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United States Government Accountability Office
Washington, DC 20548

June 18, 2009

The Honorable Max Baucus
Chairman
The Honorable Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate

The Honorable Charles B. Rangel
Chairman
The Honorable Dave Camp
Ranking Member
Committee on Ways and Means
House of Representatives

Subject: U.S. and Canadian Governments Have Established Mechanisms to Monitor Compliance with the 2006 Softwood Lumber Agreement but Face Operational Challenges

The United States and Canada have been involved in a long-standing dispute regarding the softwood lumber trade. Canada is the primary exporter of softwood lumber to the United States. In 2008, Canada exported approximately \$3.2 billion worth of softwood lumber products to the United States, about 17 times the amount supplied by the next biggest exporter to the United States. After several years of litigation related to U.S. allegations of unfair Canadian subsidies, the United States and Canada signed the 2006 Softwood Lumber Agreement (“agreement”).¹ The agreement ended ongoing litigation and requires, among other things, Canadian federal and provincial governments to establish export charges and quotas² for Canadian lumber exports and for the two countries to exchange information to support monitoring compliance with the agreement.³

In 2008, the United States passed the Softwood Lumber Act that requires, among other things, that the U.S. government reconcile and verify softwood lumber trade data.⁴ The act also

¹Softwood Lumber Agreement Between the Government of Canada and the Government of the United States of America, September 12, 2006 (“SLA 2006”).

²The agreement uses the term “volume restraint.” However, for the purposes of this report, the term “quota” will be used as an equivalent for the term “volume restraint.”

³SLA 2006, art. VI and VII.

⁴Softwood Lumber Act of 2008, Pub. L. No. 110-246, § 3301, 122 Stat. 1651, 1844-1853 (codified at 19 U.S.C. §§ 1683-1683g). The act named Treasury to implement these requirements, which Treasury delegated to the Department of Homeland Security’s Customs and Border Protection (CBP).

requires GAO to report on (1) whether countries that export softwood lumber or softwood lumber products to the United States are complying with international agreements entered into by those countries and the United States; and (2) the effectiveness of the U.S. government in carrying out the reconciliations and verifications mandated by the Softwood Lumber Act.⁵

This letter contains information in response to the first mandate concerning compliance with international softwood lumber agreements. In accordance with our agreement with the Senate Committee on Finance and the House Ways and Means Committee, we will issue a separate report in December 2009 that will supply additional information and findings on U.S. efforts to monitor compliance and will also address U.S. efforts to reconcile and verify softwood value data. We focused on Canada because it is the only country with which the United States has an agreement specifically related to softwood lumber and is by far the largest exporter of softwood lumber to the United States. We are not conducting a legal review of compliance with the Softwood Lumber Agreement. Our objectives in this review are to describe (1) U.S. government agency efforts to monitor compliance with the agreement, including cooperating with the Canadian government, (2) operational challenges agencies face in monitoring compliance, and (3) current compliance concerns.

To address these objectives, we obtained and reviewed information from the Departments of Commerce (Commerce), Justice (DOJ), and State (State), the Office of the U.S. Trade Representative (USTR), and Customs and Border Protection (CBP) within the Department of Homeland Security to identify their efforts to monitor and enforce compliance with the agreement. We also interviewed knowledgeable officials from these agencies. In addition, we obtained and reviewed information from the Canadian Department of Foreign Affairs and International Trade (DFAIT), the Canada Revenue Agency (CRA), Natural Resources Canada (NRCan), and the British Columbia Ministry of Forests and Range. We also traveled to Ottawa and British Columbia to interview officials from DFAIT, CRA, NRCan, and the British Columbia Ministry of Forests and Range to better understand Canadian efforts to comply with the agreement and coordination between the U.S. and Canadian governments related to the agreement. We also interviewed officials from the Ontario Ministry of Natural Resources. In addition, we interviewed industry representatives in both the United States and Canada to obtain their perspective on the U.S. monitoring efforts. We determined that the data and information used are sufficiently reliable for the purposes of this report.

We provided a draft of this correspondence to Commerce, CBP, DOJ, State, and USTR. The agencies provided technical comments, which we incorporated as appropriate. Commerce also commented formally that it agrees with the conclusion that operational challenges exist in several areas and that the report fairly captures the nature of the U.S. and Canadian governments' positions on these issues.

We conducted this engagement from December 2008 to June 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

⁵19 U.S.C. § 1683g.

Summary

Since the Softwood Lumber Agreement was adopted in 2006, both the U.S. and Canadian governments have implemented policies and procedures for administering and monitoring the agreement. Five U.S. government agencies (Commerce, CBP, DOJ, State, and USTR) have major roles in administering the agreement and in monitoring Canada's compliance. These agencies participate in an informal working group that meets several times a month. Both Canadian federal and provincial governments have roles in administering the agreement for Canada. U.S. agency officials noted that their monitoring of the agreement is dependent on information they receive from Canadian federal agencies and provincial governments, and that the agreement has facilitated increased dialogue between the two countries. In addition, as called for in the agreement, Canada and the United States have established a joint committee to supervise implementation. They have also established several technical working groups.

U.S. and Canadian governments face multiple operational challenges in monitoring compliance with the agreement. These challenges include reconciling value data of the softwood lumber trade; monitoring data related to the export charge that Canada collects; and monitoring whether changes to Canadian forest policies and programs are in compliance with the agreement. U.S. and Canadian officials have identified several factors that make 100 percent reconciliation of value data challenging. For example, Canadian export prices on the export permit can be reported in either U.S. or Canadian dollars, which can lead to confusion regarding which values need to be converted to U.S. dollars when reconciling with the U.S. values.

U.S. agencies have several ongoing concerns regarding compliance with the agreement. The United States and Canada have utilized the agreement's formal dispute settlement provisions to refer three cases to international arbitration. The arbitration tribunal has found one case partly in the United States' favor; judgment in the other two cases is pending. In addition, U.S. agency officials told us they are continuing to monitor other issues. One issue involves the large amount of low-grade timber being harvested in the mountain pine beetle-infested British Columbia interior region. Another relates to recently reduced fees to harvest timber in the British Columbia coast region. Although both the grading system and formula used to determine harvest fees existed prior to the agreement and were grandfathered into the agreement, U.S. agencies have some continuing questions about how these systems are now being applied.

Background

Dispute over Softwood Lumber Is Long-Standing

Since the 1980s, the United States and Canada have been engaged in a trade dispute regarding softwood lumber.⁶ One of the main causes of the dispute is differences in production costs for timber harvested on public land in Canada versus timber from private land in the United States. In Canada, federal and provincial governments own approximately 90 percent of the timberlands and set harvest fees and allocations. In contrast, in the United States, only about 40 percent of the timberland is publicly owned, and the timber from that land is sold through

⁶Softwood lumber is obtained primarily from evergreen, coniferous trees, mainly from the spruce, pine, and fir families. The main use of softwood lumber products is for new home and building construction and remodeling.

competitive auctions. The U.S. lumber industry has raised concerns that the use of government-set fees in Canada raises the possibility that private industry in Canada has access to timber at less than market prices. According to a 2006 Congressional Research Service report, comparisons between the two systems can be complicated by factors such as differences in measurement systems, quality and type of wood in U.S. and Canadian forests, environmental conditions and policies, and responsibilities imposed on timber buyers (such as road construction and reforestation).

The softwood lumber dispute has alternated between periods with a softwood lumber trade agreement and periods of litigation without an agreement. In 1982, Commerce investigated programs in several Canadian provinces, and in 1983 concluded that these programs did not constitute a subsidy sufficient to warrant the imposition of duties. In 1986, Commerce investigated again and reversed its prior determination, finding that Canada was providing a subsidy. On December 30, 1986, the two countries signed a memorandum of understanding (MOU) under which Canada agreed to impose a 15 percent export charge on certain Canadian softwood lumber products exported to the United States. In 1991, Canada announced it would withdraw from the MOU. The United States began another series of investigations and determined that U.S. industry had been materially injured. As a result, the United States imposed duties on Canadian lumber imports. Canada appealed the findings to bi-national panels established under the United States-Canada Free Trade Agreement. The dispute continued until 1996, when the United States and Canada signed another agreement effective from April 1996 through March 2001. After that agreement expired, another 5-year period of antidumping and countervailing duty proceedings followed, with the United States again imposing duties on Canadian lumber imports. In 2006, the United States and Canada ended that round of the dispute by signing the Softwood Lumber Agreement, a 7-year agreement with an option for a 2-year renewal.

2006 Softwood Lumber Agreement Established Framework for Managing U.S.-Canadian Softwood Lumber Trade

Key provisions of the 2006 Softwood Lumber Agreement include variable export measures, information exchange requirements, anti-circumvention measures, dispute settlement mechanisms, and a settlement agreement to end numerous claims that were pending when the agreement was signed.

- **Export measures:**⁷ The agreement allows Canadian regions⁸ to choose between two export control systems, with export measures that vary according to the prevailing monthly price of lumber (see table 1).⁹ All of the regions were allocated a percentage of U.S. softwood lumber consumption based on the regions' historic exports to the

⁷SLA 2006, art. VII. The export measures do not apply to certain softwood lumber products that are first produced in the Maritimes from logs originating in the Maritimes. (See SLA 2006, art. X(1) for more details on excluded products from the Maritimes.) The export measures also do not apply to softwood lumber products first produced in and from logs originating in the Yukon, Northwest Territories, or Nunavut. SLA 2006, art. X. The agreement also excludes certain companies from the export measures. SLA 2006, annex 10.

⁸The agreement defines "region" as Alberta, the B.C. Interior, the B.C. Coast, Manitoba, Ontario, Saskatchewan, or Quebec. SLA 2006, art. XXI(45).

⁹The prevailing monthly price is defined by annex 7A of the agreement. In January 2010, the provinces will have their first opportunity to change which export control option they implement. SLA 2006, art. VII(9).

United States.¹⁰ That share of a region's U.S. consumption is used by the Canadian government to calculate quotas.

- Option A consists of an export charge but no quota.¹¹ Additionally, a region is subject to a surge penalty if the total volume of exports for that region exceeds its trigger volume, which is calculated, in part, by its share of U.S. consumption in a month.¹²
- Option B consists of an export charge and a quota.¹³

Table 1: Export Control Options under the 2006 Softwood Lumber Agreement

Prevailing monthly price per thousand board feet (US\$)	Option A – export charge rate (% of export price)	Option B – export charge plus quota	
		Export charge rate (% of export price)	Quota (based on region's share of U.S. consumption)
Over \$355	No export charge	No export charge	No quota
\$336-355	5%	2.5%	Region's share of 34% of expected U.S. consumption for the month
\$316-335	10%	3%	Region's share of 32% of expected U.S. consumption for the month
\$315 or under	15%	5%	Region's share of 30% of expected U.S. consumption for the month

Source: GAO based on 2006 Softwood Lumber Agreement.

- **Information exchange:** The United States and Canada are required to exchange information to:
 - identify changes in Canadian federal and provincial forest management and timber pricing policies.¹⁴ Canada is required to notify the United States of changes made to certain timber pricing or forest management systems and, among other information, provide evidence of how these changes improve statistical accuracy and reliability of a timber pricing or forest management system or maintain and improve the extent to which stumpage charges¹⁵ reflect market conditions.¹⁶ The agreement requires each party to respond to

¹⁰The regions' shares of U.S. consumption are set forth in table 1 of annex 7B of the agreement.

¹¹Option A was chosen by Alberta, the British Columbia interior, and British Columbia coast regions. (The agreement divides British Columbia into two regions.)

¹²Under Article VIII of the agreement, if the volume of exports from a region exceeds its trigger volume by 1 percent or less in a month, Canada shall reduce the applicable trigger volume for that region during the next month equal to the overage. Furthermore, if the volume of exports from a region exceeds the region's trigger volume by more than 1 percent in a month, Canada shall retroactively apply to all exports to the U.S. from that region an additional export charge equal to 50 percent of the applicable export charge for that month. Trigger volume is calculated in annex 8 of the agreement.

¹³The quota for option B is calculated in annex 7B of the agreement. Option B was chosen by Saskatchewan, Manitoba, Ontario, and Quebec.

¹⁴SLA 2006, art. XV(13).

¹⁵According to a Congressional Research Service report, stumpage charges are fees for the right to harvest timber from province-owned timberlands.

¹⁶SLA 2006, art. XV(14).

requests from the other for information relevant to the operation of the agreement.¹⁷

- reconcile value and volume data on a region-specific basis.¹⁸ If the two countries are unable to reconcile region-specific aggregated data, the agreement requires the two countries to compare more specific data, including comparing information on the Canadian export permit with that on the U.S. entry summary form.¹⁹ The agreement calls for “complete reconciliation” within 9 months of each quarter where the parties cannot reconcile region-specific data.²⁰
- **Anti-circumvention:** The agreement prohibits parties from undertaking actions to circumvent or offset commitments under the agreement including any actions that have the effect of reducing or offsetting the export measures.²¹ Any governmental grant or benefit provided to any producer or exporter of Canadian softwood lumber is deemed to circumvent the export measures, subject to certain enumerated exceptions. Some of these exceptions include provincial timber pricing or forest management systems as they existed on July 1, 2006, and other government programs that provide benefits on a non-discretionary basis in the form and total aggregate amount in which they existed and were administered on July 1, 2006.
- **Dispute settlement:** The agreement has mechanisms to resolve disputes over compliance, which includes arbitration under the auspices of the LCIA (formerly the London Court of International Arbitration).

In addition, the agreement ended existing U.S. trade remedy investigations. It also established the Softwood Lumber Committee, with joint Canadian-U.S. representation, and several technical working groups to oversee implementation of the agreement.

Demand and Prices for Softwood Lumber Have Declined

Canada has historically been the largest exporter of softwood lumber to the United States, but its share of the U.S. market has declined in recent years. Market share can be affected by a number of factors. In addition to trade measures such as the Softwood Lumber Agreement, these factors could include, for example, changes in transportation costs and exchange rates. According to U.S. softwood lumber consumption and market share data from Commerce, in 2008, while all other countries combined accounted for about 3 percent of the U.S. softwood lumber consumption, Canada supplied about 29 percent. This percentage is down from about 34 percent when the agreement was signed in 2006 (see fig. 1).

¹⁷SLA 2006, art. XV(B)(13).

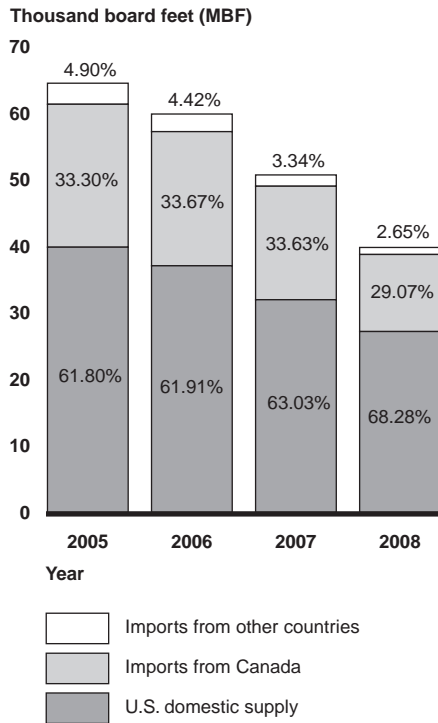
¹⁸SLA 2006, art. XV(6).

¹⁹SLA 2006, art. XV(8).

²⁰SLA 2006, art. XV(8).

²¹SLA 2006, art. XVII(1).

Figure 1: Levels and Composition of U.S. Consumption of Softwood Lumber, 2005 through 2008^a



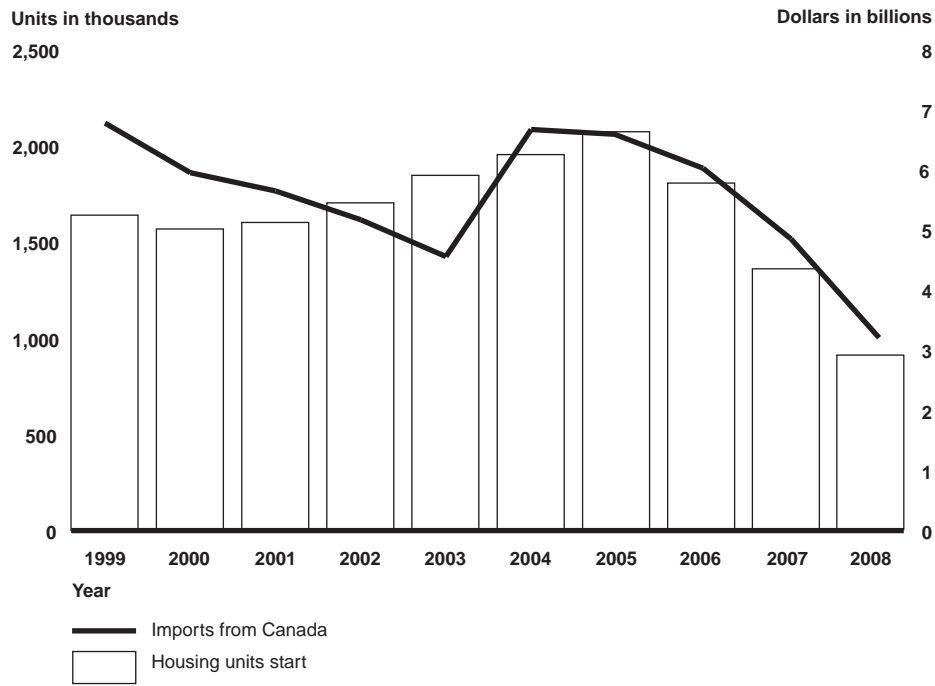
Source: GAO based on Commerce data. December 2008 numbers are estimated using the median year-to-date percentage change for January through November.

^aPercentages shown reflect share of the U.S. market in the given year.

The recent decline in U.S. housing construction has contributed to the reduced demand for softwood lumber.²² (See fig. 2.)

²²Global Insight projects housing construction in the United States will remain weak in 2009.

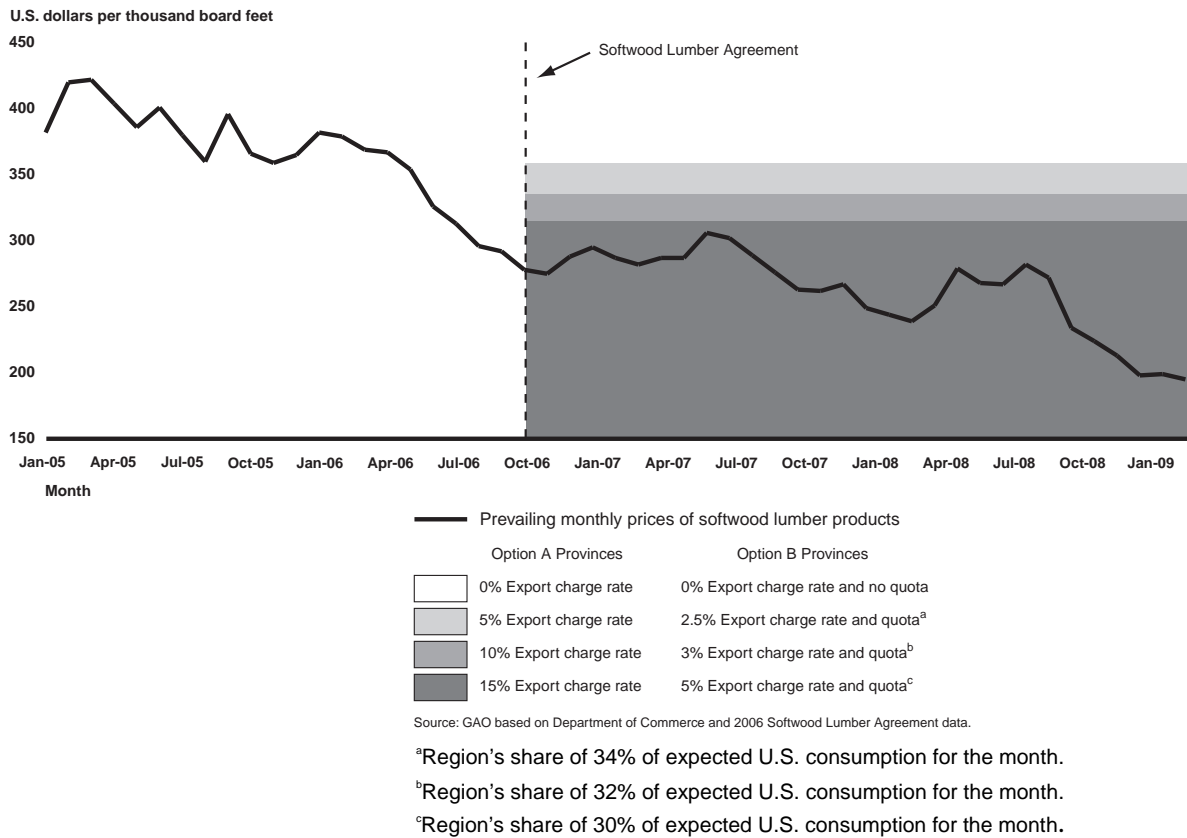
Figure 2: U.S. Housing Starts and U.S. Softwood Lumber Imports from Canada (1999 through 2008)



Source: GAO based on USDA, FAS, and U.S. Census data.

In addition, because of low softwood lumber prices, the Canadian softwood lumber industry has been paying the highest export charge rates mandated by the agreement since the enactment of the agreement. (See fig. 3.)

Figure 3: Lumber Price and Export Charge Rates, January 2005 through January 2009



U.S. and Canadian Government Agencies Have Developed Policies and Procedures to Administer the Agreement and Monitor Compliance

Since the agreement was adopted, both the U.S. and Canadian governments have implemented policies and procedures and passed legislation to aid in administering and monitoring the agreement. The agreement sets out some roles and responsibilities for the U.S. and Canadian governments and requires the establishment of bi-national workgroups to, among other duties, supervise the implementation of the agreement. In some cases the agreement prescribes functions for a government or specific government agency, while in other cases governments have tasked specific agencies to perform needed functions. The agreement requires substantial information to be collected and exchanged between the countries. Some U.S. agencies noted that their monitoring of the agreement is heavily dependent on information they receive from Canadian federal and provincial governments. Enclosure I illustrates some of the key U.S. and Canadian government responsibilities at selected steps in the Canadian lumber exporting process.

Roles of U.S. Agencies

Five U.S. government agencies (USTR, Commerce, CBP, State, and DOJ) have major roles in administering the agreement and in monitoring Canada's compliance. U.S. agencies perform many of these roles in coordination with other agencies. Officials from these agencies provided examples of their efforts related to the agreement as shown in table 2.

Table 2: U.S. Department and Agency Roles in Administering the 2006 Softwood Lumber Agreement

Department/ agency	Role in administering the agreement
All agencies	<ul style="list-style-type: none">Review notifications provided by the Canadian government on changes to forest policy/practices to identify and address whether these changes potentially circumvent the agreement.
USTR	<ul style="list-style-type: none">Acts as lead U.S. agency on international trade issues.Acts as U.S. co-chair on the Softwood Lumber Committee and technical working groups under the agreement.
Commerce	<ul style="list-style-type: none">Monitors the value and volume of softwood imports to obtain a level of assurance that Canada is collecting appropriate export charges.Monitors the U.S. softwood lumber market to determine the share of Canadian and other third country imports.
CBP	<ul style="list-style-type: none">Reconciles volume and value of softwood lumber entering the U.S. by comparing CBP 7501 entry summary data to Canadian export permit data.²³
State	<ul style="list-style-type: none">Manages diplomatic concerns related to Canadian softwood lumber issues.U.S. embassy and consulates in Canada provide U.S. agencies with information on news and events in Canada.
DOJ	<ul style="list-style-type: none">At the request of USTR, represents the United States in arbitrations brought before the LCIA—the commercial tribunal designated in the agreement for dispute settlement.Represents the U.S. government in any domestic litigation related to the agreement.

Source: GAO analysis of U.S. agency information.

To aid in implementing the agreement and ensure compliance, these five agencies participate in an informal working group that meets several times a month. Agency officials noted that the informal working group analyzes technical issues regarding scope of the agreement, Canadian policies and programs related to its lumber industry, and issues related to lumber remanufacturers.²⁴

Canadian Government Roles

Canadian federal and provincial governments have roles in administering the Softwood Lumber Agreement for Canada. The Canadian Department of Foreign Affairs and International Trade (DFAIT), Canada Revenue Agency (CRA), Natural Resources Canada (NRCan) and the provincial governments in British Columbia and Ontario provided examples of roles they perform in administering the agreement, as shown in table 3.

²³In addition to these actions undertaken in accordance with the agreement, CBP performs reconciliation of export volume and value data under the 2008 Softwood Lumber Act.

²⁴An export charge is applied to the price at primary processing, rather than after it has undergone additional processing by a remanufacturer. The agreement defines remanufactured softwood lumber products as softwood lumber that has been processed to produce components, semi-finished and/or finished softwood lumber products. Article XXI of the agreement states: “Remanufactured Softwood Lumber Products” means Softwood Lumber Products that are produced by reprocessing lumber inputs by subjecting such inputs to one or more of the following: a change in thickness; a change in width; a change in length; a change in profile; a change in texture; a change in moisture; a change in grading; joining together by finger jointing; turning; or other processes that produce components, semi-finished and/or finished Softwood Lumber Products.

Table 3: Canadian Government Roles in Administering the 2006 Softwood Lumber Agreement

Department/agency	Role in administering the agreement
Department of Foreign Affairs and International Trade (DFAIT)	<ul style="list-style-type: none">▪ Issues softwood lumber export permits.▪ Sends notifications to the United States of any new or amended measure²⁵ governing timber pricing or forest management systems related to softwood lumber products.²⁶▪ Reconciles volume and value of softwood lumber entering the U.S. by comparing CBP 7501 entry summary data to Canadian export permit data.▪ Provides information to the United States on export permits, aggregate value, aggregate volume and other information required by the agreement.
Canada Revenue Agency (CRA)	<ul style="list-style-type: none">▪ Collects and audits export charges for Canadian softwood lumber exports.▪ Provides information on aggregate export charges collected.▪ Certifies independent softwood lumber remanufacturers.²⁷
Natural Resources Canada (NRCan)	<ul style="list-style-type: none">▪ Calculates expected U.S. consumption which is used for determining the quota volume for option B provinces and the trigger for option A surge levels.
Canadian provincial governments	<ul style="list-style-type: none">▪ Choose between option A and option B for the export charges and quotas applied to softwood lumber products in their province.▪ Set and collect stumpage fees.▪ Notify the United States, via DFAIT, of any new or amended measure governing timber pricing or forest management systems related to softwood lumber products.

Source: GAO analysis of Canadian government information.

Joint Committee and Informal Communication

As called for in the agreement, Canada and the United States have established the Softwood Lumber Committee to supervise implementation. The committee is composed of Canadian and U.S. government officials with a USTR official and a Canadian DFAIT official serving as co-chairs. The committee facilitates the exchange of information between governments and provides a forum to discuss implementation issues.²⁸ The committee has been meeting twice annually.²⁹ The agreement also provides for the establishment of technical working groups, in matters relating to the implementation and operation of the agreement.³⁰ For example, a technical working group provided the Softwood Lumber Committee with recommendations on the methodology to be used in establishing the prevailing softwood lumber price and determining expected U.S. consumption. The Softwood Lumber Committee reviews the recommendations of the technical working groups and makes decisions regarding implementation of these recommendations.

²⁵ A measure could include, among others, any new or amended provincial law, regulation, and order-in-council. SLA 2006, art. XV(B)(13).

²⁶ As defined in SLA 2006, annex 1A.

²⁷ Independent remanufacturers are those that do not hold Crown tenure rights. SLA 2006, art. XXI(31). According to DFAIT officials, Crown tenure rights give the holder an exclusive legal right to use or occupy publicly-owned land. The rights are defined by the specific terms of the tenure contract and can include logging rights.

²⁸ Specifically, the agreement calls for the committee to (1) supervise the implementation of the agreement, (2) oversee its further elaboration, (3) supervise the working groups established under the agreement, and (4) consider any other matter that may affect the operation of the agreement. SLA 2006, art. XIII(B)(2).

²⁹ Article XIII of the agreement requires that the Softwood Lumber Committee meet at least once a year.

³⁰ SLA 2006, art. XIII(C).

Under the agreement, the countries have established several technical working groups.³¹ USTR described the responsibilities of three of these groups as follows:

- Data and reconciliation: Reconciles softwood lumber volume and value data collected by the United States and Canada.
- Scope and methodologies: Addresses questions with certain methodologies used in carrying out the agreement, such as expected U.S. consumption, as well as questions related to product coverage and certification of independent lumber remanufacturers.
- Permits and customs: Addresses issues related to export permits, volume restraints, and data exchange between the United States and Canada.

U.S. and Canadian agencies have noted that the agreement has facilitated improved communication between the governments on softwood lumber issues, helping both parties administer and monitor the agreement. State officials in Washington, D.C., noted that one of the benefits of the agreement is that it facilitates more interaction between the two governments regarding softwood lumber than they had previously without the agreement. Commerce officials noted that the agreement provided an opportunity for them to monitor changes to provincial forest programs. DFAIT officials stated that information exchanged between the two countries goes beyond what is required in the agreement. For example, DFAIT officials noted that it had executed a side letter with CBP for information exchanges and that it is unusual to provide this level of information to another country.

U.S. and Canadian Governments Face Operational Challenges in Monitoring Compliance with Softwood Lumber Agreement

U.S. and Canadian government officials have identified multiple operational challenges in monitoring compliance with the Softwood Lumber Agreement. These challenges include (1) reconciling value data; (2) monitoring export charge data; and (3) monitoring anti-circumvention. In addition, the Canadian government faces challenges in administering the export charge and quota system.

Challenges Shared by the U.S. and Canadian Governments

Challenges in reconciling value data

CBP and DFAIT officials stated they face challenges in reconciling entered value and export price data but have had success in reconciling volume data. Under the agreement, the United States and Canada are required to reconcile region-specific volume and value data on a quarterly basis.³² As of June 2009, the two countries have reconciled 6 quarters of volume data but have not been able to fully reconcile the value data for any quarter since the agreement went into effect. Officials told us that the differences between the U.S. and Canadian values have become smaller over time at the country level, with the differences between the two values now about 2 percent. However, the differences in value for some regions remain significant with no clear trends. The direction of the differences, whether U.S. values are greater or less than Canadian values, varies over time and by region.

³¹Two additional technical working groups relate to (1) regional exemptions (determining criteria for exemptions from export measures for certain regions) and (2) private land logs (addressing exclusions for products from U.S.-origin logs and logs from private land in Canada). According to USTR, the United States has not yet agreed to undertake work with respect to these groups.

³²SLA 2006, art. XV(6).

U.S. and Canadian officials have identified several factors that make 100 percent reconciliation of entered value and export price data challenging (see fig. 4). The Canadian value data on the Canadian export permits uses an approximate value determined at the time of shipment based on the export price definition in the agreement³³ while the U.S. entered value on the U.S. entry summary forms is defined by statute³⁴ and is expected to be higher. Both governments have conducted outreach efforts to improve the accuracy and consistency of the information when completing forms. Factors that may cause the U.S. values to be different from the Canadian values include:

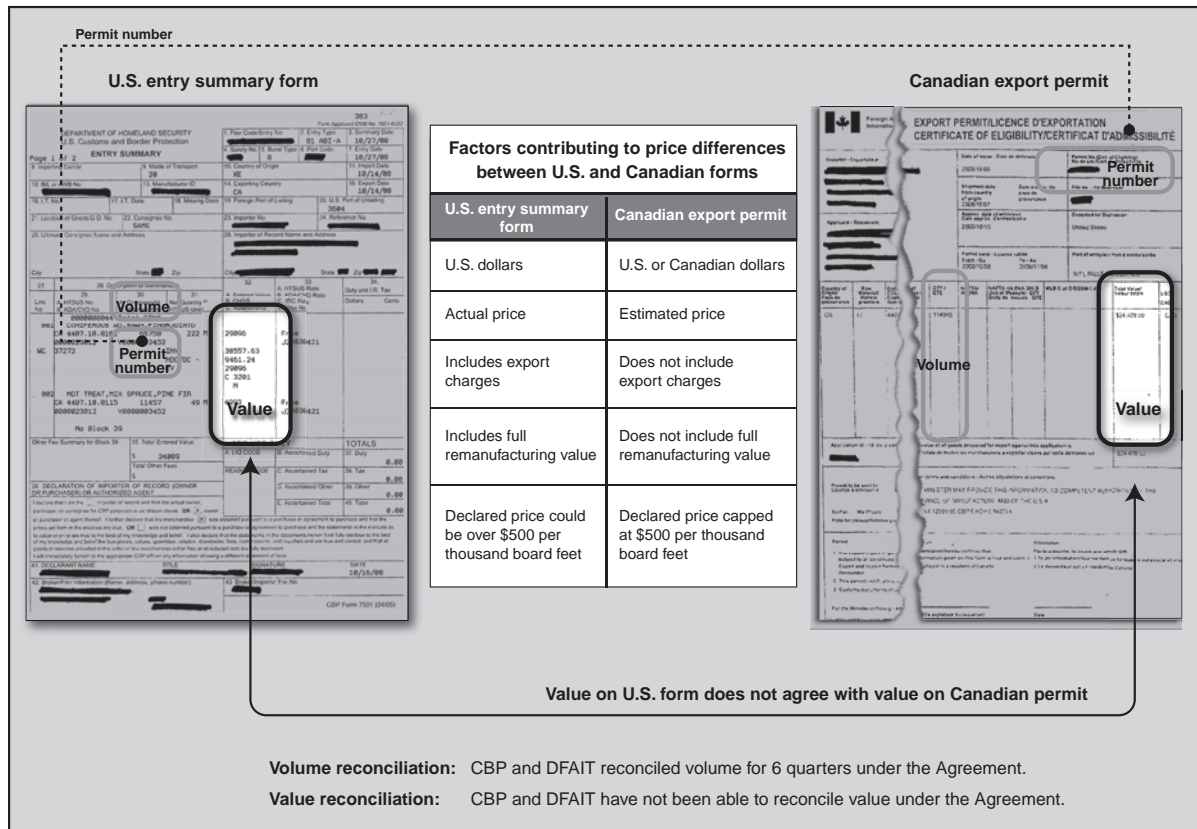
- Inconsistent units of measurement: Canadian export prices on the export permit can be reported in either U.S. or Canadian dollars, which can lead to confusion regarding which values need to be converted to U.S. dollars when reconciling with the U.S. values. The Canadian export permit allows exporters to report in either U.S. or Canadian dollars, while the U.S. entry summary form requires the importer to report the value in U.S. dollars.
- Estimated vs. actual values: The values on the Canadian export permits are estimated values and are subject to change. For example, the importer could offer the exporters incentives for early delivery, causing the actual value on the U.S. entry summary form to be higher than the estimated value on the Canadian export permit.
- Export charges: There is a lack of consistency in the inclusion of export charges in the export and entry documents. According to CBP officials, the estimated value declared on Canadian export permits should not include export charges, while the value on the U.S. entry summary forms should include the charge.
- Remanufactured goods: The U.S. value reported on the U.S. entry summary form should, as defined by statute, be the transaction value of the good while the Canadian value on the export permit should not include the value-added by the remanufacturer, as provided for in the agreement.
- \$500 cap: Under the agreement, the export price is capped at \$500 per thousand board feet for the purpose of assessing export charges.³⁵ This price cap is reflected in the value declared on the Canadian export permit, but not on the U.S. entry summary form. Thus, if the actual price is over \$500 per thousand board feet, the value on the U.S. entry summary form would be different from the value declared on the Canadian export permit.
- Dates: The Canadian export permit is issued on the date of shipment, which is defined in the agreement as the date on which the product is last loaded for export and, in the case of products exported by rail, the date when the railcar that contains the products is assembled to form part of the train for export. However, the date on the U.S. form is based on the date of entry into the United States, which is generally later than the date of shipment.

³³SLA 2006, art. XXI (25).

³⁴19 USC 1401a et. seq.

³⁵SLA 2006, art. VII(6).

Figure 4: Factors Complicating Reconciliation of U.S. and Canadian Value Data



Source: GAO analysis of Department of Homeland Security and Canadian government data.

Challenges in monitoring export charge data

Canada is responsible for collecting the export charge and conducts audits of the export charge returns filed by exporters of Canadian softwood lumber. Every month, Canada provides Commerce and USTR with the assessed charges data on a regional aggregate basis. Commerce faces challenges in its efforts to monitor whether Canada is collecting the appropriate amount of export charge because the U.S. government does not have access to individual export charge returns filed with the CRA. Commerce indirectly monitors the collection of the export charge by estimating and comparing the average unit value from three sources: DFAIT, CRA, and Random Lengths, a private company.

Various factors can cause the average unit value based on these different sources to differ. For example, the average unit value based on CRA’s data is constantly updated because of the lag between the date of export and the date exporters pay the export charge, since exporters have until the end of the following month to pay. In addition, the information provided by DFAIT is based on estimated values, while CRA’s reports are based on actual values. Commerce officials acknowledge the challenges but state that it provides a way to identify potential problems. For example, in February 2007, Commerce discovered a large discrepancy between the average unit value based on CRA and DFAIT numbers. Upon further investigation, the officials found that the difference was largely caused by companies in British Columbia mistakenly including the 15 percent export charge in the price they listed on the DFAIT export permit.

Challenges in monitoring anti-circumvention

U.S. agencies depend on information from Canada to monitor changes to Canadian forest policies and programs and often need to request additional information to determine whether these changes are in compliance with the agreement.

U.S. agencies monitor a variety of sources, including notifications from Canada that are required under the agreement, news reports, and provincial and federal government websites for announcements of changes to forest policies and programs. Since the agreement entered into force, Canada has sent over 200 notifications to the United States regarding the operation of forest management and timber pricing policies and programs. Some of the measures in the notifications can be technical and complex. According to U.S. officials, they have spent substantial resources to determine whether these programs represent a new or substantial change to existing programs that might be excepted from the anticircumvention provision of the agreement.³⁶ In addition, U.S. officials told us that because politicians sometimes make statements about assistance to their communities to reassure their constituents in difficult economic circumstances, determining whether these announcements reflect circumvention of the agreement is a challenge. USTR and Commerce officials said that the Canadian government supplies information required by the agreement.³⁷ However, they also stated that it has been difficult to obtain additional information that they have requested from Canada on certain issues to monitor compliance with the agreement.

Challenges Faced by the Canadian Government in Administration of the Agreement

In addition to the challenges in monitoring compliance, Canadian government officials also report facing some challenges in administering the quota and export charge systems.

Challenges in calculating quota

The Canadian government calculates the monthly quota volume for each option B region. Under the agreement, the quota is based in part on the calculation of monthly expected U.S. consumption from data published by Statistics Canada, the U.S. Census Bureau, and the Lumber Track publication by the Western Wood Products Association (WWPA), a private industry group.³⁸ Canadian government officials told us their analysis indicates that the WWPA's consumption data are biased and, thus, have a downward impact on provinces' allowable quota volume and surge trigger levels. The agreement requires the United States to certify to Canada each month that, to the best of its knowledge and ability, the WWPA data are an unbiased estimate of actual shipments used to determine U.S. consumption.³⁹ According to U.S. officials, the United States certified 8 months of WWPA data, but stopped providing certifications because Canada asserted they did not meet requirements; however, U.S. officials stated that the agreement does not specify what certification requires. The

³⁶ Any governmental grant or benefit provided to any producer or exporter of Canadian softwood lumber is deemed to circumvent the export measures, subject to certain enumerated exceptions. Some of these exceptions include provincial timber pricing or forest management systems as they existed on July 1, 2006, and other government programs that provide benefits on a non-discretionary basis in the form and total aggregate amount in which they existed and were administered on July 1, 2006. For an elaboration of the programs please see SLA 2006, art. XVII(2).

³⁷ USTR officials also noted that there have been occasional delays in the delivery of some reports.

³⁸ SLA 2006, annex 7B and 7D.

³⁹ SLA 2006, art. XV(18).

United States and Canada are currently working through the process provided by the agreement to resolve concerns over WWPA data.⁴⁰

Challenges in managing surge risks

Canadian government officials stated they also face challenges in managing the risks of surge penalties if exports from an option A region exceed its region's share of U.S. consumption in a month by more than 1 percent. If exports exceed this amount, additional retroactive export charges will be applied. According to Canadian officials, exporters face uncertainties and risks because they do not know if they have to pay additional charges in the future. Canadian government officials stated that they closely monitor exports when they approach the surge level; however, the Canadian government has not always been successful in preventing surge penalties. In March 2007 and October and November 2008, Alberta exceeded its share of U.S. consumption and was forced to pay the retroactive charge. The March 2007 surge was discovered by CBP and DFAIT through the reconciliation process several months after the fact.

The U.S. Government Has Ongoing Concerns Regarding Compliance with the Agreement

The United States and Canada Have Utilized the Agreement's Formal Dispute Settlement Provisions

Tribunals composed under the auspices of the LCIA (formerly the London Court of International Arbitration), a commercial court specified in the agreement, have found one softwood lumber case partly in the United States' favor, and judgment in two other cases is pending.

- LCIA Case No. 7941: The first arbitration regarding Canada's calculation of volume measures began in August 2007. The Canadian government contended that adjusting U.S. consumption only applied to provinces under the quota provision and that the adjustment mechanism only applied beginning in July 2007. The United States contended that the adjustment mechanism applied to calculating expected U.S. consumption for all provinces and should have been used beginning the first quarter of 2007. The arbitration tribunal found that, although the adjustment of expected U.S. consumption did not apply to the provinces without a quota, Canada should have begun applying the adjustment mechanism to the provinces with quotas in January 2007.

The arbitration tribunal determined that 30 days from the remedy award was a reasonable time for Canada to cure its breach of the agreement. Pursuant to the agreement, the arbitration tribunal determined that if Canada failed to cure the breach within the 30 days, as compensation for the breach, Canada shall be required to collect an additional 10 percent export charge on softwood lumber products exported to the United States from the option B regions until they had collected CDN\$68.26 million (US\$54.8 million).⁴¹

⁴⁰The agreement provides for either the United States or Canada to request an independent audit of the outside data sources, or have a technical working group verify the data. For an elaboration of the process, please see SLA 2006, art. XV(19).

⁴¹The tribunal ruling is in Canadian dollars. U.S. dollar amount is based on exchange rate at time of the award.

- LCIA Case No. 91312: On April 2, 2009, the Canadian government requested arbitration to determine whether its proposed payment of US\$34 million plus interest to the United States has cured the breach found in LCIA Case No. 7941. The U.S. government does not consider Canada's offer to make a payment as having cured the breach. In addition, because the United States considers that Canada failed to either cure its breach or impose the compensatory measures determined by the arbitration tribunal, on April 15, 2009, pursuant to the agreement, the United States imposed a 10 percent customs duty on imports of softwood lumber products from Ontario, Quebec, Manitoba, and Saskatchewan.⁴² The arbitration tribunal held hearings on this issue starting on June 11, 2009.
- LCIA Case No. 81010: In January 2008, the United States requested arbitration to determine if six provincial programs or other measures in Ontario and Quebec circumvent the agreement. The U.S. government contends that these measures include a number of grants, loans, loan guarantees, tax credits, and programs to promote wood production that circumvent the commitments made by Canada in the agreement. Canada maintains that these measures are in full compliance with the agreement. A decision on this case is expected in late 2009.

U.S. Agencies Are Monitoring Additional Issues of Concern

U.S. agencies continue to monitor other issues, including two issues related to the pricing of logs in British Columbia. The first issue involves the large amount of lumber that is produced from low-grade timber from the mountain pine beetle-infested British Columbia interior region, according to U.S. agency officials. Lumber producers pay the minimum harvest fee of 25 cents (Canadian dollars) per cubic meter for this low-grade wood. The other issue, according to U.S. agency officials, stems from the British Columbia coast region, which recently reduced its fees for harvesting timber. Although both the grading system and formula used to determine harvest fees existed prior to the agreement, and were grandfathered into the agreement,⁴³ U.S. agencies have questions about how these systems are now being applied. However, U.S. agencies have not yet reached a conclusion on whether to formally engage Canada under the dispute settlement procedures of the agreement regarding these issues.

Large amount of low-grade timber harvested in Central British Columbia

Since the mid-1990s, large sections of central British Columbia have been infested with the mountain pine beetle, a bark beetle that attacks and kills mature lodgepole pine trees. Natural Resources Canada, a federal agency, anticipates that the beetle will kill 80 percent of

⁴²In the federal register notice announcing the imposition of the duty, USTR stated that the SLA provides that in the event the complaining party finds that the defending party has failed to cure the breach or impose the compensatory adjustments determined by the Tribunal within 30 days of an award, the complaining party is entitled to impose the compensatory measures itself. Accordingly, with regard to Canada's 2007 breach of the SLA, the SLA authorizes the United States to impose duties in an amount not to exceed the additional export charges that the tribunal has specified as compensation for the breach. 74 Fed. Reg. 16436 (Apr. 10, 2009).

⁴³Under Article XVII of the agreement, any governmental grant or benefit provided to any producer or exporter of Canadian softwood lumber is deemed to circumvent the export measures, subject to certain enumerated exceptions. Some of these exceptions include provincial timber pricing or forest management systems as they existed on July 1, 2006, and other government programs that provide benefits on a non-discretionary basis in the form and total aggregate amount in which they existed and were administered on July 1, 2006.

British Columbia's mature pine forests by 2013. As a result of the beetle, lumber companies in the British Columbia interior region are currently harvesting a large volume of dead trees. Dead trees lose moisture content and are prone to developing cracks in the timber. The presence of cracks is one factor that affects whether timber is given a low grade and thus it affects the fee the British Columbia Ministry of Forests and Range charges the lumber producer for harvesting the timber.⁴⁴ Lumber companies have begun what Canadian industry and government officials describe as the practice of heating the wood to reveal any pre-existing cracks so that the timber can be graded correctly.⁴⁵ U.S. industry argues that this process is inflating the amount of low-grade timber and, because the timber costs so little, reduces the material costs for British Columbia lumber producers.

U.S. agency officials visited British Columbia in summer 2008 to investigate the grading of beetle-killed timber. Subsequently, the United States sent Canada a number of technical questions, including questions on the British Columbia log grading system. In addition, former USTR Ambassador Susan Schwab sent the Canadian government a letter regarding the log grading system. To date, the Canadian government has not provided certain specific information requested in the written questions from the United States, according to U.S. officials. Instead, in spring 2009, a delegation from British Columbia traveled to Washington, D.C., and briefed U.S. agency officials on the grading and mountain pine beetle issues. U.S. officials told us the briefings and other discussions have been helpful, but do not fully address the specific questions they had sent. The United States and Canada continue to engage in a dialogue on the issue, according to USTR officials.

Reduced fees for harvesting timber in coastal British Columbia

U.S. government officials have questions about the January 2009 reduction in the fees charged for harvesting timber in the British Columbia coast. U.S. officials are determining whether this reduction warrants formal engagement with Canada under the dispute settlement procedures of the agreement. The British Columbia Ministry of Forests and Range uses an equation to determine the fees charged for harvesting timber from public land. The equation is updated annually to account for new factors, such as the cost of road construction or replanting trees, as well as quarterly to reflect changes in the market. The equation was grandfathered into the agreement; however, U.S. officials are concerned with how British Columbia has adjusted the equation. According to British Columbia officials, the January 2009 fee reduction was the result of the confluence of the annual and quarterly updates of the timber fee equation. U.S. agency officials have sent Canada questions to clarify this issue and when officials from British Columbia visited Washington, D.C., to discuss the mountain pine beetle, they also briefed U.S. officials on the change in the timber fee in the British Columbia coast region.

We are sending copies of this report to interested congressional committees; the Secretaries of the Departments of Commerce, Homeland Security, and State; the Attorney General; and the U.S. Trade Representative. This report will also be available at no charge on GAO's Web site at <http://www.gao.gov>.

⁴⁴In British Columbia grading of timber is done using statistical sampling. Once the grade is determined, the information is sent electronically to the British Columbia Ministry of Forests and Range, which charges the company the appropriate fee for harvesting that grade of timber.

⁴⁵The mountain pine beetle carries a fungus that can cause timber to absorb moisture; according to Canadian government and industry officials, in response to this problem, lumber companies are heating, to around 80 degrees Fahrenheit, some timber in order to reveal cracks that may have closed.

If you or your staffs have any questions about this report, please contact me at (202) 512-4347 or yagerl@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Other GAO staff who made key contributions to this report are Celia Thomas (Assistant Director), Ming Chen, Karen Deans, David Dornisch, Martin de Alteriis, Tim Fairbanks, Etana Finkler, Rachel Girshick, Grace Lui, Jeremy Sebest, and Christina Werth.

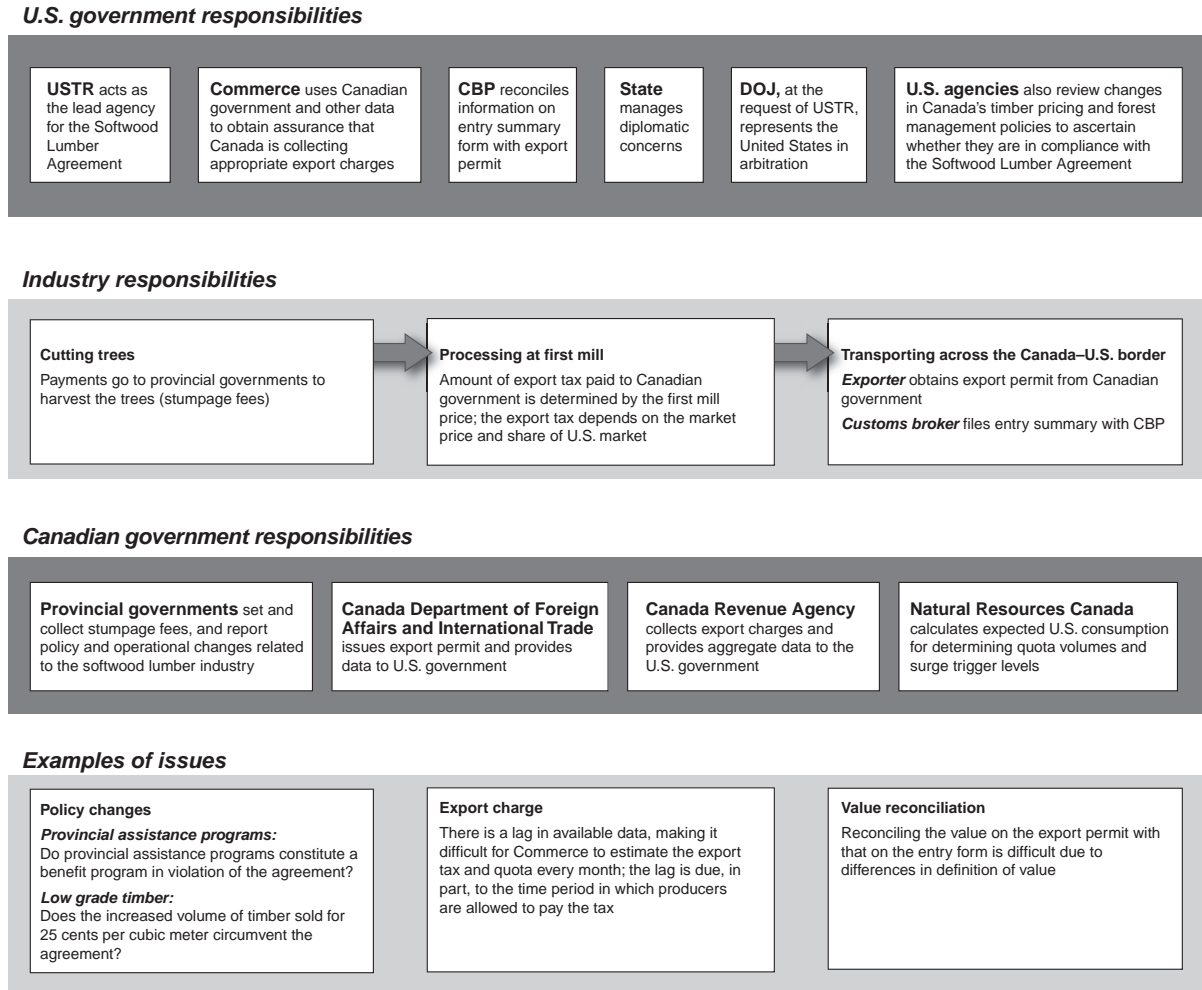
A handwritten signature in black ink that reads "Loren Yager". The signature is written in a cursive, flowing style.

Loren Yager
Director, International Affairs and Trade

Enclosures

Enclosure I: Overview of Process, Responsibilities, and Key Issues under the Softwood Lumber Agreement

Figure 5: Selected Lumber Process Steps, Government Responsibilities, and Key Issues under the Softwood Lumber Agreement



Source: GAO analysis of U.S. government and Canadian government data.

Enclosure II: Comments from the U.S. Department of Commerce

JUN 12 2009



UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for International Trade
Washington, D.C. 20230

Dr. Loren Yager
Director
International Affairs and Trade
U.S. Government Accountability Office
Washington, DC 20548

Dear Dr. Yager:

Thank you for providing us with the draft report "U.S. and Canadian Governments Have Established Mechanisms to Monitor Compliance with the 2006 Softwood Lumber Agreement but Face Operational Challenges." We carefully reviewed the draft report, and agree with the overall conclusion that operational challenges exist with respect to reconciling value data, monitoring export charge data, and identifying potential circumvention. The GAO report fairly captures the nature of the U.S. and Canadian Governments' positions in addressing these issues. We have no other comments.

Thank you again for the opportunity to comment on the draft report.

Sincerely,

A handwritten signature in black ink that reads "Michelle O'Neill".

Michelle O'Neill, Acting



(320675)

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