the US market but rather whether all of those exporters taken as a whole had the power to influence the prices within the US market - which they did. This influence did not need to be, and, indeed almost certainly was not, intentional or the result of a collaborative effort. Rather, it resulted naturally from the fact that a sizeable portion of the market enjoyed a clear cost advantage over the result of the market. Many markets might properly be characterized as having individual price takers. This did not mean that a countervailing duty could never be imposed in these markets. If subsidized imports significantly depressed the average domestic price injury was likely to exist.

281. **Canada** argued that in the case of the Canadian stumpage system, the perspective of the individual producer was not relevant as it did not change the fact that overall lumber output or prices were not affected. Regardless of how the firm regarded the stumpage or collection of economic rent, it did not derive any economic advantage that would affect output or price, as any increased output would only reduce profits.

(vi) Arguments relating to the respective rôles of the Department of Commerce and the USITC

282. **Canada** argued that under the countervailing duty legislation of the United States the task of determining the existence of material injury and causality had been assigned to the USITC. The Senate Finance Committee Report on the Trade Agreements Act of 1979 described as follows the manner in which the provisions of this Act were intended to implement the requirements of the Code regarding the initiation of countervailing duty investigations:

> "Before a countervailing duty investigation is initiated, Article 2(4) of the [Subsidies] Agreement requires consideration whether both a subsidy and injury exist. The petition determination by the authority [ITA] under section 702 (c) and the determination by the ITC under

section 703(a) will implement the requirement for the United States."[143]

The determination by the USITC referred to in this part of the legislative history was the preliminary determination by the USITC, which could be made only after initiation of an investigation by the Department of Commerce. Thus, prima facie the United States could not have had the required evidence of injury at the time of the self-initiation of the countervailing duty investigation of imports of softwood lumber from Canada. The United States had not met the requirements of sufficient evidence of injury and causality as its domestic countervailing duty legislation prevented it from considering evidence of injury and causality until after the investigation had been initiated.

283. **The United States** considered that Canada's argument was inapposite. Because the Department of Commerce was charged with the responsibility of initiating investigations under US law, under Canada's logic, the Department would be precluded per se from self-initiation because it would not be allowed to determine whether there was sufficient evidence of injury to warrant initiation of an investigation. Because Article 2:1 specifically provided for self-initiation this argument was untenable. The language in the Senate Report cited by Canada referred to initiations by petitions and was not relevant to cases of self-initiation. The Agreement required that national investigating authorities have sufficient evidence and did not specify which authorities would initiate investigations. Moreover, the issue before the Department of Commerce at the time of initiation was whether there was sufficient evidence to warrant the initiation of an investigation, not whether there was enough evidence to make an injury determination. If an investigation was initiated, the USITC subsequently rendered the actual determination of injury based on the evidence acquired during the course of its investigation.

284. **Canada** considered that the arguments of the United States did not refute its position. The Department of Commerce only had a technical requirement to ensure that a complaint contained allegations of injury. It had no rôle with respect to considering the sufficiency of the evidence of injury, a matter left to the USITC. The Agreement allowed a signatory to self-initiate an investigation subject to the authorities possessing sufficient evidence of the existence of injury. US law precluded the authority identified as responsible for self-initiation from having such information at the time of self-initiation.

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[143] Report of the Committee on Finance (United States Senate on H.R.4537 (Trade Agreements Act of 1979), reporting number 96-249, p.49.

2.5 Evidence of the existence of a threat of material injury

285. **Canada** contested that, at the time of the self-initiation of the countervailing duty investigation of imports of softwood lumber from Canada, there had been sufficient evidence within the meaning of Article 2:1 of a threat of material injury caused by imports from Canada. In the Initiation Memorandum, the Department of Commerce had given two reasons why it considered that the termination by Canada of the MOU had produced a threat of material injury. First, exports of softwood lumber from Ontario, Manitoba, Saskatchewan and Alberta were no longer subject to the 15 per cent export charge, which would result in an increased potential for undercutting US origin softwood lumber prices and for obtaining a greater share of the US market through increased exports and production (by filling excess production capacity). Second, Quebec and British Columbia might modify their forestry acts and regulations to reduce stumpage prices in order to maintain their US market share in the face of increased exports from Ontario, Manitoba, Saskatchewan and Alberta. **Canada** argued that the removal of the 15 per cent export charge from exports of softwood lumber from Ontario, Manitoba and Saskatchewan and Alberta had not caused a threat of injury. The United States had not provided evidence that there would be a significant increase in exports, an increase in the share of the US market of these exports, or that the price of exports would undercut US prices. The Agreement did not permit authorities to initiate an investigation under the unsubstantiated presumption of injury. In addition, the presumption of legislative action on the part of British Columbia and Quebec was not evidence of the existence of a threat of injury. To use this standard would allow signatories to initiate frivolous countervailing investigation simply on the basis that other signatories might change their laws. The Agreement did not permit authorities to initiate an investigation under this pretext.

286. The **United States** argued that, in addition to evidence that the US domestic industry was currently experiencing injury as a result of subsidized Canadian imports, the Department of Commerce had possessed sufficient evidence indicating that the termination of the MOU by Canada had produced a real and imminent threat of material injury to warrant initiation of an investigation. First, under the terms of the MOU, stumpage prices in British Columbia were determined pursuant to a pre-approved pricing formula. After the termination of the MOU, British Columbia was no longer bound by these terms and was free to reduce stumpage prices. Similarly, under the terms of the MOU Quebec had agreed to charge higher stumpage fees in exchange for a reduction in the export tax. Upon termination of the MOU, Quebec was free to reduce stumpage prices and was relieved of a 6.1 per cent export tax.[144] Second, four of the Canadian lumber-producing provinces (Alberta, Manitoba, Saskatchewan and Ontario) had not, under the terms of the MOU, enacted replacement measures which

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[144] Initiation Memorandum, pp-36-37.

would have effectively increased the cost of stumpage. Accordingly, exporters from these provinces had been required to pay the full 15 per cent export charge under the terms of the MOU, effectively reducing the price charged to exporters in these provinces.[145]

287. The **United States** noted that the Department of Commerce had possessed evidence that production of softwood lumber in Alberta, Manitoba, Saskatchewan and Ontario "accounted for an increasingly larger share of total Canadian softwood lumber production in each of the three years from 1982 to 1989 (15.7, 16.6 and 17.4 per cent, respectively)."[146] During this same period, the "combined softwood lumber exports of these four provinces accounted for a declining share of total Canadian softwood lumber exports to the United States (14.6, 11.2 and 9.8 per cent, respectively)."[147] Based on the foregoing, the Department of Commerce had concluded that:

> "elimination of the total export tax for these provinces, and the elimination of the partial export tax in Quebec, can be expected to produce the greatest shift in trade back to the United States by provinces which did the least to offset any unfair cost advantage. Given that these provinces will have the greatest potential for undercutting US prices, the result will be further price suppression and a greater share for Canadian imports of the US market."[148]

288. The **United States** further argued that the Department of Commerce had had evidence that Canadian capacity utilization sales had fallen consistently during the period 1987-1989.[149] Because Canadian production had fallen 7.2 per cent in 1990, and continued to decline in 1991, the Department had projected that capacity utilization would likewise continue to decline and had concluded that:

> "with such excess capacity in the industry, termination of the MOU will enable Canadian mills to rapidly increase the production and exploitation of subsidized lumber to the United States, resulting in greater Canadian imports and lower prices in the US market."[150]

289. **Canada** argued that the evidence relied upon by the United States was based on speculation and not on events which could provide a real threat of injury within a short period of time. The United States had presumed that the provinces of British Columbia and Quebec would change their legislation to "roll back" the forestry practices which were regulated and legislated

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145 Initiation Memorandum, p.37.

146 Initiation Memorandum, p.37 and Table E-7.

147 Initiation Memorandum, pp.37-38.

148 Initiation Memorandum, pp.37-38.

149 Initiation Memorandum, p.38.

150 Initiation Memorandum, p.38.

during the period of the operation of the MOU but had not provided any evidence that this was a real possibility or imminent. To accept this presumption as evidence of a threat of injury was to allow investigations to proceed on the assumption that signatories might change their laws. With respect to Ontario, Manitoba, Alberta and Saskatchewan, the argument of the United States was based on speculation and not supported by any evidence, other than the assertion that price suppression would increase and that Canadian softwood lumber would increase its market share. Given that there was no evidence of current price suppression and that Canadian market share was lower in 1991 than in 1988, the speculation by the United States that such effects would occur was erroneous and could not be considered as evidence of the existence of a threat of injury. As well, the fact that exports from these four provinces accounted for only 8.3 per cent (by value) of Canadian softwood lumber exports to the United States strongly suggested that any possible threat of injury was minimal.

290. The **United States** argued in response that over one third of Canada's softwood lumber production came from provinces which had been subject to an export tax adopted in order to offset in part Canadian subsidies before Canada had terminated the MOU. It had been demonstrated at the initiation of the investigation that the provinces which were still subject to the export tax had controlled a greater share of Canadian exports prior to the imposition of the MOU. It was natural to assume that their exports would grow significantly without the export tax. Second, Canada ignored the fact that the MOU had been terminated to a large extent at the behest of the Canadian industry which had hoped to again lower timber fees as had been done in the early 1980s. The **United States** noted in this context that nominal timber fees in British Columbia were lower than they had been in 1979. Moreover, Canada had refused to give official assurances that timber fees would not be reduced in the provinces which had increased the timber fees.

291. The **United States** noted that in the proceedings before this Panel Canada had not even attempted to rebut the evidence presented in the Initiation Memorandum regarding the existence of excess capacity in the Canadian softwood lumber industry. Excess capacity was a strong indicator that a contracting domestic industry was vulnerable to lower-priced import competition, especially in a price-sensitive market. Therefore, the Department of Commerce had had more than sufficient evidence at the time of initiation that the excess production capacity in Canada, working in tandem with the increasing import-penetration levels and the unilateral termination of the MOU, threatened to injure the US domestic softwood lumber industry.[151]

292. **Canada** argued that the decline in the capacity utilization in the Canadian softwood lumber industry was the natural consequence of the

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[151] Initiation Memorandum, pp.36-38.

recession in the integrated North American lumber market. The basis for the argument of the United States was that the existence of excess production capacity in an exporting country was evidence of a threat of injury. This argument rested on the assumption that excess capacity would be used in those Canadian provinces which, according to the United States, would roll back their replacement measures in the absence of the MOU and in those provinces whose exports were no longer subject to the export charge. **Canada** reiterated that the presumption of legislative action by provinces which had adopted replacement measures was not evidence of a threat of injury, as it was not imminent or a real possibility. For the provinces which no longer collected the export tax, the argument of the United States was that the price of softwood lumber exported to the United States would be lower by the amount of the export tax, and that this price advantage would serve to increase production and expand exports. The relevant question was whether this explanation was evidence of the existence of a threat of injury. Any possible increase in exports of softwood lumber from Alberta and Ontario would be small, given the relative small size of the industry. With respect to those provinces whose exports would no longer be subject to the export tax, any threat of injury based on increased exports was not real. Arguendo, based on provincial production data in the Forestry Facts (as cited in the Initiation Memorandum), Ontario, Alberta, Saskatchewan and Manitoba provided about 17 per cent of softwood exports in 1989. Assuming that the national capacity utilization rate (88 per cent in 1989) would be a reasonable indication of the capacity utilization rate in those provinces, full capacity utilization in those provinces would increase national production by about 2 per cent (i.e., 17x1/0.88). Even if all this production were exported to the United States, total Canadian exports would increase by about 3 per cent (i.e. national increase x 1/0.67). Given that Canada supplied about 27 per cent of the United States market, the resultant impact on the market in the United States would be an increase in the order of 1 per cent. The calculation of this figure rested on a number of assumptions, including no increase in Canadian domestic consumption, the ability of companies to produce at 100 per cent capacity, and that all the increased production were exported to the United States. Even if all these assumptions were correct, the impact on the United States domestic market could not be material. Had the Department of Commerce analysed this, it could have only arrived at the same conclusion.

293. The **United States** considered that Canada refused to recognize that declines in capacity utilization indicated an ability to ship additional product to the United States and ignored the implication of the elimination of the export charge on lumber from Quebec. Canada also steadfastly maintained that legislative changes were required to adjust stumpage charges,when the historical record indicated clearly that provincial governments had and were not reluctant to use substantial discretion in setting stumpage fees. In addition, Canada completely ignored the effects that the termination of the collection of the export charge would have on exports from those provinces which had not instituted replacement measures. Finally, Canada also ignored the pressure of lower-priced lumber from those other provinces on British Columbia and, to a lesser extent, Quebec, to

themselves provide lower fees and prices to compete with other Canadian product both within Canada and in the United States.

2.6 Evidence of injury and causality with respect to the measures relating to the export of logs

294. **Canada** argued that insufficient evidence of injury and causality had existed to include within the investigation the measures relating to the export of logs. Under Article 2:1 of the Agreement, evidence of injury caused by the effect of this "subsidy" was required to justify the inclusion of these measures within the investigation. However, no such evidence had been provided by the Department of Commerce at the time of the self-initiation of the investigation. Furthermore, the preliminary determination of injury by the USITC[152] had been issued on 18 December 1991 - and had not covered injury caused by the log export restrictions, which had been included in the investigation of the Department of Commerce only on 23 December. This lack of evidence at the time of initiation was prima facie evidence that the United States had not met its obligations under Article 2:1 of the Agreement.

295. The **United States** argued that Articles 6:1, 6:2 and 6:4 of the Agreement required investigating authorities to examine whether injury was caused by subsidized imports. There was no additional or alternative requirement that the effect of a particular subsidy programme be analysed before countervailing duties could be imposed. This analysis of the requirements of Article 6 had been followed in the recently adopted Report of the Panel on "Canada - Imposition of Countervailing Duties on Grain Corn from the United States".[153] This Panel had found that the Agreement required consideration of "the volume of the subsidized imports and their effect on prices ... and the consequent impact of these imports on domestic producers." The Department of Commerce had possessed sufficient evidence of injury caused by reason of the subsidized imports. There was no requirement in the Subsidies Code that it either gather evidence concerning, or consider, injury by reason of the export restrictions.

V. ARGUMENTS PRESENTED BY JAPAN AS AN INTERESTED THIRD PARTY

296. **Japan** noted that, as a major importer of natural resource-based products, including wood products, it had a great interest in policies of other countries concerning the development, trade and pricing of natural resources. It was undeniable that such policies could in some cases have a trade distorting effect and cause injury to domestic industries in importing countries. Therefore, Japan was not convinced by Canada's argument that natural resource pricing per se could not be considered to distort trade. However, in light of the terms of reference of the Panel,

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[152] USITC Publication 2648, December 1991.

[153] SCM/140.

Japan did not wish to make further comments on this matter in its submission to the Panel.

297. **Japan** submitted that the measures taken by the United States on 4 October 1991 with respect to imports of softwood lumber from Canada were inconsistent with the obligations of the United States under the Agreement. These measures had been taken without there having been a preliminary finding of subsidization and of injury to the domestic industry in the United States caused by the subject imports and were as such inconsistent with the requirements of Article 5:1 of the Agreement. The provisions in Article 4:6 regarding the possibility to take "expeditious actions" in case of a violation of an undertaking did not provide a legal basis for the measures taken by the United States because (1) the MOU on softwood lumber concluded between Canada and the United States on 30 December 1986 had not been an undertaking under Article 4:5 of the Agreement, and (2) even if the MOU could have been considered to be such an undertaking, the exercise by Canada of its right to terminate the MOU did not constitute a violation of an undertaking within the meaning of Article 4:6 of the Agreement.

298. In support of its view that the MOU on softwood lumber concluded between Canada and the United States was not an undertaking within the meaning of Article 4:5 of the Agreement, **Japan** presented the following arguments. First, the acceptance of an undertaking as the basis for the termination of a countervailing duty proceeding was not mandatory under the Agreement. Rather, it was an option to be exercised at the discretion of the signatories involved in the proceeding. There had to be evidence that both signatories had explicitly agreed to exercise this option for an agreement which led to the termination of a countervailing duty proceeding to be considered an undertaking under the Agreement. Second, there was no evidence to support the view that the MOU had been an undertaking under the Agreement. The MOU itself provided no direct or indirect support for the proposition that it was an undertaking. It was not explicit in the text of the MOU that it constituted an undertaking under Article 4:5 of the Agreement. The MOU also did not implicitly indicate that it was an undertaking by providing that the United States could take expeditious actions under Article 4:6 of the Agreement if the MOU was violated. Third, the conclusion that there was no evidence that the MOU had been recognized by either the United States or Canada as an undertaking under the Agreement was reinforced by the fact that the United States had failed to provide notice of the MOU as an undertaking to other signatories of the Agreement.[154] In addition, the fact that the United States relied on its authority under section 301 of the Trade Act of 1974, as amended, to impose the provisional measures taken on 4 October 1991 and not on the provisions of its countervailing duty legislation also indicated that the MOU had been concluded outside of the framework of the countervailing duty legislation of the United States. In sum, the MOU could not be considered to have been

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[154] SCM/84/Add.4.

an undertaking within the meaning of Article 4:5 of the Agreement. Consequently, Article 4:6 did not provide a legal basis to the United States to justify the application of provisional measures following Canada's termination of the MOU without having made a preliminary affirmative finding of the existence of subsidization and injury caused by the subject imports.

299. **Japan** considered that even assuming, arguendo that the MOU had been an undertaking under the Agreement, Article 4:6 still did not provide a legal basis for the application of the provisional measures imposed by the United States because Canada's termination of the MOU had not constituted a "violation" of an undertaking within the meaning of Article 4:6. It was undisputed that the MOU had entitled each party to terminate the MOU "at any time upon thirty (30) days written notice". Article 4:6 of the Agreement permitted the immediate application of provisional measures as an exception to the general rule only in cases of violation of undertakings. In this case, the MOU had provided for the right of either party to withdraw from the MOU. It had neither provided any penalty for such a withdrawal nor made any reference to actions under Article 4:6 of the Agreement in case of a withdrawal from the MOU. In addition, the Agreement did not authorize action under Article 4:6 on a unilateral basis in contradiction with the specific terms of an undertaking. The MOU could not be characterized as incorporating in its termination clause the provisions of Article 4:6.

300. **Japan** questioned whether there had been "special circumstances" as required by Article 2:1 of the Agreement to justify the self-initiation by the United States of a countervailing duty investigation on imports of softwood lumber from Canada. Article 2:1 expressed a clear preference for the initiation of countervailing duty investigations pursuant to requests made by affected industries. Accordingly, the "special circumstances" which might justify the self-initiation of a countervailing duty investigation by the relevant authorities referred to circumstances in which the affected domestic industry was unable to prepare a proper request for the initiation of an investigation. The Panel, therefore, had to examine whether in the case under consideration the domestic industry in the United States had been unable to prepare such a request.

301. **Japan** argued that the countervailing duty investigation on imports of softwood lumber from Canada had been initiated by the United States in the absence of sufficient evidence of the existence of a subsidy, which was contrary to Article 2:1 of the Agreement. The Agreement required signatories to have sufficient evidence of the existence of a financial contribution by a government or public body. In this case, it was undisputed that the United States had not demonstrated the existence of sufficient evidence of the existence of a financial contribution by governments or public bodies in Canada at the time of the self-initiation of the investigation.

302. **Japan** also considered that there had been insufficient evidence of the existence of a causal relationship between the imports from Canada and the

alleged injury to the domestic industry to justify the initiation by the United States of a countervailing duty investigation of imports of softwood lumber from Canada. In its Initiation Memorandum the Department of Commerce had assumed that Canadian imports were subsidized during the period of the MOU. By definition, the operation of the export charges had negated all effects of this alleged subsidization. Consequently, any injury suffered by the domestic industry in the United States during this period could not have been by reason of the effects of this subsidization. Furthermore, the assertion by the Department of Commerce that Canada's termination of the MOU had produced a threat of material injury was unsupported by fact. The basis for this conclusion appeared to have been conjecture that the Canadian provincial governments would modify their stumpage pricing practices following Canada's termination of the MOU. In essence, the finding that there was evidence of a threat of material injury was based on the alleged flexibility enjoyed by the Canadian governments with respect to their stumpage practices following the termination of the MOU. However,it followed from the text of footnote 17 ad Article 6:1 that the fact that provincial governments had flexibility to modify their policies was not sufficient to conclude that there was evidence of a threat of material injury.

VI. FINDINGS

1. Introduction

303. The Panel noted that the issues before it arose from the following facts. On 4 October 1991, the United States imposed bonding requirements and temporary, increased duties (contingent upon affirmative final determinations of subsidy and injury in a countervailing duty investigation which the United States intended to initiate) on imports of certain softwood lumber products from Canada following the termination by Canada on 3 September 1991 of a Memorandum of Understanding (hereinafter "MOU") concluded between Canada and the United States on 30 December 1986 with respect to trade in softwood lumber This termination was effective 4 October 1991. On 31 October 1991, the United States initiated a countervailing duty investigation on imports of softwood lumber from Canada. In initiating this investigation, the United States indicated that in view of the termination by Canada of the MOU there were "special circumstances" justifying the self-initiation of a countervailing duty investigation (i.e. the initiation of an investigation absent a request from the affected industry).

304. In the proceedings before the Panel Canada challenged the consistency with provisions of the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement (hereinafter: "the Agreement") of both the interim measures taken by the United States on 4 October 1991 and the self-initiation of the countervailing duty investigation by the United States on 31 October 1991.

305. In respect of the measures taken by the United States on 4 October 1991, Canada requested the Panel to find that these measures

conflicted with the requirements for Article 5:1 of the Agreement with respect to the conditions for application of provisional measures, and that these measures could not be justified under Article 4:6 as a response to a violation of an undertaking within the meaning of Article 4:5. The United States requested the Panel to find that the termination by Canada of the MOU had entitled the United States to apply measures provided for in Article 4:6 in case of a violation of an undertaking.

306. With regard to the self-initiation of the countervailing duty investigation by the United States on 31 October 1991, Canada requested the Panel to find that this action was inconsistent with the requirements of Article 2:1 of the Agreement in that (i) there had not been sufficient evidence of the existence of a subsidy, material injury, or threat thereof, to a domestic industry in the United States and a causal relationship between the allegedly subsidized imports and material injury, or threat thereof, to the domestic industry, and (ii) there had been no "special circumstances" within the meaning of Article 2:1 of the Agreement to warrant the self-initiation of this countervailing duty investigation. The United States requested the Panel to find that sufficient evidence existed of the existence of a subsidy, material injury, or threat thereof, to a domestic industry and a causal link between the subsidized imports and material injury, or threat thereof, to a domestic industry to justify the initiation of an investigation, consistent with Article 2:1, and that the termination by Canada of the MOU had given rise to "special circumstances" warranting the self-initiation of a countervailing duty investigation.

307. The Panel noted Canada's request that the Panel recommend to the Committee on Subsidies and Countervailing Measures that the United States (i) terminate the bonding requirements and the suspension of liquidation of entries of softwood lumber from Canada introduced on 4 October 1991 and refund with interest any cash deposits paid since that date with respect to these entries, and (ii) terminate the countervailing duty investigation initiated on 31 October 1991.

2. Measures taken by the United States on 4 October 1991

308. The Panel noted that the United States had characterized its measures taken on 4 October 1991 with respect to imports of softwood lumber from Canada as provisional measures and had invoked Article 4:6 of the Agreement as the legal basis of these measures. In particular, the United States had relied on the second sentence of Article 4:6 which provided the following:

> "In case of violation of undertakings, the authorities of the importing signatory may take expeditious actions under this Agreement in conformity with its provisions which may constitute immediate application of provisional measures using the best information available."

The Panel therefore examined whether the conditions of this second sentence of Article 4:6 were met with regard to the measures taken by the United States on 4 October 1991.

309. As reflected in Section IV.1 of this Report, there were three main aspects of the arguments of the parties with respect to whether Article 4:6 of the Agreement constituted a legal basis for the measures applied by the United States on 4 October 1991 with respect to imports of softwood lumber from Canada. First, whether the MOU concluded between Canada and the United States on 30 December 1986 "to resolve differences with respect to the conditions affecting trade in softwood lumber products" constituted an "undertaking" within the meaning of Article 4:5 of the Agreement; second, whether this "undertaking" could be considered to have been violated by Canada when it terminated the MOU in October 1991; and third, whether the measures taken by the United States on 4 October 1991 were otherwise consistent with Article 4:6 as a response to this alleged violation of an undertaking.

310. The Panel examined whether the conclusion of the MOU on trade in softwood lumber between Canada and the United States on 30 December 1986 was covered by Article 4:5(a) of the Agreement, which read in relevant part:

> "Proceedings may be suspended or terminated without the imposition of provisional measures or countervailing duties, if undertakings are accepted under which:
>
> (i) the government of the exporting country agrees to eliminate or limit the subsidy or take other measures concerning its effects ... ."

311. The Panel noted that, with respect to this question, the parties to this dispute had presented arguments based on (1) the text of the MOU, (2) various circumstances surrounding the conclusion of the MOU and the subsequent practice of the parties and (3) the treatment of the MOU under United States trade legislation. The parties had differed in respect of the importance to be attached to each of these elements. Thus, the United States had essentially argued that the MOU by its terms constituted an undertaking for purposes of Article 4:5(a) of the Agreement. Canada had contested that the text of the MOU indicated that it constituted an undertaking and had referred to other factors, such as an alleged lack of notification of the MOU to the Committee on Subsidies and Countervailing Measures and the treatment of the MOU under United States trade legislation, in support of its view that the MOU had not been intended by the parties to be an undertaking for purposes of Article 4:5 of the Agreement.

312. The Panel considered that, for purposes of determining whether the MOU was covered by Article 4:5(a) of the Agreement, the key question was whether in concluding the MOU Canada and the United States had intended to act under this provision. In examining this question, the Panel considered the text of the MOU and actions of the parties subsequent to its conclusion.

313. With respect to the text of the MOU, the Panel noted that in Articles 4 and 5 of the MOU Canada had agreed to take certain measures with respect to the products which were the subject of the countervailing duty investigation initiated by the United States on 5 June 1986. Article 4 provided for the collection by Canada of a charge on exports of certain softwood lumber products to the United States. Article 5 provided that this export charge could be reduced or eliminated on the basis of increased stumpage or other charges on softwood lumber production. As provided for in the MOU, the petition in the countervailing duty investigation initiated on 5 June 1986 had been withdrawn on the date of the conclusion of the MOU and, as a result, this investigation had been terminated by the United States on 5 January 1987. The withdrawal of the petition and termination of the investigation had been defined in Article 3(a) of the MOU as a condition precedent to the implementation of the MOU. The Panel considered the argument of Canada that the MOU could not have been an undertaking because Article 3(b) had expressly stated that the MOU was "without prejudice to the position of either Government as to whether the stumpage program and practices of Canadian governments constitute subsidies under United States law or any international agreement." However, in the view of the Panel, this was not in and of itself persuasive evidence that the MOU could not have been an undertaking within the meaning of Article 4:5 of the Agreement. The Panel did not consider that an undertaking under Article 4:5(a) of the Agreement could exist only if the exporting signatory in question agreed that the practices under investigation constituted subsidies under the countervailing duty law of the importing country or under the Agreement.

314. The Panel thus found that the text of the MOU reflected certain elements corresponding to what was contemplated in Article 4:5(a) of the Agreement: a commitment by Canada to implement certain measures regarding a product, the importation of which into the United States had been subject to a countervailing duty investigation initiated on 5 June 1986, and the termination of this investigation on 5 January 1987, following the conclusion of the MOU. The Panel considered, however, that these two elements were not sufficient to conclude that the conclusion of the MOU on 30 December 1986, and the termination by the United States on 5 January 1987 of the countervailing duty investigation, reflected an intention of the parties to the MOU that the MOU would constitute an undertaking for purposes of Article 4:5(a) of the Agreement. In this connection, the Panel disagreed with the view of the United States that any agreement between signatories of the Agreement which provided for measures to be taken by the government of an exporting country with respect to a product subject to a countervailing duty investigation and which resulted in the termination of that investigation by the importing country was necessarily an undertaking under Article 4:5 of the Agreement. In the view of the Panel, there had to be evidence of an intention of both parties to such agreement that the agreement and the termination of the countervailing duty investigation were actions taken within the framework of the rights and obligations of these parties as signatories of the Agreement. The Panel observed in this context that the Agreement treated the termination or suspension by an importing signatory of a countervailing duty

investigation following the acceptance of an undertaking as a "countervailing duty action" which was subject to requirements regarding publication and notification (Articles 2:16 and 4:8) and other procedural requirements in Articles 4:5(b) and 4:7. An analysis of the extent to which, in the case before it, these requirements had been observed was therefore relevant to the Panel's consideration of whether, in concluding the MOU on trade in softwood lumber, Canada and the United States had intended to act within the framework of their rights and obligations under the Agreement.

315. The Panel noted that the termination or suspension of proceedings pursuant to Article 4:5 of the Agreement was a form of "countervailing duty action", notifiable under the provisions of Article 2:16 of the Agreement. When signatories of the Agreement have accepted undertakings under Article 4:5, they have notified the Committee thereof in their semi-annual reports, which contain a column for the notification of undertakings. The United States had not notified in its report covering the first half of 1987 that an undertaking had been accepted on imports of softwood lumber from Canada. Rather, with respect to the termination of the investigation on imports of softwood lumber from Canada initiated on 5 June 1986, the United States notified in its semi-annual report covering the first half of 1987, that "the case" had been "withdrawn" on 5 January 1987 (SCM/84/Add.4, p.5). While in the same semi-annual report the United States had notified a list of undertakings in force on 30 June 1987, this list did not refer to the existence of an undertaking in respect of softwood lumber products from Canada. None of the lists of outstanding undertakings in the subsequent semi-annual reports submitted by the United States to the Committee during the period 1988-1991 referred to the existence of an undertaking on imports of softwood lumber from Canada. The first time a semi-annual report by the United States referred to the MOU with Canada as an undertaking was in April 1992 (SCM/136/Add.4), i.e. after the establishment of the Panel in the present dispute.

316. The Panel considered that this consistent absence in the semi-annual reports by the United States of a reference to the MOU as an undertaking could not be considered to be a mere procedural omission; rather, it suggested that when the United States notified the Committee that on 5 January 1987 "the case" had been "withdrawn", the United States did not consider this "withdrawal" of the "case" to amount to a countervailing duty action in the form of a termination of proceedings following the acceptance of an undertaking pursuant to Article 4:5(a) of the Agreement.

317. The Panel noted that the above conclusion was consistent with the fact that in the Federal Register Notice, published on 5 January 1987, of the termination of the countervailing duty investigation initiated on 5 June 1986, the United States had made no reference to the acceptance of an undertaking as the basis for the termination of the investigation, as provided for in Article 4:8 of the Agreement. Rather, the basis of the termination had been identified as the withdrawal of the petition and the determination by the Department of Commerce that termination of the investigation was in the public interest of the United States.

318. The Panel further took into consideration that in an Agreed Minute to the MOU, Canada and the United States had agreed that promptly after implementation of the MOU, both parties would notify the GATT secretariat "that a mutually satisfactory settlement has been reached in the dispute concerning the countervailing duty proceeding by the United States of America on certain softwood lumber products from Canada." In letters addressed to the Chairman of the Panel established by the Committee on Subsidies and Countervailing Measures in August 1986, Canada and the United States informed the Panel in January 1987 that a mutually satisfactory resolution of the dispute before the Panel had been reached. The Report of this Panel (SCM/83, 25 May 1987), limited to a brief summary of the provisions of the MOU, noted that a copy of the MOU was available in the secretariat for consultation by interested delegations. The Panel considered that these letters, a direct consequence of the provisions of the MOU, were relevant to the Panel's interpretation of the common understanding of the parties to the MOU with respect to its status under the Agreement. The Panel noted that the letters addressed to the Chairman of the Panel established in 1986 and the summary of the provisions of the MOU in the Panel Report consistently referred to the MOU as a mutually satisfactory settlement of the dispute before the Panel but never described the MOU as an undertaking under Article 4:5(a) of the Agreement.

319. The Panel thus concluded that until April 1992, well after the dispute settlement proceeding before this Panel had been initiated, the United States had not referred to the MOU as an undertaking under Article 4:5(a) of the Agreement in its notifications to the Committee on Subsidies and Countervailing Measures. Furthermore, the United States had not treated the MOU as such an undertaking in the Federal Register notice of 5 January 1987 of the termination of the countervailing duty investigation on imports of softwood lumber from Canada. The United States also had not treated the MOU as such an undertaking in the notices of various actions taken under Section 301 of the Trade Act of 1974 with respect to the MOU in December 1986 and January 1987. The Panel further noted that in imposing the interim measures under Section 304 of the Trade Act of 1974, the United States made no reference to the enforcement of a countervailing duty action. The Panel found that these facts were relevant as evidence of the intention of the parties to the MOU with respect to the status of the MOU under the Agreement.

320. In addition to the above-mentioned facts, the Panel considered that another relevant factor to ascertain the intention of the parties to the MOU with regard to its status under the Agreement was whether the MOU could be interpreted to constitute an alternative to ordinary countervailing duties in the same manner in which undertakings under Article 4:5 were alternatives to such countervailing duties.

321. The Panel noted in this connection that, while the Agreement expressly provided for suspension or termination of proceedings upon the acceptance of undertakings, there was nevertheless an element of continuity of the "countervailing duty action" inherent in the nature of undertakings under Article 4 as alternatives to the imposition of ordinary countervailing

duties. This was evident from the provisions in Articles 4:5(b) and 4:7. In the case under consideration, the termination of the investigation following the conclusion of the MOU did not have certain essential characteristics for this action to be considered an alternative to the imposition of countervailing duties in the specific manner in which Article 4 treated undertakings as alternatives to countervailing duties. First, it was not at all clear that a procedure was available under which the investigation of injury could have been completed (as contemplated by Article 4:5(b)) after the termination of the investigation on 5 January 1987, or how the MOU could have lapsed "automatically" in case of a negative determination in such investigation of injury. Second, Article 4:7 of the Agreement contained provisions regarding the duration and review of undertakings which were identical to those contained in Article 4:9 governing the duration and review of unilaterally imposed countervailing duties. In the case of the MOU, it appeared that no mechanism was available to ensure that effect could be given to the provisions of Article 4:7 of the Agreement. The Panel noted in this respect that in response to its question as to how such a review could be obtained by private exporters and importers, the United States had only indicated that such a request could have been filed at any time and would have been given due consideration. In the view of the Panel, this lack of "parallelism" between the MOU and ordinary countervailing duties indicated that the MOU was not intended by the two parties to operate as an alternative to the imposition of countervailing duties in the same manner in which undertakings under Article 4:5 of the Agreement operated as alternatives to unilaterally imposed countervailing duties.

322. The Panel noted the argument of the United States that a failure to meet procedural requirements with respect to notification could not defeat substantive rights of a signatory under the Agreement. The Panel did not consider, however, that in the present case it was faced with a situation in which the United States had inadvertently "failed" to notify that on 5 January 1987 it had accepted an undertaking with respect to imports of softwood lumber from Canada; rather, the United States, in consistently refraining from notifying the MOU as an undertaking, had treated the conclusion of the MOU and the termination in January 1987 of the countervailing duty investigation on imports of softwood lumber from Canada as an action which did not constitute a countervailing duty action under the Agreement in the form of a termination of proceedings upon the acceptance of an undertaking. The Panel also recalled in this respect its views expressed in paragraph 19 on the characteristics of undertakings under Article 4:5(a) of the Agreement as alternatives to countervailing duties. The Panel's conclusion regarding the lack of evidence of an intention of Canada and the United States to act under Article 4:5(a) of the Agreement was therefore not based only on the lack of notification of the MOU as an undertaking.

323. In light of the foregoing considerations, the Panel saw no merit in the argument of the United States that the parties to the MOU had never "waived" their rights under the Agreement in relation to the enforcement of the MOU. Whether or not the parties to the MOU had "waived" their rights

under the Agreement was a question which logically could not arise in view of the Panel's conclusion that the parties to the MOU had not intended to act under the Agreement in concluding the MOU.

324. The above analysis led the Panel to conclude that on 5 January 1987 the United States had not taken a countervailing duty action under the Agreement in the form of the termination of proceedings following the acceptance of an undertaking within the meaning of Article 4:5 of the Agreement. In concluding the MOU and agreeing on the termination of the countervailing duty investigation initiated in June 1986, the United States and Canada had reached a settlement, as a result of which "the case was withdrawn" and there no longer existed a countervailing duty action under the Agreement. Whatever might have been the rights of the United States under the MOU as a bilateral agreement between Canada and the United States, no aspect of the implementation or termination of this bilateral agreement could give rise to rights for the United States under the Agreement. Canada's termination of the MOU on 4 October 1991 therefore did not constitute a basis for action by the United States under Article 4:6 of the Agreement.

325. In light of the foregoing considerations, the Panel concluded that the interim measures taken by the United States on 4 October 1991 with respect to imports of certain softwood lumber products from Canada were inconsistent with Article 5:1 and could not be justified on the basis of Article 4:6 of the Agreement.

3. Self-initiation by the United States on 31 October 1991 of a countervailing duty investigation of imports of softwood lumber from Canada

3.1 Existence of "special circumstances"

326. The Panel first examined Canada's contention that the special circumstances required by Article 2:1 to self-initiate an investigation were lacking in this case. In this regard, the Panel recalled Canada's reference to the drafting history of a parallel provision in the Agreement on Implementation of Article VI of the General Agreement (1967) (Article 5:1) with respect to which the United States, in commenting on an early draft of Article 5:1 in the mid-1960s, had maintained that governments should retain authority to self-initiate anti-dumping investigations especially in cases where the domestic industry consisted of many small, not-well-organized producers.[155] Canada had argued that because the present case did not involve small producers lacking organization, there were no special circumstances warranting self-initiation by Commerce.

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[155] TN.64/NTB/10/Add.3, 28 April 1966, page 7.

327. The Panel noted that the text of the Agreement did not define the term "special circumstances" and that the circumstances mentioned by Canada were not referred to in this text. The Panel therefore concluded that the text of Article 2:1, in and of itself, provided no basis for a finding that the right to self-initiate an investigation was limited to the situation identified by Canada. The Panel considered that the term "special" had to be interpreted in the light of the main purpose of the initiation provisions in Article 2:1, which was to ensure that investigations were normally initiated through a petition procedure. A self-initiation in circumstances occurring so rarely that this main purpose was not undermined could therefore, in the view of the Panel, be considered to be covered by Article 2:1. The Panel considered that the circumstances identified by the United States in the present case - that is, Canada's termination of an agreement which had been the basis of the United States industry's decision to withdraw its petition - were sufficiently exceptional to warrant the conclusion that they were "special circumstances" within the meaning of Article 2:1.

328. The Panel noted that the Department of Commerce had stated in the notice of initiation of the investigation that special circumstances had not existed with respect to the Maritime Provinces because these Provinces had not been subject to the MOU. The Panel then recalled Canada's argument that on the same basis there could be no special circumstances with respect to the Province of British Columbia because that Province had not been subject to export charges under the MOU since 1987. The evidence suggested that although both British Columbia and the Maritime Provinces had formally been subject to the MOU, the MOU had been amended in December 1987 to exempt the Maritime Provinces from the export charge after 1987 (but not the MOU's monitoring and reporting requirements). British Columbia, in contrast, was never formally exempted from the export charge under the MOU; it had instead provided MOU-sanctioned replacement measures in lieu thereof after 1987. In view of this different status of the Maritime Provinces and British Columbia under the MOU (with only the latter remaining subject to specific measures with an economic impact), the Panel considered that it was not unreasonable for the Department of Commerce to have treated the Maritime Provinces and British Columbia differently in finding that Canada's termination of the MOU constituted special circumstances.

329. On the specific question of whether there were special circumstances warranting the United States' initiation of an investigation with respect to Canada's log export restrictions, the Panel recalled Canada's position that the special circumstances cited by the United States - Canada's termination of the MOU - bore no relation whatsoever to the issue of log export restrictions. The Panel agreed with Canada that the MOU and the special circumstances cited by the United States manifestly did not cover the issue of log export restrictions. However, in light of its discussion below (paragraph 59), the Panel considered that it need not here address the issue of "special circumstances" in respect of Canada's log export restrictions.

3.2 Standard of sufficient evidence

330. The Panel noted that the self-initiation of a countervailing duty investigation was subject to the provisions of Article 2:1 of the Agreement. This Article provided in relevant part:

> "An investigation to determine the existence, degree and effect of any alleged subsidy shall normally be initiated upon a written request by or on behalf of the industry affected. The request shall include sufficient evidence of the existence of (a) a subsidy and, if possible, its amount, (b) injury within the meaning of Article VI of the General Agreement as interpreted by this Agreement[6] and (c) a causal link between the subsidized imports and the alleged injury. If in special circumstances the authorities concerned decide to initiate an investigation without having received such a request, they shall proceed only if they have sufficient evidence on all points under (a) to (c) above". (emphasis added)

Whereas the Agreement called for "sufficient evidence" and identified the subject matter on which such evidence was to be adduced, the Panel noted that no specific guidance was given as to what might constitute sufficient evidence. The Panel thus proceeded to consider the meaning of the term "sufficient evidence" in Article 2:1 guided by the customary principles of international law on treaty interpretation, according to which treaty terms were to be given their ordinary meaning in their context and in the light of the treaty's object and purpose.

331. The Panel considered that the concept of sufficiency of evidence had to be judged in relation to the particular action contemplated in Article 2:1 of the Agreement, that of initiating a countervailing duty investigation, as was made clear in Article 2:3 which referred to "sufficient evidence to justify initiating an investigation". (emphasis added) In the view of the Panel, the initiation requirement in Article 2:1 reflected a careful balancing of the rights and obligations of the parties, in particular between (1) the interest of the import-competing domestic industry in the importing country in securing the initiation of a countervailing duty investigation and (2) the interest of the exporting country in avoiding the potentially burdensome consequences of a countervailing duty investigation initiated on an unmeritorious basis. With regard to the second of these, the Panel considered that in applying the appropriate standard to a review of the decision of a national authority to initiate a countervailing duty investigation, it should in particular be sensitive to the intended anti-harassment function of Article 2:1.

332. In analysing further what was meant by the term "sufficient evidence", the Panel noted that the quantum and quality of evidence to be required of an investigating authority prior to initiation of an investigation would necessarily have to be less than that required of that authority at the time of making a final determination. At the same time, it appeared to the Panel that "sufficient evidence" clearly had to mean more than mere

allegation or conjecture, and could not be taken to mean just "any evidence". In particular, there had to be a factual basis to the decision of the national investigative authorities and this factual basis had to be susceptible to review under the Agreement. Whereas the quantum and quality of evidence required at the time of initiation was less than that required to establish, pursuant to investigation, the required Agreement elements of subsidy, subsidized imports, injury and causal linkage between subsidized imports and injury, the Panel was of the view that the evidence required at the time of initiation nonetheless had to be relevant to establishing these same Agreement elements.

333. The Panel recalled Canada's position that "sufficient evidence" in the context of initiation meant "that amount of proof which ordinarily satisfies an unprejudiced mind". The Panel further recalled the United States' position that "sufficient evidence" meant "evidence that provides a reason to believe that subsidies may exist and that the domestic industry may be injured by reason of the subsidized imports". The Panel was not persuaded of the correctness of either of these proposed standards. In the Panel's view, the Canadian proposed standard suggested a level of proof more suitable to a determination made at a stage of the process subsequent to initiation rather than to the initiation itself. As for the United States' proposed standard, the Panel agreed that "reason to believe" was an appropriate yardstick, but that it was not the potentiality of the existence of subsidy or injury for which there had to be a reason to believe but rather a reason to believe that those two elements existed. This interpretation was confirmed by the wording of the last sentence of Article 2:1 which made clear that the investigating authorities "shall proceed only if they have sufficient evidence [of the existence of subsidy, injury and causation]". In the view of the Panel, therefore, the term "sufficient evidence" in the context of initiation of a countervailing duty investigation was to be interpreted to mean "evidence that provides a reason to believe that a subsidy exists and that the domestic industry is injured as a result of subsidized imports".

334. The Panel noted that it was the rôle of the national investigating authority in the importing country, not that of the Panel, to make the necessary determinations in connection with the initiation of a countervailing duty case. This point was underlined by the language in Article VI:6(a) of the General Agreement, which provided:

> "No contracting party shall levy any ... countervailing duty on the importation of any product of the territory of another contracting party unless it determines that the effect of the ... subsidization ... is such as to cause or threaten material injury ...". (emphasis added)

The rôle of the Panel was thus not to determine whether there was sufficient evidence for initiation but to review whether the national authorities in the importing country had made the initiation determination in accordance with relevant provisions of the Agreement.

335. The Panel considered that in reviewing the action of the United States authorities in respect of determining the existence of sufficient evidence to initiate, the Panel was not to conduct a de novo review of the evidence relied upon by the United States authorities or otherwise to substitute its judgment as to the sufficiency of the particular evidence considered by the United States authorities. Rather, in the view of the Panel, the review to be applied in the present case required consideration of whether a reasonable, unprejudiced person could have found, based upon the evidence relied upon by the United States at the time of initiation, that sufficient evidence existed of subsidy, injury and causal link to justify initiation of the investigation.

336. The Panel noted the argument of Canada that Article 2:1 required a higher standard of sufficient evidence to self-initiate a countervailing duty investigation than to initiate based upon a petition. The Panel noted that the relevant portion of Article 2:1 stated the following:

> "If in special circumstances the authorities concerned decide to initiate an investigation without having received such a request, they shall proceed only if they have sufficient evidence on all points under (a) to (c) above."

In the view of the Panel, Canada's claim was not well-founded in that there was nothing in the text of Article 2:1 to suggest a different level of evidence for self-initiation than for initiation pursuant to petition. Moreover, the Panel could not discern any purpose under the Agreement which could be served by a different level of "sufficient evidence" in the case of self-initiation. The Panel recalled Canada's contention that the words "only if" in the sentence cited above suggested a higher standard for self-initiation than for initiation based upon a petition. However, the Panel considered that the words "only if" in the above context referred only to the elements mentioned in the second sentence of Article 2:1, not to a different level of "sufficient evidence". What was required in addition to "sufficient evidence" was the existence of "special circumstances".

3.3 Evidence of Existence of a Subsidy

(i) Canadian Stumpage Pricing Practices as Subsidies

337. The Panel then turned to the question of whether there was sufficient evidence of the existence of a subsidy, as required by Article 2:1, to justify the initiation by the United States of a countervailing duty investigation on imports of softwood lumber from Canada. In examining this matter, the Panel was guided by the considerations set forth in paragraph 335. It was therefore not for the Panel to determine whether Canadian stumpage pricing practices were in fact subsidies.

338. The Panel noted that the Canadian stumpage pricing practices at issue concerned the governmental setting of a fee for the right of access to, and harvest of, standing timber. In this regard, the Panel recalled the Notice

of Initiation in the Federal Register on 31 October 1991 in which the Department of Commerce had indicated the following with respect to the alleged subsidy:

> "The Department has current information indicating that discretion is exercised in the awarding of stumpage rights and the setting of stumpage prices. The exercise of discretion in the awarding of stumpage rights is an indication of specificity, and as such, is sufficient to meet the threshold for initiation. ... We also have evidence that stumpage is preferentially priced. ... [W]e estimate that subsidies exist, based on comparisons of administratively set stumpage prices to either competitive or private stumpage prices in Canada."

339. The Panel then recalled that Canada raised a number of arguments as to why stumpage pricing per se could not as a matter of law be considered to constitute a subsidy which could be subject to countervailing duty actions. The Panel considered that it should look to the Agreement and the General Agreement for guidance on the issue of whether these practices could be subject to countervailing duty investigations.

340. On the basic legal question of whether natural resource pricing practices could be subsidies subject to countervailing duty measures, the Panel noted that neither Article VI of the General Agreement nor the Agreement provided a general definition of the term "subsidy". The closest the agreements came to defining the term was in Article VI:3 of the General Agreement, and in a virtually identical provision in Article 1, footnote 4 of the Agreement. Article VI:3 of the General Agreement provided in relevant part:

> "The term 'countervailing duty' shall be understood to mean a special duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly or indirectly, upon the manufacture, production or export of any merchandise."

341. The Panel noted that where the drafters of the General Agreement and the Agreement had intended to exclude certain government measures from the coverage of the term "subsidy", they had explicitly provided for such exclusion, e.g. tax exemptions or rebates pursuant Article VI:4 of the General Agreement. No such explicit exclusion could be said to be contained in either agreement with respect to natural resource pricing practices.

342. The Panel then noted that some further guidance on the concept of subsidies was provided in Part II of the Agreement. In particular, Article 11:1 recognized that "subsidies other than export subsidies are widely used as important instruments for the promotion of social and economic policy objectives ...", and Article 11:3 indicated "that the objectives mentioned in paragraph 1 above may be achieved, inter alia, by means of subsidies granted with the aim of giving an advantage to certain enterprises." Article 11:3 then went on to provide an illustrative

enumeration of forms of such subsidies, all of which appeared to involve a cost to the government[156] and a benefit to certain enterprises. The Panel realized that although the examples of subsidies given in Article 11:3 contained these two elements, it was not perforce the case that these elements were required for a governmental measure to be subject to countervailing duty actions under Part I of the Agreement. The Panel did not consider it necessary to pronounce itself on the issues raised by the parties regarding the relationship between Parts I and II of the Agreement: assuming that considerations in Article 11 of Part II of the Agreement applied also to Part I of the Agreement, and assuming further that Article 11 contained a "cost to government" requirement, the Panel considered that neither of these assumptions would necessarily lead to the conclusion that the Canadian stumpage pricing practices at issue could not be determined, pursuant to investigation, to be countervailable subsidies.

343. In the Panel's view, even assuming as argued by Canada that "cost to government" (also referred to as "financial contribution" by a government or "revenue foregone") was a required element of the definition of a countervailable subsidy, it was not clear on the present record that Canadian provincial stumpage programmes could not in fact include an element of governmental cost or revenue foregone. Assuming that stumpage prices charged to some users were in some cases lower than stumpage prices charged to other users, the Panel considered that the question of financial contribution was an empirical one which could only be resolved through further investigation. In the view of the Panel, the "cost to government" aspect of this allegedly required element of a subsidy could potentially include the opportunity costs of making stumpage available to customers at less than a competitive market rate. On the current record, therefore, there was no basis to conclude that an assumed financial contribution criterion disqualified the Department of Commerce's initiation of a countervailing duty investigation.

344. The Panel then addressed Canada's argument that natural resource pricing practices could not be countervailable subsidies on the grounds that the pricing of access to <u>in situ</u> natural resources, in and of itself, could not have any trade effects. The Panel recalled in this connection the arguments of Canada that the focus of Article XVI of the General Agreement and that of Part II of the Agreement was on governmental measures having trade effects; and that Article VI of the General Agreement and Part I of the Agreement were narrower in scope than Article XVI of the General Agreement and Part II of the Agreement, respectively. The Panel further recalled the United States arguments that Articles VI and XVI of the General Agreement, and Parts I and II of the Agreement, were "stand alone" provisions with respect to each other; one

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[156]However, the "Illustrative List of Export Subsidies" contained items which could be said to contradict the "cost to government" standard.

was not narrower in scope than the other, and that Canada's stumpage pricing practices did, in any case, have trade effects.

345. The Panel noted that Canada had referred to the theory of economic rent in support of its position that the governmental setting of a fee or charge for the right of access to a natural resource in situ could not have trade effects.

346. In this connection, the Panel recalled Canada's contention that the theory of economic rent taught that the exaction of economic rent - or revenue collection - for access to a natural resource such as timber could not cause any countervailable market distortion, in terms of an increase in the output or a decrease in the price of products made from the timber, which could constitute a subsidy. According to Canada, the granting of the right of access to the land on which the trees were standing and the collection of revenue (stumpage fees) from those granted the right of access was not the sale of a good. The tree became a good only once it was cut down and turned into a log. The Panel further recalled Canada's argument that stumpage fees were a component of the total cost of making logs but that they were not part of the per unit production cost or variable cost of producing the logs in that the stumpage fee did not influence the marginal cost of producing the next unit of product. The Panel then recalled the United States' contention that the administratively set stumpage fees in the Canadian provinces reduced the cost of the input product (logs) to the forest products industries, thus conferring a benefit on those industries.

347. Reviewing these arguments, the Panel considered that assuming that Article XVI of the General Agreement and Part II of the Agreement only covered measures that had trade effects and that this trade effects characteristic also applied to countervailable subsidies under Article VI of the General Agreement and Part I of the Agreement, and assuming further that the theory of economic rent was relevant to the question of whether a governmental measure could have trade effects, the applicability of these arguments in the present case was nonetheless an empirical issue, in that it was not possible to determine without further investigation whether stumpage pricing practices in Canada affected the volume or pricing of lumber. The Panel noted in this regard, as argued by the United States, that there were also a number of studies suggesting, contrary to the argument of Canada, that stumpage fees did in fact affect prices and output of lumber. In the Panel's view, whereas the setting of the price for access to the natural resource in and of itself might relate only to the revenue collection function of government and might not constitute a benefit in connection with the harvesting or extraction of that resource, if the conditions of access were such that stumpage was available only to a specific group of enterprises, then the stumpage programme could potentially be considered as a benefit in connection with the right of access to harvest the resource.

348. Given that, as explained above, the applicability of the theory of economic rent to the Canadian stumpage pricing practices was an empirical

issue, the Panel did not consider it necessary to pronounce itself on the argument advanced by Canada that Article VI of the General Agreement was narrower in scope than Article XVI.

349. In the light of the foregoing considerations, the Panel concluded that the argument of Canada based on the theory of economic rent did not provide a basis for finding that the United States lacked sufficient evidence to initiate a countervailing duty investigation.

350. Given the lack of any apparent legal bar to considering Canadian stumpage as potentially a countervailable subsidy, the Panel then turned to a consideration of the stated factual basis upon which the Department of Commerce had relied in determining the existence of sufficient evidence of subsidy to initiate the countervailing duty investigation.

351. In this respect, the Panel recalled the United States contention that the Department of Commerce had sufficient evidence of both the selective provision of the natural resource ("specificity") and the provision of that natural resource at preferential rates ("preferentiality") to warrant initiation on the issue of stumpage as a subsidy. The Panel noted that the Department of Commerce considered the evidence of "specificity" in this case to be the exercise of governmental discretion favouring the forest products industries over other potential users of standing timber and that the evidence before the Department of "preferentiality" was based on comparisons of administratively set stumpage prices in the Canadian provinces to various benchmark prices. The Panel then recalled Canada's arguments as to the inconsistency of the United States' actions with Article 2:1 of the Agreement, noting that a number of the arguments advanced by Canada as to the insufficiency of the analysis by the Department of Commerce were of a legal nature whereas others were of a more factual nature, relating to the use of the specific data relied upon by the Department. As for the arguments of a legal nature, the Panel recalled Canada's contentions that the tests applied by the Department of Commerce of "specificity" and "preferentiality" were improperly applied to governmental pricing of <u>in situ</u> natural resources because, as a matter of law, such governmental pricing could not be a subsidy in that it did not involve a financial contribution by a government, that administratively set stumpage prices should not have been compared to market stumpage prices or to stumpage prices in other jurisdictions because there was no "right" price for publicly owned natural resources and that reliance by the Department of Commerce on the exercise of governmental discretion as an indicator of "specificity" was improper. As for the factual arguments, Canada had argued that much of the data relied upon by the Department of Commerce in assessing "preferentiality" was either wrong or inappropriate. In addition, the Panel recalled the United States' position that while it agreed with Canada that there was no single "right" price for stumpage, the Department of Commerce nonetheless had reasonably determined that evidence of subsidization existed when it had information that stumpage was being provided to certain users at a price which was lower than the price that would obtain under competitive market conditions.

352. The Panel considered each of these arguments, noting first that it had earlier addressed Canada's contention that stumpage pricing per se could not be a subsidy.[157]

353. As for Canada's argument that the existence of governmental discretion was not a proper measure of "specificity" in examining the question of subsidy, the Panel agreed with Canada that the mere existence of governmental discretion might not be very probative evidence of "specificity". However, to the extent that such governmental discretion was exercised so as to favour access to stumpage by certain groups of enterprises, it appeared to the Panel that this aspect of governmental discretion could potentially constitute probative evidence of "specificity". This view was of course without prejudice to the question of whether or not specificity was a requirement under Part I of the Agreement.

354. As for Canada's argument that there was no right price for publicly owned natural resources and that it was improper to compare administratively set stumpage prices to market stumpage prices or to administratively set stumpage prices in other jurisdictions, the Panel considered that in determining whether or not a subsidy existed it was not necessarily unreasonable for the Department of Commerce to attempt to make stumpage price comparisons as a measure of "preferentiality". In the view of the Panel, preferential pricing could be one of several elements relevant to examining the question of subsidy.

355. Before considering Canada's arguments regarding the use by the Department of Commerce of particular data in conducting its "preferentiality" analysis, the Panel first noted that the United States authorities had had reasonable access to data on stumpage programmes in Canada. Indeed, it appeared that the Department may have had more data at its disposal than was typically the case for national investigating authorities at the point of initiation of a countervailing duty case. The Panel reviewed the data in the Initiation Memorandum in considerable detail, noting that much of the data and analyses used by the Department of Commerce appeared not to be the most current or most appropriate with respect to the stumpage programmes in certain of the Canadian provinces. The Panel then proceeded to examine the various factual arguments of Canada, as described in Section 2.3.2 of this Report, in respect of the "preferentiality" analysis conducted by the Department.[158]

356. Regarding the finding by the Department of Commerce of preferential stumpage pricing in British Columbia, the Panel recalled Canada's contention that this finding was inconsistent with testimony of a Department of Commerce official before the United States Congress in

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[157] Supra, paragraphs 343 and 347.

[158] Initiation Memorandum, pages 19-28.

February 1991, to the effect that replacement measures in British Columbia fully offset the export charge under the MOU. However, the Panel was not persuaded that the Congressional testimony cited by Canada related to anything other than a report on Canada's compliance with the MOU; it was not clear to the Panel that this statement should be seen as a bar to an investigation into possible stumpage subsidies in British Columbia. Canada also had argued that the stumpage programmes used as a basis for the analysis by the Department in British Columbia were so fundamentally different that they could not reasonably be compared. But the Panel noted that the Department had made certain adjustments in its analysis to account for the differing tenure conditions of the stumpage programmes compared and, in the Panel's view, the record did not suggest that the Department's "preferentiality" analysis of British Columbia stumpage pricing was, on its face, unreasonable for the initiation stage of a countervailing duty investigation.

357. The Panel recalled that Canada had made similar arguments about the inappropriateness of the Department of Commerce's "preferentiality" analyses in respect of stumpage pricing programmes in the Provinces of Quebec, Alberta and Ontario. With respect to Quebec and Alberta, Canada had argued that the Department had used out-dated, cross-jurisdictional data in comparing fundamentally different forest tenure systems, and that with respect to Ontario, the evidence of price differences presented by the Department was prima facie incorrect. It further recalled the United States' argument that comparisons made by the Department of administratively set and competitive stumpage programmes in these provinces was adequately supported by record evidence and that in making these comparisons, the Department of Commerce had made necessary adjustments to account for differences in tenure requirements for such factors as silviculture and road construction. After carefully reviewing the Initiation Memorandum and giving full consideration to the arguments of the parties, the Panel was not convinced that the stumpage price comparisons made by the Department of Commerce for Quebec, Alberta and Ontario were unreasonable. Again, the Panel could not conclude that the use of these comparisons was unreasonable for the initiation stage.

358. The Panel then recalled Canada's contention that for the Provinces of Saskatchewan and Manitoba, as well as for the Northwest and Yukon Territories, the Department of Commerce had not analysed any pricing data but had nonetheless presumed there to be preferential pricing in these provinces and territories because of the government's rôle in administratively setting stumpage prices. The Panel further recalled the United States' contentions that the Department's stumpage price calculations and comparisons for the Provinces of Manitoba and Saskatchewan and the Department's statement regarding the administratively set pricing of stumpage in the Yukon and Northwest Territories fully satisfied the initiation requirements. After carefully reviewing these arguments and the the Initiation Memorandum, the Panel noted the following: With respect to both Manitoba and Saskatchewan, the Department had made reference to the types of provincial stumpage programmes, the percentage of stumpage pricing set administratively and the range of stumpage prices. It had then stated

that "the administratively set, low stumpage rates in these provinces also indicated that the provincial governments in these provinces may be providing subsidies". With respect to the Yukon and Northwest Territories, the Department had stated that the majority of timber harvested in these territories was from federally-owned land. Without citing to any particular price data, the Department had then stated its belief "that stumpage rates in these territories are administratively set at price levels consistent with provincial stumpage rates preliminarily determined to have been subsidized in 1986". Although the Panel recognized that the Department's level of analysis of the stumpage programmes in these provinces and territories was not as detailed as in other cases, the Panel could not conclude that this level of analysis was unreasonable at the initiation stage. This was particularly true in view of the fact that lumber from these provinces and territories accounted for a very small percentage of total Canadian lumber exports to the United States.

359. In summary, bearing in mind that the Panel was reviewing the sufficiency of the evidence relied upon by the Department of Commerce at the initiation of an investigation, the record did not suggest to the Panel that the selection and use by the Department of Commerce of particular data and price comparisons was, on its face, unreasonable. Given that the Panel's rôle in reviewing the initiation decision was not to weigh the relative value of certain evidence in relation to other evidence, but rather to review the evidence relied upon by the Department in light of the considerations set forth in paragraph 335, the Panel did not consider that the varying quality of the data and analyses employed by the Department of Commerce was such as to disqualify the initiation action under Article 2:1 of the Agreement.

360. In the Panel's view, a reasonable, unprejudiced person could have found, based upon the evidence relied upon by the Department of Commerce at the time of initiation, that sufficient evidence existed of subsidy in respect of Canadian stumpage pricing practices to justify initiation of an investigation on this issue. Accordingly, the Panel concluded that the decision by the United States that it had sufficient evidence to initiate on the question of subsidy in respect of Canadian stumpage pricing practices was not inconsistent with the United States' obligations under Article 2:1 of the Agreement.

(ii) Inclusion of Log Export Restrictions in Commerce's Investigation

361. The Panel recalled that on 31 October 1991, at the time of the self-initiation of the countervailing duty investigation on lumber from Canada, the Department of Commerce did not consider that it had sufficient evidence to initiate on the question of whether Canadian log export restrictions constituted subsidies. Thus, by the United States' own admission, there was insufficient evidence in October 1991 to initiate the investigation as to log export restrictions. Because the terms of reference of the Panel related to actions taken by the United States in October 1991 and not to actions taken subsequently thereto, it was the view of the Panel that the decision of the Department of Commerce on

23 December 1991 to include log export restrictions in the countervailing duty investigation was not a matter properly before this Panel. The Panel therefore decided to dispense with all further consideration of issues relating to Canada's log export restrictions.

3.4 Evidence of the existence of material injury, or threat thereof, caused by the allegedly subsidized imports

362. The Panel then proceeded to examine Canada's claim that the self-initiation by the United States on 31 October 1991 of a countervailing duty investigation on imports of softwood lumber from Canada was inconsistent with Article 2:1 of the Agreement because there had not been sufficient evidence of the existence of material injury, or a threat of material injury, to the domestic industry in the United States caused by the imports under consideration.

363. The Panel noted that in the Notice of Initiation of the countervailing duty investigation, the Department of Commerce had made the following statement regarding the evidence of material injury, or threat thereof, caused by allegedly subsidized imports of softwood lumber from Canada:

> "Evidence available to the Department demonstrates that the U.S. softwood lumber industry is currently suffering material injury as a result of subsidized softwood lumber imports from Canada, and faces the threat of further more extensive material injury. The indicators that the International Trade Commission (ITC) considers when assessing material injury point to weaknesses in the domestic industry. In particular, the data show a downward trend in domestic production, shipments, capacity utilization, employment, and prices. As a result, the industry is experiencing a considerable decline in profitability. Canada has consistently captured a significant and substantial share of the U.S. market, even during the MOU. Furthermore, U.S. lumber prices have been depressed. Given that lumber is an extremely fungible commodity and U.S. prices are depressed, and given that Canada's already significant share of the U.S. market appears to be rising, there is a clear indication that subsidized Canadian lumber imports are a cause of injury to the U.S. industry."[159]

A more detailed description of the factual basis for the Department's conclusion on the existence of evidence on material injury and causation was contained in the Initiation Memorandum, pp.30-39. As reflected in Section 2.3 of this Report, in the proceedings before the Panel the analysis presented on pp.30-39 of the Initiation Memorandum and the statistical data referred to on these pages were the basis of the arguments of both parties to the dispute.

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[159] 56 Fed.Reg., 31 October 1991, p.56057.

364. As indicated in the passage from the Notice of Initiation quoted in paragraph 363, the Department of Commerce had referred both to material injury currently experienced by the domestic industry and to a threat of material injury caused by allegedly subsidized imports from Canada. In the Initiation Memorandum the Department had first presented an analysis of data pertaining to current material injury experienced by the domestic industry as a result of the allegedly subsidized imports from Canada and had then presented data pertaining to evidence that, following the termination of the MOU by Canada, imports of allegedly subsidized softwood lumber from Canada threatened to cause material injury to a domestic industry in the United States. The analysis of the evidence of a threat of material injury caused by allegedly subsidized imports from Canada was introduced by the following statement:

> "Even assuming, arguendo, that the U.S. industry was not continuing to experience material injury caused by subsidized Canadian imports during the tenure of the MOU, there exists considerable evidence indicating that the MOU's termination has produced a real threat of imminent material injury."[160]

The Panel noted that footnote 6 ad Article 2:1 of the Agreement defined the term "injury" under the Agreement as "material injury to a domestic industry, threat of material injury to a domestic industry or material retardation of the establishment of such an industry". Given that in its Notice of Initiation the United States had referred to evidence of both current material injury to the domestic industry and a threat of material injury, the self-initiation by the United States of a countervailing duty investigation of imports of softwood lumber from Canada would be inconsistent with Article 2:1 if there were neither sufficient evidence of material injury actually experienced by the domestic industry in the United States as a result of allegedly subsidized imports from Canada nor sufficient evidence of a threat of material injury caused by such imports.

365. Before examining the issues raised by Canada regarding the evidence presented by the Department of Commerce in its Initiation Memorandum, the Panel considered Canada's argument that the Department of Commerce could not have had sufficient evidence of material injury (or threat of material injury) for purposes of Article 2:1 of the Agreement, because under the countervailing duty legislation of the United States the Department of Commerce had no authority to consider the sufficiency of evidence on material injury for purposes of initiation of a countervailing duty investigation (supra, Section 2.4(vi)). The Panel considered that, as reflected in the Notice of Initiation of the Investigation, in the case before it, the United States Department of Commerce had made a determination that sufficient evidence of material injury (or threat of material injury) existed to warrant an investigation. For purposes of

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[160] Initiation Memorandum, p.36.

examining whether the United States had acted inconsistently with Article 2:1 on the grounds that insufficient evidence of material injury existed, the Panel therefore had to review the evidence presented by the Department of Commerce. Whether, in finding that there was sufficient evidence of material injury, the Department of Commerce had acted consistently with United States legislation concerning the respective rôles of the Department of Commerce and the USITC was a domestic matter which was not properly subject to review in a dispute settlement proceeding under the Agreement. The Panel therefore concluded that Canada's argument regarding the manner in which the United States legislation defined the responsibilities of the Department of Commerce and the USITC could not constitute a ground to find that the United States had initiated this countervailing duty investigation in the absence of sufficient evidence of the existence of material injury or threat of material injury.

3.4.1 Whether there was sufficient evidence of the existence of material injury

366. The Panel then proceeded to examine the issues raised by Canada with respect to the specific data relied upon by the Department of Commerce in its finding that there was sufficient evidence of material injury currently experienced by the domestic industry as a result of allegedly subsidized imports of softwood lumber from Canada to warrant an investigation. In so doing, the Panel applied the standard set forth in paragraph 335. Accordingly, the Panel considered whether, based on the data presented by the Department of Commerce, a reasonable, unprejudiced person could have concluded that sufficient grounds existed to warrant an investigation of whether the subject imports from Canada were causing material injury to the domestic softwood lumber industry in the United States.

367. The Panel recalled its view that the requirement of "sufficient evidence" in Article 2:1 implied that there had to be a factual basis for a decision to initiate a countervailing duty investigation, susceptible of review under the dispute settlement provisions of the Agreement. The Panel noted in this respect that it had before it, in the Initiation Memorandum, a description of the analysis (and factual basis of that analysis) relied upon by the Department of Commerce in its finding that there was sufficient evidence of the existence of material injury to warrant an investigation.

368. As described in Section 2.4 of this Report, in contesting the sufficiency of the evidence relied upon by the Department of Commerce, Canada advanced arguments pertaining in particular to the Department's analysis of the alleged rôle of the subject imports from Canada in causing material injury to the domestic industry in the United States. Thus, Canada considered that there had been insufficient evidence with respect to both the relative and absolute volume of the subject imports from Canada, the price effects allegedly caused by these imports, and the alleged impact of these imports on the domestic industry. Canada generally had argued that the evidence presented in the Initiation Memorandum of the existence of material injury caused by the subject imports from Canada was selective and that the Department of Commerce had ignored other evidence which would

have led to the conclusion that allegedly subsidized Canadian imports were not causing material injury to the United States softwood lumber industry.

(i) Volume of imports

369. The Panel noted that on page 33 of the Initiation Memorandum, the Department of Commerce, in the context of its discussion of the rôle of the subject imports from Canada in causing material injury to the domestic industry, had made the following statement on the volume of these imports:

> "First, Canadian softwood lumber imports have consistently commanded a significant share of the U.S. market - over the last three years (1988-1990) Canada accounted for 27.8 per cent of total U.S. consumption. Moreover, the Canadian import penetration rate rose from 26.2 per cent in the first quarter of 1991 to 27.1 per cent in the second quarter. Recent information gathered by the Department indicates that import penetration rose even further in July and August, climbing to 28.6 per cent. See Table E-2."

Canada had challenged the sufficiency of the evidence presented by the Department of Commerce regarding the volume of the subject imports from Canada essentially on the following grounds. First, the time frame used in the analysis of the industry indicators on the basis of which the Department had concluded that the industry was suffering material injury was inconsistent with the time frame used to analyse the increase of the imports from Canada. Had the Department examined the evolution of imports over the same time frame as the evolution of the industry indicators (first half of 1991-first half of 1990), it would have found that the Canadian market share was static at 26.7 per cent. Alternatively, had the Department examined the industry indicators over the same time period as the increased import penetration (second quarter of 1991-first quarter of 1991), it would have found that the industry indicators showed large increases during that period. Second, the Department of Commerce had ignored that, as demonstrated by data in Table E-2, during the period 1988-1990, the volume of the imports from Canada had been decreasing consistently both in absolute and in relative terms. Third, the increase in imports from the first to the second quarter in 1991 was due to seasonal fluctuations and therefore insignificant.

370. The Panel noted with respect to Canada's argument on the use of differing time frames that Canada had specifically stated that the increase in the Canadian market share between the first and second quarters of 1991 was juxtaposed with the performance of the US industry as based on a comparison of six industry indicators for the first half of 1991 with those of the first half of 1990 and that on this basis the increase in the Canadian market share was used by the United States as evidence that Canadian imports caused injury. However, it appeared to the Panel that this statement did not correctly describe the analysis reflected in the text of the Initiation Memorandum. First, the comparison of the performance of the US industry in the first half of 1991 with the performance of the industry in the first half of 1990 was made after the

Department had examined data on the industry indicators over the period 1988-1990 and served to support the statement that "many of these unfavourable economic trends accelerated in the first half of 1991."[161] (emphasis added). Thus, the Department had not defined injury as a deterioration of the performance of the industry in the first half of 1991 compared with the performance of the industry in the first half of 1990. Rather, it had identified the injury in terms of the existence of "unfavourable economic trends" during the period 1988-1990 and had observed that these trends had "accelerated" in the first half of 1991. Second, the text of the Initiation Memorandum indicated that the Department of Commerce had not relied only on the increase of the Canadian import penetration rate from the first to the second quarter of 1991 as evidence that Canadian imports were causing injury. Rather, the Department had relied on the significant market share held by the Canadian imports over the period 1988-1990, together with the increase in that market share in 1991 in its analysis of the volume of imports from Canada[162] and, after noting that softwood lumber was a commodity product sold primarily on the basis of price and that Canadian and US softwood lumber were fungible products which directly competed with one other in the North American market[163], had linked the Canadian import penetration rate to the alleged price suppressing effects of the imports from Canada.[164]

371. The Panel then turned to Canada's argument that, over the period 1988-1990, the volume of Canadian imports had been decreasing consistently both in absolute and in relative terms, a fact which had been ignored by the Department of Commerce. The Panel noted that it was factually correct that the text of the Initiation Memorandum did not explicitly mention the fact that, during this period the Canadian import penetration rate had fallen from 28.2 per cent to 26.8 per cent. However, the Panel considered that Canada's argument on this issue rested on the view that the Department of Commerce had somehow attached decisive importance to the increase of imports in 1991; had this been the case, it might indeed have been unreasonable and arbitrary for the Department not to discuss the decrease of Canadian import penetration over the period 1988-1990. As discussed in the previous paragraph, the Panel did not consider that the analysis of the volume of the subject imports from Canada undertaken by the Department of Commerce relied in a decisive manner on the increase in Canadian import penetration from the first to the second quarter in 1991.

372. The Panel observed in this latter respect that under Article 6:2 of the Agreement a consideration of the significance of the increase of the volume was a mandatory factor in an investigation of whether material injury was caused by allegedly subsidized imports; however, the last

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[161] Initiation Memorandum, p.31.

[162] Initiation Memorandum, p.33.

[163] Initiation Memorandum, p.33.

[164] Initiation Memorandum, p.34.

sentence of this provision indicated that a finding of a significant increase was not a necessary requirement for an affirmative injury determination to be consistent with the Agreement. It followed that, a fortiori, the absence of a significant increase in the volume of imports could not a priori be considered to mandate a finding that there was insufficient evidence to initiate an investigation. The text of the Initiation Memorandum indicated that the Department had analysed the significance of the level of the Canadian import penetration in particular in relation to the alleged price effects of these imports. The Panel was of the view that this could not be considered to be inconsistent with Article 2:1 of the Agreement as a matter of law. The Panel therefore considered that the decline in the Canadian market shares over the period 1988-1990 did not necessarily mean that insufficient evidence existed of the existence of material injury caused by allegedly subsidized imports from Canada to warrant the initiation of a countervailing duty investigation.

373. The Panel then turned to Canada's argument that the increase in the Canadian import penetration from the first to the second quarter in 1991 was not significant because this increase could be explained on the basis of seasonal fluctuations.

374. The Panel found that Canada was factually correct in asserting that the Department of Commerce had not explicitly considered and rejected the possibility that this increase might be the result of a seasonal fluctuation. The Panel noted that, while the United States had argued that a comparison of data for the third quarter 1991 with data for the third quarter 1990 undercut the argument that the increase of Canadian imports in 1991 was the result of a seasonal fluctuation, the Department of Commerce only had before it at the time of initiation data for July and August 1991. The Panel therefore considered that the argument of the United States on this issue was not entirely supported by the facts before the Department of Commerce at the time of initiation. However, in view of its finding in paragraph 370 that the Department had not exclusively relied on the increase in the volume of imports from the first quarter to the second quarter of 1991, the Panel considered that the absence of complete data on the volume of Canadian imports in the third quarter of 1991 could not constitute a sufficient ground to conclude that the evidence on the volume of the subject imports was insufficient for purposes of Article 2:1.

(ii) Price effects of the imports under consideration

375. The Panel then proceeded to examine whether the evidence relied upon by the Department of Commerce regarding the price effects of the imports under consideration was sufficient within the meaning of Article 2:1 of the Agreement.

376. The Panel noted that on page 34 of the Initiation Memorandum the Department of Commerce had stated that:

"Given these market and product characteristics, it is likely that the existence of subsidized Canadian imports, which account for a significant share of the U.S. domestic market, suppressed domestic prices to a point significantly below the level they would have been had it not been for the subsidized imports. In addition, prices can drop significantly with little effect on the quantity of softwood lumber consumed, thereby depressing revenues and profits for U.S. softwood lumber manufacturers. See Table E-4."

This statement was followed by an examination of price trends and comparative average prices which allegedly supported the contention of price suppression. As described in Section 2.4 of this Report, Canada contested the adequacy of each of the four indicators used by the Department of Commerce in its examination of the price effects of the imports from Canada: (1) a comparison of an index of prices of domestic softwood lumber with an all commodity producer price index; (2) a comparison of prices of imported softwood lumber with prices of domestic softwood lumber over the period 1988-1990; (3) a comparison of the Random Lengths composite framing lumber price in the period 1987-1990 with what were alleged to be "average Canadian f.o.b. export prices" to the United States over the same time frame, and (4) a comparison of Random Lengths prices of Douglas Fir (green) 2x4s, from both Portland and Vancouver.[165]

377. With regard to the first of these four indicators, the Panel noted that the Department of Commerce had observed that "U.S. softwood lumber prices rose only 3.2 per cent during 1989 and 1990, while the all-commodity producer price index rose 8.8 per cent over the same period."[166] Canada had argued that this comparison could not provide sufficient evidence of price suppression because there was no logical reason to expect that the domestic softwood lumber price index should be equal to the all-commodity producer price index (which was the average of a number of commodity indices) and because the Department of Commerce had failed to consider that the decline in housing starts was a more relevant explanation of the low price increases for domestic softwood lumber. Canada had also argued that, even assuming arguendo that this comparison was justified, the domestic softwood lumber price index had increased significantly from the first to the second quarter of 1991 (the period during which the Canadian import penetration had increased), while the all commodity producer price index had fallen by 1.2 per cent.

378. The Panel noted that the comparison between the softwood lumber price index and the all commodity producer price index was one of several elements of the evidence adduced by the Department of Commerce on the question of price suppression. While the decrease in housing starts might

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[165] Initiation Memorandum, pp.34-35.

[166] Initiation Memorandum, p.34.

well have been "a more relevant explanation" of the low price increases in the United States softwood lumber industry, this was an issue pertaining to the interpretation and evaluation of evidence which was not properly the subject of the Panel's review.[167] The Panel considered that the existence of an alternative, plausible explanation of the price performance in the industry did not, in and of itself, mandate the conclusion that the Department of Commerce could not have relied on this evidence as one of the elements with respect to the issue of price suppression for purposes of initiation. With regard to Canada's argument on the increase in the domestic price index from the first to the second quarter of 1991, the Panel considered that this argument rested on the assumption that the Department of Commerce had somehow identified the increase in Canadian import penetration from the first to the second quarter as the key element in its analysis of the volume of imports from Canada. The Panel recalled in this respect its views expressed in paragraphs 370 and 372.

379. The Panel then turned to the issues raised by Canada with respect to the use by the Department of Commerce of a comparison between the import price index for softwood lumber and the domestic producer price index for softwood lumber as evidence of the price effects of the imports from Canada. First, Canada had argued that the comparison of the import price index and the domestic producer price index did not provide evidence of price suppression caused by the subject imports from Canada because of the different product compositions of these two indices. Second, Canada had argued that in comparing the import price index with the domestic producer price index, the Department of Commerce had relied on two indices based in different years (1985 and 1982). Finally, Canada had argued that the Department of Commerce had misrepresented its data on the evolution of the import price index; while the text of the Initiation Memorandum claimed that there had been a decline of the Canadian import price of 4.6 per cent over the period June 1988-June 1991, this figure was in fact based on the period June 1988-April 1991. Had the Department used the period June 1988-June 1991, it would have found an increase of the import price index of 8.2 per cent.

380. With regard to the issue raised by Canada concerning the differences in product composition between the import price index and the domestic price index, the Panel noted that in the Initiation Memorandum the Department of Commerce had referred to two previous investigations in which the USITC had found that softwood lumber imported from Canada and domestically produced softwood lumber were "generally interchangeable and fungible" and that "this substitutability was not dependent on the products being fabricated from the same species of tree".[168] The Panel considered that this matter required a degree of factual analysis which would go

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[167] Supra, paragraph 359.

[168] Initiation Memorandum, p.33.

beyond what was appropriate in the context of a review of a decision to initiate a countervailing duty investigation.

381. The Panel found that Canada was factually correct in its assertion that the Department had compared price indices with different base years (1985 for the import price index and 1982 for the domestic price index). In addition, the Panel found that, as the United States had conceded, Canada was also factually correct in asserting that the statement on page 36 of the Initiation Memorandum on "price depression resulting from Canadian imports of 4.6 per cent over a three-year period (June 1988 through June 1991)" suggested that the Department of Commerce had included in its consideration of the import price data the price increases which had occurred in the second quarter of 1991 while in fact it had not. The Panel considered that in particular with respect to the use of indices with different base years the Department of Commerce had made an invalid comparison. The Panel however was not persuaded that these deficiencies were such as to warrant the conclusion that the Department of Commerce had insufficient evidence of a price suppressing effect of the imports from Canada to warrant the initiation of an investigation. In this respect, the Panel noted that it was evident from the text of the Initiation Memorandum that the Department had attached significance to the fact that while during the period 1989-1990 domestic softwood lumber prices in the United States had risen slightly, prices for imported softwood lumber had remained unchanged over the same time period.[169] After examining the indices of prices of imported and domestic softwood lumber in Table E-4 of the Initiation Memorandum, the Panel considered that the error made by the Department of Commerce in using indices based in different years was not such that these statements on page 34 of the Initiation Memorandum were not supported by fact. Furthermore, the Panel's examination of these data also indicated that the error made by the Department of Commerce in using price indices with different base years did not detract from the fact that while in the second quarter of 1991 import prices had risen more than domestic prices, they were still below the domestic price level.

382. The Panel then turned to the issues raised by Canada regarding the comparison made by the Department of Commerce between the Random Lengths composite framing lumber price in each of the years from 1987 to 1990 with what was alleged to be an "average Canadian f.o.b. export price", based on Government of Canada data. In this respect, the Panel was faced with directly contradictory statements by the parties to the dispute regarding the adequacy of the data on export prices. Canada argued that the data used by the Department of Commerce did not provide a basis to calculate f.o.b. export prices. Moreover, even if f.o.b. export prices could be calculated on the basis of these data, such prices would not provide evidence of prices of Canadian softwood lumber as sold in the United States. The United States argued that the export notices from which

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[169] Initiation Memorandum, p.34.

these data were derived had specifically contained f.o.b. prices of lumber, as sold in the United States. The Panel noted that the United States had provided it with a copy of one of these export notices, containing entries for the "unit f.o.b. mill price" and the "total f.o.b. mill price". Absent any other factual material on this issue, it was not clear to the Panel that, as alleged by Canada, the Department of Commerce had constructed an artificial export price for purposes of comparison with the Random Lengths composite framing lumber price. However, the Panel did not consider that it could be concluded from the document provided by the United States that the prices derived from the export notices were in fact prices of the product as sold in the United States.

383. The Panel then turned to Canada's arguments concerning the comparison made by the Department of Commerce between the Random Lengths published prices for Douglas Fir (green) 2x4s in Portland and Vancouver. Canada had argued that this evidence was inadequate in that no explanation had been provided of the basis on which the Department of Commerce had made an adjustment for costs of transport. Furthermore, the Department had ignored more relevant price comparisons which would have yielded a different result. In this respect Canada had emphasized that end-use, not species should have been the relevant criterion in the selection of the price comparisons.

384. With respect to the issue of the adjustment for costs of transportation, the Panel considered that the Department of Commerce had not unreasonably relied on publicly available information in its estimate of the costs of transportation. There was no evidence before the Panel suggesting that more accurate data were available to the Department of Commerce to estimate the adjustment for costs of transportation. With regard to the choice of the product for which this price comparison had been made, the Panel noted the differing views of the parties as to whether species or end-use was the relevant criterion in determining which price comparisons to make. The Panel considered that the question of whether species or end-use constituted the relevant criterion in selecting the product for which price comparisons should be made required an extent of analysis which would go beyond what was appropriate in the context of a review of a decision to initiate an investigation.

385. The Panel noted that the United States had also argued that the price comparison for Douglas Fir 2x4s was in line with aggregate price comparisons for other species. However, the Panel could not find any reference in the Initiation Memorandum to price comparisons for other species, and therefore considered that this argument of the United States was unsupported by fact.

386. In sum, the Panel concluded that the examination of the data on price trends and price comparisons relied upon by the Department of Commerce revealed that some of these data raised questions of fact and questions pertaining to the methodology used. While in some instances there were manifest deficiencies in the analysis of the Department, taken as a whole, the evidence was not such as to permit the Panel to conclude that a

reasonable, unprejudiced person could not have found that that there was sufficient evidence that allegedly subsidized Canadian imports had contributed to price suppression in the United States market to warrant initiation of an investigation.

(iii) Impact of the allegedly subsidized imports on the domestic industry

387. The Panel then proceeded to examine the issues raised by Canada with respect to the evidence presented by the Department of Commerce on the impact of the subject imports on the domestic industry. Canada had in particular contested the sufficiency of the evidence on the decline in net income and on lost sales.

388. The Panel noted Canada's argument that the data on declines in net incomes pertained to a small part of the domestic industry. The Panel noted in this respect that it had no data before it suggesting that the financial experience of other domestic producers was significantly different. The Panel found that in conjunction with the evidence on lost sales, and put in the context of the Department's analysis of the alleged price suppressing effect of the subject Canadian imports, the fact that the data on declining net incomes pertained to a small portion of the industry, could not necessarily be considered grounds to find that this evidence was insufficient for purposes of the initiation of a countervailing duty investigation under Article 2:1. With regard to Canada's argument on the evidence on lost sales, the Panel noted that Canada had only referred to the fact that the Department of Commerce had explicitly stated that such evidence was difficult to identify clearly and that it had obtained "limited data" on this issue. The Panel found that this statement alone could not be a basis for the Panel to conclude that the evidence before the Department on this issue was insufficient.

(iv) Injury caused by the allegedly subsidized imports from Canada "through the effects of the subsidy"

389. The Panel noted that Canada had argued that the Department of Commerce had not provided any evidence of how the alleged subsidies enabled the subsidized imports to cause material injury to the domestic softwood lumber industry in the United States. Canada had pointed out that the level of fees charged for the right of access to a natural resource could not cause any countervailable market distortion.

390. The Panel recalled its view expressed previously that the question of the applicability of the theory of economic rent to the specific facts of the Canadian stumpage pricing practices was an empirical question which could not be decided in the abstract.[170] Therefore, even if one assumed that Article 6:4 of the Agreement contemplated the type of analysis

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[170] Supra, paragraph 347.

suggested by Canada and that such an analysis was required at the initiation stage of an investigation, Canada's argument on the nature of the stumpage fees as reflective of the collection of economic rent could not be a basis to find that the Department of Commerce did not have sufficient evidence of causation to warrant the initiation of an investigation.

(v) Other factors allegedly injuring the domestic industry

391. Regarding the issue of the causal relationship between the alleged injury and the subject imports, the Panel noted that Canada had in particular argued that the Department of Commerce had failed to give any consideration to the effects on the domestic softwood lumber industry of factors such as the cyclical downturn in the industry, the general economic recession and exchange rate developments, thereby acting inconsistently with the requirement of the second sentence in Article 6:4 of the Agreement.

392. The Panel found that, as a matter of fact, it was correct that the Initiation Memorandum nowhere referred to the factors mentioned by Canada. However, while an express consideration of these factors would in the circumstances have been appropriate, it was not clear to the Panel that this lack of express consideration of possible alternative causes of material injury at the time of the initiation of an investigation warranted a conclusion that the Department of Commerce had acted inconsistently with its obligations under Article 2:1 of the Agreement. For purposes of a final injury determination, Article 6:4 did not require that imports under investigation be a more important cause of injury than other factors. Rather, injury caused by such other factors could not be attributed to the subsidized imports under investigation. Therefore, assuming arguendo that this requirement had to be observed at the initiation stage of an investigation (a matter on which the Panel did not consider it necessary to pronounce itself), the Department's decision that there was sufficient evidence of causation would have been inconsistent with Article 2:1 only if material injury to the domestic industry was entirely explained by other factors. The Panel considered that the data before it did not warrant the conclusion that, had the Department considered this issue at the initiation stage, it would necessarily have come to that conclusion. Nonetheless, in the view of the Panel, factors such as the cyclical downturn and the economic recession continued to merit further examination during the course of the investigation.

(vi) Effects of the MOU

393. The Panel noted that the major focus of the evidence relied upon by the Department of Commerce was on the volume and price effects of the subject Canadian imports of softwood lumber and on the impact of these imports on the domestic industry. As explained in the previous paragraphs, the Panel considered that, while in certain respects the data were of varying quality, the data before the Department of Commerce could have constituted a basis upon which a reasonable, unprejudiced person could

consider that there was sufficient evidence of current material injury experienced by the domestic industry in the United States as a result of allegedly subsidized Canadian imports to justify the initiation of an investigation. However, it appeared to the Panel that the Department of Commerce had failed to address an additional element which, in the present case merited serious consideration: given that most of the data examined by the Department of Commerce covered the period during which the MOU on softwood lumber between Canada and the United States had been in effect, a critical question was whether in the presence of the 15 per cent Canadian export tax (or its equivalent in the form of replacement measures), imposed to offset the alleged Canadian subsidies, any material injury to the domestic industry in the United States could still be the result of subsidized imports of softwood lumber from Canada, as required by Article 6:4. The Panel noted in this context that Canada had argued that the determination by the United States that there was sufficient evidence of material injury suffered by the domestic industry as a result of the subject imports from Canada was inconsistent with testimony of the Deputy Assistant Secretary of Commerce before the United States Congress that the export tax imposed under the MOU had been adequate to offset the effect of the Canadian lumber subsidies, and that Canada had not taken any measures since the conclusion of the MOU which would offset the effects of the MOU.

394. The Panel was therefore not persuaded that the Department of Commerce had acted reasonably when it had completely neglected all consideration of the possible relevance of the measures taken by Canada under the MOU to its examination of the data on injury and causation. However, in light of the Panel's analysis below of the evidence relied upon by the Department of the existence of a threat of material injury, the Panel did not find it necessary to make a finding on whether this failure of the Department to consider the possible relevance of these measures meant that the Department's determination of the existence of sufficient evidence of current material injury was inconsistent with Article 2:1.

3.4.2 Whether there was sufficient evidence of a threat of material injury

395. The Panel then examined whether, as required under Article 2:1, there had been sufficient evidence of a threat of material injury caused by the allegedly subsidized imports from Canada to justify the initiation of a countervailing duty investigation.

396. The Panel noted that in its Initiation Memorandum the Department of Commerce had stated that:

> "Even assuming arguendo that the U.S. industry was not continuing to experience material injury caused by subsidized Canadian imports during the tenure of the MOU, there exists considerable evidence

> indicating that the MOU's termination had produced a real threat of imminent material injury."[171]

In support of this contention regarding the evidence of a threat of material injury the Department had mentioned the following circumstances:

397. First, the Department had observed that without the MOU, the Government of British Columbia would have the flexibility to use stumpage prices to aid its lumber industry because stumpage prices in that province would no longer be subject to an MOU-approved pricing formula. Quebec, which had partially replaced the export tax under the MOU with higher stumpage prices, would enjoy the same flexibility in stumpage pricing.

398. Second, the Department had identified as another circumstance indicating the existence of a threat of injury to the domestic industry in the United States the fact that four of the Canadian provinces (Alberta, Manitoba, Saskatchewan and Ontario) had not enacted replacement measures under the MOU. While exports from these four provinces had been subject to the full export tax of 15 per cent, the absence of replacement measures meant that exporters from these provinces had not incurred increased costs on either domestic sales or on sales to countries other than the United States. Data before the Department indicated that in 1987, 1988 and 1989 the combined softwood lumber production of these four provinces had accounted for an increasingly larger share of total Canadian softwood lumber production (15.7, 16.6 and 17.4 per cent respectively). At the same time, the combined softwood lumber exports of these four provinces to the United States had accounted for a declining share of total Canadian softwood lumber exports to the United States (14.6, 11.2 and 9.8 per cent, respectively). Based on these data, the Department had considered that it could logically be expected that:

> "the elimination of the total export tax for these four provinces, and the elimination of the partial export tax in Quebec, can be expected to produce the greatest shift in trade back to the United States by provinces which did the least to offset any unfair cost advantage. Given that these provinces will have the greatest potential for undercutting U.S. prices, the result will be further price suppression and a greater share for Canadian imports of the U.S. market."[172]

399. Third, the Department had also considered that this expected increase of exports of softwood lumber to the United States from the four provinces which were no longer subject to the 15 per cent export charge could have an impact on stumpage pricing in British Columbia and Quebec:

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[171] Initiation Memorandum, p.36.

[172] Initiation Memorandum, pp.37-38.

> "With the expected increase on the U.S. market lumber from Alberta, Manitoba, Saskatchewan and Ontario, those provinces which had enacted replacement measures (BC and Quebec), and thereby charged relatively higher stumpage rates, will find themselves under enormous competitive pressure to reduce those rates, thus increasing the potential level of subsidies in the two largest exporting provinces. The result would be even greater price suppression in the U.S. market."[173]

400. Finally, the Department of Commerce had noted that Canadian softwood lumber capacity utilization rates in 1987-1989 were 91.6 per cent, 89.5 per cent and 88.4 per cent, respectively and had noted that the capacity utilization rate probably had continued to decline as Canadian production had decreased by 7.2 per cent in 1990 and had continued to fall in 1991. From these data, the Department had concluded that:

> "With such excess capacity in the industry, termination of the MOU will enable Canadian mills to rapidly increase the production and exportation of subsidized lumber to the United States resulting in greater Canadian imports and power prices in the U.S. market."[174]

401. In support of its view that the United States had initiated this investigation without there being sufficient evidence of the existence of a threat of material injury, Canada had argued that the analysis in the Initiation Memorandum was based on speculation and did not involve evidence of events which could constitute a real threat of imminent material injury to the domestic industry in the United States. Thus, in respect of British Columbia and Quebec, the Department of Commerce had presumed that these provinces would change their legislation to reduce stumpage prices but had not provided evidence that such legislative action was a real possibility or imminent. In the view of Canada, to accept this presumption of a change in legislation as evidence of a threat of injury would amount to allowing the initiation of investigations based on the assumption that a signatory might change its laws. With regard to the Department's analysis on the consequences of the removal of the 15 per cent export tax on exports from Ontario, Manitoba, Saskatchewan and Alberta, Canada considered that the Department had not provided evidence that there would be a significant increase in exports, an increase in the share of the United States market, or price undercutting in the United States market by exports from these provinces. In addition, exports from these four provinces accounted for only 8.3 per cent (by value) of Canadian softwood lumber production to the United States which suggested that any possible threat of material injury was minimal. Finally, Canada had contested that the data before the Department of Commerce on excess production capacity provided evidence of the existence of a threat of injury. The decline in capacity utilization in the Canadian industry was the natural consequence of the recession in

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[173] Initiation Memorandum, p.38.

[174] Initiation Memorandum, p.38.

the integrated North American lumber market. Moreover, even if the four provinces which had not enacted replacement measures under the MOU would produce at full capacity and all this extra production would be exported to the United States, the result could only be an increase of the Canadian market share of not more than 1 per cent. This could not have a material impact on the domestic industry in the United States.

402. The Panel considered that a resolution of the legal issue before it with respect to the alleged insufficiency of the evidence of a threat of material injury following Canada's termination of the MOU required an examination of whether the evidence relied upon by the United States was based on mere speculation, or whether, as contended by the United States, there had been a real threat of imminent material injury following the termination of the MOU. The Panel noted in this respect that the Agreement did not provide substantive standards regarding the concept of a threat of material injury especially regarding the point in time at which potentially threatening elements could be regarded as constituting a threat of material injury within the meaning of the Agreement. However, the Panel noted that as applied in the practice of signatories, this concept had been interpreted as requiring factual evidence of a clearly foreseen and imminent change in circumstances in which subsidized imports would cause material injury. Thus, a determination of threat of material injury could not be based on mere speculation as to possible future events.

403. The Panel noted that the parties to the dispute had not suggested a different interpretation of the concept of a threat of material injury. Rather, the parties had disagreed as to the adequacy of the factual basis upon which the United States had determined that there was sufficient evidence of a threat of material injury to warrant the initiation of a countervailing duty investigation. In its examination of this question, the Panel was guided by the considerations set forth in paragraph 33. The Panel therefore considered whether a reasonable, unprejudiced person could have found, based upon the evidence before the Department of Commerce at the time of the initiation of this investigation, that sufficient evidence existed of a threat of material injury caused by allegedly subsidized imports from Canada to justify the initiation of a countervailing duty investigation.

404. With respect to the specific elements relied upon by the Department of Commerce as constituting sufficient evidence of a threat of material injury, the Panel first considered the argument of the Department that the termination of the MOU had provided the governments of British Columbia and Quebec with new flexibility to adjust their stumpage pricing programmes. In the view of the Panel, the mere existence of governmental discretion to adjust stumpage pricing in these provinces could not be a pertinent factor in considering whether there was sufficient evidence of a threat of material injury from allegedly subsidized imports to warrant an investigation because the Agreement did not permit actions in the case of possible future subsidies. The Panel also noted in this respect that Canada had argued that its Government had given informal assurances to the

United States in October 1991 that the replacement measures in British Columbia and Quebec would continue.

405. The Panel then turned its attention to the second element relied upon by the Department of Commerce in finding that there was sufficient evidence of a threat of material injury to warrant the initiation of a countervailing duty investigation. As described in paragraphs 96 and 97, this second element pertained to the expected consequences of the removal of the 15 per cent export tax provided for under the MOU for the exports from Alberta, Manitoba, Saskatchewan and Ontario. The Department had considered that it was likely that the exports from these provinces would increase and that, in turn, these increased exports would lead to pressure on British Columbia and Quebec to reduce their stumpage rates.

406. The Panel noted that in its analysis of the expected consequences of the elimination of the 15 per cent export tax from exports from these four provinces the Department of Commerce had relied upon data indicating that while in the period 1987-1989 the combined softwood lumber production in these four provinces had accounted for an increasingly larger share of total Canadian softwood lumber production, during the same period the combined softwood lumber exports from these four provinces had accounted for a declining share of total Canadian softwood lumber exports to the United States. The factual correctness of these data had not been contested before the Panel. The Panel noted that the Department of Commerce had related this decline in the share of these four provinces in total Canadian exports to the effect of the export tax charged under the MOU and had concluded that the elimination of this export tax could be expected to produce a significant shift in trade back to the United States from these provinces. With the elimination of the export tax (as a result of the termination of the MOU) exporters from these provinces could in the immediate future sell for export to the United States at lower prices. The Panel therefore considered that the statements made by the Department of Commerce with respect to the potential of the exports from these four provinces for undercutting United States prices and the consequent price suppression and increased market share of Canadian imports could not be said to amount to mere speculation in the context of a review of a decision to initiate an investigation.

407. The Panel in this connection noted that the Department of Commerce had also relied on data on the existence of excess production capacity in Canada. It had not been contested by Canada that the data referred to by the Department of Commerce were factually correct. Rather, Canada had argued that these data did not constitute sufficient evidence of the existence of a threat of material injury. Canada had in particular argued that any increase in the Canadian market share in the United States resulting from an increased use of capacity utilization in Canada would be of a limited magnitude.

408. The Panel considered that the existence of excess production capacity in an exporting country could be a relevant factor, although not a determining factor, in the context of a consideration of whether a threat

of material injury existed, especially in a price-sensitive and integrated market such as that for softwood lumber in North America. The Panel recalled in this respect that a large percentage (about 70 per cent) of Canadian softwood lumber production was destined for export to the United States and that such Canadian exports accounted for approximately 27 per cent of the United States softwood lumber market. It could therefore reasonably be concluded that any increased capacity utilization in Canada could have an effect on the volume of Canadian exports to the United States. The Panel further observed in this connection that the Department of Commerce had referred to the data on excess production capacity in Canada after it had discussed the increased flexibility of British Columbia and Quebec to set their stumpage prices and the expected consequences (in terms of competitive pressure on British Columbia and Quebec) of the elimination of the export tax from exports from the four provinces which had not enacted replacement measures. Based on these factors, it was not unreasonable for the Department to expect that the excess production capacity would actually be used. The Panel therefore considered that the reliance by the Department on the data before it with respect to excess production capacity as an element of evidence of a threat of material injury had not amounted to mere speculation.

409. The Panel noted in this connection that Canada had argued that any increase in capacity utilization would result in only a very limited increase in the market share of Canadian imports in the United States. It appeared to the Panel that Canada's argument did not accurately reflect the manner in which the Department of Commerce had relied on its data on the existence of excess capacity utilization in the Canadian industry. Canada had calculated that there would be an increase in Canadian market share in the United States of, at maximum, 1 per cent, based on full capacity utilization in Alberta, Ontario, Saskatchewan and Manitoba. However, the text of the Initiation Memorandum indicated that the Department of Commerce had not limited its consideration of the data on excess production capacity to these four provinces but had found on the basis of these data that:

> "Termination of the MOU will enable Canadian mills to rapidly increase the production and exportation of subsidized lumber to the United States, resulting in greater Canadian imports and lower prices in the U.S. market."

Moreover, the Panel noted that, as described in paragraph 97, the Department of Commerce had not only discussed the likelihood of increased exports from these four provinces (resulting from the elimination of the export tax) but had also discussed the competitive pressure caused by these increased exports on British Columbia and Quebec. In light of these considerations, the Panel found that Canada's argument on the allegedly minimal impact of increased capacity utilization in Alberta, Ontario, Saskatchewan and Manitoba was not a basis for the Panel to conclude that the Department of Commerce could not reasonably have relied on the data on excess production capacity as one element of evidence of a threat of material injury.

410. For the above reasons, the Panel concluded that it was not unreasonable for the Department of Commerce to have concluded that, following the termination by Canada of the MOU, there was sufficient evidence of a threat of material injury to the domestic industry caused by allegedly subsidized imports of softwood lumber from Canada to justify the initiation of a countervailing duty investigation. The Panel nevertheless considered this conclusion to be a close judgment and that several of the Canadian arguments regarding the lack of sufficient evidence of a threat of material injury deserved more serious attention by the United States during the course of the investigation.

411. Accordingly, for the reasons stated in paragraphs 360 and 410, the Panel concluded that in initiating the investigation on imports of softwood lumber from Canada the United States had not acted inconsistently with its obligations under Article 2:1 of the Agreement.

VII. CONCLUSIONS

412. In light of the considerations set out in the above findings, the Panel concluded that:

(a) the interim measures taken by the United States on 4 October 1991 with respect to imports of softwood lumber from Canada were inconsistent with Article 5:1 and could not be justified on the basis of Article 4:6 of the Agreement; and

(b) the initiation of a countervailing duty investigation by the United States on 31 October 1991 with respect to imports of softwood lumber from Canada was not inconsistent with the requirements of Article 2:1 of the Agreement.

413. The Panel noted that Canada had requested the Panel to recommend to the Committee that it request the United States to terminate the bonding requirement, release the bonds, refund (with interest) any cash deposits and amounts collected and terminate the suspension of liquidation of softwood lumber products from Canada. The Panel further noted that panels, having found a measure to be inconsistent with a signatory's obligation, generally recommended that the signatory be requested to bring its measure into conformity with the Agreement. The Panel considered that such a recommendation was especially appropriate in those cases where there were several options available to a signatory to bring itself into conformity with the Agreement. The Panel considered however that such multiple options were not available to the United States in the present case and that the only option open to the United States was, with respect to imports of softwood lumber from Canada, to terminate the bonding requirement, release any bonds, refund any cash deposits and terminate the suspension of liquidation of entries made during the period of application of the inconsistent interim measures imposed in October 1991 under the authority of Section 304 of the Trade Act of 1974.

414. Moreover, the Panel noted that the CONTRACTING PARTIES of GATT had adopted two panel reports which had recommended the reimbursement of duties found to have been imposed in a manner inconsistent with GATT obligations, the first involving anti-dumping duties[175] and the second involving countervailing duties.[176] The Panel considered that such a recommendation was also appropriate in this case.

415. The Panel therefore recommends to the Committee that it request the United States, with respect to imports of softwood lumber from Canada, to terminate the bonding requirement, release any bonds, refund any cash deposits and terminate the suspension of liquidation of entries made during the period of application of the inconsistent interim measures imposed in October 1991 under the authority of Section 304 of the Trade Act of 1974.

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[175]Report of the panel on New Zealand - Anti-Dumping Duties on Imports of Electrical Transformers from Finland, adopted on 18 July 1985, BISD 32S/55, 70.

[176]Report of the panel on United States - Countervailing Duties on Pork from Canada, adopted on 11 July 1991, DS7/R.