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5 Do Precedent and Legal Argument Matter in the Lumber CVD Cases?

Joseph P. Kalt

5.1 Rational Political Economy and U.S.-Canadian Lumber Disputes

Efforts by interested parties to secure trade protection are frequently carried out in the United States through the quasi-judicial regulatory framework of countervailing duty (CVD) law, as administered by the Department of Commerce (DoC). Parties who participate in the department's litigation process, however, often confess to perceptions that the process is a charade; the hearings and filings before the department's International Trade Administration (ITA) and International Trade Commission (ITC) have no influence on the ultimate policy outcomes. Instead, it is averred, the policy outcomes are driven by interest group politics, leaving the litigatory apparatus to serve merely as beside-the-fact packaging for decisions made elsewhere and through different, "purely political" processes.

This paper tries to get at the questions of whether and how the quasi-judicial regulatory process by which CVD law is administered affects the success or failure of parties petitioning for protection. The ongoing dispute between the United States and Canada over trade in lumber and logs serves as the context.¹ The "timber trade war" centers on claims by U.S. milling interests that the Canadians provide publicly owned trees to loggers at subsidized prices, and that Canadian log export restraints subsidize the prices that Canadian sawmills pay for raw logs.

This research focuses on the role that a particular legal institution—*legal*

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The author has benefited greatly from access to the documentary record in the proceedings of the Canadian Lumber III trade dispute. Any errors or omissions are his, as are the preliminary views set forth.

1. See Kalt (1988).

precedent—plays in determining the successes and failures of the contending parties as they tussle over such matters as the applicability of CVD law. Legal precedent is treated as a costly barrier that litigants face when trying to exert political influence. Resources are expended by competing parties to defend or break down precedents in a stochastic process of “take your best shot (via legal argument) and hope you hit the bull’s-eye.” What arguments work and why?

At some risk of caricature, economic theories of rational political economy are currently pulling scholars into two broad camps: Capture Theory (CT) and the New Institutionalism (NI). Under the former, it is argued that political outcomes can be explained by a combination of two primary economic factors: (1) the differential stakes that contending parties have in a particular law or regulation, that is, where the rents are; and (2) the differential costs of effective political organization that contending rent-seeking interest groups confront as a result of standard Olsonian forces of free riding.² Within this framework, regulatory outcomes and processes are “captured” by successful interest groups who wield the most effective political influence, where “influence” is usually measured either by votes delivered to politicians or votes plus campaign contributions delivered to politicians.

The New Institutionalism does not deny that the two primary factors underlying CT are indeed important (if not strictly “primary”), but adds a third fundamental explanatory factor to efforts to understand political outcomes. This factor is the institutional context—laws, procedures, precedents, regulations, voting rules, and so on—that forms the playing field upon which contending rent seekers meet. NI lays claim to every bit as much economic rationality in the modeling of political actors as does CT, but argues that institutional structure constitutes binding constraints, or at least conditioning costs, that limit the range of actors’ investments in political outcomes and hence play determinative roles in political outcomes.³

As these theories play out in the investigation of a particular class of political action, such as decisions of the ITA regarding trade protection for U.S. lumber interests, they carry testably different implications. According to CT, institutions such as legal proceedings are “Stiglerian theater”; the real game is being played out behind the scenes of the hearing rooms by interest groups and support-maximizing politicians.⁴ Legal rulings and such matters as precedent may be a language by which the game is explained or justified after the fact to appease the press and the public, but they are not determinative of outcomes. NI would hold, however, that such institutions as precedent, standards of evidence, and burdens of proof *matter*; agency decision makers and judges can’t simply ignore precedent, evidence, or procedure no matter how much political

2. The classic statements here are from the Chicago School: Stigler (1971), Peltzman (1976), Becker (1983).

3. See, e.g., North (1990), Bates (1988), and the writings of the “rational political economists.”

4. The nature of such support maximization is worked out for the case of no principal-agent slack by, e.g., Peltzman (1976) and Becker (1983).

clout the beseeching interest group has. If a group does not have a good argument by which to satisfy or overcome precedent, or meet its evidentiary burden, it runs a substantial risk of losing before the agencies and the courts. Within the New Institutionalism, precedents should be “stronger”—that is, harder for an opposing party to overcome, or easier for a supporting party to uphold—the longer and more frequently they have withstood previous challenges and have been reaffirmed by appropriate authorities, and the more clear the underlying legislative intent and/or directive is.

Below I identify a set of stakes-bearing issues that have been adjudicated by the ITA in the latest round of the U.S.-Canada lumber dispute. These issues can be categorized according to whom—the U.S. petitioners or the Canadians—has won each of them as of the ITA’s Final Determination, reached in May 1992. This creates a dichotomous winner-loser variable by which to gauge the outcome of the legal proceedings. For each of the arguments in the data set, I then code the stakes at issue in the argument for their magnitude (large or small), and dichotomously code the argument of the winning party for its consistency with precedent, its analytic or theoretical straightforwardness, the strength of the winner’s evidence, and the ease of exposition entailed by the winner’s argument. The pseudoregression Boolean techniques pioneered by Ragin (1987) are used to reduce the panel of dichotomous data to its parsimonious informational content in terms of necessary and sufficient conditions for an argument’s success before the ITA. The test then is whether a party’s success in making an argument can be systematically explained as a function of determinants of the severity of the beseeching party’s precedential burden or other institutional aspects of the legal proceedings (per NI theory). That is, are particular institutional configurations (e.g., favorable precedent) part of the set of necessary and/or sufficient conditions needed to make a specific argument a winner? Or is success unrelated to apparent precedential burdens and the institutional context of the legal proceedings, being instead driven solely by parties’ stakes in the matter (per CT theory)?

An illustration is helpful to explain the nature of the arguments in the lumber dispute. The U.S. lumber industry has long argued that the Canadian federal and provincial governments provide the rights to cut trees (“stumpage” rights) at below-market prices to Canadian loggers, *and* that this constitutes a counter-actable subsidy to lumber production in Canada. Economists testifying on behalf of the Canadians (e.g., William Nordhaus of Yale University) and economists researching the matter independently (e.g., Kalt 1988⁵) have argued that the evidence *and* the theory indicate that to the extent Canadian stumpage may be below market, the consequence is merely an inframarginal transfer of Ricardian and Hotelling rents to loggers. The supply of logs and hence lumber is left unchanged. U.S. lumber producers therefore face no incremental competitive

5. This research was undertaken and published prior to any engagement with any party to the lumber dispute.

pressure from Canadian lumber producers and are not harmed by Canadian stumpage policy.

This argument has held little or no sway before the ITA or the ITC. Concepts of inframarginality and rent appear to be difficult to comprehend, and the argument has been dismissed as irrelevant and obfuscating theorizing by university economists. Moreover, although they have offered considerable empirical evidence for their case, little or no precedent has supported the Canadians' argument for exempting "subsidies" that are inframarginal from the definition of the kinds of subsidies that CVD actions are designed to counteract. The stakes in the issue are very large, since exemption of inframarginal subsidies would put an end to the U.S. interests' case for CVD action against Canadian stumpage policies. In fact, the U.S. interests have won the issue before the ITA as of the 1992 Final Determination. It appears that, in the absence of precedent on the Canadians' side, their economic theorizing and empirical evidence are to no avail.

This single case suggests that precedent matters. The Boolean analysis of this study will reject this suggestion, however, if other sample points (arguments) show the U.S. interests winning when the pattern for such variables as the strength of the Canadians' evidence, the difficulty of exposition, and the size of stakes is the same as in the case of the inframarginal stumpage argument, but precedent is on the Canadians' side (i.e., unlike the inframarginal stumpage argument). That is, if the U.S. interests are observed winning arguments with large stakes, whether or not precedent is on their side (and holding other explanatory factors constant across arguments), it cannot be concluded that precedent matters in the NI sense.

5.2 Lumber I, II, III: History and Issues

Over the past dozen years, Canadian softwood lumber imports have prompted three separate CVD inquiries. The first round of the timber trade war—Lumber I—was launched in 1982. It ended upon a final negative determination in 1983, with the DoC finding that Canadian stumpage rights were allocated in a way that failed to satisfy the technical legal criterion of "specificity" (which requires that a subsidy be provided to a specific enterprise or industry, or group of enterprises or industries, in order for such a subsidy to be countervailable).

Lumber II arose in 1986 in response to a petition for investigation of Canadian stumpage policy by the Coalition for Fair Lumber Imports (CFLI), a trade organization and lobbying group representing (predominantly) small and medium-size U.S. sawmill companies. Consistent with evolving precedent (in unrelated cases) that broadened the definition of "specificity," the DoC found that the Canadian stumpage system was both "specific" (in the sense described above) and "preferential" (i.e., it "distorted" the marketplace for lumber by affecting the supply schedule of Canadian lumber). The DoC set the counter-

vailing duty rate for Canadian lumber imports at 14.5 percent ad valorem. The Lumber II CVD was effectively preempted, however, when escalating retaliatory threats by the Canadians compelled the United States and Canada to enter into a Memorandum of Understanding (MOU). The Lumber II MOU obligated Canada to impose a 15 percent fee on softwood lumber exports to the United States.⁶

In 1991, Canada and a number of its provinces concluded that the MOU had been satisfied and lifted the 15 percent export fee. The DoC's ITA immediately launched Lumber III to investigate whether Canadian stumpage policies continued to constitute a countervailable subsidy. At the invitation of the ITA, the Coalition for Fair Lumber Imports filed submissions arguing that Canada's log export restraints (LERs) also constitute a countervailable subsidy.⁷ On Final Determination in 1992, the ITA found both Canadian stumpage and LERs to be countervailable and set an ad valorem CVD of 6.51 percent for lumber imported into the United States from Alberta, British Columbia, Ontario, and Quebec. As of 1994, the Final Determination was subject to ongoing appeal before a binational panel created pursuant to the recent U.S.-Canada free trade agreement.

The stakes in the lumber dispute are large. Duties on the order of 5 percent to 15 percent translate into hundreds of millions of dollars annually. Lumber II, for example, concerned only stumpage, yet it has been estimated that its CVD would have produced (i.e., but for the MOU) tariff revenues of more than \$340 million per year for the United States, and net gains for U.S. lumber producers of more than \$400 million per year.⁸ In the case of Lumber III, the duties set forth by the ITA's Final Determination would offset alleged subsidies totaling more than \$390 million per year.

These stakes obviously motivate the contending parties. The tariff-seeking interests throughout Lumber I, II, and III have consisted of medium and smaller U.S. logging and milling operations organized as the Coalition for Fair Lumber Imports, joined with force by at least one of the very large U.S. operators (Georgia Pacific Corporation), and orchestrated by a U.S. law firm renowned for lobbying and legal efforts on behalf of protection-seeking parties. A number of large U.S.-based operators, such as Weyerhaeuser, have been expanding their investments in Canada. This apparently has tended to cool any enthusiasm for CVD action against Canadian lumber imports. U.S. lumber consumers (who stand to lose from tariffs on Canadian lumber) have largely been inactive in the lumber dispute. The active opposition to CVD action has consistently come from Canadian sawmills and the Canadian government. In particular, participation in the legal proceedings has primarily been led and

6. See Kalt (1988) for a discussion and calculation of the international welfare effects of Lumber II.

7. Ironically, since Lumber II, the United States had tightened log export restrictions of its own—aimed at stemming log exports across the Pacific.

8. See Kalt (1988).

Table 5.1 Hypothetical Boolean Summary Table (upper case = presence; lower case = absence)

$Y = \text{Win}, y = \text{Lose}$	Factor—A or a	Factor—B or b
Y	a	B
Y	A	B

financed by the provincial forestry ministries. Canadian mill operators have cooperated with their governmental agents.

5.3 Boolean Representation of the Legal Arguments in Lumber III

The tariff-seeking U.S. interests have been the most influential party in Lumber III, in the sense that they have won their case before the ITA—but this does not explain why they won. As noted, I use the Boolean pseudoregression techniques pioneered by Ragin to investigate the factors that might explain what makes a winning argument in the Lumber III CVD proceedings before the ITA.⁹ Boolean analysis proceeds by coding an outcome of interest for dichotomous results. In the case at hand, the outcome of an argument is coded Win or Lose. Possible explanatory factors in determining when an outcome (e.g., Win) occurs are coded for their presence or absence. The resulting coding can be represented by a table of the kind illustrated above.

Boolean analysis describes the outcome in the first case (row) as $Y = aB$. The second case is coded as $Y = AB$. Multiplication in Boolean analysis is read as “and,” while addition is read as “or.” Thus, we can say that $Y = aB + AB$; that is, Y occurs when either a and B are present together or A and B are present together. If this is a well-specified model of the factors explaining Y , $Y = aB + AB$ can be further reduced by factoring to $Y = B(a + A) = B$. In other words, B is a necessary and sufficient condition to cause Y , and it doesn’t matter whether A is present or not. More generally, necessary and sufficient conditions are reflected as

$Y = B$	B is both necessary and sufficient;
$Y = A + B$	A and B are each sufficient, but not necessary;
$Y = AB$	Both A and B are necessary, but not sufficient;
$Y = A(B+C)$	A is necessary, but not sufficient.

The coding of “left-hand-side” variables in a case such as the Lumber III Final Determination entails identifying the objective “winner” of a particular argument in the proceeding, as this is indicated in the actual ITA decision. The

9. See Ragin (1987).

explanatory factors (coded for presence or absence with upper and lower case designations) are (from NI)

1. precedent (P/p): precedent on one's side increases the likelihood of winning;

2. straightforward theory (T/t): a coherent, straightforward theory (e.g., an economic reasoning or theory) improves the likelihood of winning;

3. evidence (E/e): having the preponderance of evidence increases the likelihood of winning;

4. ease of exposition (X/x): the likelihood of winning an argument increases with the ease with which it can be communicated;
and (from CT)

5. stakes (S/s): the likelihood of the more influential party winning increases with the stakes at issue in the argument (with the success of U.S. interests in Lumber III making them the most influential party).

I have coded the foregoing factors for a set of fourteen actual arguments from Lumber III. This coding and the winning party in each argument are set forth in table 5.2. The basic assertions of the fourteen arguments are¹⁰

1. Rent theory: Canadians assert that any below-market stumpage is infra-marginal and does not affect lumber production.

2. LER as subsidy: the DoC/CFLI asserts that LERs lower log prices to Canadian millers.

3. Market distortion: Canadians assert that LERs merely offset other countries' (especially Japan's) distortive trade policies.

4. LER price change: Canadians assert that any effect of LERs on log prices must be measured relative to the no-LERs equilibrium, rather than current U.S.-Canadian price differences.

5. General equilibrium effects—existence: Canadians assert that general equilibrium effects that offset log price effects of LERs must be accounted for.

6. General equilibrium effects—measurement: Canadians assert that general equilibrium effects significantly offset log price effects of LERs.

7. Causation tests: Canadians assert that the DoC/CFLI has the burden of demonstrating empirically a "direct and discernible" impact of the LERs on Canadian sawmillers' costs.

8. Other provinces: Canadians assert that LERs in provinces other than British Columbia are not economically binding.

9. Law of One Price: DoC/CFLI asserts that observed differences between U.S. and Canadian prices demonstrate the subsidizing effect of LERs.

10. Relevant market/1: Canadians assert that any price effect of LERs does not "ripple" uniformly from exportable logs across all log types and the entire province of British Columbia.

10. I merely state the assertions here. No opinion is expressed regarding the validity of the arguments.

Table 5.2 Boolean Summary of the Attributes of Observed Winning Arguments in the U.S.-Canadian Lumber Dispute (affirmative = 1; otherwise = 0)

Issue	Winner	Precedent Favors Winner P = 1; p = 0	Large Stakes S = 1; s = 0	Applicable Theory Is Straightforward T = 1; t = 0	Evidence Favors Winner E = 1; e = 0	Winner's Ease of Exposition X = 1; x = 0
Rent theory	DoC/CFLI	0	1	0	0	1
Log export restraint as subsidy	DoC/CFLI	0	1	0	0	0
Market distortion	DoC/CFLI	0	1	1	0	1
Log export restraint price change	Canada	1	0	1	1	1
General equilibrium effects— existence	Canada	1	0	1	1	1
General equilibrium effects— measurement	DoC/CFLI	0	1	0	0	0
Causation tests	DoC/CFLI	0	1	0	0	0
Other provinces	Canada	1	0	1	1	1
Law of One Price	DoC/CFLI	0	1	0	0	1
Relevant market/1	Canada	1	1	0	0	0
Relevant market/2	DoC/CFLI	0	1	0	0	1
Export preparation costs	DoC/CFLI	1	0	0	0	1
Transport costs	Canada	1	0	1	1	1
Company exclusions	Canada	1	0	1	1	1

11. Relevant market/2: Canadians assert that the ITA erred in Preliminary Determination by assuming a uniform “ripple” of LER price effects across all logs in British Columbia.

12. Export preparation costs: Canadians assert that any comparison between foreign and domestic log prices must be adjusted for costs of preparing logs for export.

13. Transport costs: Canadians assert that transport costs should be deducted from foreign-derived log prices in any attempt to determine no-LER equilibrium prices in domestic British Columbian markets.

14. Company exclusions: Canadians assert that individual mills can be exempted if they are not affected by the alleged subsidy (e.g., do not use British Columbian logs).

Upon factoring table 5.2 (per above), the resulting designation of a winning argument is $Win = pSt + PsX[tE + Te]$. In words this says that

a winning argument before the ITA has either precedent running against it (p) and a complicated theory (t) but large stakes (S); or precedent in its favor (P), low stakes (s), and easy exposition (X), and either a combination of a complicated theory (t) but strongly supportive evidence (E) or a simple theory (T) albeit weak evidence (e).

Closer inspection of the process of factoring and reduction that produces the prime implicant for Win above reveals that the cases in table 5.2 that produce the first term (pSt) in Win entirely are cases in which the DoC/CFLI is the winning party. Similarly, the cases that produce the second term in Win (i.e., $P s X [t E + T e]$) entirely are cases in which the Canadians are the winners of the argument. From this observation come the key findings of this study:

$$\text{DoC/CFLI Wins} = pSt \text{ and Canadians Win} = PsX[tE + Te].$$

To interpret these results, consider the above expression for “DoC/CFLI Wins.” The p in pSt represents the absence of supporting precedent for the position taken by the winning party. It is only reasonably interpreted as an impediment to winning an argument. The same interpretation applies to t —the absence of a straightforward theory behind the position taken on the winner’s argument. In short, p and t impede the ability of the DoC/CFLI to win an argument. Yet, when the stakes are large (S), the DoC/CFLI wins anyway. We cannot quite say that no matter which institutional factors (i.e., p , t , x , and/or e) run against the DoC/CFLI, the group wins when the stakes are large; the sample of issues in table 5.2 does not include cases in which the DoC/CFLI wins or loses with large S and x and/or e running against it. Nevertheless, it can be said that in the cases available none occur in which institutional aspects of ITA proceedings block a DoC/CFLI win if the stakes in the matter are large.

This last observation is the prediction of Capture Theory. It says, contrary to the New Institutionalism, that at least in the cases represented here, no evidence is found that large stakes will not permit the influential, capturing party

from overwhelming institutional blockades such as the absence of supportive precedent or the absence of a noncomplicated theory for one's argument. The New Institutionalism is not wholly rejected, however. While the DoC/CFLI has succeeded in Lumber III in securing the ITA's support for tariff protection against Canadian forest products, the Canadian parties have won some arguments along the way. In so doing they have tempered the level of protection successfully sought before the ITA by the DoC/CFLI. As noted above, the second term in "Win" arises from cases in which the Canadian parties prevail in their legal arguments before the ITA, and the Canadian parties win arguments when $PsX[tE + Te]$. Imposing on this expression the priors that neither complicated theories (t) nor weak evidence (e) assists the Canadians in winning the argument, the prime implicant for Canadians Win reduces to

$$\text{Canadians Win} = PsX[tE + Te] = PsX[E + T].$$

This result says that, within the sample of cases encompassed by table 5.2, if the Canadians are to win arguments before the ITA, they require not only issues for which the stakes are small (s), but also institutional help in the form of supportive precedent (P), easy exposition (X), and either strong evidence (E) or a straightforward theory (T). Apparently, the Canadians do not need to have everything in their favor (i.e., $PsXET$) to win an argument before the ITA. Yet even when the issue is a matter with small stakes, they need a considerable array of institutional factors on their side in order to win (i.e., P , X , and E or T).

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