

Democracy and Trade Conflicts

The previous chapter reveals how the complementary trade relationship between the United States and China, by creating such deep divisions in U.S. politics, decreases the probability of trade war between the two sides. Although, according to the literature on crisis bargaining, trade conflicts between democratic and authoritarian regimes should more frequently escalate into trade wars, complementary trade relations between many of these dyads structure domestic politics in the sender of threats in a way that dampens the incentives for brinkmanship in bilateral trade disputes. Domestic division on the democratic side of the dispute compensates for any possible aggravation of relations caused by the inferior signaling capabilities of authoritarian states, preventing trade disputes between autocracies and democracies from escalating into trade war.

This chapter contrasts the “trade peace” between authoritarian and democratic regimes (such as that between the United States and China as described in the previous chapter) with the greater frequency of the imposition of retaliatory measures between democratic dyads. Through detailed analyses of the trade dispute between the United States and the EC over EC enlargement and U.S.–Canada timber trade conflicts, this chapter highlights how trade competitiveness between democratic regimes creates stronger domestic pressure for the use of threat tactics, increasing the risk of trade war. In both the U.S.–EC and the U.S.–Canada cases, sanction threats enjoyed widespread domestic support. In the enlargement case, since a wide range of U.S. agricultural interests faced the effects of unfair EC competition, both U.S. interest groups seeking to eliminate the newly erected trade restrictions in the Iberian markets and those facing import competition lent their support to the sanction threats. Unlike trade negotiations between the United States and China, there was a particularly large import-competing constituency in the United States that welcomed

sanction threats promising to restrict the imports of products that they had been trying to keep out of the U.S. market. Similarly, in the U.S.–Canada timber trade conflict, softwood lumber producers' campaign for protection won the support of diverse segments of the forest products industry threatened with growing Canadian penetration of the U.S. market. Competitive trade relations solidified domestic industries' support for sanction threats, exerting strong pressure on the executive branch of the government to provide relief for domestic industry. Such unified domestic support for sanction threats overwhelmed the constraints imposed by democratic norms of conflict resolution, thus lowering the threshold for trade wars and leading the United States to opt for retaliatory measures in both cases.

EC Enlargement

The dispute over EC enlargement was the natural outgrowth of a series of U.S.–EC confrontations in the farm sector. Ever since the formative years of the EC, the U.S. government and agricultural producers have been irritated by the EC's highly protectionist agricultural trade policy. American farm interests argued that the EC's Common Agricultural Policy, by shielding European farmers from market competition, threatened the survival and competitiveness of the U.S. agricultural sector. Although in the 1960s and 1970s both sides sought to limit the scope of trade frictions to prevent disruptions to the Atlantic relationship, they found it difficult to avoid trade wars even then due to diametrically opposed domestic interests. Consequently, the Americans and the Europeans have found themselves engaged in tit-for-tat retaliation over EC policies discriminating against imports of chicken and turkey from the United States, alleged EC practices in third markets that displaced American producers from their traditional agricultural markets, and the EC's preferential trading system that granted lower customs duties to citrus fruit exports from a select group of Mediterranean countries.¹

The U.S.–EC trade spat over the accession of Spain and Portugal into the EC similarly took place over U.S. concerns about the EC's protectionist policies excluding American farmers from the Iberian markets. When Spain and Portugal acceded to the EC in March 1986, the EC implemented new trade restrictions against agricultural imports from third countries, particularly feed grains. Under the accession agreement, the EC raised Spanish tariffs on feed grains from 20 to

100 percent, imposed new quotas on soybean and soybean oil imports, and reserved 15 percent of Portugal's grain import market for EC members. The United States, charging that these restrictions violated the spirit of the GATT since they disproportionately favored European farm interests at the expense of U.S. exporters of corn, sorghum, and soybeans, demanded that the EC rescind the quotas and provide U.S. producers with full compensation or else face retaliatory tariffs on roughly \$1 billion of EC exports. In April, the EC threatened counter-retaliation and targeted politically active U.S. groups such as producers of corn gluten feed, wheat, and rice. When bilateral negotiations were still going on, the United States imposed nonbinding quotas in retaliation against the Portuguese restrictions on U.S. soybeans and soybean oil. The Portuguese quotas on oilseeds and the U.S. retaliatory quotas remained in effect until 1991.² Although the Reagan administration later refrained from carrying through with threats to retaliate against the Spanish restrictions, that both sides decided to go ahead with retaliatory measures in the Portuguese case indicates the intensity of the conflict.

The frequent escalation of U.S.–EC agricultural trade conflicts into trade wars, as the few episodes cited previously illustrate, can be explained in terms of the competitive trade relationship between the United States and the EC and the effect of this trade structure on the level of domestic support for aggressive negotiation tactics. A broad spectrum of U.S. farm groups, which competed with European farm products, had for years decried the EC's anticompetitive trade practices. As a result, threats of trade retaliation garnered support both from groups seeking enhanced market access in Europe and in third markets and from groups that had to compete with European imports in the U.S. market. For example, in the U.S.–EC trade war over export subsidies mentioned earlier, most American agricultural groups saw subsidies as an effective instrument with which to correct the market distortions caused by the EC's protectionist agricultural policies. Wheat producers, the main protagonists in this dispute, naturally advocated an aggressive negotiation strategy. But other major agricultural groups such as corn and gluten feed producers also endorsed a proactive trade policy, which in their view provided the single most effective means to alleviate the competitive onslaught they faced in the domestic market. Domestic opposition to the export subsidy program was thus muted, permitting a united front among U.S. producers.

Moreover, on most issues related to agricultural trade with the EC, both the Reagan and Bush administrations favored a considerably

tough posture. From the executive branch's point of view, agriculture was an internally competitive and crucial area of economic activity that ought to be provided with a level playing field. Some form of government action was necessary to ensure the continued viability of agriculture. These considerations, reinforced by strong industry and congressional pressure for government support in the face of European intransigence, resulted in executive branch policies favorable to the agriculture sector. Given the consensus among domestic interest groups and the government institutions in favor of retaliation, the risk of trade war was much enhanced.

The dynamics of domestic politics in the EC enlargement case provides a good illustration of this broad pattern characterizing U.S.–EC agricultural trade conflicts. In EC enlargement, America's sanction threats designed to eliminate trade restrictions in the Spanish and Portuguese markets obtained the support of both U.S. exporters seeking to gain a greater share of the EC market and importers hurt by subsidized European agricultural exports in the United States, in addition to the backing of Reagan administration officials, who felt that some form of government intervention was needed to prevent U.S. agriculture from withering away in the face of unfair EC competition. The following section will describe in detail the positions adopted by the various actors involved in the enlargement dispute to reveal how the complex interplay of political forces shaped the U.S. response.

U.S. Farm Interests and EC Enlargement

An important reason why the trade dispute over enlargement evolved into an open trade war was the almost uniform policy preferences of U.S. farm groups. As the case study by John Odell suggests, the enlargement case unified major elements of the U.S. farm lobby. U.S. corn (maize) farmers were a major group that would be negatively affected by the restrictions the enlargement treaty placed on U.S. exports. But other groups targeted by EC retaliation, such as producers of feed grain, barley, and grain sorghum, also had strong grievances about the perceived unfair European agricultural policies and so had little incentive to oppose the sanction threats.³ Broad sectors of American agriculture long have complained about the EC's protectionist agricultural policies that undercut American producers' ability to compete in the world market. At a time when U.S. farm exports and income were undergoing a steady decline, EC's import restrictions inevitably stirred American farmers into action.

American farmers of feed grains had a particularly strong stake in the dispute. Since the Spanish and Portuguese feed grains markets were one of the most important for U.S. exports, American feed grains farmers were loathe to seeing the protective walls that EC enlargement would erect in the Iberian market. While the Spanish and Portuguese markets absorbed 15 percent of U.S. exports in 1982, that number had declined to 8 percent by 1985. The additional loss in sales that EC enlargement would incur to the United States, estimated at \$640 million per year in Spain and another \$55 million in Portugal, was perceived as particularly damaging, as they merely added to the existing problems of deteriorating farm exports and income. In the mid-1980s, the U.S. farm sector was already mired in a crisis induced by declining export demands and the appreciation of the dollar, which in effect raised the price of U.S. exports vis-à-vis other major agricultural suppliers. For instance, in 1981-84, real farm income in the United States dropped to only half of the level in 1971.⁴ A series of farm closures and widespread unemployment accentuated the appeal of calls for government support. Naturally, the EC's unfair trade practices, as embodied in the CAP, received the brunt of the blame for the problems plaguing the U.S. agriculture sector.

During the enlargement dispute, American farm interests accused the EC of supporting an inefficient farm sector through the use of variable import levies, thus displacing competitive world-market suppliers from both the European and third-country markets. They asserted that CAP policies were not only inefficient but also undermined the accepted norms of the international trading system. U.S. farm groups also denounced the EC practice of using export subsidies to dispose of its agricultural surpluses onto the world market, which in their view was the chief culprit behind the loss of U.S. export market shares. As one of the U.S. farm groups with a major stake in the enlargement dispute, feed grains producers had insisted on full compensation. They remained unconvinced of the argument that the lower Spanish and Portuguese industrial barriers would compensate for the higher agricultural duties and refused to accept any settlement that failed to offer full compensation to U.S. farmers, stressing that they were the ones with their "dollars on the line."⁵

Other U.S. farm groups such as producers of corn, barley, and sorghum, which similarly felt victimized by unfair EC competition, also supported efforts to expand U.S. market shares in the Iberian states. American corn farmers, for example, relied primarily on the domestic market and, thus, did not have the extensive investments in

foreign markets that would expose them to the risks of EC counterretaliation. Between 1982 and 1985, even before the additional barriers associated with the Spanish and Portuguese entry came into place, U.S. corn exports to the EC had already dropped from 14.2 million tons to 6 million tons.⁶ As a result, corn producers, far from constraining the retaliatory strategy, pushed for a tough negotiation position.

Thus, major U.S. farm interests, including producers of corn, feed grains, barley, and grain sorghum, had forged a unified position, forming a trade policy coordinating committee to protest the enlargement treaty. These groups urged the Reagan administration to take forceful action to press the EC to provide full compensation for U.S. farmers and to reduce agricultural export subsidies that dampened U.S. exports in third markets. U.S. producers insisted on the elimination of EC export subsidies because it was in this area that they felt most alarmed by EC's unfair trade practices. Yet this demand was also more sweeping and more difficult to meet than simply reducing the Spanish and Portuguese quotas to pre-accession levels.

The farm lobby obtained strong backing from legislators, who in April 1986 passed a resolution urging the president to retaliate. Representatives of the U.S. farm lobby visited European capitals in the summer to communicate directly with EC farm leaders and government officials about the United States' determination for a positive outcome. In the fall, farm groups launched an even more aggressive campaign for trade relief, explicitly making their endorsement of a GATT agreement on agricultural trade in the Uruguay Round contingent on the satisfactory settlement of the enlargement dispute.⁷ At the end of the year the Feed Grains Council directly warned American negotiators:

Our membership has clearly indicated that the feedgrains sector is willing to face the possible consequence of EC counter-retaliation. What they are not willing to face is anything less than full compensation for the Spanish market, or a lack of resolve by our government if such compensation cannot be achieved. . . . The time has come to draw the line and take a strong stand against the unfair trading practices of the European Community. Any further delay in the settlement of this dispute is totally unacceptable.⁸

Importantly, almost no interest group took any visible measures that could have undercut the effectiveness of the feed grain and corn growers. Importing interests, as well as a number of groups that could be hurt by possible EC counterretaliation, voiced their concerns about

the sanction threats but did not push their case as forcefully as the corn and feed grain producers. A number of interest groups targeted by EC counterretaliation faced trade restrictions in Europe themselves and were willing to go along with the tough approach demanded by the corn and feed grain producers. In the words of one U.S. negotiator in reaction to the level of political activism of U.S. groups that would potentially lose from EC counterretaliation,

Sure, we had heard from them [the groups targeted by EC]. We got a few letters saying they were concerned about it, but they were not beating our door down. It was not heavy-duty political pressure. The corn gluten feed people [targeted by Brussels] have their own zero [duty] binding in the EC. They know that if they want us to go to bat for them, they have to play along sometimes when we're working for somebody else. We did hear a lot from the import interests—representing the French products, Belgian endive, and so forth.⁹

In other words, political pressure exerted by groups that could suffer from possible EC counterretaliation was almost negligible. Neither was there much opposition from those whose imports might be cut off by potential EC retaliation, although these interests did raise some concerns. In short, since so many U.S. agricultural groups faced EC competition, both import-competing and export-seeking interests could expect to win from trade retaliation and, hence, both backed threats to open European agricultural markets. Virtually negligible domestic resistance allowed the feed grains and corn producers to exercise considerable political influence, intensifying the pressure on the Reagan administration to pursue a more aggressive approach in negotiations with the EC.

Reactions in Washington

U.S. farm groups' calls for trade sanctions received a sympathetic hearing in Washington. Indeed, the Reagan administration itself had become concerned about the impact of EC export subsidies on U.S. agriculture, one of the most important American exports. As the world's agricultural superpowers, both the United States and the EC had adopted policies privileging the agricultural sector. In providing European farmers with export subsidies and other restrictive import policies, the EC's CAP played a particularly important role in sustain-

ing the steady growth of European agricultural exports. By compensating EC farmers for the difference between the higher internal EC price and the lower world market price, the CAP helped European farmers export their agricultural surpluses to the world market, in the process transforming the EC from a net food importer to the world's largest exporter of beef, sugar, poultry, and dairy products.¹⁰

But such substantial gains to European agriculture also came at the expense of American farmers. As the EC moved from a net importer to a self-sufficient exporter of a variety of agricultural commodities, the United States lost the ability to export to the EC a number of products for which it used to be a major supplier, as America's share of world trade steadily declined. Moreover, U.S. agricultural exports to the EC plummeted from \$9.8 billion in 1980 to \$6.7 billion in 1984; overall U.S. agricultural exports declined from \$48 billion in 1981 to \$26 billion in 1986.¹¹ In addition, the EC's aggressive trading posture induced a visible drop in America's share of world trade.

In an environment of steadily deteriorating farm exports, the executive branch had been subjected to enormous pressure from Congress, the media, and various domestic constituencies to provide trade relief. The U.S. Congress, in particular, agitated for reform of domestic support policies to combat the effects of the CAP, a policy that was alleged to be directly responsible for the plight of U.S. agriculture. Even before the dispute over EC enlargement took place, Congress had passed, and sent to the president for approval, highly protectionist bills targeted at Europe. Given the EC's competitive assault on world markets, there was a strong sentiment among legislators that the United States could no longer condone the EC's unfair trade practices that limited imports, drove down prices, encouraged overproduction, and displaced U.S. products.¹²

The EC's attempt to use the accession of Spain and Portugal to further restrict U.S. exports of corn, sorghum, and oilseeds logically became to many congressional members an excellent example of the distortions caused by unfair foreign trade practices. In the context of steadily rising U.S. trade deficits, the potential loss of another \$1 billion in trade that EC enlargement would incur irritated many congressional members. Thus, despite many legislators' professed willingness to support the political integration of Spain and Portugal into the EC, there eventually emerged a congressional consensus that EC policies had created such excessive trade distortions that they could be corrected only through trade retaliation. As a manifestation of congressional determination, a group of twenty-one senators, including Senate

Majority Leader Robert Dole, submitted a letter to President Reagan calling on him to retaliate against the EC by withdrawing equivalent tariff concessions.

As Congress increasingly moved into the fray, the Reagan administration hardened both its rhetoric and policy stance. Indeed, beginning in the early 1980s, the executive branch adopted an increasingly mercantilist approach to counter the protectionist policies of its leading competitor in agricultural trade. Government support and retaliatory strategy, where necessary, were justified by the objective of maintaining the share of the world agricultural market going to one of the United States' internally competitive sectors. After the enlargement treaty took effect, the Reagan administration, with a view of protecting long-term U.S. agricultural interests, raised several objections to the treaty's provisions. Above all, Washington considered the 15 percent Portuguese quota reserved for EC countries to be clearly illegal under the terms of the GATT. It also strongly objected to the Spanish restrictions that raised the Spanish tariffs on imports of corn and sorghum from below 20 percent to over 100 percent, thus nullifying a prior bilateral agreement. American negotiators insisted that, in view of the substantial damage that the enlargement treaty imposed on American producers, the United States was entitled under the GATT's international rules to full compensation. Second, Washington was irritated by the fact that the Europeans resorted to the action without prior consultation with the United States. The Americans complained that they did not receive advance notice about the consequences of entirely new tariff structures for the two Iberian states and, therefore, were caught by surprise by the EC move.

Third, American officials raised their concerns about the substantial economic costs of EC enlargement, pointing out that the Spanish tariffs alone would cut American exports of maize and sorghum animal feed by roughly \$500 million a year. At a time when Washington was increasingly occupied with its loss of world market share in agriculture and with its \$170 billion trade deficit, including nearly \$30 billion with Western Europe, many administration officials felt that the United States could no longer countenance half a billion dollars in trade losses in the name of preserving a harmonious alliance relationship.¹³ Moreover, since one of the products involved was soybeans—the largest U.S. farm export to Europe, with annual sales of more than \$4 billion—there was also a strong reluctance on the part of administration officials to surrender soybean export markets. Finally, the Reagan administration emphasized that, contrary to the EC's claims, the U.S.

loss in agricultural trade would outweigh the potential benefits of lower industrial tariffs in the EC and of the further integration of the two Iberian states into the Western alliance.¹⁴

Thus, as negotiations in late 1985 and early 1986 bogged down, the White House began to run out of patience. U.S. Commerce Secretary Malcolm Baldrige began to refer to an exceedingly difficult situation in which trade disputes would take precedence over issues of geopolitical relationship. Later in 1986, in a meeting with farm group leaders, Baldrige reassured them that the administration would not “sit by” and watch the farm sector continue its downward slide.¹⁵ Similarly, USTR Clayton Yeutter reassured farm groups that the United States could not accept the accession agreement without adequate compensation. The rhetoric of senior administration officials sent an unmistakable signal that the Reagan team, having staved off protectionist pressures in the past, was no longer in a position to compromise on trade issues. Thus, in contrast to many trade disputes with the EC in which Congress usually played the leading role, the White House initiated the move for retaliation. Moreover, unlike past trade conflicts such as the Mediterranean citrus fruit case, the White House invoked the threat of retaliation at a fairly early stage in the dispute. These unusual moves reflected a clear shift of U.S. policy preferences away from adjudication to a more coercive strategy. The executive’s increasingly tough stance made a trade war with the Europeans all the more likely.

The Negotiations

In early 1986, when the enlargement treaty took effect, American negotiators immediately demanded adequate compensation. When initial informal discussions led by USTR Clayton Yeutter and Secretary of Agriculture Richard Lyng failed to produce any change, the Reagan administration announced on March 31 that the United States would retaliate against the Portuguese quotas on oilseeds and grains by May 1 and the higher tariffs in Spain by July 1, unless the new restrictions were removed. The total amount of trade affected by the threatened sanctions amounted to about \$1 billion, the estimated value that enlargement cost the U.S. farm sector.

In announcing the decision, U.S. negotiators took care to pick items that would inflict the most harm on politically well-organized EC groups. Almost half of the retaliation was directed at French exports (including white wine, brandy, cheese, and chocolates), with the rest of the sanctions targeted at exports from Germany, Italy, the Nether-

lands, and Britain. Notably, unlike U.S.–China trade disputes where the U.S. retaliation list was composed primarily of items no longer manufactured in America (such as bicycles, toys, shoes, and consumer electronics), U.S. sanctions against the EC deliberately targeted a wide range of products for which American importers could find ready American-made substitutes, thereby neutralizing resistance from U.S. importers. American negotiators backed up the retaliatory decision with tough rhetoric. President Reagan justified the retaliation as a means of preventing U.S. farmers from “once again” having to “pay the price for the European Community’s enlargement.” Secretary of Agriculture Richard Lyng stated that the retaliatory measures were designed to “bring the EC to the negotiating table as soon as possible.”¹⁶ Washington’s retaliatory move was unprecedented and fully revealed the U.S. resolve because, in contrast to past negotiations, it took place early in the dispute, without several rounds of negotiations.

However, since the interests of the politically powerful European farm groups were diametrically opposed to those of their American counterparts, Washington’s heavy-handed pressure was unable to make any substantial inroads in modifying EC policies. Indeed, the CAP enjoyed considerable support from European agricultural interests because it contributed significantly to the EC’s ability to maintain its status as one of the important players in world agriculture trade¹⁷ and to creating and maintaining a sense of cohesion among EC member states. CAP was particularly important to countries such as France, which viewed an enlarged and protected market as a guarantee to the viability of its large agriculture sector. Due to the unwavering support of European farmers with considerable political clout in European national capitals, the CAP had become one of the most entrenched policies of the EC. Consequently, any challenge to the CAP almost certainly would provoke a strong response from European farm interests. This helps to explain why, in the early stages of the enlargement dispute, the EC remained largely unmoved by American demands, insisting that the United States should not be given special agricultural compensation.

Determined to defend what it viewed as its legitimate trade interests, the EC on April 9 responded to the U.S. sanction threats with vows to counterretaliate, carefully selecting the products on the sanction list to target politically powerful U.S. groups, including producers of corn gluten feed, wheat, and rice. Since these products figured prominently in U.S. exports, the counterthreats were considered to be the equivalent of “using a nuclear weapon in a trade war.”¹⁸ During subsequent

negotiations in the spring, the two sides came up with various compromise proposals but could not narrow their differences. At this point, it was clear that neither was bluffing and that both were actively preparing for the trade war that seemed likely to follow.

While discussions were still under way, the U.S. government announced decisions to impose nonbinding quotas on a range of Portuguese products to retaliate against the Portuguese restrictions on soybeans and soybean oil. The imposition of quotas not only indicated the Reagan administration's resolve to attack the EC's continued assault on world markets but also reflected the political clout and influence of U.S. soybean producers. The American Soybean Association had long been actively involved in trade disputes with the EC because of the importance of the European market to the U.S. soybean industry. In the 1960s, the U.S. government had made as a precondition for its recognition of the CAP the European guarantee not to impose any tariffs on soybeans or corn gluten feed. This tacit agreement proved crucial to expanding American soybean exports to the EC. As EC enlargement seriously challenged the soybean zero-duty binding system, it nearly ensured that the soybean producers would launch an aggressive lobbying campaign against the new restrictions. The absence of opposition from other domestic groups, as described earlier, bolstered the soybean producers' chance of success in this case.

Since the retaliation against the Portuguese quotas still left the Spanish issue unresolved, Washington continued negotiations with the EC regarding Spanish restrictions throughout the year. On July 2, 1986, the two sides reached a temporary agreement whereby the EC promised to increase its imports of feed grains for six months in exchange for a U.S. guarantee to suspend the retaliatory tariffs until December 31, 1986. In essence, the agreement amounted to a concession on the part of the EC to temporarily provide the United States with some compensation and to increase EC purchases of U.S. grain, measures that the EC would not have taken in the absence of U.S. pressure. It addressed some of the most immediate concerns of the United States, thus providing the two parties with more time for negotiation and bargaining.

This interim agreement, while welcomed by both American and European negotiators, drew sharp criticism from farm interests on both sides of the Atlantic. The U.S. Feed Grains Council, for example, was critical of the amount of compensation provided in the agreement, which was less than half of the losses feed grain producers claimed they had suffered from Spanish accession. The council decried the agree-

ment as “a bitter pill to swallow,” stating that “any agreement that does not fully compensate the producers of corn and sorghum who have lost access to the markets of Spain and Portugal will be unacceptable to the U.S. Feed Grains Council and our members.”¹⁹ Then, toward the end of the year, as the negotiation deadline approached, the Feed Grains Council again urged American negotiators to stand firm, explicitly expressing their willingness to face the effects of EC counter-retaliation.

U.S. and EC negotiation positions remained far apart throughout the year. By November it was clear that the EC did not increase its imports of feed grains to the amount specified in the interim agreement. There was also evidence that the EC deliberately manipulated its import levy system in a way that continued to disadvantage U.S. exports. Given the lack of progress, the Reagan administration threatened to impose 200 percent retaliatory duties on \$400 million of European agricultural exports by January 30, 1987, unless an agreement could be reached by then. Even at this point, the negotiations remained deadlocked. Washington clearly stated that it would carry through with the retaliation if no agreement were in sight. But, at the same time, U.S. negotiators were prepared to soften the severity of their blow: Washington reduced the total amount of compensation it demanded in the previous rounds of negotiations; it also contemplated the possibility of some form of industrial compensation.

The United States and the EC continued negotiations right up to the deadline and finally reached a settlement on January 29, 1987. Brussels agreed to substantially increase its imports of corn and sorghum from third countries in the next four years, with two-thirds of these purchases guaranteed to go to American producers. Moreover, it guaranteed zero-duty binding for American soybean products and corn gluten feed exports in Spain and Portugal, eliminated the 15 percent restrictions on the Portuguese import market for grain, and offered to reduce import duties on a variety of industrial products. The removal of restrictions on the Portuguese grain import market was particularly important to American producers, as it promised to substantially increase U.S. sales of cereal in the Portuguese market. Total EC agricultural and industrial concessions were estimated at \$400 million. While the EC eventually conceded on the Spanish issue, both the Portuguese quotas on oilseeds and the U.S. retaliatory measure had remained in effect. It was not until 1991, when Portugal rescinded the oilseed quotas, that the United States removed the restrictions on Portuguese imports.

The Effect of American Politics on European Perceptions

The analysis just presented suggests that diametrically opposed domestic interests on both sides of the Atlantic was the main reason for the intense U.S.–EC trade confrontation over EC enlargement. Since American farmers faced across-the-board competition from the Europeans, EC enlargement united a broad spectrum of U.S. farm interests into aggressive lobbying campaigns. Not only did U.S. producers of corn, feed grains, and soybeans who were directly affected by the newly erected restrictions protest the enlargement treaty, but also even those targeted by EC counterretaliation such as producers of corn gluten feed, barley, and grain sorghum supported the sanction threats, as they would benefit from the restrictions on these European imports if the sanctions had to be carried out. Furthermore, the dispute against the EC was supported by Reagan administration officials, who felt that the new restrictions accompanying Spanish and Portuguese accession represented another episode in the history of unfair EC competition in the agricultural sector. U.S. retaliation in the Portuguese case resulted from, and reflected, these intense domestic pressures, which made the risk of trade war quite high.

Relative unity on the side of the United States helped to signal to the Europeans the strong U.S. resolve to obtain a positive outcome. At the same time it increased the risks of trade war, unified domestic support forced Brussels to back down from its original negotiation position. As Odell's first-hand account of the enlargement dispute reveals, by the end of 1986, EC member countries had unmistakably felt the highly orchestrated pressure from the United States. Indeed, in view of Washington's retaliatory measures against the EC in the past, the relevant EC officials all took the U.S. threat seriously and no one considered the U.S. move a mere bluff. An EC commission official reportedly stated, "I think everyone was pretty much convinced they would do it."²⁰ A French official concluded from his visit to Washington that "it was very clear that a very powerful lobby was working the agencies on this issue" this time around, as all the American officials with whom he had spoken, including even those at the Commerce Department, were of one mind with regard to Spanish accession. These reactions in Washington formed a sharp contrast with his past negotiation experience, where different agencies in Washington often came up with different views over a single issue.²¹ Given the perception that some compromise would be inevitable, European negotiators began to show a greater willingness to reach a settlement. One European negotiator

offered his explanation as to why the EC agreed to an interim agreement in July 1986:

From the U.S. side, the EC was beginning to give up on its principle that we did not owe any compensation. For the European side, once we realized that there was a risk of a major trade war and possible strains on cohesion in the Community—our tendencies were far from unanimous—we saw that probably we would not have successfully resisted a trade war. It was decided that it would be better to drop something on the table, something limited, that would not prejudice our position later, but would allow time for people to realize that such a thing was a possibility.²²

Thus, all the signals from Washington suggested that all relevant actors in the United States were resolved to obtain some concessions from the EC. These signals were filtered through EC internal politics and helped to induce the desired compromises from Brussels, although it did take Washington tremendous effort, including the imposition of retaliatory measures, to get Brussels to modify its policy.

U.S.–Canada Timber Trade Dispute

As the largest and most resilient trade dispute between the United States and Canada, the softwood lumber dispute spanned more than fifteen years, costing industry and government officials on both sides of the border considerable time and financial resources. The dispute began in 1982 when the U.S. Coalition for Fair Lumber Imports (CFLI) submitted a petition to the International Trade Administration of the Commerce Department calling for the imposition of CVDs on imports of softwood lumber supplied by Canada to compensate for the loss of employment resulting from the high level of Canadian stumpage price, or the price at which Canadian authorities sold the rights to remove trees from public forests to private lumber producers.²³ The U.S. Commerce Department conducted an investigation into these complaints but found no evidence of systematic government support that would justify levying CVDs. In 1984, the ITA in its ruling turned down the U.S. industry's request for protection on the grounds that Canadian stumpage programs were freely "available within Canada on similar terms regardless of the industry or enterprise of the

recipient” and that there was “no evidence of governmental targeting regarding stumpage.”²⁴

The ITA’s negative determination temporarily resolved the issue but did not prevent U.S. timber producers from mounting another major challenge to Canada’s forest industry policies two years later. In 1985, in a prelude to the second softwood dispute, U.S. cedar shakes and shingles producers, confronted with growing import competition from Canada and declining supplies and rising costs of raw materials, requested and received government support to restrict Canadian exports of shakes and shingles. When the Reagan administration announced the imposition of ad valorem duties of 35 percent on wooden shakes and shingles supplied by Canada in June 1986, it immediately invited Canadian retaliation against such American products as computers, semiconductors, and books.²⁵ The U.S. sanctions remained in place until 1991. Although the shakes and shingles industry was relatively minor in both economies,²⁶ this confrontation heralded a more serious trade battle that would emerge between the United States and its largest trading partner later in the year.

Shortly after the settlement of the shakes and shingles dispute, the CFLI, with strong backing from congressional representatives, for a second time petitioned the ITC for trade relief on the grounds that the rates at which Canadian timber was sold in the United States constituted an explicit subsidy that would be countervailable under U.S. trade law. They further referred to a number of specific Canadian government programs and legislations as evidence of such subsidies. When the ITA and the Commerce Department determinations affirmed the existence of government subsidization, the Reagan administration imposed a 15 percent countervailing tariff on softwood (construction) lumber imports from Canada,²⁷ prompting the Canadians to retaliate with a 70 percent countervailing GATT duty on corn imported from the United States.²⁸ Canadian negotiators eventually reached an agreement with the United States to place a 15 percent export tax on softwood lumber exports to the United States, but the corn retaliation remained in effect.

The magnitude of this second round of the softwood lumber dispute was unprecedented when one takes into consideration the size of the import sector and the impact of the retaliatory duties on domestic prices. As Joseph Kalt points out, the U.S. lumber tariff represented the largest countervailing/antidumping action undertaken by the United States within the framework of the GATT. In addition, the

Canadian corn retaliation was not only the first CVD ever imposed on the United States by its trading partner but also one of the few CVDs Canada had ever implemented against any nation.²⁹ Moreover, the lumber trade war entailed considerable costs for both sides, given the importance of the softwood lumber industry to both economies. Total annual sales of softwood lumber in the United States and Canada amounted to about \$10 billion and \$5 billion, respectively. In particular, since Canada exported about \$3 billion in softwood lumber to the United States each year, capturing nearly 30 percent of the U.S. market, a 5–15 percent duty could translate into hundreds of millions of dollars in lost sales each year.³⁰

The U.S.–Canada timber trade rift reemerged in the 1990s. In 1991, when the Canadian government unilaterally eliminated the 15 percent export tax on the grounds that a series of stumpage pricing reforms had removed the subsidies to domestic producers, the ITA immediately self-initiated an investigation into Canadian stumpage policies. Based on its final determination that the Canadian stumpage policies constituted implicit subsidies, the ITA in 1992 imposed a CVD of 6.51 percent on lumber imports supplied by several Canadian provinces. The binational panel established according to the new free-trade agreement between the United States and Canada subsequently reviewed the case and requested the ITA to reconsider its determination. The ITA in its remand found additional evidence of subsidization by British Columbia and increased the CVD to 11.54 percent.³¹ In 1993, the binational panel turned down the ITA's determination on the grounds that there was no convincing evidence that Canadian stumpage and export controls were "specific" or distorted. The ITA appealed this challenge to its authority without success. The binational panel eventually overruled the ITA's decision, allowing Canadian producers an important victory in this third round of the dispute.

Table 7.1 summarizes the militant history of U.S.–Canada timber trade conflicts. As we will see from the following discussions, the durability of the U.S.–Canada softwood lumber dispute can be explained by a combination of relentless lobbying by the softwood lumber industry and sustained congressional pressure on the executive to deter Canada's aggressive pricing policies. The softwood lumber industry, as a unified, orchestrated group, went out of the way to persuade congressional representatives and administration officials of the existence of Canadian subsidies. The regional concentration of the industry further enhanced the lobbying power of lumber producers, permitting them to apply tremendous pressure on their congressional delegates

and, through them, on the executive branch of the U.S. government to garner sufficient support for the countervail.

Moreover, the softwood lumber producers' petition won the support of various segments of the U.S. forest products industry, including producers of plywood, fir, and shakes and shingles. Because Canadian producers had been capturing a growing share of the U.S. forest products market, these U.S. forest industries favored the sanction threats against Canada. Lumber users are a major group that had reason to object to the threats. However, these opposing interests did not have as great a stake in the outcome as did the lumber-producing interests. Their geographical dispersion and inadequate representation in individual constituencies further diminished their political influence on government action. Meanwhile, faced with the possibility of drastic action by Congress that would contradict and challenge the president's policy, the executive branch found it necessary to act in order to preserve a measure of control over future trade policy. Although the Commerce Department and the ITA under it were sympathetic to industry demands, the Reagan administration seemed unwilling to fuel congressional support for more restrictive trade legislation or to frustrate a domestic industry with allies on Capitol Hill. As in the enlargement

TABLE 7.1. U.S.–Canada Timber Trade Disputes

Case	U.S. Charges	Commerce Department Finding	CVD Imposed	Result
Phase I	Canada's below-market stumpage rates constitute countervailable subsidies	Canadian stumpage subsidy is not specific	None	No further action
Phase II (1986)	Canada's below-market stumpage rates constitute countervailable subsidies	Canadian stumpage subsidy is both specific and distorting	14.5% ad valorem	Canada retaliates against U.S. corn exports; eventually agrees to replace U.S. CVD with 15% export tax.
Phase III (1992–94)	Canada's below-market stumpage rates and log export controls are countervailable under U.S. trade law	Both Canadian stumpage subsidy and export controls are specific and distorting	11.54% ad valorem	Commerce Department finding overruled by binational panel

Source: Kalt, *Political Economy*.

dispute, unity among domestic interest groups and government institutions heightened the risks of escalating the dispute.

Industry Coalition and the Countervail Petition

The U.S. timber industry started the campaign for trade relief in the early 1980s in light of deteriorating industry conditions. Starting in the early 1980s, the timber industry had experienced a steady erosion of comparative advantage due to shrinking sizes, declining productivity and quality of timber, and rising production costs of the extractive and processing sectors in the United States.³² The success of timber producers in obtaining a favorable Commerce Department determination in the second and third phases of the timber trade rift can be attributed not only to the regional concentration of the industry and its effective lobbying effort but also to the absence of organized domestic opposition. The following analysis will focus on the second phase of the U.S.–Canada timber trade conflict, when both sides implemented trade sanctions, to illustrate the dynamics of interest group involvement.

In the 1986 U.S.–Canada lumber trade dispute, the CFLI, the main industry pressure group, launched the CVD action and orchestrated a highly effective lobbying campaign in Washington. The CFLI, which represented major softwood producer and forest products associations and was responsible for 70 percent of softwood lumber production in the United States, united both softwood lumber producers in the Northwest and those in the southern mountain states. In its 1986 petition to the ITA requesting administrative assistance, the CFLI presented a wide array of evidence supporting the contention that Canadian stumpage policy conferred a subsidy.

The CFLI pointed out that several indicators of industry performance fully revealed the extent of the distress faced by the U.S. lumber industry and sought to attribute the plight of the U.S. timber industry to unfair competition policies adopted by the Canadian government. First, the CFLI argued that the penetration of Canadian imports in the U.S. market had deepened steadily since the late 1970s. Between 1983 and 1985 the share of Canadian imports in the total U.S. consumption of softwood lumber had increased from 27.6 percent to 31.6 percent.³³ Second, profitability and productivity of the lumber industry had experienced a sharp decline over the last decade. Since the late 1970s, the growth rate of total productivity of the U.S. lumber industry had dropped by 2.63 percentage points per year. This distinctive lag in productivity growth would have sharply reduced the competitiveness of the

lumber industry in the services of capital and labor in national markets.³⁴ Third, not only did sawmill capacity in the United States decline steadily, but real U.S. lumber prices remained stagnant despite some improvement in demand. The CFLI took these indicators as unmistakable evidence that “something is not right” with the workings of the free market, asserting that Canadian stumpage policy was directly responsible for the lackluster performance of the U.S. lumber industry.³⁵

The CFLI emphasized that the U.S. stumpage price consistently outstripped the Canadian stumpage price (see figure 7.1). It charged that Canadian stumpage fees, unlike those in the United States, were not derived through a competitive bidding process and hence failed to reflect their full market values. The result was that Canadian prices were only a small fraction of U.S. prices. According to the CFLI, this huge gap gave Canadian producers such a crucial edge in the U.S. market that by 1984 Canadian softwood lumber imports had captured nearly one-third of the U.S. market.

The lumber producers defended their case by arguing that they were presenting new information regarding Canadian timber policies. They asserted that there had been a marked shift in the use of timber in Canada toward lumber production since 1983. In particular, government intervention at the provincial level channeled the bulk of timber resources into lumber production, much to the benefit of Canadian lumber producers. The CFLI contended that Canadian stumpage policy, by subsidizing Canadian loggers, indirectly subsidized the lumber industry. The CFLI petition cited a number of other Canadian programs and regulations—such as preferential tax treatment, loan guarantee programs, and public reforestation programs—as additional evidence of the implicit subsidies provided by the Canadian government.³⁶ To back up its argument, the petition further referred to a 1986 report produced by the ITA, which concluded that Canadian lumber producers were benefiting from an unfair advantage.³⁷

The CFLI structured its petition around this factual evidence to meet the criteria of “specificity” and “preferentiality” required by ITA for CVD action. The CFLI also sought to develop the concept of a “primary beneficiary” of a certain government program to bolster its assertion that Canadian lumber practices provided benefits to a specific group or industry. Drawing on lessons from its past failed countervail initiatives, the CFLI devoted considerable attention to gathering necessary legal expertise and advice. For example, in 1985 the CFLI hired the law office of Dewey-Ballantine as its legal and political advisor to help reverse the ITA’s earlier decision.³⁸

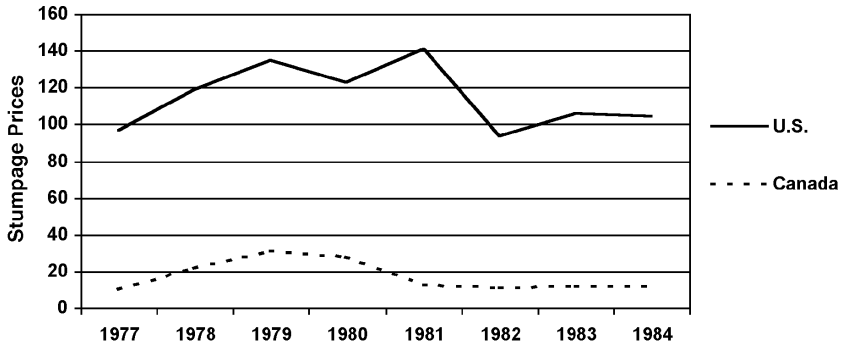


FIGURE 7.1. U.S. and Canadian stumpage prices, 1977–84 (in U.S.\$ per 1,000 board feet [mbf]). (Data from U.S. International Trade Commission, *Conditions Relating to the Importation of Softwood Lumber into the United States*, 1985.)

However, it was in the U.S. Congress that the CFLI spent most of its energy cultivating political support. The industry's unique geographical distribution enhanced its ability to take advantage of U.S. trade law to obtain import protection. As a resource extracting and processing industry, the forest products industry in the United States is an important element of the economic base of the Pacific Northwest and of certain states in the South. Many communities within these regions depend on lumber products as a main source of income and went through a difficult period adjusting to the decline of one of the most important pillars of the regional economy. As a result, these timber interests brought a considerable amount of political pressure to bear on congressional representatives, especially in the Senate, where they had strong representation. In view of the economic importance of the timber industry to the Pacific Northwest and to the South, senators and congressmen from these regions responded to the petition positively, vigorously advocating trade protection on behalf of the timber industry. By 1986, the timber industry had established such a solid friendship with Congress and a number of relevant administrative agencies that the Reagan administration found it difficult to ignore the demands of the timber industry and, in the end, was compelled to retaliate against softwood lumber imports from Canada, the largest U.S. trading partner and one of its closest allies.

As in the EC enlargement case, the absence of any organized, effective opposing domestic interests guaranteed the success of the softwood lumber producers' petition. Various segments of the U.S. forest

products industry applauded the threats against Canadian softwood lumber products because Canadian producers' growing incursions into the U.S. market directly threatened competitiveness and employment in their own industries. For example, the American Plywood Association for several years had lobbied for a change in U.S. trade law to raise the tariffs on Canadian plywood imports. The association argued that, without effective government protection, U.S. producers would continue to trail in the market place behind less efficient Canadian mills.³⁹ U.S. producers of Douglas fir and white fir, two of the primary commodities that were being displaced in the U.S. markets by Canadian lumber exports, also called on the government to take measures to halt the Canadian forest industry's growing penetration of the U.S. market.

Shake and shingle manufacturers, another major component of the forest products industry that was confronted with a deteriorating market share, supported the sanction threats as well. For example, between the late 1970s and early 1980s, U.S. production of western red cedar shake had declined steadily so that total U.S. production in 1984 was only one-sixth of the 1977 level. The decline of U.S. production was accompanied by a perceptible increase in the Canadian share of the U.S. market, which rose from 21.3 percent in 1975 to an alarming 79 percent in 1984.⁴⁰ The U.S. Shake and Shingle Association attributed this growing import penetration to Canadian government subsidies that allowed Canadian producers to consistently undercut U.S. mill prices. The association urged the U.S. government to take actions to ensure the survival of the shake and shingle industry. Furthermore, the industry's successful Section 201 petition earlier in the year reflected the industry's determination to deter Canada's aggressive pricing strategies. When the softwood lumber producers filed their countervail petition, the shake and shingle industry expressed its support for the action.

Lumber users, the group with the most reason to oppose trade sanctions, did not strongly lobby against the protection sought by lumber producers. The National Association of Home Builders (NAHB), which represented construction contractors, estimated that a 15 percent duty on Canadian lumber would have only a marginal effect on the price of housing in the United States.⁴¹ Because trade between the United States and Canada was competitive, and because housing was a large U.S. industry with surplus capacity, the import duty would be unlikely to induce sharp price hikes. Because they could afford a small increase in lumber prices, the NAHB did not make a visible effort to

oppose the lumber producers' trade initiative. Although a small number of lumber dealers, home builders, unions, and railroad and port organizations had organized themselves into an ad hoc body, the Coalition to Stop Unfair Wood Tariffs, to defeat both the countervail petition and the proposed restrictive congressional legislation, they had minimal influence on government action both because of the lack of strong political incentive and because of the geographical dispersion of its membership.⁴² The absence of effective domestic opposition increased both the attractiveness and the persuasiveness of the softwood lumber producers' countervail petition before the ITA.

Process and Rationale of the ITA Decision

U.S. lumber producers were highly successful in enlisting the support of individual congressmen and senators. Although these legislators were a minority in Congress, they were able to make substantial inroads in congressional debates. Meanwhile, to preempt a forceful and serious congressional challenge to the executive influence over trade policy, the Reagan administration responded favorably to industry pleas with full protection. Although the Commerce Department was supposedly more sympathetic to the perspective of business groups, the desire to avoid provoking Congress into adopting more restrictive trade legislation reinforced the appeal of policy proposals for trade relief. In particular, the ITA, despite its proclaimed political neutrality as a quasi-judicial body, turned out to be amenable to industry and congressional pressure. In addition, considerations for the viability of U.S. forest industries made the executive office more receptive to industry and congressional demands. The broad consensus that was eventually forged between the executive and legislative branches, reinforced by strong, unified industry pressure, resulted in a highly confrontational approach in the U.S. lumber trade dispute with Canada.

As mentioned earlier, U.S. lumber interests worked assiduously to impress upon congressional members the merit of their case and to lobby for a change in U.S. trade law in order to ensure the countervailability of subsidized natural resources. The softwood lumber issue appealed to many congressional representatives as a clear case of unfair foreign competition that placed U.S. producers at a disadvantage in international markets. Congress also was concerned about the economic viability of single-industry resource producers and, to some extent, about certain large regional economies. Many congressional members had linked the steadily rising Canadian share of the U.S. tim-

ber market to stagnant employment and investment levels at home. They alleged that the increasing ability of Canadian producers to penetrate the U.S. market did not reflect the two countries' comparative advantages in terms of the quality of natural resources and their costs of production. Rather, it resulted from government pricing policies that subsidized resource producers.⁴³ Thus, in view of the threat posed by unfair Canadian competition, Congress entered the debate on the side of the softwood lumber industry.

Congressmen and senators from timber-producing states in the South, Pacific Northwest, and mountain states played a crucial role in publicizing the plight of the industry and in extracting concessions from the administration. Their representation in certain important congressional committees, particularly those in charge of international trade policy, created a highly visible platform for the lumber industry. For example, Senator Robert Packwood of Oregon was chairman of the Senate Finance Committee and a member of the Subcommittee on International Trade. Senator Packwood was reportedly "compelled to oppose [U.S.–Canada free-trade] negotiations if no solution (to the Softwood Lumber dispute) appears."⁴⁴ Senator Russell Long of Louisiana was the ranking minority member. In addition, Representative Sam Gibbons of Florida was chairman of the Subcommittee on Trade of the House Ways and Means Committee.⁴⁵ Representative Don Bonker of Washington and Senator Max Baucus of Montana voluntarily stepped into the debate on behalf of lumber producers and soon became strong advocates on Capitol Hill.⁴⁶

This emerging congressional coalition, at the urging of the CFLI, exerted tremendous pressure on the ITA to reverse its earlier ruling. Several legislative proposals were introduced to address the alleged unfair trade practices. Some of them aimed to place strict limits on Canadian softwood lumber exports to the United States; others sought to broaden the definition of subsidy so that there would be no doubt that Canadian provincial governments had subsidized their lumber industry.⁴⁷

At the same time as the softwood lumber dispute unfolded, U.S. negotiators were seeking fast-track approval in Congress for the upcoming free-trade talks with Canada. Members of Congress quickly moved to make approval of a Canada-U.S. free-trade agreement contingent upon satisfactory resolution of the softwood lumber dispute. In other words, an important part of the congressional strategy was to forge a link between acceptance of trade liberalization and a specific case of administered protection.⁴⁸ Congress was positioned to do so

because it would have been difficult for senators to justify free trade with Canada when Canadian import penetration was increasingly threatening a domestic industry that served as an important pillar of the economic base of certain regions.⁴⁹ To signal congressional determination to settle the dispute, a majority of senators sent a letter to President Reagan in late 1985 insisting that they would not proceed with the Canada-U.S. free-trade negotiations before the lumber dispute was resolved to their satisfaction. In February 1986, Senator Baucus, with the support of fifteen senators, warned Canada to reduce softwood lumber exports or to be prepared to face the consequences. Furthermore, half of the members of the Senate Finance Committee wrote to USTR Clayton Yeutter emphasizing their “concern about Canadian softwood lumber imports”:

Any free trade agreement must be built on a foundation of mutually advantageous trade practices. Therefore, we believe the administration should seek an early resolution of the softwood lumber trade issues. This would facilitate Finance Committee consideration of any Administrative proposals relating to the negotiation of a free trade agreement with Canada.⁵⁰

Yeutter responded that the administration already had taken measures to address the issue and also had persuaded the Canadians to come to the negotiation table. Dissatisfied with Yeutter’s response, a group of senators, led by Senator Baucus, again brought up the issue on the Senate floor in February 1986. Baucus reiterated the congressional position:

They [Canadians] cannot have it both ways. If they expect the United States to enter a free trade agreement, they must engage in free trade. . . . I am optimistic about the benefits a free trade agreement might bring, but I cannot support such an agreement, so long as subsidized Canadian lumber makes a mockery of free trade.⁵¹

In April 1986, in an ultimatum to the Reagan administration, the Senate Finance Committee explicitly stated that it would deny fast-track approval of the Canada-U.S. free-trade talks unless the softwood lumber dispute could be addressed to industry satisfaction.

Besides its active effort to link the softwood lumber dispute to broader issues in U.S. trade policy, the U.S. Congress also tried to broaden the definition of “subsidy” to ensure the countervailability of Canadian softwood lumber practices. Even prior to the lumber dis-

pute, Congress tried to seek a redefinition of "subsidy." In 1984, Congress amended the Tariff Act of 1930 to include provisions that would have made certain "upstream" or "input" products countervailable.⁵² This broadening of the legal definition increased the chances of success of the softwood countervail appeal because it assured that subsidized log production also constituted a countervailable subsidy to the lumber industry.

In the face of enormous congressional pressure, the Reagan administration veered decisively toward a trade policy favoring the forest industry. With future control of the Senate at stake, the administration could no longer shield Canada, one of its closest allies, from charges of violating free-trade principles. At a 1985 "timber summit" sponsored by the CFLI, Commerce Secretary Malcolm Baldrige came under intense pressure from the CFLI and its congressional representatives to provide trade relief. At this point Baldrige still emphasized that the administration would adhere to the position adopted by ITA in 1983.⁵³ By the spring of 1986, however, growing congressional support for the lumber industry had fundamentally altered the administration's calculus.

For fear that lack of progress on the softwood issue would fuel protectionist sentiment in Congress, the United States managed to persuade Canada to resume negotiations in early 1986. At the same time, the administration undertook a series of initiatives to placate forest industry officials and their representatives in Congress. In his statements before the Senate Finance Committee, USTR Clayton Yeutter indicated a growing willingness to accept congressional proposals. Commerce and USTR officials also held meetings with industry leaders and senators from lumber-producing states, assuring them of the administration's willingness to resolve the dispute.⁵⁴ The executive department wanted to prevent Congress from derailing the talks with Canada over the Free Trade Agreement or from enacting more stringent, congressionally mandated legislation.

The changing mood of the administration was reflected in a discussion between President Reagan and advocates of the lumber issue in the Senate Finance Committee on the eve of congressional vote, where President Reagan finally succumbed to industry and congressional pressure. In a public letter to Senator Packwood, President Reagan promised for the first time to resolve the softwood lumber dispute before reaching a bilateral free-trade agreement with Canada. Reagan's political concessions signaled the evaporation of executive support that previously had protected Canadian softwood lumber from domestic protectionist pressure.

Furthermore, the Commerce Department, in which the ITA was

located, was not insulated from political pressure from Congress. Indeed, Congress's threat to pass legislation targeted specifically at foreign, "underpriced," raw material imports to resource processors had posed genuine concerns to the Commerce Department. In the event such legislative proposals became law, the United States would be seen to have violated its obligations under the GATT, thus inviting retaliatory legislation by its trading partners. Such congressional action could have made billions of dollars of U.S. agricultural and primary manufactured exports easy targets of foreign retaliatory duties, leaving the Commerce Department with the problem of how to deal with increasingly contentious trade disputes with major trading partners. Thus, the choice facing the Commerce Department was clear: either to achieve a satisfactory outcome in the softwood lumber dispute or to provoke a forceful legislative response that could affect other trade areas. The latter scenario was by no means appealing to the Commerce Department. Consequently, the Commerce Department decided to reverse its earlier ruling and to grant the softwood lumber industry a favorable determination.

Thus, when the ITA announced its determination on October 16, 1986, the result was hardly surprising. The ITA ruled that Canadian provincial stumpage programs conferred a subsidy on Canadian softwood lumber producers. Moreover, the ITA finding confirmed the CFLI's contention that Canadian subsidies were countervailable because they were targeted at specific lumber producers and caused distortions in the domestic lumber market. Given these findings and pursuant to U.S. trade law, the ITA imposed a 15 percent tariff on lumber imported from four Canadian provinces. Although the 15 percent figure was lower than the 25 percent duty sought by the lumber industry, U.S. lumber interests nevertheless emerged as the principal victors and beneficiaries in this dispute, as the ITA decision effectively barred a significant portion of Canadian softwood lumber exports from entering the United States. The imposition of sanctions thus, by and large, satisfied a domestic industry that had put forth the most compelling political demands.

Canadian Reactions

Just as lumber producers were politically active in the United States, their Canadian counterparts were influential in the making of Canadian public policy. Indeed, the lumber industry occupied an important place in the Canadian economy and was even dominant in several

regions of the country. At the time of the second lumber dispute in the mid-1980s, softwood lumber production amounted to \$5 billion a year; the softwood lumber industry was larger in size than the aggregate of metals, agriculture, fisheries, and autos. Lumber contributed roughly 4 percent of Canadian gross national product (GNP) and Canadian exports to the United States. Canadian imports supplied roughly 30 percent of the U.S. market and accounted for more than 99 percent of foreign lumber imported into the United States.⁵⁵

Given the importance of the softwood lumber industry in the Canadian economy, it was not surprising that the Canadians responded so forcefully to Washington's trade restrictions. Canadian sawmills and the Canadian government had consistently organized active opposition to CVD actions against Canadian lumber. While provincial forestry ministries and, to a lesser extent, the federal government of Canada led and financed participation in legal proceedings, Canadian sawmill producers played the key supporting role, supplying the necessary information and testimony to assist in efforts to defend what were perceived as Canada's legitimate interests. Since Canadian mills clearly stood to lose from U.S. import restrictions, their stakes in influencing the role and forcefulness of the various Canadian government agents were indeed substantial. The Canadian Forest Industry Council, a coalition of forest industry enterprises in which the Forest Industries of British Columbia played a leading part, employed legal counsel in the United States, made submissions to the ITC, and actively opposed the countervail actions before the ITA.

Ever since the failure of the first countervail initiative, the Canadian forest industry learned that U.S. lumber producers were able to successfully elicit congressional support and that, to counter such strong protectionist pressure, it was necessary for them to adopt a "political" strategy focused on the U.S. Congress and to develop necessary legal expertise to help bolster the case of forest products producers in British Columbia. The second countervail appeal, in particular, convinced Canadian lumber producers that the adjudication process was politically influenced and that there was substantial support within the United States for CFLI's countervail appeal. As Apsey and Thomas reported on the reactions of Canadian forest producers, "We failed to appreciate that the case has taken on such significance in U.S. politics that the normal handling of a trade case would be put aside. We did not know that the professionalism and independence of judgment that had resulted in the earlier determination in Canada's favor had dissipated under intense political pressure."⁵⁶ The industry subsequently

devoted most of its effort to influencing the decisions of the U.S. Congress.

The Canadian forest industry was not the only actor opposing U.S. CVD actions. Since U.S. CVD actions against Canadian stumpage and log export policies were perceived as frontal assaults on Canadian sovereignty in the area of natural resource policy, the fight against U.S. trade restrictions also gained the sympathy of the Canadian public as a whole. Such broad public support bolstered the government's active resistance to the CVD duties and heightened the risks of confrontation on the Canadian side as well.

Thus, in September 1986, Canadian federal, provincial, and forest industry representatives concerned with the countervail action conducted meetings to arrive at a common strategy of opposition. In early October, a week prior to the announcement of the U.S. lumber decision, Canada's minister for international trade called U.S. producers' lobbying for tariff protection "unjustified harassment . . . meddling around in our natural-resource pricing" and explicitly warned retaliation.⁵⁷ On November 7, with support from liberals and conservatives in Parliament, the Canadian government imposed a 67 percent CVD on U.S. corn exports to Canada, a duty that remained in place until 1987. The swift, highly visible, and vociferous retaliatory response of the Canadian government in Lumber II, the second episode of the softwood lumber dispute, reflected a strong domestic sentiment against aggressive U.S. trade action.

In this case, both the British Columbia industry and the federal government, operating on the assumption that they ought to have prevailed in a fight against the United States, would have preferred to fight this through the U.S. adjudication process were it not for intervention by British Columbia's new premier, Bill Vander Zalm, who considered an export tax a possible solution to British Columbia's revenue problem. The new premier, who was looking for new sources of revenue, apparently determined that if some form of duty had to be imposed on lumber it would benefit Canadian authorities to collect the tariff revenues to enrich British Columbia's coffer than to let this income go to the United States. Thus, two months later, soon before the 15 percent U.S. duty was scheduled to become permanent, U.S. and Canadian negotiators reached an agreement on December 31 that implemented a 15 percent Canadian export duty in exchange for the U.S. lumber industry dropping its countervail action. According to a key CFLI official, had it not been for the actions of the British Columbia government, the memorandum of understanding would never have come into

place.⁵⁸ Since the Canadian lumber industry had experienced considerable distress, reflected in increasing numbers of layoffs and decreasing revenue, it was entirely possible that the Canadian lumber producers would have insisted on a hard-line position had it not been for Bill Vander Zalm's intervention. That the third episode of the lumber dispute would take place only a few years later reveals the intense pressure for trade conflict from Canadian lumber producers.

Conclusion

In both the EC enlargement case and the U.S.–Canada timber trade conflict, the United States escalated the disputes to trade wars because of the absence of major domestic opposition to sanction threats. In the EC enlargement case, both export-seeking and import-competing interests supported an aggressive negotiation strategy because both competed with EC agricultural products and would win whether the threat was carried out or not. Hence, the enlargement case united both producers seeking to remove the restrictions in the Iberian market and import-competing interests targeted by EC counterretaliation. Similarly, in the timber trade conflict, U.S. softwood lumber producers did not encounter domestic resistance. Since many U.S. forest product groups were alarmed by the growing Canadian penetration of the U.S. market and in the past had pushed for restrictions on Canadian products, they simply had no reason to object to the retaliatory measures. Moreover, import users did not oppose the threats, as they easily could substitute reduced imports with domestic products at comparable qualities without paying substantially higher prices, an option that import users in a complementary trade situation simply did not have. Table 7.2 presents a summary of the impact and position of the key actors involved in the EC enlargement and the U.S.–Canadian softwood lumber disputes.

This unity among U.S. domestic interest groups was reinforced by the executive branch's willingness to level the playing field for U.S. industries that it viewed as fundamentally competitive but suffering from unfair barriers and subsidies. With regard to EC enlargement, the executive was sufficiently concerned about declining farm exports and the deleterious effects of protectionist EC agricultural policies to initiate trade retaliation. It viewed the new EC trade restrictions as reflecting another conspicuous attempt by the EC to block U.S. products from the European market. In the dispute with Canada, the timber

TABLE 7.2. Profiles of Main Actors Involved in U.S.–EC Enlargement and U.S.–Canada Softwood Lumber Disputes

	Companies and Associations	Position	Impact
U.S.–EC: EC Enlargement			
Directly Affected Exporters	Feed Grains Council (representing feed grains producers)	Demanded full compensation to American farmers caused by increased Spanish and Portuguese tariffs associated with EC enlargement.	Instrumental in pushing for trade sanctions.
Exporters Not Directly Affected	Other agricultural groups such as producers of corn, barley, and grain sorghum	Have long complained about the EC's protectionist trade policy; came out in favor of trade sanctions.	Increased the pressure for proactive trade policy.
Import-Competing Interests	Producers of corn (maize), barley, and grain sorghum	Supported efforts to expand U.S. market shares in the Iberian states, as they similarly felt victimized by unfair EC competition.	Supported sanction threats; strengthened the impact of feed grain producers.
Import-Using Interests	—	—	—
U.S.–Canada: Lumber			
Directly Affected Exporters	—	—	—
Exporters Not Directly Affected	—	—	—
Import-Competing Interests	U.S. Coalition for Fair Lumber Imports; softwood lumber producers; producers of plywood, fir, shake, and shingle; American Plywood Association; U.S. Shake & Shingle Association	Claimed that Canadian stumpage and export control policies caused considerable harm to U.S. producers and remained countervailable under U.S. trade law.	Was major actor pushing for trade sanctions.
Import-Using Interests	National Association of Home Builders	Because there is a large domestic industry with surplus capacity, users did not face any price hike and therefore did not oppose the sanction threat.	Unlike in U.S.–China cases, did not oppose sanction threats.

industry, which had traditionally enjoyed a home market advantage, was able to exert sufficient political pressure on executive action. Both in 1986 and in 1991, the lumber industry, with the help of Congress, solidified its friendship with relevant administrative agencies and gained their full support in obtaining protection from Canadian imports. By 1991, this friendship was so strong that it led the Commerce Department to take the unusual step of initiating a Section 301 petition. Such sympathetic hearings from administrative agencies increased the chances of successful industry petition.

This pattern of unified domestic support contrasts with the highly divisive domestic politics in U.S.–China trade disputes. Because of competitive trade relations between the United States and its European and Canadian trading partners, there were very few import-using groups, as in the U.S.–China cases, that sought to undermine the sanction threats. Instead, import-competing interests entered the policy debate in favor of trade retaliation. Trade structures affected domestic politics in these two sets of cases in different ways, increasing the likelihood of trade wars in the U.S.–EC and U.S.–Canadian cases while reducing the chances of escalation in trade disputes between the United States and China. The discussions in this chapter have focused on the internal political dynamics in the sender of threats, without discussing how trade structure impinges on the political processes in the EC and Canada. This question will be taken up in the next chapter, which briefly examines the political dynamics in target countries with varying degrees of trade competitiveness with the United States to show how trade structure shapes political coalitions in the target in a way that reinforces patterns of trade war and threat effectiveness described so far in this book.

The conclusion that countries with competitive trade relations (such as U.S. trade relations with Canada or the EU) face heightened risks of trade war is particularly salient in view of the belief that international institutions presumably serve to ameliorate trade conflicts for such states. For example, many trade conflicts between the United States and Europe are undertaken within the framework of the WTO, whereas U.S.–Canada trade conflicts are increasingly placed within the orbit of the Free Trade Agreement/North American Free Trade Agreement (NAFTA). Scholars in the neoliberal institutional tradition have argued that institutions may enhance the prospects for international cooperation by altering the transaction costs faced by the states, lengthening their time horizons, creating issue linkages, producing iterated games, and reducing the incentives to cheat by increasing the

transparency of information.⁵⁹ If institutions do help to reduce states' incentives for defection by helping to routinize conflicts between member states and by preventing escalation into wider trade wars, then the reality that trade wars do frequently take place between competitive trade partners only serves to highlight the intense domestic pressure generated by trade complementarity. For example, in the most recent trade spats between the United States and the EU over bananas and beef hormone, the two sides barely avoided a tit-for-tat retaliation, even given the presence of international institutions, suggesting that the asymmetrical domestic interests generated by competitive trade structure may produce highly contentious trade conflicts that preclude institutional solutions.

Moreover, the specific designs of certain international institutional arrangements may not be particularly conducive to insulating domestic pressure for trade relief. Some international institutions may have actually heightened, rather than lessened, protectionist pressure. The third episode of the softwood lumber dispute (Lumber III) provides an example in support of this argument. Judith Goldstein, for example, argues that the establishment of binational panels under FTA/NAFTA was intended by Congress to insulate itself from protectionist pressures by transferring some of its authority to the FTA.⁶⁰ Benjamin Cashore argues to the contrary that protectionist pressure at the congressional level actually increased after the third softwood countervail attempt, even though agency discretion appeared to have been reduced during Lumber III. He finds that rather than shielding congressional members from powerful domestic interests, as Goldstein's argument would predict, the binational panel helped to formalize the procedures employed by the Commerce Department to affirm the existence of a subsidy in Lumber III, thereby reducing the possibility of a finding in favor of a foreign competitor in the future and increasing congressional activism on the countervail file. In other words, the establishment of a binational panel actually strengthened the U.S. domestic industry's ability to threaten or to use countervail actions to secure increased relief, in the process reducing the likelihood that future NAFTA binational panels would remand ITA and ITC decisions.⁶¹ Therefore, even though international institutions do play an important role in helping to constrain trade conflicts among countries such as the United States, the EU, and Canada from spilling over into wider trade wars, they do not always prevent trade wars both due to the asymmetric interest structure between the parties and because of specific features of institutional design.