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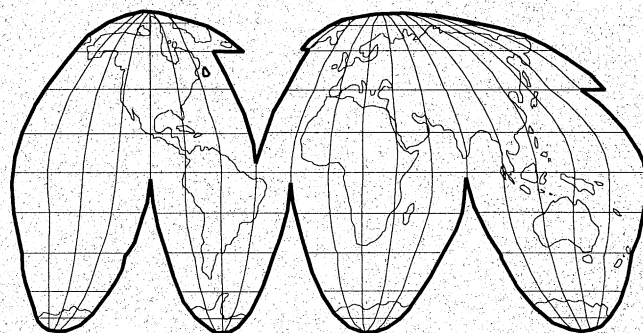
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# Understanding Technical Barriers to Agricultural Trade

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## **National Administered Protection Agencies: Their Role in the Post-Uruguay Round World\***

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National trade remedy laws have a long, although not a particularly honorable, history. Laws to govern “unfair” trading practices were put into place in the United States [US], early in the twentieth century, to deal with predatory pricing by foreign firms (antidumping [AD] law) and government subsidized foreign competition (countervailing duty [CVD] law). In addition, the US has trade remedy laws to protect domestic industries from fairly traded imports (Section 201 - Escape Clause of the Trade Act of 1974). National Administered Protection Agencies [NAPAs] are charged with the application of these laws and they are the primary focus of this paper.

Internationally, the rules governing AD and CVDs have been a continuous source of controversy in the General Agreement on Tariffs and Trade [GATT]. The US has generally taken a position in favor of more stringent AD/CVD laws. Other countries view contingency protection laws as a way to harass and impede imports. The GATT (1947) allowed for AD/CVD laws through Articles VI and XVI. While Article VI required an injury test, US CVD law in 1947 did not, and this departure from GATT rules was grandfathered into the Agreement. In accepting the Tokyo Round Subsidies Code, the US agreed to an injury test for countervailing duty cases relating to dutiable imports (CBO 1994). Significant changes were made in AD/CVD law as a result of the Uruguay Round [UR] of trade negotiations.<sup>1</sup> Schott argues that the Uruguay Round Agreement [URA] on countervailing duties represents considerable progress while the new rules on anti-dumping are a disappointment.<sup>2</sup>

National administered protection agencies not only take AD/CVD actions against the unfair trading practices of foreign exporters, but these agencies also provide input into the proceedings of other forms of trade remedy measures. The US International Trade Commissions [USITC] has recently carried out Section 332 investigations of the Canadian beef cattle and durum wheat industries and it provided economic analysis of the US Section 22 investigation of Canadian durum wheat exports.

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<sup>1</sup>For CVD investigations the changes include: 1] specific time schedules for decisions, 2] a higher de minimus level, 3] a five year sunset provision, 4] the opportunity for consumers of the foreign product to make representations, 5] different rules for developing nations, and 6] an appeals process (Schott 1994). Most importantly, World Trade Organization [WTO] panel reports cannot be blocked from adoption except by consensus. The WTO rules governing AD and CVD actions are not self-executing, hence these procedures must be incorporated into domestic legislation and applied by national administered protection agencies like the US International Trade Commission [USITC].

<sup>2</sup>There are several excellent surveys of these issues (CBO 1994; USITC 1995; Schott 1994).

## Background

It is instructive to begin by asking if AD/CVD laws are important in international commerce? There are some facts which would suggest that they are not. First, although 40 countries have AD/CVD laws, only a few countries are heavy users of these laws; namely, the US, Canada, EU and Australia. Trade remedy laws are used only rarely by other developed countries and almost never by developing countries. Second, in agriculture AD/CVDs are seldom applied to the imports of major commodities. They find their most heavy use, in the US, against products like cut flowers, red raspberries, kiwi fruit and fresh asparagus. Third, of the 1,112 AD/CVD cases filed in the US between 1980 and 1992 only 34.2 percent ended with affirmative outcomes and final duties being applied (DeVault 1993). Finally, in only one year (1982) did the subject imports account for more than 1 percent of total US imports (USITC 1995). Based on this evidence, it might be argued that AD/CVD laws are of no real consequence to international commerce.

This would be an erroneous perception. First, although only 34.2 percent of US AD/CVD cases ended in final affirmative duties, DeVault calculates that fewer than 25 percent result in negative outcomes. The remainder of the cases involved the application of provisional duties or were concluded with price agreements and/or voluntary restraint agreements. All of these less formal trade actions involve import harassment and import protection.<sup>3</sup> Second, the increasing use of AD/CVD laws in major industrial countries is a reflection of their advanced legal systems and the sophistication of their rent-seeking producer groups. Third, AD/CVDs have typically been used to impede the exports of developing nations, for example, the US has brought fourteen separate cases against Colombia's cut flower industry (CBO 1994). Fourth, there has been a substantial increase in the average duty applied to "unfair" imports by the US. Between 1980-1986, the average duty was 21.6 percent, by 1987-1992 the average duty had increased to 47.2 percent (DeVault 1993).

The evolution of US AD/CVD law has almost eliminated the use of the Section 201 Escape Clause. There is little need for an industry to complain about fairly traded imports, only to receive temporary protection, when the standard of injury is lower for unfairly traded imports. Unfairness can almost always be found and with a finding that imports are unfairly traded, protection has historically been permanent. Even the US Congressional Budget Office notes: "Proving dumping or subsidies is not much of a hurdle, ..., since Department of Commerce's procedures find dumping or subsidies in the vast majority of cases" (CBO 1994, p. 51). The stringency of AD law has led Canada's Minister for International Trade, Roy MacLaren, to suggest the "necessity of considerably tightening the international discipline on - if not the outright dismantling - of antidumping law." The weakness of the UR/AD agreement has led Schott to state "the agreement provides a bandage to a festering sore of trade policy" (Schott 1994, p. 85).

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<sup>3</sup>It is generally accepted that bringing a AD/CVD case results in import harassment. The uncertainty surrounding the possibility of a trade action results in caution being exercised by foreign exporters, especially considering the cost of defending themselves, even when successful.

If AD/CVD laws are often used as a protective device, what are the economic principles underlying their application? AD laws were originally put in place to prevent predatory pricing. Predatory pricing is the practice of a firm selling products below cost to drive out rival firms, thereby creating a monopoly for itself and enabling it to subsequently raise prices above those that prevailed before the predatory pricing began. This form of firm behavior stifles competition and is welfare decreasing. However, there is a general consensus that successful predatory pricing is extremely rare. Shin, in her study of 282 AD cases, could find only 10 percent that were consistent with dumping behavior. Some might argue that this behaviour reflects the “new trade theory” but even Krugman argues that such behaviour is rare in the real world. The probability of a firm creating a monopoly in the production of an agricultural good, unless it is government sanctioned through a domestic marketing board or marketing order, seems remote. Whatever its original intent, AD laws are now used primarily against international price discrimination, selling in a foreign market for less than in the home market. Behavior which, if practiced by domestic firms in the domestic market, is perfectly legal.

The economic basis for a CVD complaint is different than for an AD action. An AD action is brought by domestic producers against foreign firms who are alleged to be engaging in unfair pricing practices. A CVD case is brought by domestic producers against foreign governments. As Horlick notes, there is “a grain of truth, which is the distortion caused by subsidies” lying behind the rationale for a CVD, while AD actions are “90 percent pure protectionist” (Horlick 1991, p. 137). Essentially, domestic firms should not be expected to compete against the treasuries of foreign governments, or to use an overworked cliché the “playing field should be level.”<sup>4</sup>

The welfare effects of AD/CVD laws on the country imposing these duties are familiar to anyone who knows welfare economics. Since the country imposing the AD/CVD is an importer, the duty acts like a tariff and it lowers the economic welfare of the country imposing the duty.<sup>5</sup> Welfare is lowered because expensive home country production or “fairly” traded imports are substituted, for “unfairly” traded ones.<sup>6</sup> This is a “beggar your consumer” policy. It should be noted that from a welfare economics perspective it makes no difference if the low prices result from the actions of foreign firms or foreign governments.

The USITC, in a comprehensive analysis of the economic effects of AD/CVD actions in the US, calculated a net welfare loss of \$1.59 billion and job losses of 4,075 in the affected sectors (USITC 1995). This amounts to about \$39,000 per worker transferred from employment in the affected sector to alternative employment elsewhere in the economy.<sup>7</sup>

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<sup>4</sup>A former Commissioner of the USITC once noted that countries should be concerned less about the tilt of the playing field and more about the quality of the team they put on the field.

<sup>5</sup>The exception is when the importing country is “large” and the duty approximates an optimal tariff.

<sup>6</sup>There is considerable evidence of trade diversion from unfairly to fairly traded imports as a result of AD/CVD actions in the US (USITC 1995).

<sup>7</sup>The model employed by the USITC assumes full employment (USITC 1995).

However, these calculations were sufficiently troublesome to have two of the six USITC commissioners vote against the release of the USITC study.

Commissioner Newquist noted, “the estimates provided here are not “facts” or “findings” in the usual sense of Commission 332 studies; instead they are theoretical, untested results of certain modelling exercises undertaken by Commission economists and should be viewed with that understanding and limitation.”

The dissenting Commissioners, as well as two other Commissioners who had serious reservations about the report, seemed to base their negative opinions on two assumptions. First, the results of the computable general equilibrium model used by the USITC can not capture the “localized” negative effects on the affected industries. Second, a political decision has been taken to discourage unfairly traded imports, regardless of their benefits, if they cause harm to competing domestic industries and workers. These views are consistent with Corden’s description of a conservative welfare function and more flattering than Baldwin and Steagall’s assertion that “in recent years President’s have tended to nominate, and Senate to confirm, individuals who do not apply strict injury or causation standards.”

AD/CVD laws apply to manufactured and agricultural products. In practice, contingency protection laws are designed to deal primarily with “fix price” markets rather than the “flex price” markets that generally characterize trade in agricultural commodities. This has implications particularly with regard to price under-cutting. Further, the UR of trade negotiations continues the tradition of agricultural products being treated differently within the GATT/WTO than manufactured products.

Whatever the merits of CVDs on welfare grounds they deal with questions with which economists are comfortable. What are the effects of subsidies or pricing practices on the volume of trade, production, prices and industry welfare? It is instructive to compare the administrative procedures followed in CVD cases to what is taught in Economics 101. The time constraints national administered protection agencies work under, and the requirement, in the US, to examine an exhaustive set of economic indicators often means that these agencies are attempting to apply basic economic principles to complex real world situations. Seldom will national administered protection agencies have the luxury of estimating crucial economic parameters, testing theory or applying the latest theoretical or econometric techniques.

The WTO Agreement on Subsidies and Countervailing Measures specifies a three step process for determining if a country may legally impose a countervailing duty on the exports of another country:

***Standing:*** *Are the complainants representative of the domestic industry that produces the subject product? In making this determination, the Agreement on Subsidies and Countervailing Measures states that an application can be considered to have been made on behalf of the domestic industry if it is supported by domestic producers whose collective output constitutes more than 50 percent of the total production of the*

*like-product. No investigation should be undertaken if the petition is supported by less than 25 percent of total like-product production.*

**Subsidy:** *Does a domestic or export subsidy exist in a foreign nation which influences domestic imports? The WTO provides an illustrative list of export subsidies, a definition of non-actionable general (non-specific) subsidies, and a short list of non-actionable specific subsidies. The WTO also specifies a de minimus level for actionable subsidies of 1 percent ad valorem in countervailing duty cases. In addition, the Agreement on Agriculture contains a number of exceptions which apply to agriculture.*

**Injury/Causality:** *Is the complainant's industry materially injured or threatened with material injury as a result of the subsidized imports and not by other factors which could be harming the industry? On this point, the Agreement on Subsidies and Countervailing Measures is quite specific. It says that "it must be demonstrated that the subsidized imports are, through the effects of subsidies, causing injury." In addition, "the demonstration of a causal relationship between the subsidized imports and the injury shall be based on an examination of all relevant evidence before the authorities - other factors (affecting the industry) should not be ascribed to the imports."*

The three step process used in evaluating the domestic effects of subsidized imports is generally consistent with the principles of economic policy evaluation. The rules on standing are designed to reduce frivolous complaints, although they are not sufficiently stringent to keep Canada's single producer of padded, perfumed ladies coat hangers from alleging injury resulting from imports of foreign like-products.

The calculation of the level of the subsidy is more problematic, but many of the subsidies provided to agricultural producers are fairly transparent. There will always be disagreements about specificity and measurement techniques but the existence and value of particular subsidies is less controversial than the injury determination.<sup>8</sup>

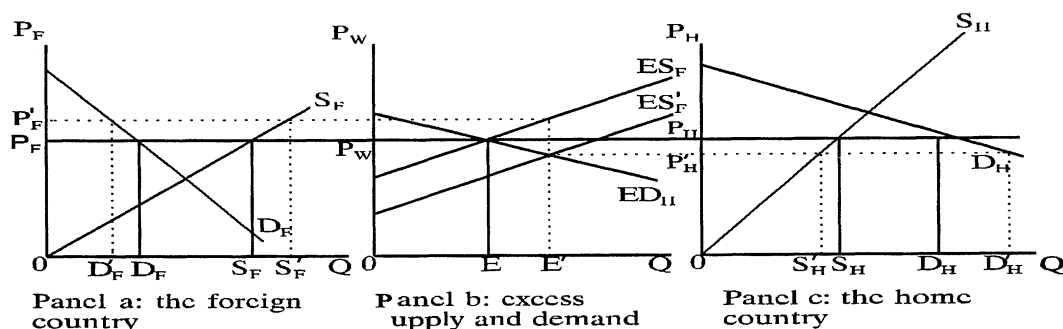
The WTO allows for countervailing duties to offset foreign export subsidies or domestic subsidies, even though export subsidies are expressly prohibited on manufactured goods. Export subsidies on agricultural products are restricted but not prohibited.

It is instructive to consider the trade effects of export subsidies as illustrated in Figure 1. Panel (a) in Figure 1 denotes the foreign country, panel (c) the home country and panel (b) the excess supply and excess demand curves whose intersection determines the free trade world market price of  $P_w$ . At this price the foreign country consumes  $D_F$ , supplies  $S_F$ , and the home country supplies  $S_H$  and demands  $D_H$ . The world trade volume is  $E$ , as illustrated in panel (b). The effect of a constant per unit export subsidy in the foreign country is to shift

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<sup>8</sup>The WTO and US CVD law require that a subsidy be specific to an industry in order for it to be countervailable.

the excess supply function from  $ES_F$  to  $ES'_F$ . This results in the price in the home country declining from  $P_W$  to  $P'_H$  and the price in the foreign country increasing from  $P_W$  to  $P'_F$ . The quantity traded increases from  $E$  to  $E'$ . Clearly, home producers and foreign country consumers lose as a result of the foreign export subsidy, while foreign producers and domestic consumers gain as a result of the export subsidy. If a countervailing duty equal to  $P'_F$  minus  $P'_H$  is levied on imports, it shifts the excess supply curve from  $ES'_F$  back to its original position  $ES_F$ . In effect, the countervailing duty exactly offsets the export subsidy so the free trade equilibrium price  $P_W$ , and the free trade equilibrium quantity traded ( $E$ ) is restored.



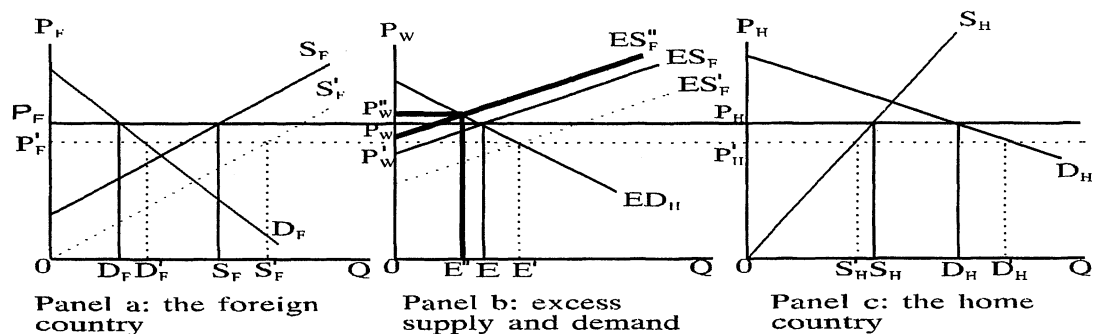
**Figure 1. Effects of an export subsidy.**

Continuous lines represent equilibrium before the subsidy.

Dashed lines represent equilibrium after the subsidy.

Consider now Figure 2, which illustrates the effects of either an input subsidy or an output subsidy in the foreign country. In panel (a) the competitive supply curve  $S_F$  is shifted to the right to  $S'_F$ , as a result of. This results in the excess supply curve shifting from  $ES_F$  to  $ES'_F$ . World prices decline from  $P_W$  to  $P'_W$  in both the importing and exporting regions. The quantity traded increases from  $E$  to  $E'$ . If the home country imposes a countervailing duty equal to the per unit subsidy in the foreign country the new excess supply function will be shifted to the left of the competitive excess supply function ( $ES_F$ ). This results in a higher world market prices and lower world trade volumes than in the free trade situation. The degree of the overestimation depends on the elasticity of the excess supply and excess demand curves. Only when the excess demand curve has an infinite elasticity would the countervailing duty be calculated correctly. However, in this case the foreign nation is a “small country” and its exports would have no effect on price in the home market. Hence, a small country can not cause material injury. The WTO rules clearly anticipate this potential situation when they discuss remedies for domestic subsidies.





**Figure 2. Effects of a domestic subsidy.**

Continuous lines represent equilibrium before the subsidy.

Dashed lines represent equilibrium after the subsidy.

Bold lines represent equilibrium after the subsidy and a countervailing duty.

**Remedy:** *If an investigation uncovers subsidies above the de minimus level and material injury has occurred, the WTO allows a countervailing duty to be applied to the subsidized imports. The WTO allows the countervailing duty to be up to the level of the measured subsidy. The Agreement on Subsidies Countervailing Measures says that "it is desirable that the duty should be less than the total amount of the subsidy if such lesser duty would be adequate to remove injury to the domestic industry." While calculating the proper level for the countervailing duty in the case of a domestic subsidy is more complicated than in the case of an export subsidy, because it relies on economic parameters (supply and demand elasticities), these parameters are often needed to determine injury. Hence, this information could be used in selecting a more proper remedy.<sup>9</sup>*

In addition to the WTO rules and the simple analytics discussed above, there are several key decisions that must be taken in every countervailing duty investigation that influence the potential for an adverse ruling. These decisions are a part of the standing determination but go well beyond the legal issue of who has the right to bring a case.

Article 11.4 of the Agreement on Subsidies and Countervailing Measures says domestic producers have the legal right to bring a countervailing duty case if they produce a product

<sup>9</sup>This discussion assumes that the proper role of a CVD is to restore the competitive solution. An alternative explanation is that the CVD is simply the agreed upon penalty for a government which subsidizes production and, as such, it has nothing to do with the competitive solution. Under this viewpoint subsidizing countries have agreed to be over-penalized for their activities.

“like” the one subsidized by the foreign government. The term “like-product” is not well defined leaving this decision largely up to the complainant and national authorities to decide. In general, the complainant will have an incentive to reduce the size of the allegedly injured domestic industry. In this way, the effects of the subsidized imports are more concentrated making it easier to find injury. An example, cited by the Congressional Budget Office relates to the CVD cases against cut flowers. When the industry was defined as cut flowers as a whole, or for broad segments of the flower industry, the USITC usually found no injury, but when the industry was defined for specific flowers injury was found.

A second key decision relates to the issue of whether the foreign subsidized product is similar to, or identical to, the domestic product. Economists tackle this question through the use of elasticities of substitution in final consumption for a consumption good, or production for an input. An infinite elasticity of substitution implies homogeneous goods, while an elasticity of substitution greater than zero but less than infinity signifies differentiated products. An elasticity of substitution equal to zero shows that the goods are used in fixed proportions. In general, the complainant will argue that the imported goods are identical to the domestic good, while the defendant will argue that the imported product is differentiated. If no injury is found using the homogeneous good assumption, it seems unlikely that injury could be proven if the goods are considered differentiated products. However, injury might be found for homogenous goods but not for differentiated products, hence the importance of the decision.

Finally, some agrifood products are traded in more than one form and at multiple levels of the market. The use of an agrifood product as an input in another product raises the issue of “upstream” subsidies. An upstream subsidy investigation requires two steps. The first step is to document the government programs that provide subsidies and to determine at which market level they most logically apply. The second step is to analyze the potential for the subsidies to injure the domestic industries at both market levels. An example will help to illustrate the point.

Suppose a price support scheme for raw product producers in country 1 results in increased production of the raw product in that country, and a lower market price for the raw product in both countries. In this case, subsidies in country 1 injure the raw product producers in country 2, but the raw product subsidy does not injure the processing sector in country 2. The processing sectors in both countries gain access to a lower priced input and both sell their output for the same price. Therefore, the processing sectors in both countries benefit while raw product producers in country 2 are injured and raw product producers in country 1 benefit.

Now suppose that country 1 provides an energy subsidy to its processors. Lower fuel costs allow processors in country 1 to bid up the price of other inputs including the raw product. This causes injury to country 2’s processing sector and benefits raw product producers in both countries. Finally, suppose country 1 offers a subsidy on every unit of raw product purchased from domestic sources. In the long run, this scheme increases the supply of the raw product in country 1 and the raw product price in both countries declines. Therefore, raw product producers and processors in country 2 would be injured. The variety

of possible scenarios suggests that it is crucial to evaluate the potential effects of the existing subsidies on the various market participants before defining the domestic industry.

While the economic analysis of various stylized subsidy schemes is straight forward, “real world” CVD cases are messy. Seldom will the facts fit neatly into a textbook example. Consequently, the issues and economic analysis conducted in four recent trade disputes are reviewed. Two CVD cases brought by the US against Canada (softwood lumber and hogs/pork), one Section 22 investigation against Canada (durum wheat), and one CVD action brought by Canada against the US (corn).

The purpose of these reviews is not to provide the definitive economic analysis of each case. Instead the cases are used to illustrate the range of issues which must be addressed and the types of economic analysis undertaken.

## Case Studies

### *CASE 1: The US CVD Case Against Canadian Softwood Lumber*

In 1991, Canada exported about 70 percent of its softwood lumber production and 77 percent of the exports were to the US. Canada is essentially the sole foreign supplier of softwood lumber in the US market. The bilateral softwood lumber trade was worth \$2.82 billion (USITC 1992) in 1991. However, despite its size, or perhaps because of its size, softwood lumber has been at the centre of a lengthy and heated trade dispute.

The market share of Canadian softwood lumber in the US rose from 17 percent in 1975 to 33 percent in 1985 (Doran and Nostali 1987) and has since stabilized at 29 percent (in value terms). The increasing market share of imported Canadian softwood lumber during the early 1980s created concern among US lumber producers. In October 1982, the US Coalition for Fair Canadian Lumber Imports (a group of eight trade associations and 350 lumber producing firms) filed a formal CVD complaint against softwood lumber imported from Canada. The Coalition alleged that Canadian federal and provincial governments subsidized Canadian forest products through a number of programs and practices. In November 1982, the USITC found, in a preliminary ruling, that the US lumber industry had been materially injured by allegedly subsidized softwood lumber imported from Canada. However, in May 1983, the International Trade Administration [ITA] of the Department of Commerce came up with a negative subsidy determination which terminated the case. The ITA argued that the benefits provided through Canada’s provincial stumpage programs were not export subsidies and the domestic program benefits were “generally available” to all forest products.<sup>10</sup> Since

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<sup>10</sup>Stumpage programs in Canada are operated by the Ministry of Natural Resources in each province. Individuals and companies acquire the right to cut and remove standing timber from Crown lands. The individuals and companies also assume the responsibility to regenerate the forest they harvest up to the stage of “free to grow.” The royalty/price/rent paid to the provincial government for the standing timber is known as stumpage.

the program benefits were generally available, Canada's stumpage programs could not be construed as domestic subsidies under US countervailing duty law.

While the negative determination by the ITA was discouraging to US interests, the Coalition did not give up. In May of 1986, after the market share of imported softwood lumber from Canada had risen to 33 percent, the Coalition filed a second countervailing duty petition. The Coalition alleged that the provincial governments in Canada sold standing timber at "below market value" prices which amounted to an "upstream" subsidy to Canadian softwood lumber producers. The Coalition argued that the growing market share captured by Canadian softwood lumber was a reflection of this subsidy and that these imports were causing material injury to the US lumber industry. In July 1986, the USITC's preliminary investigation found that the US softwood lumber industry was materially injured because of allegedly subsidized softwood lumber imports from Canada. In October 1986, the ITA in its preliminary determination ruled that softwood lumber imported from Canada was subsidized through administratively set stumpage prices and through the provision of public resources (eg. expenses for forest regeneration and construction of logging roads) to lumber producers. The subsidy was calculated to equal 15 percent ad valorem.

The Trade and Tariff Act of 1984 may have contributed to the reversal of the ITA's decision about softwood lumber imports from Canada. Two provisions of this act are particularly notable. First, the Act provided a reinterpretation of the statute which allowed the ITA to find a product to be subsidized if the subject product was produced from subsidized inputs (CBO 1994, p. 28). Second, the Act required all agencies administering US trade laws to give technical assistance to US firms on how to make successful AD/CVD petitions (CBO 1994, p. 28). The assistance provided by US government agencies may have helped the US lumber coalition to redesign its complaint to be more consistent with a positive subsidy determination. The fact that the market share of Canadian softwood lumber in the US was growing at a faster rate between 1983 and 1986 than in the past (Doran and Nostali 1987) also contributed to the decision reversal. Following the preliminary determination of subsidy by the ITA, the USITC ruled that the subsidized softwood lumber imported from Canada caused "material injury" to the US lumber industry and immediately imposed a 15 percent CVD on all softwood lumber imported from Canada.

The final determination of the value of the CVD was to be announced by December 30, 1986. However, the CVD case was terminated when the governments of Canada and the US negotiated a Memorandum of Understanding [MOU] on softwood lumber. Under the MOU, the government of Canada agreed to impose a 15 percent export tax on certain softwood lumber exports bound for the US market. The export tax could be reduced or eliminated with 30 days notice, if provincial governments adjusted their stumpage fees upward and charged an appropriate fee for forest regeneration. The MOU took effect on January 8, 1987 and influenced Canada-US lumber trade for almost five years.

On September 3, 1991 the government of Canada unilaterally announced that provincial stumpage charges had increased to the extent that it was no longer necessary to collect the

export tax.<sup>11</sup> Following this action, US trade representatives announced that the Department of Commerce would be self-initiating a CVD case involving softwood lumber imports from Canada. The US government also imposed temporary import duties ranging up to 15 percent on softwood lumber imported from certain provinces of Canada. This duty was imposed as a contingency protection measure while the investigations for final subsidy and injury determination were undertaken.

In May 1992 the ITA reported the results of its final subsidy determination. The ITA identified two domestic subsidies: provincial stumpage programs and log export restrictions in British Columbia. These two subsidies, according to the ITA, equalled a subsidy margin of 6.51 percent (2.9 percent for stumpage and 3.6 percent for provincial log export restrictions in British Columbia). Based on this ruling, the USITC started its final investigation for determining material injury. In July 1992 it ruled that subsidized softwood lumber imported from Canada caused material injury to lumber producers in the US. Accordingly, a 6.51 percent ad valorem duty went into effect on May 28, 1992.

Although the magnitude of the final tariff was less than one-half of its initial value, the government of Canada appealed the ITA and USITC decisions to a binational panel under Article 1904 of the Canada-US Free Trade Agreement [FTA]. On July 26, 1993 the Binational Panel remanded the ITA and USITC decisions. In particular, the Panel asked the Department of Commerce to recalculate the softwood lumber dumping margin. The Panel found that the record did not support the finding that Canadian softwood lumber imports had a significant price-suppressing effect on the US softwood lumber market. It noted that the cross-sectoral comparison used by the USITC to support its positive determination of material injury was "seriously flawed." As a consequence, the Panel asked the USITC to provide additional statistical evidence to support its determination of material injury. Both the ITA and USITC responded to the request. The ITA revised its softwood lumber subsidy estimate to 11.54 percent, almost double its earlier estimate. The USITC also reaffirmed its original determination of material injury to the US softwood lumber industry caused by subsidized softwood lumber imports from Canada. After reviewing the responses from the ITA and the USITC, the Binational Panel ruled that the analysis of the determination of subsidy was flawed and that the USITC's determination of material injury to the US lumber industry was not based on sound statistical evidence. As a result, the Panel dismissed the CVD case against Canadian softwood lumber on January 28, 1994.

While the case is complex, the softwood lumber dispute deals with the standard questions asked in every CVD investigation. Is Canadian lumber production subsidized? Do imports of allegedly subsidized softwood lumber cause material injury to the lumber industry in the US?

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<sup>11</sup>The MOU was terminated on October 4, 1991.

In a competitive industry, which seems to characterize the US-Canada softwood lumber market, price is determined by the intersection of supply and demand.<sup>12</sup> The supply curve is the marginal cost function, but the supply of timber depends on a renewable natural resource, primarily second-growth forests. Given the soil and climatic conditions in Canada, a typical planting-harvest cycle takes from 60 to 120 years to complete. Thus, the current stock of timber is largely fixed. This is true even under the new forest management regime which allows large companies to lease crown land for 10-20 years for harvesting and regeneration.

The countervailing duty statute in the US requires the USITC to determine if the softwood lumber industry in the US is materially injured by reason of subsidized imports from Canada. Explicit in this statute is a requirement that the domestic and foreign products are "like products." Many people in the softwood lumber industry, both in the US and in Canada, believe that the assumption of like products may not be appropriate for softwood lumber produced in Canada (Spruce-Pine-Fur type) and softwood lumber produced in the US (Southern Yellow Pine). Most of the softwood lumber imported from Canada is considered of better quality because of its straightness, strength and superior nail holding ability (Wallace 1987, p.37). In many end uses, particularly in house building, softwood imported from Canada is used for inside framing. The southern yellow pine has the characteristic of absorbing chemicals (USITC 1992, pp. A-72-A-75). Consequently, southern yellow pine is used in building patio decks, side walls etc. At least in this end use, softwood lumber imported from Canada and softwood lumber produced in the US are complements rather than substitutes. The argument that the two types of softwood are complements is consistent with econometric evidence that finds a positive coefficient for the US lumber price variable in simple Canadian-US lumber trade models (Buongiorno et al. 1988; Sarker 1993). If Canadian and US softwood lumber are complements, Canadian shipments cannot cause material injury.

The ITA found two countervailable practices in Canada in its final determination 1] provincial stumpage programs, and 2] log export restrictions in the province of British Columbia. In calculating the subsidy implicit in the stumpage programs, the ITA compared the price of stumpage for softwood with the stumpage price for other types of timber. The benchmark price for Alberta and Ontario was the price of pulp logs; for British Columbia, the competitively-bid price for softwood; and for Quebec, the price for private softwood stumpage. The production processes of pulp and softwood lumber both use timber as an input but they result in two different outputs. The demand and supply conditions for wood pulp and soft wood are quite different. Since the stumpage fee is determined as a residual value, the differences in output prices and the differences in operating expenses contribute to differences in stumpage rates. Hence, it is not clear how the differences in these two stumpage rates could be used to calculate an appropriate subsidy margin. Nevertheless, program benefits per unit of shipment for each of the four provinces were calculated and then

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<sup>12</sup>According to the USITC (1982), there were 8,367 establishments in the US and Canada involved in producing softwood and hardwood lumber during 1980. The concentration ratio in this industry is also modest. The five largest companies account for 30 percent of production in the US and only 22 percent of production in Canada. These figures suggest that a competitive market model applies to the North American softwood lumber industry.

the export shares of each province were used as weights to calculate the average country-wide subsidy margin.

In calculating the subsidy equivalent of the British Columbia log export restriction, the ITA argued that the export ban was an indirect domestic subsidy to the primary lumber producing industry. The log export restrictions in British Columbia, which also prohibits shipments to other provinces, could depress local log prices and give an advantage to local processors/companies in terms of higher rents. However, the log export restrictions have been in place since 1906 and it is unclear why such long standing restrictions have only recently become problematic.

The way in which stumpage fees are determined and the fact that the supply of timber is fixed are essential components in understanding the economics of this case. In Canada, stumpage fees are set administratively using a “residual” approach. The stumpage fee is calculated as the difference between the output price and operating costs per unit. Essentially, the authorities use a cost of production procedure, where working backwards from the lumber price and subtracting transportation, processing and logging costs the “value” of standing timber is determined. This value is a rent and not profit. Competitive profit is built into the firm's operating costs. Under the formula pricing system, actual stumpage fees may deviate from competitive stumpage charges due to weak competition (constrained entry due to high initial capital investment) or overestimation of sawmills’ costs. The question is: what is the supply effect of such underpricing? The answer is zero. Why?

Since stumpage is an economic rent, its over- or under-collection by a resource owner does not alter supply decisions unless it is so high it causes firms to shut-down. Ricardo (pp. 38-39) made this point when he noted,

“[The price of] Corn is not high because a rent is paid, but a rent is paid because corn is high; it has been justly observed that no reduction would take place in the price of corn although landlord should forego the whole of their rent. Such a measure would only enable some farmers to live like a gentlemen, but would not diminish the quantity of labour necessary to raise raw produce on the least productive land in cultivation.”

Therefore, the stumpage fees charged in Canada cannot have any price depressing effect in the US market, unless they influence the supply of lumber!<sup>13</sup>

#### *CASE 2: The US CVD Case Against Canadian Hogs and Pork*

Canada has a long history of providing price and income support to farmers. Although agriculture in Canada is a shared responsibility of federal and provincial governments, the federal government was largely responsible for providing income stabilization programs until the early 1970s (Meilke and Warley 1990). Following this time period, a number of provinces

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<sup>13</sup>A colleague suggests there is a negative correlation between current allowable cut and stumpage fees. This is a point worthy of further investigation.

introduced farm income support programs which reflected province-specific desires. Among these were programs to support the incomes of red meat producers. By the mid-1980s competitive subsidization of red meat producers, across provinces was a well recognized problem. An amended National Tripartite Stabilization Plan [NTSP], which provided floor prices to hog producers and imposed negotiated ceilings on the support provided to the red meat sector, appeared to be a solution to the problem (Meilke 1991).<sup>14</sup> While the formation of the NTSP helped to bring diverse provincial hog stabilization programs under one set of rules, in retrospect, it may have made hog stabilization payments an easier target for CVD action by the US.

However, the hog/pork trade dispute preceded the establishment of the NTSP, and like softwood lumber the dispute has stretched over more than a decade. In November 1984 the United States National Pork Producers Council along with a number of meat packers in the US filed a CVD petition with the Department of Commerce and USITC against hogs and pork imported from Canada. After the preliminary investigation the ITA identified twenty-four federal and provincial programs providing countervailable subsidies to hog and pork producers in Canada. The calculated subsidy was \$0.0439 per pound of live weight. The ITA considered hogs and pork to be members of the same industry and, based on its subsidy determination, the US imposed preliminary duties equal to the subsidy margin on both hogs and pork imported from Canada.

In its preliminary investigation of material injury, the USITC overturned the ITA's preliminary decision that hogs and pork were members of the same industry and treated hogs and pork as separate industries. Based on its preliminary investigation, the ITC found that hog producers in the US were materially injured by hog imports from Canada, but that there was no evidence of material injury or threat of material injury to the US pork sector. The positive injury decision on hogs and the negative injury decision on pork began a long series of appeals and remands. A chronology and discussion of the various judicial decisions is beyond the scope of this paper (Meilke and van Duren 1990; Meilke and Moschini 1992; Veeman 1994; Ludwick 1994). Suffice it to say, appeals have been heard by the US Court of International Trade, at least two binational panels formed under the FTA, two extraordinary challenge committees under the FTA and by the GATT. The result has been the continuous application of countervailing duties on Canada's exports of live hogs to the US, with no permanent application of duties against imports of Canadian pork. There have been temporary duties applied to pork imports during various stages of the dispute.

Given the length of the hogs and pork dispute and the multitude of legal actions it is easy to lose sight of the basic economics of the case. However, there are four facts on which both sides agree. First, the dispute involves domestic production subsidies, export subsidies were never an issue. Second, both hogs and pork are priced in competitive North American markets. Third, with the exception of technical regulations involving Canada's importing of hogs, no significant trade barriers inhibit trade between Canada and the US in either the hog

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<sup>14</sup>Tripartite because it is funded jointly by producers and both levels of government.



or pork markets. Fourth, of the domestic production subsidies identified by US authorities, almost all were paid to hog, not pork producers.

Given these facts there are three key questions that need to be answered in this trade dispute.

- Subsidy: Is hog and pork production in Canada subsidized?
- Injury: If Canadian hog and pork production is subsidized do these subsidies materially injure US hog and pork producers?
- Remedy: If hog and pork producers in the US are injured as a result of Canada's domestic production subsidies, what is the appropriate remedy?

On the subsidy question the issue hinges on the "specificity" of Canada's domestic production subsidies. The Department of Commerce ruled that the production subsidies given to Canadian hog producers through various federal and provincial programs are not generally available to all producers in agriculture and hence, can be considered specific to the hog sector. Canada argued that while the NTSP applied to only a limited number of commodities, nearly all other Canadian agricultural commodities were covered by some form of stabilization plan. At least one binational panel agreed with the Canadian point of view, but from an economic perspective it seems clear that the type of deficiency payment program used in the hog sector does have the potential to increase the output of hogs. More will be said about this when considering injury.

The Department of Commerce ruled the production subsidies given to Canadian hog producers were equivalent to subsidies being given to pork producers. On this point they were clearly wrong. Both Canadian and US pork producers benefit from Canadian hog production subsidies if they lower the market price for their major input. Packers in both countries buy hogs on the open market and sell pork on the open market. The production subsidies in Canada, assuming perfect arbitrage and that Canada remains an exporter of both hogs and pork, provide no competitive advantage to pork producers located in Canada.

On the question of injury the economics are simple. First, have Canadian hog production subsidies increased Canadian hog production and exports? Most of the available econometric estimates on this issue would suggest the answer is either not at all or to a very limited extent (Martin and Goddard 1987). Second, has the increase in Canadian hog production and exports caused by the production subsidies, reduced the US hog price to such an extent as to cause material injury to US hog producers? Again, the available economic analysis would suggest the answer is no (Moschini and Meilke 1992; Meilke and Scally 1988). In essence, a proper economic analysis must trace the causal effect from the domestic production subsidies through to the increase, if any, in Canadian exports of hogs and pork to the US, and then to the price impact in the US market. Injury, if it has occurred, results from the marginal increase in Canadian production and exports resulting from the production subsidies - not from the entire quantity of hog exports into the US market. To argue otherwise implies that Canadian hog exports would be zero in the absence of the production subsidies, a conclusion which has no support either in theory or in reality.

The USITC in some of their economic analyses appeared to accept this argument but applied it in a flawed manner. To analyze the effects of Canadian hog and pork exports on the US market, the USITC estimated injury to US hog producers by: 1] calculating the ratio of Canadian hog marketings to total North American hog marketings; 2] determining the change in this ratio from year to year; and 3] using the change in this ratio to determine the impact of Canadian production subsidies on US hog prices. Sensitivity analysis was conducted using a range (-1.0 to -2.0) of domestic demand flexibilities. The USITC logic seems to suggest that any increase in Canada's North American market share of hog production results from its domestic hog subsidies. Interestingly, it also suggests that a decline in Canada's North American market share is also a result of Canadian hog production subsidies! In fact, in one year of the USITC's analyses Canada's market share did decline.

It is difficult to see how Canada's hog production subsidies provided a competitive disadvantage or materially injured US packers. However, based on simple correlations and trend analysis, this was the USITC's conclusion. Both a GATT panel and a FTA binational panel agreed with the Canadian position that the US would have to conduct an upstream subsidy investigation. An upstream subsidy investigation would require the US to show that Canada's hog production subsidies provided a competitive benefit to Canadian pork producers and materially injured US packers. It was incorrect to assume that 100 percent of the subsidies provided to swine producers were passed through to pork producers without establishing factually what proportion of the subsidy, if any, was passed through.

While the USITC was wrong to assume that the full impact of hog production subsidies applied to the pork production sector, the vertically linked nature of this market is important in determining the proper remedy for a domestic production subsidy. While Canada's domestic production subsidies provide no competitive advantage to Canadian pork producers, a CVD applied only to hog production does. A CVD on hogs lowers Canada's hog prices below the free trade equilibrium price thus providing considerable effective protection to the Canadian pork producing industry. Moschini and Meilke show that an upstream subsidy investigation is required to determine the pass through of hog production subsidies to the pork sector. Using a vertically integrated trade model, Moschini and Meilke derive the analytical expressions for the proper CVDs for hogs and pork. The proper CVD depends on whether the objective of the complainant country is to protect the interests of hog producers only, or to protect the interests of both hog and pork producers. The CVDs in either case depend on the elasticities of supply and demand for hogs and pork. If the objective is to protect the interests of both hog and pork producers, CVDs must be imposed on both products. However, the level of the CVD should be less than the subsidy margin in both cases and the CVD on pork should be less than that on hogs.

### *CASE 3: The US Section 22 Case Against Durum Wheat from Canada*

Prior to the signing of the FTA, only a trickle of wheat crossed the border between Canada and the US. Canada had a restrictive import licensing system for wheat, and the US imposed a tariff of \$0.21 per bushel. However, both countries agreed on a formula to eliminate these trade barriers during the FTA negotiations and on May 9, 1991 Canada removed its import licensing system. Although the US is the world's dominant wheat exporter, it has recently become an important destination for Canadian wheat. This is particularly true for premium quality durum wheat produced in Western Canada. Since 1989, Canadian wheat exports to the US have increased steadily, rising to over two million metric tonnes in 1993/94. While these shipments were only 3 percent of the total US wheat availability, in 1993/94 wheat imports from Canada became a hot political issue (Loyns, Knutson and Meilke 1995). In fact, political bickering and manouvering to protect the interests of durum wheat producers in the US began almost immediately after the FTA was ratified.

Initially, durum wheat producers in North Dakota complained that the freight subsidy given to Canadian durum producers under the Western Grain Transportation Act [WGTA] constituted an export subsidy and hence, violated Article 701.2 of the FTA.<sup>15</sup> The US Trade Representative investigated this complaint and determined that the wheat shipped to the US did not receive the freight subsidy, and that any specific transportation subsidy was generally available to all grain shipments from Western Canada to Thunder Bay.<sup>16</sup> Consequently, Canada did not violate the FTA. After this determination, the US Congress, which was under pressure from the wheat producers lobby, requested the USITC to examine the "conditions of competition" between the US and Canadian durum industries. In response to this request, the USITC initiated a 332 investigation and submitted its final report in June 1990. The USITC stated in its report that:

"it is not apparent from the data collected by the Commission in this investigation that prices paid by US Millers for Canadian durum are significantly different than prices paid for US durum. [USITC 1990, p. ix]..... For like quantities of wheat, US prices and Canadian prices fluctuate, with no consistent price difference between US and Canadian durum that explains the growth of durum imports from Canada between 1986 and 1989 [USITC 1990, p. 7-1]."

The USITC concluded that the durum industries in the US and Canada are competitive and that the drought of 1987-89 was the main reason for the increased Canadian durum shipments into the US. However, this did not bury the issue. Relentless lobbying by durum

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<sup>15</sup>Article 701.2 of the FTA states that: "Neither party shall introduce or maintain any export subsidy on any agricultural goods originating in, or shipped from, its territory that are exported directly or indirectly to the territory of the other party."

<sup>16</sup>Small quantities of wheat destined for the US have been shipped through Thunder Bay in order to be eligible for transportation subsidies to that point. The WGTA transportation subsidy was eliminated on August 1, 1995.

producers resulted in the US government bringing a trade action against Canadian durum imports under Chapter 18 of the FTA. The US government argued that the CWB had violated Article 701.3 of the FTA by selling wheat in the US below acquisition cost (including storage, handling and freight). Article 701.3 of the FTA prohibits either of the signatories from exporting agricultural commodities to the other country at less than its acquisition price.<sup>17</sup>

The Binational Panel made its final ruling in favour of Canada in January 1993. The panel could find no compelling evidence that the CWB was selling durum wheat in the US market at prices lower than its acquisition costs.

A number of weather related and political events have contributed to the most recent round of the wheat trade dispute. Adverse weather conditions in the US during the Summer of 1993/94 resulted in higher demand for Canadian wheat in the US market. Due to flooding in the Midwest, an increased quantity of Canadian wheat was trucked to elevators in Montana and North Dakota. This made the trade more visible and the timing could not have been better for US wheat producers, because President Clinton was desperate for votes to gain Congressional approval of the North American Free Trade Agreement [NAFTA]. As a consequence, some members of Congress, particularly those from the Northern Plain States, told the President that their support for the NAFTA hinged on his taking action against imports of Canadian wheat.<sup>18</sup> After a successful NAFTA vote, President Clinton directed the USITC to initiate an investigation under Section 22 of the Agricultural Adjustment Act [AAA] to determine whether wheat, wheat flour and semolina imported into the US from Canada was taking place “under such conditions or in such quantities as to render or tend to render ineffective, or materially interfere with, the price support, payment and production adjustment program conducted by the Department of Agriculture for wheat” (USITC 1994, p. A-3).

A Section 22 investigation differs from a CVD investigation because there is no need for the US to demonstrate that foreign exports are subsidized, or that they are injuring US producers. It is sufficient to show that the imports are interfering with US agricultural support programs. As directed by the President, the USITC started its investigation on January 18, 1994. The final report of this investigation was forwarded, along with a number of recommendations, to the President on June 15, 1994. The USITC determined that Canadian wheat, wheat flour, and semolina were not being imported under such conditions and in such quantities as to render, or tend to render, ineffective the USDA wheat program. While the determination was generally negative, the USITC provided the President with

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<sup>17</sup>Article 701.3 states that: “Neither party, including any public entity that it establishes or maintains, shall sell agricultural goods for export to the territory of the other party at a price below the acquisition price of the goods plus any storage, handling or other costs incurred by it with respect to those goods.”

<sup>18</sup>Destler describes the horse trading that takes place in developing US trade policy. See also Orden for a specific discussion of agriculture and NAFTA.

recommended levels of import restrictions should the President determine (contrary to its findings) that there was evidence of material interference (USITC 1994b, pp. b-1 - b-18).

On August 1, 1994, the wheat trade dispute came to an end as a result of a negotiated settlement. Canada agreed to limit wheat exports to the US while the US agreed not to pursue an Article XXVIII action under the GATT to restrict wheat imports. Under this agreement, tariff rate quotas were used to restrict US imports of wheat from the Canadian Wheat Board [CWB].<sup>19</sup> The voluntary export restraint agreement was written for one year and expired in September 1995 (Alston et al. 1994). A binational commission of nongovernmental experts was appointed to examine all aspects of the Canadian and the US grain marketing and support systems. During the Commission's investigation, the US agreed to place no restrictions on Canadian wheat shipments and Canada agreed not to take action against the US on wheat under the WTO or NAFTA. The Commission's mandate was to "assist the two governments in reaching long-term solutions to existing problems in the grain sector" (Canada-US Joint Commission on Grains, p. 1). The Commission's preliminary report was delivered in June 1995 and its recommendations met with a largely hostile reaction in Canada. The Commission's recommendations are not binding on either country and the wheat dispute seems to be off the front of the political burner for at least three reasons: 1] the US gave up its Section 22 waiver in the UR of trade negotiations; 2] the US has reduced its use of export subsidies; and 3] international wheat prices have increased significantly.

Nonetheless the economic analysis used by the USITC to investigate the durum wheat dispute is interesting and illustrates its role in trade disputes not involving ADs or CVDs. In addition, this case is one of the few times the USITC has used an estimated econometric model to examine historical evidence of causal relationships embodied in data. Perhaps, the Commission had little choice. The evidence presented in the USITC hearings was based on a wide variety of formal and informal economic models. On behalf of the CWB, Sumner, Alston and Gray [SAG] presented results from an econometric model which was used to examine the effects of Canadian wheat imports on the US wheat market. SAGs analysis included an extensive discussion of the assumptions and parameters underlying the model. The Law and Economics Consulting Group made a submission on behalf of US wheat producers arguing that imported Canadian wheat was underpriced in the US market because its quality is understated. The USDA argued, based on expert opinion, that wheat imports from Canada increased wheat supplies in the US, and lowered domestic wheat prices. The lower price then resulted in higher deficiency payments and higher program costs. Hence, it argued, Canadian wheat imports interfered with domestic price and income support programs under Section 22 of the US AAA of 1933 (amended). Abel, Daft and Earley presented economic analysis on behalf of the Millers National Federation, the National Pasta Association, and the National Grain Trade Council arguing that imports of Canadian wheat

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<sup>19</sup>For durum wheat the tariff rates were as follows: \$3 per ton for the first 300 kt; \$23 per ton for the next 150 kt and \$50 per ton for imports above 450 kt. For "other" wheat from the CWB, the tariff rate was \$3 per ton for the first 1.05 million tons and a tariff rate of \$50 per ton for imports above that limit. There were no restrictions on wheat flour, semolina or Canadian soft red winter wheat imported from outside the CWB area.

increased because of lower wheat production in the US, attributable to weather and USDA farm policies. After reviewing all these arguments, models, and results, the USITC staff concluded that the results of any quantitative analysis depend on assumed supply and demand elasticities and that the more elastic the relevant response functions, the lower the impacts on US prices and program costs.

It is important to keep the legal issue clearly in mind. How large is the effect of Canadian wheat exports on US wheat prices and on the cost of US government support programs? The direction of effect is obvious, only the size of the effect is at issue. The import-induced program costs estimated by the USDA were \$230.4 million (\$0.12 per bushel), while SAG estimated the costs to be \$25.9 million (\$0.014 per bushel) and the USITC (1994) \$73.2 million (\$0.038 per bushel), all for 1993/94. The USITC investigated this issue using the Vector Autoregression [VAR] methodology popularized by Sims (1980, 1986). They specified a five dimensional VAR with domestic supply, domestic demand, exports, ending stocks, and average market price of wheat as the variables.<sup>20</sup> Note that in a VAR framework, all variables are endogenous. The USITC estimated the five-variable VAR model using quarterly data from 1979:1 to 1993:2 and generated impulse responses from the model. Based on their analysis, the USITC concluded that the changes in the supply of durum wheat due to Canadian exports had not influenced the average US wheat price, and had not affected program costs to a “statistically significant degree.”

This paper is not the proper forum in which to provide a detailed critique of agricultural commodity modelling and policy analysis. It is always easier to criticize empirical work than it is to conduct high quality analysis. However, this case illustrates the inherent limitations of empirical economics. If the “true” economic model was known, then it could be used to determine if the effect of Canadian wheat exports was to lower US wheat prices by one cent or twelve cents. Unfortunately, the “true” model is never known and discrepancies of a few cents in the estimation of any impact multiplier, from different economic models, is hardly surprising or cause for great concern.

In fact, even if we knew the “true” impact multiplier for Canadian wheat imports, the outcome of the trade dispute may not have been different in the absence of an exact definition of “material interference.” The determination of material interference is a decision made by the President, and it is beyond the USITCs jurisdiction. Consequently, without a precise definition of what constitutes material interference, does a difference of a few cents in economic estimates really matter? If there is a compelling political reason, a price depressing effect of one cent per bushel could be interpreted as causing material interference with the operation of domestic support programs.

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<sup>20</sup>The USITC VAR-model did not account for the US Export Enhancement Program, a seemingly important omission.

#### *CASE 4: Canadian CVD Case Against US Corn*

Canada's CVD case against US corn is interesting because it is the only example of a successful CVD action against the US and because it illustrates the use of a public interest hearing to help in setting the final duty.

Grain corn is grown commercially in only three Canadian provinces: Ontario, Quebec and Manitoba. Ontario accounts for 75-80 percent of total Canadian corn production which reached 7.0 million metric tons by the late 1980s. During the 1970s Canadian corn production increased substantially, due to the development of short season hybrids suitable for cooler climatic conditions. Between the mid-1970s and mid-1980s, Canada moved gradually towards self-sufficiency in corn production. Imports declined from an average of 1.0 million metric tons (17 percent of domestic production) during 1978-1980, to 0.48 million metric tons (7 percent of domestic production) by 1984-1986. In fact, during the 1980s Canada was an occasional net exporter of corn. The increasing importance of corn in Ontario made producers more sensitive to US corn prices and support programs. Canada is the classic small country price-taker in the corn market. Thus, if US farm policies contribute to higher corn production and lower market prices, the effect is quickly transmitted into Canada. Between the 1983-84 and 1986-87 crop years the average corn price in the US declined from US\$3.25 per bushel to US\$1.57 per bushel. However, corn producers in the US were largely protected from income losses by a target price that remained at US\$3.03 per bushel. While increased deficiency payments of US\$1.46 per bushel in 1986-87 protected US corn producers, Canadian corn producers received support through a stabilization program where support was designed to ratchet downward (95 percent of the five-year moving average price).

Faced with dim prospects for higher market prices, the newly formed Ontario Corn Producer's Association filed a CVD action against the US in the Fall of 1986. The Association alleged that US farm programs for corn had increased production above what would have occurred in an unsubsidized market and that the lower corn prices resulting from these subsidies were causing material injury to Canadian corn producers. Under Canadian law, Revenue Canada determines if the alleged product is subsidized and the size of the subsidy.<sup>21</sup> The Canadian Import Tribunal [CIT] then determines whether the subsidy has caused, is causing, or is likely to cause material injury to domestic producers.

After a preliminary investigation, Revenue Canada determined that US corn subsidies led to higher than normal (i.e., market determined) production of corn and depressed corn prices. The countervailable subsidy was calculated to be US\$1.05 per bushel. This calculated subsidy margin was lowered, in January 1987 to US\$0.85 per bushel (Can.\$1.10 per bushel).

On March 6, 1987 the CIT determined that imports of subsidized grain corn in all forms, excluding seed corn, sweet corn and popping corn from the US had caused, was causing and

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<sup>21</sup>Canada's administrative procedures in a CVD case are very similar to those in the US (van Duren 1989).

was likely to cause material injury to Canadian corn producers. The positive injury finding is interesting because injury was found even though imports of corn, both in absolute and relative terms, were declining. The ruling affirmed that domestic policies can “harm” foreign producers, even when imports are not increasing.

The corn case is also interesting for another reason. It was the first time the CIT conducted “public interest” hearings where different groups, individuals, and businesses presented their views on the likely impact of the CVD on their economic interests.<sup>22</sup> Following these hearings, the CIT advises the Minister of Finance if it is in the public interest to impose a partial countervailing duty. The final decision is made by the Minister of Finance.

During the course of the public interest investigation, the CIT arranged public hearings and received representations from a number of corn users who claimed that imposition of the CVD would not be in the public interest. The CIT, after considering the evidence advised the Minister of Finance that the imposition of a CVD on corn imports from the US in excess of \$0.30 per bushel would not be in the public interest. On February 4, 1988 the Minister of Finance reduced the CVD to \$0.46 per bushel. Hence, the final CVD was set at less than one-half of the calculated subsidy. While this determination did not rely on estimated supply and demand curves or formal welfare analysis, the result is consistent with the argument that the proper CVD for domestic subsidies is lower than the subsidy margin. The public interest hearings provide a forum where interests of other economic agents can be taken into account in a CVD investigation.

### **Lessons to be Drawn from the Case Studies**

The preceding case studies provide considerable “food for thought.” First, the legal arsenal that US industries have to challenge imports they perceive as being unfairly traded is impressive. Second, the quality of the economic analysis used to address the issue of unfairly traded imports does not always meet professional standards. Third, national CVD laws, dispute settlement procedures developed within regional free trade areas, and improved dispute settlement procedures within the WTO have the potential to conflict and overlap with one another, creating different bodies of trade law and general confusion. There must be a better way. A proposal which draws upon the strengths of the recent trade reforms, while eliminating some of the weaknesses of the current system, is offered for consideration. Any proposal for reform must be judged against its ultimate objectives. The goal of this proposal is to move the world economy towards more liberal and predictable international trade in agrifood products. At the same time, it allows domestic industries to have recourse against imports “unfairly” subsidized by foreign governments. However, the rules used in trade disputes should be transparent, the economic analysis underpinning the decisions beyond reproach, and the process as timely and as harassment free as possible. This is a tall order - but a worthy objective.

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<sup>22</sup>Since 1984 the CIT has been required to hold public interest hearings in CVD cases.



Before proceeding, it is useful to review the current status of agriculture within the WTO. The WTO has taken on the responsibility of monitoring and policing the AAA. This involves making sure countries live up to their export subsidy reduction commitments, do not exceed their calculated aggregate measure of support, and that the minimum access commitments specified in the various country schedules are upheld. In addition, the WTO will be called upon to make rulings with regard to countries using innovative tactics to circumvent the commitments they have made. The WTO also sets the ground rules for national CVD investigations and it will get more heavily involved in these disputes as a result of its “policeman’s” role with regard to the AAA. The AAA contains the exceptions for agricultural products from the Agreement on Subsidies and Countervailing Measures, which governs trade in manufactured products. Table 1 and Table 2 show the rules of the WTO, in condensed form, as they apply to CVD investigations of manufactured and agricultural products. For manufactured goods export subsidies and domestic use regulations are prohibited. For agriculture only export subsidies on “new” goods not identified in a country’s tariff schedule are prohibited.

For manufactured products, actionable subsidies and a presumption of serious prejudice include to ad valorem subsidies greater than 5 percent, government debt forgiveness, and subsidies to cover an industry’s operating losses. For agriculture, actionable subsidies include export subsidies and some forms of specific domestic subsidies.

The list of “non-actionable” subsidies for manufactured products is relatively short. It includes generally available subsidies, as well as specific subsidies for research assistance to developed regions and assistance to promote the adoption of existing facilities to new environmental requirements. Even for these subsidies, there are restrictions applied to the allowable expenditures. For agriculture, the list of non-actionable subsidies is much longer. Most notably, it allows subsidies to farmers through direct payments and financial participation in safety net programs, as long as these programs meet certain criteria. The result of these differences, in the way subsidies on manufactured goods and subsidies on agricultural products are handled, means that in many cases national administered protection agencies decisions on agrifood CVDs will be appealed to the WTO.<sup>23</sup> While this makes work for lawyers and perhaps even economists, it is not a healthy situation for industries that are attempting to sell their products internationally. To a large extent this justifies the WTO becoming the sole dispute settlement body for CVDs.

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<sup>23</sup>For example, any new Canadian income stabilization plan will be developed with a close eye on the “green” criteria of the WTO. If these programs are treated as commodity specific, in a US trade action, Canada will appeal the ruling to the WTO.

**Table 1. WTO rules as they apply to subsidies and countervailing measures: manufactured products**

<b>Prohibited Subsidies</b>
Government Transfers of Funds, Revenue Foregone, or Provision of Services other than General Infrastructure to a Specific Industry
Income or Price Support
Export Subsidies
Domestic Use Regulations
<b>Actionable Subsidies</b>
Ad Valorem Subsidization Exceeds 5 percent <sup>1</sup>
Subsidies to Cover an Industries Operating Losses <sup>1</sup>
Forgiveness of Government Held Debt <sup>1</sup>
<b>Non-Actionable Subsidies</b>
Generally Available Subsidies
Specific Subsidies Which Met the Following Conditions:
ad valorem subsidization less than 1 percent
assistance for research activities if the assistance covers not more than 75 percent of the costs of industrial research or 50 percent of the costs of pre-competitive development activity <sup>1</sup>
assistance to disadvantaged regions, based on specified development criteria <sup>2</sup>
assistance to promote adoption of existing facilities to new environmental requirements, provided the assistance is limited to 20 percent of the cost of adoption <sup>2</sup>

<sup>1</sup>These subsidies must also be shown to have trade effects as described in the Agreement on Subsidies and Countervailing Measures.

<sup>2</sup>Other conditions apply.

**Table 2. WTO rules as they apply to subsidies and countervailing measures: agriculture**

Prohibited Subsidies
Export Subsidies on Products not Identified in the Country's Schedule of Commitments
Actionable Subsidies
Ad Valorem Product Specific Support exceeds 5 percent
Ad Valorem Product Specific Support 1 percent - 5 percent <sup>1</sup>
Ad Valorem Non-Specific <sup>2</sup> Support exceeds 1 percent <sup>1</sup>
Direct Payments under Production Limiting Programs <sup>1</sup>
Export Subsidies on Products Specified in the Countries Schedule of Commitments <sup>1</sup>
Non-Actionable Subsidies
Generally Available Subsidies
Ad Valorem Subsidization less than 1 percent
General Services:
research
pest and disease control
training services
extension and advisory services
inspection services
marketing and promotion services
infrastructure
Public Stockholding for Food Security Purposes
Domestic Food Aid
Direct Payments to Producers through Decoupled Income Support
Government Financial Participation in Income Insurance and Income Safety-Net Programs
payments for relief from natural disasters
structural adjustment assistance provided through:
producer retirement programs
resource retirement programs
investment aids
Payments Under Environmental Programs
Payments Under Regional Assistance Programs
Specific Subsidies which Meet the Following Conditions:
assistance for research activities if the assistance covers not more than 75 percent of the costs of industrial research or 50 percent of the costs of pre-competitive development activity
assistance to disadvantaged regions, based on specified development criteria
assistance to promote adoption of existing facilities to new environmental requirements, provided the assistance is limited to 20 percent of the cost of adoption

<sup>1</sup>With a determination of injury and "due restraint" must be shown in bringing a case.

<sup>2</sup>The term non-specific is used in the context of Article 6 of the Agreement on Agriculture.

If the WTO is going to become the primary judicial body to deal with CVDs - is there still a role for national administered protection agencies, like the USITC and CITT? There is, if these agencies are given a different mandate. A redefined mandate for national administered protection agencies would facilitate increasingly liberal trade compared to their current role as protectors of national interests.

What should be the new role for the national administered protection agencies? It would involve them having three primary functions: 1] as a “transparency” agent; 2] as an investigatory agent; and 3] as an advocacy agent.

The call for a “transparency” agency is far from original having been made by both Leutwiler and Long. Leutwiler suggested the agency should operate at the international level and Long at the national level. The objective of these agencies would be to calculate and publicize the costs and benefits of various domestic and trade policies. Leutwiler called this a “protection balance sheet” and the model generally held up as a shining example is the Australian Industry Commission. The argument is that good economic policy can only be made in the full light of day - where the disparate costs of domestic and trade policies are made as apparent as the concentrated benefits of most policy actions (Spriggs 1991). In the agrifood sector, the calculation and publication of producer subsidy equivalents has been helpful in exposing the horrendous international costs of agricultural support policies, and in illustrating the comparative costs across commodity sectors within national economies. Domestic cross commodity estimates are important when protection in some sectors is provided by hidden policies, such as import and tariff rate quotas, while the protection for other sectors is in the form of highly visible output and input subsidies. The role of a national transparency agency is considerably different than that of the Trade Policy Review Mechanism created within the WTO. The WTOs trade policy reviews are designed to examine the impact of a member’s trade policies on the multilateral trading system. The transparency agencies mandate would be to examine the impact of their own countries domestic and trade policies on their own consumers, producers and taxpayers. In this way, the national agencies become advocates for trade liberalization. To properly fulfill this role, the national agencies need to be removed, to the extent possible, from the political process. At times, the economic analysis of the transparency agency will be popular with politicians, but many times it won’t. For this reason, the analysis should be undertaken by a domestic as opposed to an international body. It is just too easy to ignore “foreign” economic advice. However, in order to maintain political support the agency would need other roles.<sup>24</sup>

The second role for redefined national administered protection agencies would be as an investigatory agent. Domestically this is consistent with the transparency function since doing quality economic analysis requires top flight institutional knowledge. National administered protection agencies might undertake studies of foreign governments and foreign government policies as well as domestic policies. This would serve two purposes. First, like a section 332

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<sup>24</sup>We will leave it to those in public administration to decide if the separate roles we envisage can coexist in a single agency. We believe they can and that there are good reasons for doing so; e.g., the sharing of common knowledge about economics, industries and institutions.

investigation, it would provide a bone to throw to domestic vested interests. It is also always helpful when the President or Prime Minister can say, "there is an investigation underway." In many cases these investigations may absolve the foreign government of any wrong doing. In other cases, the investigation might uncover unfair trade practices. Models for this type of activity could be the analyses that the Australian Bureau of Agricultural and Resource Economics undertook of the US and EC agricultural policies. It might also mirror the economic analysis undertaken by the Canada-United States Joint Commission on Grain.

Finally, national administered protection agencies would have a third role as an advocacy agent. This role would mirror the current mandate of national administered protection agencies. Domestic industries that felt they were being harmed by foreign subsidies would approach the agency indicating they wanted to take action against a foreign government subsidy in the WTO. The advocacy agency would undertake economic analysis of the industry's claim. Hopefully, the agency could filter out false or weak claims and refer enough others to the investigatory agency that only a relatively few cases would be taken to the WTO. At this point, the agency would become the spokesperson for the domestic industry. It would prepare state-of-the-art economic analysis to back up the domestic industry's claims.

There are several potential shortcomings of this proposal. First, that the WTO would be overwhelmed by cases. This might be a problem even under the current rules, as more and more disputes are taken to the WTO. However, it is not clear that the proposal would result in more cases. In fact, if the advocacy agency is doing its job it should filter out a large number of the smaller and less significant cases before they ever reach the WTO. A second objection, is that it might discriminate against poor, less developed countries. This is a non-issue. What could be more difficult, for any country, than attempting to defend itself in a foreign nation under their unique rules and institutions? At least at the WTO everyone would be following a common set of procedures and rules. Poorer countries could pool resources to hire lawyers and economists to make their case in Geneva. They would not require different teams of lawyers in the US, Canada and the EU. Finally, the proposal would require that the WTO develop legal and economic talent to undertake the enhanced mandate. This is essentially an institutional issue that can be handled with the proper provision of resources, training and manpower.

By far the biggest objection to the proposal is that national governments, particularly the US, will never concede so much authority to a foreign body. While it is difficult to be optimistic on this score, there is some hope for progress. With the expansion of regional trading agreements and their attendant dispute settlement mechanisms, and the increasing propensity to take disputes to the WTO, it may become obvious that three different levels of dispute settlement are inefficient and counterproductive. With the increasing complexity of dispute settlement it is possible progress can be made in this area during the next round of multilateral trade negotiations.

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