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## **SOFTWOOD LUMBER – SOME LESSONS FROM THE LAST SOFTWOOD (LUMBER IV) DISPUTE**

Elaine Feldman

### **SUMMARY**

The checkered history of softwood lumber disputes between Canada and its southern neighbour stretches back to the 1800s, with five of them occurring since 1982. Two years ago, the settlement obtained in 2006 expired and most Canadian softwood lumber exporters now face a combined countervailing and anti-dumping duty rate from the Americans of around 27 per cent.

On the surface, the last dispute, known as Lumber IV, appeared to be a squabble over subsidization and dumping of Canadian softwood lumber exports. However, closer scrutiny revealed that this dispute was really about commercial interests triumphing over policy – the U.S. lumber industry wanted to ensure it kept a certain share of the market at the highest price possible.

Complicating attempts to resolve any dispute is the fact that Canada is not a single entity in the lumber business; interest in quota or duties varies across regions as do the countervailing (CVD) and anti-dumping (AD) rates that the U.S. imposes on particular Canadian producers. These variations thus create almost a divide-and-conquer situation in which one group of producers feels others are getting an advantage. The Canadian industry instead should be standing together as much as possible, creating a united front in any dispute with the U.S.

Drafting new policy and resorting to litigation to settle Lumber IV failed because the potential settlement got bogged down by the drawbacks of both of those routes. Policy failed because it quickly became clear that the U.S. was going to act with impunity to determine whether there was a subsidy,

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regardless of what the trade rules permitted. And litigation created an endless loop in which contradictory rulings were handed back and forth between NAFTA panels and the U.S. International Trade Commission, stalling any resolution. Lumber IV also taught the Canadians that taking their complaints to both NAFTA and the World Trade Organization, which does not order a refunding of wrongly collected duties, only further muddied the hoped-for outcome. It took political will on the part of both the U.S. and Canada to finally reach a solution.

Nevertheless, Chapter 19 of NAFTA played a key role in establishing the 2006 softwood lumber accord between the U.S. and Canada, and the return to Canada of approximately \$4 billion of the \$5 billion worth of duties deemed to have been wrongly collected by the Americans. A renegotiation of NAFTA that would see the elimination of Chapter 19, which the U.S. has called for, would make the settlement of Lumber V much more difficult, politicized and litigious. The absence of Chapter 19 could also threaten other Canadian industries should the U.S. proceed with industry requests to impose CVD and/or AD duties (Boeing and its complaint against Bombardier being the most recent example).



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## **BOIS D'ŒUVRE RÉSINEUX – LEÇONS À TIRER DU 4<sup>E</sup> CONFLIT SUR LE BOIS D'ŒUVRE\***

Elaine Feldman

### **RÉSUMÉ**

L'histoire chaotique des conflits sur le bois d'œuvre entre le Canada et son voisin du Sud remonte aux années 1880, et cinq différends du genre ont eu lieu depuis 1982. Il y a deux ans, l'accord conclu en 2006 est venu à échéance et la plupart des exportateurs canadiens de bois d'œuvre résineux font maintenant face à un mélange de droits compensateurs et antidumping imposés par les États-Unis et s'élevant à près de 27 pour cent.

En apparence, le dernier conflit, quatrième du genre, semblait une dispute portant sur les subventions et le dumping liés aux exportations de bois d'œuvre canadien. Un examen détaillé révèle toutefois que le conflit mettait plutôt en scène la prévalence des intérêts commerciaux sur la politique : l'industrie du bois d'œuvre aux États-Unis voulait s'assurer de conserver une part du marché au plus haut prix possible.

Un des facteurs qui compliquent les tentatives de résolution de conflit est le fait que le Canada n'est pas une entité homogène dans le contexte du bois d'œuvre : les taux d'intérêt des quotas et des droits varient d'une région à l'autre. Il y a aussi variation dans les taux des droits compensateurs et antidumping que les États-Unis imposent à certains producteurs canadiens. Ces variations créent une situation qui s'apparente à la stratégie du « diviser pour régner », puisque des groupes de producteurs ont l'impression que les autres jouissent de meilleures conditions. Pourtant, l'industrie canadienne devrait s'unir autant que possible pour faire front aux États-Unis.

Dans le cadre de ce quatrième conflit, l'élaboration d'une nouvelle politique et le recours aux procédures judiciaires ont tous deux échoué parce que les

\* Cette recherche a été soutenue financièrement en partie par le gouvernement du Canada via Diversification de l'économie de l'Ouest Canada.

règlements visés se sont heurtés à des embûches dans chacune de ces deux avenues. La politique a échoué parce qu'il est vite devenu clair que les États-Unis agiraient impunément en déterminant s'il y avait ou non subvention, sans égard pour les règles commerciales. Quant au recours aux procédures judiciaires, on y a observé un cycle sans fin où des règles contradictoires allaient et venaient entre les groupes spéciaux de l'ALENA et la Commission du commerce international des États-Unis, entravant ainsi toute possibilité de résolution. Le quatrième conflit sur le bois d'œuvre a aussi montré aux Canadiens que le dépôt de plaintes devant l'ALENA ou l'Organisation mondiale du commerce, laquelle n'ordonne pas le remboursement des droits perçus à tort, n'a fait qu'embrouiller davantage les décisions espérées. Il a fallu une volonté politique de la part des États-Unis et du Canada pour finalement trouver une solution.

Néanmoins, le chapitre 19 de l'ALENA a joué un rôle clé dans l'accord de 2006 sur le bois d'œuvre entre les États-Unis et le Canada ainsi que dans le remboursement au Canada d'environ 4 des 5 milliards de dollars en droits considérés comme perçus à tort par les États-Unis. Une renégociation de l'ALENA qui verrait le retrait du chapitre 19 – ce que demandent les États-Unis – rendrait encore plus difficile, politisée et litigieuse la résolution d'un cinquième conflit sur le bois d'œuvre. L'absence du chapitre 19 pourrait aussi menacer d'autres industries canadiennes, si les États-Unis accédaient aux demandes d'un secteur industriel quelconque d'imposer des droits compensateurs et antidumping (le cas de la plainte de Boeing contre Bombardier en étant l'exemple le plus récent).

## INTRODUCTION

Forest products have been a cause of trade friction between Canada and the United States for a very long time, with disputes going back to the early 1800s. However, the current era of softwood lumber disputes began with Lumber I in October 1982. The U.S. Coalition for Fair Canadian Lumber Imports alleged that certain Canadian softwood lumber products were subsidized and petitioned the U.S. Department of Commerce for the imposition of a countervailing duty against Canadian softwood lumber imports. Since that time, there have been periods of relative peace (usually as a result of a managed trade agreement between Canada and the United States), interspersed with disputes. Canada now finds itself enmeshed in the latest such dispute (Lumber V) which fits this pattern. After the expiry of the 2006 Canada- U.S. Softwood Lumber Agreement in 2015 and the one-year standstill agreement preventing U.S. industry from bringing any trade cases, most Canadian softwood lumber exporters now face a combined countervailing (CVD) and antidumping duty (AD) rate of approximately 27 per cent. Some Canadian companies have their own specific individual rates. For example, J.D. Irving has the lowest combined rate of 9.87 per cent, composed of an AD rate of 6.87 per cent and a CVD rate of 3.02 per cent. Canfor Corporation has the highest combined rate, composed of an AD rate of 7.72 per cent and a CVD rate of 20.26 per cent.

At the time of writing, there is a “gap period” during which the CVD duties are not being collected. That is because the U.S. Tariff Act provides that preliminary CVD duties cannot be in place for more than 120 calendar days. As the duties began to be collected as of 12:00 am on April 28, 2017, the period during which they could be collected ended as of 11:59 pm on August 26, 2017. AD duties are still being collected as they began to be collected later (June 20, 2017) and a similar 120 period is not yet up. The U.S. Department of Commerce has announced that it will postpone until no later than November 13, 2017 its final determinations in both the countervailing and anti-dumping duty investigations.

A Commerce final determination date of November 13, 2017 would be followed by a final injury determination by the U.S. International Trade Commission, no later than December 21, 2017. Final duties would then be imposed upon publication of the final duty order in the U.S. Federal Register. This is expected to occur in late 2017 or early 2018, although it is possible that these dates could be moved up.

Why do Canadian softwood lumber exports to the United States create such trade friction, which at times spills over and can have detrimental effects on broader issues between the two countries? How does NAFTA fit into it? As a member and then for a time head of the Canadian negotiating team for the last softwood lumber dispute, I believe that there are lessons that can be learned from Lumber IV which went on from 2001-2006.

The United States softwood lumber industry, often with the support of their government, has been arguing since Lumber I in 1982 that Canadian softwood lumber is subsidized, mainly through provincial stumpage systems, and that this subsidy is injuring or threatening to injure the U.S. industry. Since Lumber IV they have also argued that Canadian softwood lumber is exported at dumped prices, i.e., that the product is being sold in the United States at a price lower than that at which it is sold on the Canadian domestic market.

It might surprise many Canadians to know that softwood lumber, like almost every other good (dairy and poultry products are notable exceptions) is covered by NAFTA and subject to no tariffs on exports to the United States. Similarly, the United States could export its softwood lumber duty-free to Canada. Both countries, however, retain their ability to apply their respective trade remedy laws against imports from the other country. Trade remedies are tools that allow governments to take action against imports which are causing or threatening to cause injury to a domestic industry. For the purposes of the softwood lumber dispute, the remedies are anti-dumping (AD) and

countervailing (CVD) duties. Article 1902 of the NAFTA states: “1. Each Party reserves the right to apply its antidumping law and countervailing duty law to goods imported from the territory of any other Party.”

This means that a domestic industry which considers that it is injured or there is a threat of injury as a result of subsidized or dumped (or both) imports, can request that its government take actions against such imports. Should the government find that imports are subsidized or dumped (or both) and that such imports are causing or threatening to cause injury to the domestic industry, the government can impose AD or CVD, or as in Lumber IV and V, both AD and CVD duties. The findings, leading to the imposition of the duties, can be challenged in domestic courts, under NAFTA Chapter 19 binational panels or in the dispute settlement proceedings of the World Trade Organization (WTO).

The foregoing fits neatly into the realm of trade policy and dispute settlement: the U.S. industry alleges subsidy and dumping of Canadian softwood lumber; the Department of Commerce finds that to be the case and determines the amount of the subsidy and the dumping; the U.S. International Trade Commission determines whether there is injury or threat of injury to U.S. softwood lumber producers. But a close examination of Lumber IV shows that the U.S. industry is not really interested in whether Canadian softwood lumber exports are subsidized or dumped, but rather in ensuring that the U.S. industry maintains a certain share of the market, at the highest possible price. And the U.S. government is largely captive to industry perceptions. Commercial interests, not policy, prevail.

What does this mean for Canadian interests? It is important to recognize that there is no one Canadian interest, but rather regional interests. At one end is British Columbia, generally supported by Alberta. B.C., which has traditionally accounted for about half of Canada’s softwood lumber exports to the United States, has large trees and large, efficient producers. Quebec and Ontario have small trees and smaller producers. The Atlantic provinces have traditionally been exempt from any CVD actions and have worked strenuously to remain exempt from any managed trade agreement. (While Lumber IV included Atlantic producers in the U.S. AD determination, they were not included in the 2006 Softwood Lumber Agreement).

As a result, one of the main issues for the Canadian federal negotiators in their attempt to resolve the dispute with the United States has been keeping “Team Canada” together. Producers across the country are suspicious that others may have an advantage. The fact that the U.S. sets specific CVD and AD rates, which vary, for some of the large companies and then applies an “all others” rate to every other producer reinforces those concerns. At one point during the Lumber IV dispute there was an attempt to reach a settlement which was brokered by some of the large B.C. companies. This attempt foundered because it did not take sufficient account of the concerns of companies across the country. One-size solutions don’t work, and the 2006 agreement reflected this.

## **POLICY-BASED SOLUTION**

Much of the early negotiations to resolve Lumber IV centered on provincial stumpage systems, which differ from province to province. In 2002-2003, while vigorously contesting the U.S. finding that provincial stumpage systems constituted a countervailable subsidy under both the NAFTA and the WTO dispute settlement systems, the federal and provincial negotiators were willing to explore whether there was a potential policy-based resolution to the dispute. As a result, the U.S. Department of Commerce led a process to develop a policy bulletin which would set out the changes that individual provinces would make to their stumpage systems, thereby reducing or eliminating the alleged provincial subsidies. Once those measures were in place, Commerce would carry out a changed-circumstance review with the implicit understanding that it would find that the subsidies no longer existed and the CVD rate would be zero. (The policy bulletin process did not address the AD issues).



The federal and provincial negotiators, particularly from the four largest softwood lumber exporting provinces (B.C., Quebec, Ontario and Alberta) entered into discussions on the policy bulletin approach with Commerce. However, it became clear that reforms to stumpage were not sufficient – the U.S. industry insisted on an effects test, i.e., they wanted a determination by Commerce that the reforms had actually had the effects that the U.S. industry was seeking. That was effectively the end of the policy-based approach to resolving Lumber IV. It was clear that the U.S. industry and the Department of Commerce would use whatever methodologies they found convenient, whether or not permitted by trade rules, to determine what was or was not a subsidy.

It can be argued that the latest U.S. CVD finding reinforces this point. The U.S. has now subjected New Brunswick producers to the CVD duty, despite historically exempting them because of their system of largely privately owned forest lands.

It was also clear during Lumber IV that the producer lobby in the U.S. has much more influence than the consumer lobby. The U.S. National Association of Home Builders was firmly opposed to the U.S. imposition of CVD and AD duties, arguing that the duties would raise the cost of housing, but their position had no influence on U.S. government actions then, and is unlikely to have any influence now. It is possible that the rebuilding that will be necessary in Texas and Florida as a result of Hurricanes Harvey and Irma may give some additional economic and political clout to those, such as the Home Builders, who oppose duties that raise the cost of lumber. But this remains to be seen and the producer lobby continues to carry the heavy hand.

## LITIGATION

At the same time as the policy bulletin was under development, Canada had challenged U.S. findings of subsidy, dumping and threat of injury under both the NAFTA and the WTO. The U.S. International Trade Commission had not found that the U.S. industry was injured by the allegedly subsidized and dumped imports of Canadian softwood lumber, but only that there was a threat of injury to U.S. producers. Threat of injury is sufficient to allow for the imposition of CVD and AD duties. Conversely, without injury or threat of injury, no CVD or AD duties can be imposed.

The WTO and NAFTA dispute settlement systems look at different issues and have different remedies. A WTO case looks at whether the international rules governing trade remedies which both Canada and the U.S. have signed onto have been followed. If they have not, the WTO calls on the party that violated the rules to remove its inconsistent measures and to bring itself into conformity with the rules. If it fails to do so, the winning party can then retaliate. This is not always easy, particularly if the winning party is small and the loser large.

Panels established under Chapter 19 of the NAFTA examine whether the country that has found subsidy, dumping, injury or the threat of injury has followed its own laws. If the NAFTA panel finds that the country has not acted according to its own laws, then the CVD or AD or injury or threat of injury finding is set aside and the duties that have been collected until then are refunded to the companies that paid them. This is a key difference between the WTO and NAFTA dispute settlement systems – there is no refund of duties improperly collected under the WTO.

The legal cases against the U.S. CVD, AD and threat of injury findings were made more complicated by the fact that the U.S. applies a system of retrospective application of duties. It sets a preliminary rate and then subsequently revisits the issues to determine the final rate. The result is that litigation is always playing catch-up. This, along with the interplay of the two different dispute settlement systems, the NAFTA and the WTO, did not always lead to the results that Canada had anticipated.

The most telling example of the complexities around the approach to bringing all disputes to both the NAFTA and the WTO arose in the summer of 2005 with the interplay between the findings

related to threat of injury in the two different dispute settlement systems. The NAFTA Chapter 19 panel established to examine the U.S. finding of threat of injury found that the U.S. International Trade Commission (ITC) had not acted in accordance with U.S. law when it made its finding. It sent the issue back to the ITC to reconsider. The ITC, on remand, continued to find threat of injury. Each time, the ITC finding went back to the NAFTA panel, which found there was no proper evidentiary basis for the ITC's finding. In its third ruling, the NAFTA panel concluded that the ITC had refused to follow the panel's instructions and directed it to find no threat of injury: "The Commission has made it abundantly clear to this Panel that it is simply unwilling to accept this Panel's review authority under Chapter 19 of the NAFTA and has consistently ignored the authority of this Panel in an effort to preserve its finding of threat of material injury." In September 2004 the ITC, while disagreeing with the panel, issued a determination that the U.S. softwood lumber industry was not threatened with material injury.

At the same time as the NAFTA panel was proceeding, Canada had challenged the ITC finding of threat of injury before the WTO and had also been successful in that forum. However, given that the WTO remedy is for the losing Party to bring its measure into conformity with the international trade rules, the U.S. asked the ITC to make a new determination consistent with the WTO ruling. This allowed the ITC to make yet another finding of threat of injury (called a Section 129 determination) in November 2004, subsequent to its September finding of no threat of injury.

Complicated. But it gets worse! The U.S. challenged the NAFTA panel's direction to the ITC to an Extraordinary Challenge Committee (ECC). On August 10, 2005 the ECC upheld the NAFTA panel's ruling. That should have been sufficient to overturn the CVD and AD duties and enable the return of the monies (approximately \$3 billion at that point) to the Canadian producers.

Canada had in the meantime challenged the Section 129 determination as not being in compliance with WTO rules and had asked the WTO for authority to retaliate. A WTO Injury Compliance Panel had been set up to look at those issues and it upheld, in an interim decision on August 29, 2005 and in its final decision in November 2005, the ITC Section 129 determination.

So where did that leave Canada and the U.S. and what lessons can be drawn? The U.S. refused to refund the duties, arguing that the ITC's November 2004 Section 129 determination was valid and so, therefore, was its continued collection of CVD and AD duties despite the NAFTA panel's and ECC findings. In the latest lumber dispute Canada will need to assess the strategy of bringing effectively the same issue to both the NAFTA and the WTO in order to avoid the threat of injury result.

Litigation continued under both the NAFTA and the WTO until an agreement was finally reached outside of these fora in 2006. That agreement ended the outstanding litigation. Without an agreement, would Canada finally have prevailed and would the U.S. have returned the duties collected, approximately \$5 billion by 2006, as they eventually did? There were some in the U.S. who attempted to argue that the NAFTA did not actually require the refund of the wrongly-imposed duties to those who paid them.

There are some in Canada who argue that litigation is the only route to follow, that it is the only way to ensure that the U.S. cannot at will impose CVD and AD duties on Canadian softwood lumber. Others believe that given the ingenuity of legal arguments that can be devised, there will be an endless loop of litigation and that winning is not sufficient. Not to be forgotten is that litigation is expensive. It is estimated that Lumber IV cost the Canadian federal and provincial governments, industry associations and individual companies over \$500 million by the time the agreement was finalized.

Moreover, the amount of duties that the U.S. collected in Lumber IV was an issue in itself. At various points in the negotiations that were underway at the same time as the litigation, the ever-increasing amount of duties collected became a stumbling block to resolution. Canadians believed firmly that the duties, having been wrongly collected, were to be returned pursuant to the NAFTA



rules. The U.S. industry was worried that returning such large amounts to the Canadian producers would enable the Canadians to ride out market downturns. The agreement that was finally struck in 2006 left \$1 billion of the \$5 billion that had been collected to fund a binational group designed to look to future Canada-U.S. cooperation on growing the market for softwood lumber.

There were added complications in Lumber IV relating to the refund of the duties, namely the so-called Byrd Amendment legislation. This U.S. legislation would have allowed the duties collected to be distributed to the U.S. producers rather than remain with the Treasury. This law was found by the WTO to be contrary to international trade rules. While the Byrd Amendment legislation has been repealed, the arguments against the refund of duties under the NAFTA may well reappear as Lumber V drags on.

## **REACHING AN AGREEMENT - POLITICAL WILL**

By the summer/fall of 2005 it became apparent to Canadian negotiators that a solution to Lumber IV that was either a quota deal or an export tax deal and that did not exempt the Atlantic provinces and the Quebec border mills would not succeed in achieving consensus within the Canadian industry and provinces. While the exemption for the Atlantic provinces did not sit especially well with the rest of the country, their relatively small share of the U.S. market and their demonstrated political capacity to scuttle a deal that included them, eventually overcame objections within Canada to their exemption. At the same time, the concept of an asymmetrical solution that broadly aligned with regional interests – an export tax for British Columbia and Alberta and quotas coupled with lower rates of export tax for Quebec and Ontario – gained currency.

On the political stage, the 2006 federal election led to a minority Conservative government under Prime Minister Stephen Harper, who was eager to resolve the lumber dispute and put relations with the United States on a more even keel. However, while softwood lumber was a key irritant for Canada in its relationship with the United States, it was not viewed the same way in the U.S. Political will at the highest level in the U.S. was a prerequisite to reaching a negotiated solution. Without that, the interests of the lumber producers who call the shots by bringing subsidy and dumping cases forward to the government would continue to prevail. This required a willingness on the part of the President to use some political capital to bring U.S. industry on board for a negotiated solution that was also acceptable to Canada.

Companies have such clout because they bring forward the initial CVD and AD cases. Chapter 19 only comes into play after the government has imposed the AD and CVD duties, which are then subject to challenge. A key piece of any lumber agreement is getting the U.S. producers to agree to not bring forward any cases during the term of the agreement. This was done in 2006 by U.S. producers agreeing to submit and be bound by "no injury" letters. Without injury or the threat of injury, no CVD or AD duties can be imposed by the government.

That political will became apparent following the election of Prime Minister Harper and his meeting with then-president George W. Bush at the "Three Amigos Summit" in Mexico in March of 2006. Responsibility for the conduct of the bilateral negotiations shifted from the Department of Commerce (the senior U.S. official at DOC responsible for lumber had left his position) to the Office of the U.S. Trade Representative (USTR). Negotiations on the Canadian side were led by Canada's recently appointed Ambassador to the United States - Michael Wilson. These efforts eventually led to the 2006 Softwood Lumber Agreement which resolved the Lumber IV trade dispute.

What does this tell us about where we are today? The United States under President Trump has begun the process of renegotiating NAFTA, in which one of their demands is the abolition of the Chapter 19 dispute settlement system. Chapter 19 was key to the eventual resolution of Lumber IV and the return of 80 per cent of the duties collected to Canadian producers. (As an aside, Chapter 19 may well be key to other current disputes between Canada and the U.S., eg., in aerospace and steel).

It is still unclear as to what the mindset of U.S. trade negotiators and indeed the President himself will be in trade negotiations, whether relating to the NAFTA or specific disputes such as softwood lumber. Will it be a “one side wins, one side loses,” as some of the President’s rhetoric would lead one to believe? Or will it be more along the lines of what President Obama suggested, but was unable to deliver - “each side will want 100 per cent, and we’ll find a way for each side to get 60 per cent or so of what they need, and people will complain and grumble but it will be fine”?

## About the Author

**Elaine Feldman** joined the University of Ottawa's Centre on Public Management and Policy in 2014, where she works on the design and delivery of the certificate program in public sector leadership and governance. Her last position before retiring from public service was that of President of the Canadian Environmental Assessment Agency. Prior to joining the agency, Feldman held a number of positions at Foreign Affairs and International Trade, in Ottawa and abroad, including those of Assistant Deputy Minister for North America and Deputy Permanent Representative of Canada to the World Trade Organization.

During her career in the federal public service, Feldman led a number of trade negotiations, including the negotiations over softwood lumber with the United States and free trade negotiations with Mercosur and the Americas. She also participated in the Uruguay Round of Trade Negotiations.

Feldman is a member of the Law Society of Upper Canada. She has also been a member of three World Trade Organization dispute settlement panels.

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906 8th Avenue S.W., 5th Floor  
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