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How The United States Treats Its Friends In Trade Disputes: A Recent Revealing Example

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Introduction

U.S. trading partners can learn a lot from the way the United States treats the countries it actively calls its friends. In recent years, while the Doha Round of multilateral trade negotiations has stalled, many countries have queued up to enter bilateral trade agreements with the United States. Each has reckoned that it has improved its trade situation and, often more importantly, has enhanced its friendship with the United States. No one, it seems, wants to be left out.

The United States seems long past the period of "friendship" treaties, notwithstanding the continuing political and trade union complaint that trade agreements work to the benefit of foreigners and to the detriment of Americans. Bilateral trade agreements are the products of tough negotiations in which special U.S. interests are always sure to get their way. One need only ask countries that would like to sell sugar in the United States what free trade really means to American negotiators.

The United States Senate frequently pressures the Executive Branch to enforce the letter of free trade agreements because Senators typically have influenced the final terms of agreements and are confident that strict enforcement will benefit their constituents. U.S. agencies responsible for enforcement are very responsive to the Senate because their officials can be summoned for public hearings where, should it appear that they have not protected U.S. interests abroad, they can be humiliated.

Foreign partners of the United States need to understand how strictly and narrowly the terms of agreements may be interpreted by the United States, and how vigorously they may be enforced. Countries negotiating with the United States often are ready to compromise in order to finalize the new symbol of friendship. The United States knows that these agreements are almost always more important for the foreign country than for the United States. Consequently, American negotiators are more prepared to walk away, more prepared to be demanding, more prepared to make light of critical clauses that later may surprise, and hurt, the trading partner. U.S. trading partners are especially surprised, it seems, when their new friendship does not

produce in Americans what might be expected from friends. As it is often said in Washington, “If you are looking for a friend, buy a dog.”

Some of the most important trading partners of the United States, such as China, Japan, and the European Union, do not have bilateral trade agreements with the United States. Nevertheless, they, as well as countries with recent agreements who have not yet been subjected to much treaty interpretation – such as Australia and Peru -- can learn a great deal by observing closely how the United States often deals with its friends when interpreting agreements. The United States characteristically takes the same approach with the WTO.

Canada As Best Friend

Canada is unmistakably the United States’ best friend. No other two countries have shared such an extended border in peace for so long. No other two countries have fought alongside each other more often in war. No other two countries trade as much with each other. No other two countries are more interdependent: Canada is the principal supplier to the United States of the energy that powers the American economy; Canada’s economy could not survive without access to the U.S. market and the availability of American goods.

“The People Of America’s Oil And Natural Gas Industry” bought a full page color advertisement in *The Washington Post* on June 9 that proclaimed, “Americans know Canada as a good neighbor. What many don’t know is that the United States gets more oil from Canada than any other country.” The advertisement went on to report that Canada has “the world’s second-largest reserves” of “recoverable oil” and plead that “Congress should avoid policies that, by blocking use of Canadian oil, would jeopardize the creation of new jobs and the oil and gas industry’s ability to continue meeting North America’s growing energy needs.”

Despite the good neighbor, the essential relations in war and peace, the volume and quality of trade and energy interdependence, the possibility that Congress would interfere with the flow of energy is but one of many examples in which expectations about how the United States would treat such a valuable ally are not met. The very same week that the energy advertisement lauding the bilateral relationship appeared in the Washington press, the United States was pursuing a $34 million damages claim against Canada before an international tribunal convened at the World Bank under the authority of the Softwood Lumber Agreement between Canada and the United States.

Lessons From The Softwood Lumber Wars

The subject matter of the arbitration and the proceedings were byzantine but illustrative. The export of softwood lumber to the United States from Canada, at an annual value of approximately $8 billion, has met with sustained objection from the competing U.S. industry for decades (some would argue, centuries). The United States housing industry cannot do without Canadian lumber, which represents roughly one-third of U.S. consumption, yet the U.S. industry insists that imports from Canada drive down U.S. prices because, the U.S. industry says, government ownership of most of the natural resource in Canada yields systemic subsidies. The U.S. industry repeatedly has alleged unfair trade.

Four times since 1982 the U.S. industry has petitioned against Canada for trade relief. Although U.S. agencies have found in favor of the U.S. industry repeatedly, U.S. courts, binational panels convened under the Canadian-U.S. Free Trade Agreement and the North American Free Trade Agreement, and panels convened at the World Trade Organization have all found, repeatedly, to the contrary. At the end of the legal proceedings, every time, Canadian softwood lumber has been found not to be unfairly traded.

Despite these legal outcomes, Canada capitulated in 2006 because of continuous U.S. pressure and apparently interminable litigation. The United States was withholding from Canadian industry $5.5 billion that the courts ultimately said should be returned to Canadians, but the withholding crippled Canadian operations. In order to get the money back, Canada entered an agreement restricting trade.

There are several lessons to be learned here about the United States, even before turning to the arbitration:

Lesson 1: The United States will use legal proceedings for trade advantages.

Lesson 2: The United States does not accept losing legal proceedings.

Lesson 3: The United States will use correlative means – legislation, publicity, illegal withholding of funds – when it is unable to prevail in the legal process.

Lesson 4: The United States will prolong legal proceedings as long as necessary to make foreign competitors feel the pain of a protracted legal contest.

Lesson 5: The United States will give no quarter when negotiating a trade agreement.

The Arbitration

The Softwood Lumber Agreement of 2006 ("SLA") requires Canadian industry to obtain export permits from the Government of Canada for every shipment of softwood lumber to the United States. Because provincial governments own the forests in Canada, they determine the basis for selling standing timber to industry. The core complaint of U.S. industry concerns the price of standing timber, and each province in Canada manages the forests and prices the timber in its own way according to its own laws. Consequently, the basis for issuing export permits varies among the provinces.

The SLA allows provinces two options for restricting the sale of softwood lumber to the United States. "Option A" provinces pay a graduated export tax to the Government of Canada that has been at 15 percent since the SLA came into effect in October 2006. Unlike the duty deposits the United States had been collecting on Canadian shipments prior to the SLA, which were 100 percent recoverable by Canadian industry, the export tax is, for Canadian industry, a permanent loss, but attractive to the Canadian Government that negotiated the deal.

"Option B" provinces have a strict numerical quota on shipments based on complex calculations of U.S. consumption; by the terms of the SLA, no matter how efficient Canadians may be and no matter how superior their product may be considered by U.S. consumers, they are not permitted to exceed a specific percentage

of U.S. consumption. The Government of Canada's job is to collect the export tax and to enforce the quotas.

In the first months of the SLA, the Government of Canada miscalculated and issued too many export permits in the Option B provinces. When the Government realized the error, it made the necessary corrections and thereafter did not issue too many permits. Moreover, as demand cratered in the United States, Option B provinces stopped using all their quota, persistently shipping to the United States less than they otherwise would have been permitted.

The United States alleged a breach of the SLA and took Canada to arbitration. Canada thought the exercise pointless because it believed that the purpose of arbitration was to stop breaches, and Canada already had stopped. The United States, however, interpreted the SLA as providing for damages in the case of breach, and the international tribunal interpreting the SLA agreed. The tribunal found that Canada had breached, and valued the damages to U.S. industry at approximately $34 million. No consideration was given to the period subsequent to the breach when Canada did not fill its quota, thereby, in theory, "repaying" the United States for exceeding quota in prior months.

The SLA is an agreement between sovereigns. Private parties are not signatories, and are subject to the agreement only on the Canadian side where legislation was passed to garnish $1 billion from the Canadian industry to transfer to the United States as part of the settlement, and to impose the export permit regime. Nevertheless, the arbitral tribunal concluded that the U.S. industry had suffered the loss from the excessive Canadian shipments, and said that an award should "wipe out" all of the consequences of breach.

Canada interpreted the arbitral award as meaning that it could pay the United States $34 million in compensation for the estimated damages. The United States, however, interpreted the award, in conjunction with the terms of the SLA, to mean that the value of the compensation for the damages should reach the U.S. industry. The United States reasoned that, because U.S. law would not permit a simple transfer of $34 million from the Government of Canada to the U.S. industry (no explanation was offered, and $500 million was transferred from the Government of Canada to U.S. industry when the SLA was signed), Canada would have to impose export taxes on Canadian shipments until the full value of the damages was realized. Moreover, because the Option B provinces were the "beneficiaries" of the excessive shipments (a point of economics hotly debated by experts during the arbitration), the taxes should be imposed exclusively upon them.

Canada offered $34 million in cash. The United States refused, and instead imposed duties the U.S. Government would collect and keep at the equivalent rate of what the Government of Canada could have been assessing and keeping as an export tax had it chosen to accept the penalty from the arbitral tribunal on the terms the United States demanded. Canada asked for a second tribunal then to examine whether the United States was obliged to accept the $34 million, or could impose duties as it had done. That issue was the subject of the June hearing in Washington.

At the hearing, the tribunal asked whether it should consider current economic circumstances (the most depressed economy in housing in seventy years) when deciding the case. Canada, of course, answered affirmatively, emphasizing that many of its mills are shuttered, unemployment in the forest sector is growing, and the survival of the industry, especially in the Option B provinces, is precarious. The United States aggressively argued the contrary.

First, notwithstanding that the SLA is strictly between sovereigns, that the excessive shipments were the exclusive result of Canadian Government action, and that the Eastern Canadian industry (Option B provinces) is endangered, the United States argued that a cash payment from the Government of Canada was not acceptable, in significant part because, "Such a payment does not emanate from the Canadian producers." It did not matter that Canada would use $34 million from the export taxes it had been collecting from Canadian producers to pay the damages.

With sharp criticism, the United States repudiated the Canadian cash offer because, "Canada has succumbed to pressure from Option B producers to pursue an approach that has minimal impact on them," insisting that those producers benefited from the breach and so must be the ones to pay.

The SLA provides for compensatory damages. Canada argued that this term should mean cash payment; the United States insisted it must mean compensation from the beneficiaries to the victims, and concluded, "If Canada feels that compensatory measures or adjustments to compensatory measures, which I will add are the central framework of the entire agreement, if Canada feels that they are so punitive, then perhaps it shouldn't have entered into the Agreement in the first place. But now having entered into the Agreement, it can't collaterally attack this Tribunal's Award as punitive, which it is essentially doing."

Summarizing U.S. Views In The Arbitration

Canada, the United States' best friend, entered an agreement to terminate protracted litigation and subject trade of more than $8 billion annually to strict and market-distorting management to accommodate a protectionist U.S. industry. It erred in managing the agreement. It was not enough for the United States to see the error corrected and the violation of the agreement to end. Nor was it enough to receive a significant cash award for the breach, even though the breach arose from excess shipments that promptly were followed by shipments well below allowances. According to the United States, compensation for breach of the agreement, however inadvertent the breach, had to punish the sector of the Canadian industry that supposedly benefitted from the breach, even as the Government of Canada argued that punishment was inappropriate and that the U.S. action, with help from the tribunal, could devastate a portion of Canadian industry and create significant unemployment. Canada, the United States said, should have understood what it was signing and must accept the consequences.

Lessons From The Arbitration

Lesson 1: The United States will always interpret the law to the advantage of its industry.

Lesson 2: The United States is not interested in equitable arguments.

Lesson 3: The United States will interpret the law or an agreement in the harshest possible light with respect to its trade partner.

Lesson 4: The United States demands strict compliance with trade laws, particularly to the detriment of trade partners.

Lesson 5: The United States takes into account in trade disputes only the substance of the dispute itself, unaffected by other aspects of the bilateral relationship.

What Should China Make Of This Story?

China will never be able to claim a level of friendship with the United States comparable to Canada's. Many Americans see China as a rival or a threat, immediate or potential. The countries are separated by language and culture and geography and history and experience in world affairs.

Canada, despite its experience, usually comes around at some point to an expectation of friendship from the United States. This expectation often is warranted and rewarded. Out of view, the bilateral relationship is extremely rich in cooperation over security, for example. But Canadians, like most countries with parliamentary systems of government, fail to understand the role and operations of Congress. They can articulate the American principle that "all politics is local," but they cannot really comprehend it because they experience party discipline where Americans experience ward-healing.

International trade is, for the United States, dominated by Congress, not the President. The United States Trade Representative functions in the Executive Office of the President, but exists to negotiate trade agreements, not to enforce them. Enforcement resides principally with the legal terms prescribed by Congress, in the trade remedy laws implemented by the Department of Commerce and the International Trade Commission. The latter is expressly a creature of Congress, not the Executive Branch. The former, although an Executive agency with a seat in the President's Cabinet, houses the government apparatus organized to promote U.S. industry.

The way the United States treats Canada in trade – not only in softwood lumber, but also, for example, in the application of Buy American provisions of recent congressional legislation – should teach Chinese, as it should teach Canadians, yet again, that in trade even the best friends of the United States can expect no favors, must endlessly fight for their rights, and must contest every word and action, just as the United States will do with them. For Americans, who believe that a boxing match should begin and end with a handshake, while the fight in between should be both ruthless and rule-bound, trade is an extension less of friendship than of business and pragmatism. Like the mafia assassins who famously ask their victims not to take it personally but to accept that their deaths are "just business," American officials relentlessly pursuing trade interests for American industry expect trade partners not to take their treatment personally, and not to let it spill over into other domains.

The United States does not like linking trade disputes to any other considerations. When Canada entered the SLA, it openly did not understand this

cardinal principle of U.S. policy. It may be that eventually the United States cannot always have its way with respect to trade, and that partners will link trade disputes to other foreign policy questions successfully. But for now, and for the foreseeable future, partners must understand that friendship does not translate into friendly treatment and that, in trade disputes, the United States does not treat its partners as friends.

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