



# Implementing Freer Trade: The Canadian Experience 1986- 1995

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Between 1986 and 1995, the government of Canada negotiated and implemented three major international trade agreements: the 1989 Canada-US Free Trade Agreement (CUFTA), the 1994 North American Free Trade Agreement (NAFTA), and the 1995 World Trade Organization Agreement (WTO). Individually, each marked a major venture; together, the three agreements constituted a revolution in Canadian trade policy making.

Much of the political controversy surrounding these agreements arose during their negotiation, as critics worried about their impact on various aspects of Canadian life, from culture to agriculture. Their ability to make a difference, however, depended on the government's success in enshrining them into domestic law and practice and establishing the necessary institutional capacity to ensure their full and effective implementation.

This paper focuses on Canadian experience in implementing these three agreements into domestic law and practice. The Canadian example illustrates the challenge posed by late conversion to an open economy. Canada's early pursuit of import substitution industrialization, its slow conversion to liberalization, and its eventual commitment to an open economy effected through free-trade with the United States parallel many of the trajectories pursued more recently by countries in Latin America and the Caribbean.

The paper begins by setting the policy context of the problems posed for developing countries in internalizing external obligations. This is followed by a brief survey of earlier Canadian experience in implementing trade agreement obligations into Canadian law and practice and its impact on the country's economic development. It then examines each of the three major agreements negotiated between 1986 and 1995 and what governments in Canada – at both the federal and provincial levels – needed to do to take full advantage of the rights and obligations embedded in these agreements. The paper concludes with a brief discussion of the legal, institutional, and economic impacts of such trade legislation and the lessons the Canadian experience poses for developing countries.

### **Trade Agreements and Developing Countries**

*Summary: As with Canada, developing countries have confronted obstacles in implementing trade agreements into domestic law and practice in the form of politically convenient but economically specious arguments in favour of special status justifying protection. In developing countries, continued reliance on special and*

*differential treatment has the perverse effect of retarding economic development. Bilateral and regional agreements involving a major metropolitan economy offer more scope for overcoming the debilitating effect of special and differential treatment.*

International agreements provide a vehicle for states to yield autonomy over areas of national policy in return for complementary action by other states. In the case of trade agreements, states agree to govern state regulation of the flow of goods, services, capital, and technology across borders, and the treatment of imported goods, services, capital, and technology in domestic markets. Broadly speaking, trade agreements serve three basic goals:

- 1) Reduce and eliminate barriers to the markets of the parties to the agreement;
- 2) Establish better rules and procedures to resolve trade-based conflict among the parties; and
- 3) Reinforce domestic economic reform. This third objective is often the most neglected, particularly in developing countries.

In her overview paper for this project, Anabel Gonzalez identifies a number of problems that can complicate the full implementation of trade agreement rights and obligations into domestic law and practice, including political sensitivities and weaknesses in the management of public policy<sup>(Gonzalez 2009)</sup>. To these, one could add another: the culture of special and differential treatment (SDT) for developing countries embedded in the multilateral trade regime.

Many developing countries have long adhered to the conceit that only developed countries can fully benefit from open international exchange. Proponents of this notion argue that countries in the early stages of economic development are not well placed to take full advantage of opportunities created by liberalization. According to this argument, these countries should be allowed to shelter their economies, at least initially, from the full application of liberalization and the rules that underpin it. In practical terms, developing country reliance on SDT has meant that few of them have taken the opportunity to use trade agreements to reinforce domestic economic reform. Instead, they have approached trade negotiations as a wholly mercantilist project in which they have focused on maximizing exports while ignoring the benefits of imports and an open economy.<sup>ii</sup>

International trade rules – whether negotiated bilaterally, regionally, or multilaterally – are built on the promise that individual, national, and global economic prosperity can be

advanced by removing barriers to the international exchange of goods and, more recently, services, capital, and technology. The principal benefit from participating in a trade regime, however, has always been support – through rule development and enforcement – for domestic economic policy reform. This benefit accrues whether a country is in the early or more advanced stages of economic development and whether it is high-income or low-income. Gaining and maintaining support for open, market-oriented policies can be politically difficult, underlining the importance of the secondary benefit of trade agreements: improved export market access achieved through negotiations underwritten by rules and procedures to resolve disputes.

Achieving the benefits of trade agreements, however, can often be vitiated by the extent to which a country insists on special and differential treatment. While politically seductive, SDT has proved misguided and perverse, more likely to retard than aid economic development. The benefits of an open economy, and the costs of a closed economy, are now among the most widely accepted canons of economic orthodoxy. Nevertheless, discussion of SDT proceeds as if the issue remains an open question. Its appeal is wholly political and bereft of any economic underpinning.<sup>iii</sup>

The longevity of SDT lies in part in its affinity to the process of mercantilist bargaining, that mainstay of multilateral trade negotiations. While mercantilist bargaining proved critical to gaining political support for economically beneficial but politically risky liberalization, it was based on a fundamental fallacy: that opening one's market involved "concessions" that needed to be "paid" for.<sup>iv</sup> The General Agreement on Tariffs and Trade (GATT), for example, worked for the more economically advanced countries because they were prepared to "pay" by opening up their own markets in order to gain better access to the markets of other countries. The politically necessary process of pursuing mercantilist export opportunities resulted in economically beneficial commitments to rules and to opening one's own markets, leading to competition, consumer choice, economic growth, and other benefits. But developing countries, , by being excused from the need to pay for new export opportunities on the basis of SDT, were harmed in two ways:

- By not opening their markets to more competition, a step that may have been politically attractive, but was economically short-sighted; and

- By adding to the difficulty of convincing developed countries to open their markets to products of export interest to developing countries, particularly temperate-zone and tropical agricultural products and standard-technology, labour-intensive consumer products such as textiles, clothing, footwear, toys, and electronics.

By supporting each other's short-sightedness through such forums as the UN Conference on Trade and Development (UNCTAD) and the UN Industrial Development Organization (UNIDO), as well as through special and differential treatment in the GATT, developing countries ensured that, with few exceptions, they would gain less than was available to them through active participation in the international trade regime.<sup>v</sup>

While maintaining full rhetorical commitment to special and differential treatment in the WTO's now moribund Doha Development Round in Geneva, developing countries eagerly pursued bilateral and regional agreements, particularly with major economies such as the United States and the European Union. These agreements contain few if any provisions extending special and differential treatment, particularly agreements with the United States.

As a result, many developing country governments for the first time face the demanding but critical task of implementing their trade obligations into domestic law and practice and creating the institutional capacity needed to ensure that they can take full advantage of trade agreement rights and obligations. To add insult to injury, the United States insists that its free trade partners fully implement their agreements into domestic law and will not bring such agreements into force for the United States until it has certified that the necessary legislative and institutional changes have been enshrined in domestic law and regulation.<sup>vi</sup>

Canadian political instincts were for many years similar to those in developing countries. Rather than SDT, Canadian officials relied on exceptions and the conceit that resource-based economies were at a disadvantage in negotiating with industrialized countries. For years, Canada sought access to world markets for its resources while keeping much of its domestic economy sheltered from international competition. Not until the free trade negotiations of the 1980s did Canadian ministers find the political courage to confront this mindset and re-orient Canadian commercial law and policy. Within the space of a decade, Canada agreed to a reversal in the political economy of trade policy. For most of its history, liberalization was the challenger and protectionism the default position; since 1995, the

reverse has held true. Achieving this revolution required not only a change in attitude, but also the establishment of the necessary laws and institutions.

## **Trade Agreements and Domestic Law**

*Summary: Unlike US practice, Canadian constitutional practice provides the federal government with considerable flexibility in implementing trade agreement rights and obligations into domestic law and institutions.*

In Canadian constitutional practice, the conduct of foreign policy, including negotiating and entering into international agreements, falls within the Crown's prerogative. In effect, therefore, the executive (i.e., the Governor-in-Council or Cabinet) has full authority to engage other countries in international negotiations, to determine whether any resulting agreement meets Canadian interests and objectives, and, if so, to ratify and implement the agreement. There is no requirement for the executive to seek the approval of Parliament for the agreement to enter into force, although it may do so as a matter of political management.

When an agreement has been approved and ratified by the executive, Canada is wholly bound by its obligations as a matter of international law. For the agreement to have full effect in domestic law, however, the government may need to pursue enabling legislation. Therefore, in order for Canadians to gain all the benefits of an agreement and to give greater effect to some of the agreement's rights and obligations, it may be necessary for the federal government to seek legislative changes through an Act of Parliament.<sup>vii</sup>

If an international agreement touches upon matters that fall within provincial jurisdiction, the federal government still has the authority to negotiate and enter into the agreement. Its full force, however, may depend to some extent on provincial involvement and implementation. As a matter of practice, the federal government consults with the provinces and, on matters that fall wholly or even partially within their jurisdiction, seeks their cooperation and consent. International commerce falls wholly within federal jurisdiction; trade agreements, therefore, can be pursued without provincial engagement or consent. Additionally, the federal government has the constitutional capacity to pursue matters that fall within provincial jurisdiction in a trade negotiation if the issue is incidental to broader trade obligations (e.g., resource exploitation or the licensing of professionals). Only on matters that fall wholly within provincial jurisdiction and that are not incidental to a broader agreement does the federal government face the need to engage the provinces and gain their



approval.<sup>viii</sup> As a matter of political practice, however, recent federal governments have found it prudent to consult provincial governments in their pursuit of national trade goals, including trade agreements.

Canadian practice differs substantially from that in the United States. The Crown prerogative extends to all international agreements and arrangements, from simple memoranda of understanding to full-fledged treaties. In the United States, practice differentiates among treaties, executive agreements, and congressional-executive agreements. The US Constitution provides the president with authority to make foreign policy, including entering into international negotiations. For the results of such a negotiation to have force in US and international law, however, the agreement must fall within one of three types and be approved based on the applicable procedures:

- Treaties require the advice and consent of two-thirds of the Senate to become law, implying the need for continual consultations with the Senate and a formal act of approval before the treaty becomes law. Once a treaty does gain approval of the Senate it becomes part of US law and no further legislation may be required. To make the treaty fully effective, however, further legislation may be sought, for example, to provide for regulation-making authority, to establish necessary institutional machinery, or to extend necessary resources to implement the treaty.
- Executive agreements govern issues that fall wholly within the president's foreign policy-making authority, are pursuant to treaties that have already been approved by the Senate and brought into force, or fall within authority previously granted to the president by Congress. Their force in domestic law, however, is of a lesser order than that of treaties. The GATT, for example, long enjoyed no more status in US law than that of an executive agreement. In periodic trade legislation, Congress drew attention to this fact by indicating that new trade legislation implementing GATT-related obligations should in no way be construed as extending congressional approval to the GATT itself.<sup>ix</sup>
- Congressional-executive agreements require legislation granting the president negotiating authority subject to congressional oversight and approval through implementing legislation. The so-called "fast-track" or "trade-promotion" negotiating

authority provides a good example. Under it, Congress delegates trade negotiating authority to the president, subject to very specific objectives as well as detailed consultation and approval procedures. Such agreements enter into US law as a result of implementing legislation passed on the basis of procedural rules set out in the original authorizing legislation.<sup>x</sup> In the absence of such authority, the administration may still pursue trade negotiations leading to executive agreements or submit the results to Congress for approval, but without the procedural safeguards provided by delegated authority. In practical terms, such agreements can be implemented in ways that are inimical to the interests of the parties but that reflect congressional priorities.

Canadian trade negotiating authority and practice is, by contrast with that in the United States, relatively straightforward, as is Canadian experience in implementing the results of such negotiations into domestic law and practice.

### **Earlier Canadian Experience**

*Summary: It has long been a truism that Canada is a trading nation. From their earliest days, Canadians have relied on exports to create bigger and wealthier markets for their livelihoods. They have benefited from a wide array of imported goods, services, capital, and technologies to satisfy their daily needs and desires and contribute to the country's economic development. Less well-appreciated is the extent to which Canadians have underperformed. It took until well into the 1980s for them to fully grasp that their prosperity depended not only on exports, but also on maintaining an open, competitive domestic economy. Trade agreements, and their implementation into domestic law, played a critical role in bringing Canadians around to this perspective. But this change of attitude took place slowly and sometimes painfully as the scope and impact of trade agreements expanded to govern a broadening array of issues that would in earlier years have been considered matters of domestic, rather than international, jurisdiction. It was not until 1967 that Canada accepted that a trade agreement obligation would require changes in law and practice that went beyond tariff levels. Free trade with the United States, however, would fundamentally alter this reality. Implementing the CUFTA would entail substantive changes in domestic law and practice. Nevertheless, it can be fairly said that Canadian law and practice, as in most OECD countries, had by this time gradually evolved to conform to*

*GATT requirements. As originally intended, the GATT proved not only an important instrument for gaining access to foreign export markets, but also for effecting reform in domestic law and practice.*

The Canadian colonies that ultimately joined together to become the Dominion of Canada in 1867 existed at the periphery of British imperial concerns. For most of the colonists, the British connection was important as both a market and as a source of manufactured goods, and remained so for many years. But the colonists were not averse to taking advantage of their proximity to the United States, either as a source of goods that were not readily available from local suppliers, or as an export outlet for some of their own production. Canada's first government after Confederation recognized this reality and tried to forge a trade relationship with the United States that would facilitate the development of two-way trade along a north-south axis.<sup>xi</sup>

Events, however, conspired against the best efforts of Canadian officials. With few exceptions, US lawmakers did not find freer trade with Canada attractive on any terms other than annexation, and Canadian officials considered this too steep a price to pay. The National Policy adopted by the second government of Sir John A. Macdonald in 1879 was decidedly a second-best option.<sup>xii</sup> Subsequent historiography has emphasized its nation-building virtues. Perhaps this was so, but for the first quarter century, efforts to strengthen east-west, national economic links brought meager results at best. The opening of the western prairies to dry-land wheat farming early in the 20<sup>th</sup> century made the east-west orientation look more successful. But Canadians continued to pay a heavy price for the National Policy. By that time, high tariffs and other protectionist devices had succeeded in stimulating the development of a high-cost manufacturing sector in Central Canada (i.e., the provinces of Ontario and Quebec). Exporters of resource products to world markets, on the other hand, found that their ability to compete at world prices was frequently undercut by the high cost of machinery and other inputs protected by the high tariffs of the National Policy. Canadians paid the price of lower wages, higher prices, and less choice. The National Policy may have fostered the growth of a larger economy, but it retarded the development of a more prosperous one (Dales 1966a & b).

Forging an east-west economy also created sectoral and regional tensions. The two central provinces became the main sites for import-substitution manufacturing and thus the principal clients of the National Policy's protection. In later years, even some of their

agricultural output – particularly dairy and poultry products – became dependent on the peculiar Canadian institution of supply management, itself dependent on tight border restrictions. The eastern and western provinces, on the other hand, came to rely largely on resource exploitation – agriculture, fish, forest products, metals, and minerals – for international markets. Western grain and cattle producers, for example, learned to live with the vagaries of international prices and competition. Even the huge growth in US demand for Canadian metal, mineral, and forest products in the middle decades of the 20<sup>th</sup> century did not dispose the federal government to ease protection for Central Canada’s manufacturing output.

Thus two sets of tensions developed: between export-oriented resource sectors and import-competing manufacturers, and between the resource-rich periphery and the people-rich centre.

The economic structures and trade patterns that developed over the course of Canada’s first seven decades as a nation (1867-1935) proved difficult to alter. Canadian manufacturers became deeply attached to protection and succeeded in convincing their fellow citizens that higher prices, lower wages, and less choice were important contributors to national identity, a view still held in some protected sectors. But change did come. First, bilateral negotiations responding to the disaster of the depression of the 1930s, and then multilateral negotiations following the even larger crisis of the Second World War, gradually chipped away at the patterns fostered by the National Policy. It took several generations before protection was sufficiently low and opportunities elsewhere sufficiently enticing to convince cautious Canadian manufacturers to convert to the virtues of a more open economy.

Starting in the mid-1980s and gaining confidence in the 1990s, Canadians gradually accepted that their future prosperity depended critically on developing a more outwardly oriented economy. The negotiation of the Canada-US free-trade agreement, followed by its extension to Mexico and, finally, the conversion of the GATT into the WTO, succeeded in undoing much of the lingering effect of the National Policy and replacing it with a more economically rational policy mix geared to reaping the full benefits of Canada’s comparative advantage. As Jan Tumlir, former chief economist at the GATT, observed: “It is depressing to think of all the effort wasted over generations, and the income forgone, because of the belief that an economy gains by protecting its industries.” (Tumlir 1985)

The first decade of the 21<sup>st</sup> century has proven Tumlrir's point in spades. Canadian cross-border – north-south – trade intensity today is twice what it was a generation ago, while inter-provincial – east-west – trade patterns have remained basically flat over the same period. As a result, Canada is a more prosperous country: consumers have more choices and pay less for them; firms have more opportunities and service them more easily; and Canadians are better paid and find their jobs more satisfying.

### **From Negotiation to Implementation**

From 1867 to 1932 Canada and many other Western Hemisphere countries – particularly the United States – maintained an autonomous trade and tariff policy unencumbered by any trade agreement obligations. While Canada was formally a part of the British Empire and heir to British treaty obligations, their practical effect was minimal. Canada's government could largely set its trade and tariff policy as it saw fit. As such, Canada earned a well-deserved reputation for inventing and implementing a wide range of protectionist devices to maximize the impact of its high tariff, from antidumping duties to classification dodges and valuation fiddles. Some of the less attractive elements of US trade legislation in the 1920s and early 1930s unfortunately can also be found in contemporary Canadian practice.

Over this period, Canada pursued a number of efforts to negotiate trade agreements, including with the United States. But few of these agreements succeeded in producing more than preferential arrangements with other members of the British imperial family. These latter agreements were limited to reciprocal commitments to maintain preference margins but without specifying rates. The first significant step toward binding the tariff and subjecting its administration to agreed rules came as part of the 1932 Imperial Economic Conference in Ottawa that sought to implement an Empire-wide system of preferences. While the results were less than that, Canada did conclude a number of agreements, including with the UK, which for the first time seriously limited the autonomy of Canadian policy making.

The major breakthrough came when the US converted to a negotiable tariff in the 1934 Reciprocal Trade Agreements (RTA) Program. Canada was the first to conclude an agreement with the United States under this program in 1936, and expanded the agreement considerably in the trilateral negotiations with the UK and the US in 1937-38.<sup>xiii</sup> By the conclusion of these negotiations, Canada had completely reversed its position and was now committed to a trade policy anchored in trade agreement rights and obligations.

The 1936 and 1939 Canada-US reciprocal trade agreements were exceedingly simple by today's standards: 15 and 18 articles respectively, plus schedules setting forth tariff concessions and a few letters to clarify specific points and ratification procedures. The emphasis was on product-specific tariff reductions rather than on commercial policy as a whole. Implementing the agreements, insofar as Canada was concerned, could be accomplished on the basis of an order by the Governor-in-Council authorizing the government to ratify the agreement and the introduction of a ways and means motion by the minister of finance in the House of Commons setting out the revised tariff rates.<sup>xiv</sup> Any other commitments were sufficiently general and vague to fall within the rule-making authority provided to ministers under the Customs Act and the Customs Tariff.

The conversion of the RTA program into a multilateral regime after the Second World War and the conclusion of the General Agreement on Tariffs and Trade in 1947 did not materially change the need for implementing legislation. Negotiating and ratifying the GATT fell easily within the Crown prerogative. Implementation could again be achieved through an order by the Governor-in-Council and parliamentary passage of a ways and means motion introduced by the minister of finance.<sup>xv</sup> The need for a more demanding implementation process, however, had been embedded in the new agreement. While the economically most important provisions were still the tariff concessions set out in the schedules to the agreement, articles III through XXIII (part II of the GATT) set out a detailed code of commercial practice.

A requirement to implement the provisions of these articles immediately, however, had been neatly sidestepped as a result of the Protocol of Provisional Application (PPA),<sup>xvi</sup> which indicated that governments were only required to implement this part of the GATT "to the fullest extent not inconsistent with existing legislation." Changes to domestic law, however, had in future to conform to the requirements set out in these articles.

Originally conceived as a temporary measure until such time as the Havana Charter for an International Trade Organization would enter into force and subsume the GATT, the PPA cast a long shadow. Canada, for example, did not bring its antidumping practices into line with GATT Article VI until 1968<sup>xvii</sup> and did not enact legislation to take full advantage of the same article until 1984.<sup>xviii</sup> Similarly, Canada did not bring its tariff valuation practices into line with Article VII until 1984.<sup>xix</sup> The United States, similarly, did not bring

its valuation and countervailing duty practices into conformity with GATT requirements until 1980.<sup>xx</sup>

While the PPA cast a long shadow, the dynamic nature of tariffs and other trade-related regulations ensured that most developed contracting parties did gradually bring their domestic legislation and practice into line with GATT's requirements. Through the first five rounds of negotiations – Geneva (1947), Annecy (1949), Torquay (1951), Geneva (1955-56), and Dillon (1960-61) – the focus was almost exclusively on binding and reducing tariffs. Starting with the Kennedy Round (1964-67) and through the Tokyo Round (1973-79) and the Uruguay Round (1986-94), however, there was steady expansion into non-tariff barriers, trade in services, intellectual property rights, and investment. Implementing these commitments required extensive changes in domestic legislation and ensured that at least developed country contracting parties would internalize their external trade obligations into domestic law and practice, Canada included.

Throughout this period, the political management of trade negotiations was largely carried out in the House of Commons. The elaborate consultative mechanisms that became integral to trade negotiations in the 1980s were unknown in this period. It was not until the Kennedy Round negotiations that the government established the Canadian Tariffs and Trade Committee to solicit briefs from business and other economic interests and to conduct hearings. During the Tokyo Round, the government continued this pattern with the establishment of the Canadian Trade and Tariffs Committee. For the first time, the federal government engaged the provincial governments in consultations.

Part of the reason for the relative lateness of these consultative mechanisms can be found in the modesty of Canada's concessions in the first few rounds of negotiations. The combined effect of a high tariff, the many clever devices that had been built into its administration – including valuation uplifts, made/not-made in Canada provisions, the machinery program, and more<sup>xxi</sup> – provided Canadian negotiators with much to give without much economic effect and, more importantly, without much political opposition.<sup>xxii</sup> The mercantilist bargaining process further facilitated Canadian participation. Canada's relatively small market could be sheltered, even while export opportunities increased as a result of the most-favoured-nation (MFN) clause and the concessions traded by larger countries. Looking back from the perspective of 2009, one can now appreciate that Canada did not seriously

begin to open its market to products that competed with domestic manufacturers until the 1970s.

One other important international trade agreement is worth mentioning: the 1965 Canada-United States Automotive Products Agreement.<sup>xxiii</sup> Negotiated to facilitate cross-border rationalization of the automotive sector, its implementation again involved no more than an order from the Governor-in-Council and a ways and means motion. Nevertheless, the government of the day sought, and received (June 30, 1965), parliamentary approval for the agreement.

Finally, a word about the role of dispute settlement in influencing Canadian law and practice. The GATT from the outset contained important provisions for the settlement of disputes among its members on the interpretation and application of the agreement.<sup>xxiv</sup> Canadian officials were instrumental in fleshing out these provisions into the customary practice of relying on panels to adjudicate disputes that had become the norm by the 1960s. With a couple of exceptions, however, Canada made little use of these provisions prior to the 1980s, nor was Canada the target of many complaints prior to then.<sup>xxv</sup> A raft of cases in the 1980s involving issues as diverse as practices under Canada's Foreign Investment Review Act, prohibitions on exports of salmon and herring, provincial liquor board practices, restrictions on imports of ice-cream and yoghurt, and countervailing duties on grain corn from the United States, all required Canada to make changes in its domestic law and practice. At the same time, Canada similarly pursued a number of complaints against the United States, the European Communities, and Japan, some of which led to changes in the laws and policies of these trading partners. By the 1980s, therefore, dispute settlement had become an important instrument for ensuring that GATT contracting parties lived up to their trade agreement obligations. Again, they helped in the process of internalizing external obligations. Most cases, however, involved developed countries both as complainants and as respondents.

### **Negotiating Free Trade with the United States**

*Summary: In the first half of the 1980s, changing domestic and international economic circumstances revived Canadian interest in bilateral free trade with the United States. Extensive discussion and analysis by think tanks, business groups, academics, a Royal Commission, the provincial governments and, eventually, the federal government led to a growing consensus in the country that the time was ripe to*



*proceed. The issue remained controversial, however, and required adroit political management. In 1986-87 the two countries succeeded in concluding a comprehensive agreement that responded to most of their principal objectives; the agreement entered into force January 1, 1989. The Canada-US agreement provided the basis for the subsequent negotiation of the North American Free Trade Agreement that entered into force January 1, 1994, and also proved an important precursor to the expansion of the GATT into the WTO, which was officially established on January 1, 1995.*

As already indicated, Canada came late to opening its economy to its closest neighbor and natural trading partner, the United States. From the 1891 federal election through the 1983 Conservative Party leadership campaign, conventional wisdom held that free trade with the United States was a political minefield. By 1984, however, the time had come to test that proposition. A new government with a much more pro-business, pro-market, and pro-US attitude took office in September of that year. It inherited a debate that had raged for more than a year among academics, business leaders, and provincial officials, many of them convinced that the time had come for Canada to pursue a free-trade agreement with the United States.<sup>xxvi</sup>

A number of considerations underpinned these sentiments. First, Canada's long-standing reliance on the export of raw materials as the mainstay of economic growth and development was being challenged at one end by a growing number of new, more competitive suppliers, particularly from developing countries, and at the other end by increasing extraction, upgrading, and distribution costs. Secondly, the Canadian economy was becoming both more diversified in its product mix and more focused on the lucrative and proximate US market. Trade and related domestic economic policies suited to the needs of an export-oriented resource economy and a protected manufacturing sector needed to give way to policies in tune with the needs of a more advanced, diversified, and open economy. Thirdly, investment and growth in the non-resource sectors of the economy required that competitive firms look beyond the confines of the Canadian market and secure access to at least one major world market. Experience over the previous 20 or more years had demonstrated that geography, business preference, consumer choice, and political reality all pointed to the United States as the obvious market to serve this need. Fourthly, the US market, responding to increasing import pressure from lower cost offshore suppliers, was becoming a less certain

market. Growing protectionist sentiment in political and business circles was finding expression in increasing resort to trade remedies and other, non-conventional forms of protection. Finally, Canada's post-war reliance on solving its export-market access problems through multilateral trade negotiations at the Geneva-based GATT appeared increasingly remote from the most pressing Canadian priorities, particularly after the failure of the 1982 GATT ministerial meeting to launch a new round of negotiations.

Circumstances had changed, as had political alignments. The Canadian Manufacturers' Association, for example, long the mainstay of central Canadian protectionism, by 1984 had become a cautious voice favouring bilateral free trade. It was now economic conservatives who preferred market-based solutions, while liberals had grown suspicious of potential curbs on government programs. Academic analysts had long considered the pros and cons of freer bilateral trade, with economists generally in favour and political scientists more dubious. But now, think tanks, lobby groups, and policy gurus were all lining up in support. Over the course of 1983–84, every major business conference included bilateral free trade on its agenda. Not every analyst saw bilateral free trade with the United States as the solution to some of Canada's economic problems, but they all acknowledged that the option of bilateral free trade could not be ignored. At the same time, freer trade fit well with other, more market-oriented aspects of the more conservative tenor of society.

All of this churning and debate found its most detailed expression in the research and hearings of the Royal Commission on the Economic Union and Development Prospects for Canada, which was chaired by former Liberal finance minister Donald Macdonald.<sup>xxvii</sup> By the time the commission formally reported in September 1985, its central recommendation of a bilateral Canada-US free-trade agreement had become an open secret. But the full expression of that recommendation and the volumes of its supporting research and analysis added to the credibility of the bilateral option.

The bureaucracy had been similarly engaged in exploring the options. Already in 1982–83, officials had engaged in a detailed review of Canada's trade policies.<sup>xxviii</sup> While some officials advocated an interventionist and protectionist industrial policy, others had begun to consider once again the benefits of a comprehensive reciprocity agreement with the United States. The professional attachment to the multilateral gradualism of the GATT was

being squeezed between two groups: those prepared to pursue a bilateral approach with the United States to achieve more open trade and stronger market disciplines, and those ready to reverse the achievements of the previous 40 years by reintroducing interventionist import-substitution policies. Multilateral gradualism was beginning to appear dated and irrelevant, offering either too little or too much.

The review offered a solid, professional assessment of past Canadian trade policy but found it hard to come to grips with emerging challenges. Nevertheless, in the chapter devoted to Canada-US relations, officials suggested a possible initiative: Canada and the United States could negotiate sectoral free-trade agreements to address the growing range of irritants between the two countries in selected sectors of the economy. This soon became the main focus of public discussion and spawned a modest project to explore its prospects. By the summer of 1984, however, the initiative had run out of steam, its well-intentioned but flawed approach underlining the need to think “outside the box” and consider a full-scale bilateral initiative as a necessary complement to multilateral orthodoxy.

The process leading to the decision to negotiate, and the conduct of the negotiations, have been well told elsewhere.<sup>xxix</sup> Suffice it to say that both entailed high doses of political drama, much uncertainty, many false starts, and astounding levels of hyperbole and cant. In the end, a federal election vindicated the government’s policy. The immediate catalysts were the combined impact of business leaders looking for better ways to defuse and resolve trade and investment disputes with the United States, senior civil servants determined to find better ways to manage Canada-US relations, and a new government eager to change the tone of Canada’s relations with the United States and to foster a more entrepreneurial economy. The most important element in the equation was not that trade would be free – although that obviously had important ramifications – but that it would be governed by a set of rules that would be equally binding on the US and Canadian governments and that it would contain procedures to ensure that these rules would actually be implemented. The price for meeting these objectives would, naturally, be to enhance and secure US access to the Canadian market.

Successfully negotiating free trade with the United States proved a formidable task. It took a government that was prepared to take hard decisions and see the issue through to its logical conclusion, despite setbacks and frustrations along the way, including frequent counsel to abandon the project. At the same time, the government recognized that there are limits to

change and that some of Canada's sacred cows would have to be guarded from the full logic of free trade, including agricultural supply management and cultural industries. Other policy areas needed at least the cover of transitional fig leaves before facing the full effect of international competition, including foreign investment and financial services. US reluctance to go as far as its own rhetoric sometimes suggested resulted in a tendency to protect certain areas from the full application of free trade, such as government procurement.<sup>xxx</sup> In all three cases, however, time began to erode some of these decisions. Canadian foreign-investment policy, for example, with the exception of a few residual areas, is now generally open to all investors. Given the decision that Canada would embrace an open economy, the public-policy purposes served by some remaining areas of discrimination and protection became increasingly difficult to justify.<sup>xxx1</sup>

The political management of the negotiations proved a much larger task than had been the case during earlier GATT negotiations and led to a number of innovations. From the outset, the government recognized that free trade with the United States would be a major undertaking and would not succeed without significant support from provincial governments, business leaders, and opinion makers. Even before committing to negotiations, therefore, the government engaged in extensive discussions with officials in the ten provinces, held parliamentary hearings, and pursued cross-country discussions with business and other economic interests. The government delayed committing to negotiations with the United States until it was convinced that it had a solid base of support for bilateral negotiations.

In order to maintain and sustain this support, the government engaged in an unprecedented level of consultations. The prime minister met frequently with the provincial premiers over the course of the negotiations; trade and other ministers met periodically with their provincial counterparts; and senior negotiators met regularly with provincial officials, kept them fully informed of progress in the negotiations, and consulted them on how best to address issues of particular concern to the provinces. Similarly, the minister of international trade established an International Trade Advisory Committee (ITAC) made up of a cross-section of business and other interests as well as 15 sector-specific Sectoral Advisory Groups on International Trade (SAGITs) to act as both sounding boards and sources of advice on specific issues. As a result, ministers and their most senior advisors were able to stay abreast of sensitive issues and to instill a level of confidence in the most directly affected sectors of

society. Political opposition to the negotiations did gradually build as they proceeded, but the government's extensive consultations succeeded in maintaining a broad base of informed support among critical constituencies, ensuring that it would be well-placed to conclude and implement an agreement should negotiations succeed in meeting Canada's fundamental objectives. (Hart, Dymond, and Robertson 1994)

The agreement that resulted, while revolutionary in intent and psychology, was quite orthodox and straightforward in execution. It built on the well-trodden paths of the GATT, took a page or two out of the European experience in creating a more integrated market, and cautiously assessed how far both governments were prepared to go in forging a new agreement. In negotiating the agreement, Canada sought three overriding objectives. The most important, if least publicized, was to effect domestic economic reform by eliminating, at least for trade with the United States, the last vestiges of the National Policy and by constraining the more subtle new instruments of protection. Exposing the Canadian economy to greater international competition, while simultaneously improving access to the large US market, provided Canadian firms with an incentive to restructure and modernize and become more efficient, productive, and outward-looking. The most publicized objective was to provide a bulwark against US protectionism. By gaining more secure and open access to the large, contiguous US market, Canadian business would be able to plan and grow with greater confidence. Finally, the government wanted an improved and more modern basis for managing the Canada-US economic relationship. Since 1948, the GATT had served this function but had grown increasingly inadequate. New and more enforceable rules, combined with more sophisticated institutional machinery, were needed to place the relationship on a more predictable and less confrontational footing.<sup>xxxii</sup>

The agreement that entered into force on January 1, 1989, largely met these objectives. The preamble and first chapter summarize the agreement's basic aims and objectives, providing the philosophical framework within which the whole document needs to be viewed. The heart of the agreement, set out in chapters 3 to 13, establishes a conventional free-trade agreement for trade in goods, eliminating various barriers to trade, including the tariff, thereby providing Canadian and US firms with open access to each other's markets. Where either side was not prepared to go as far as the other, provisions were made to continue negotiations, but within a new and more secure framework.

Chapters 14 to 17 make a cautious start on the so-called new issues of professional and other tradable services, business travel, investment, and financial services. They freeze the status quo and provide that any future laws and regulations should extend equal treatment to each other's service providers, investors, and business travelers. Canada and the United States would remain free to set their own rules and priorities: investors and service providers would have to satisfy Canadian rules in Canada and American rules in the United States. But in each country they could count on being treated the same as their domestic competitors.

Chapters 18 and 19 establish rules for managing the trade and economic relationship. Chapter 18 takes well-established GATT practice, commits it to a clear body of rules and procedures, and applies these to the enhanced and improved rules dealing with trade in goods as well as the new rules dealing with services, investment, and business travel. Chapter 19 addresses the thorny issues of trade remedies – anti-dumping and countervailing duties – with the United States; for the first time it recognized that disputes between the two countries arising from dumped or subsidized goods are not a matter for the application of domestic law and unilateral decisions alone but should also be subject to bilateral scrutiny. While both countries could continue to use their respective trade-remedy laws, they agreed to replace judicial review of domestic decisions with bilateral review. Canadians would sit on panels to determine whether US laws were properly followed and whether any changes in US laws were consistent with the GATT and the CUFTA.<sup>xxxiii</sup>

Negotiating the CUFTA was a major undertaking and its successful implementation into Canadian law and practice laid the foundation for major changes in the Canadian economy. From the outset, the government insisted that bilateral negotiations with the United States should not replace but complement multilateral negotiations. The government's perception that multilateral negotiations were likely to take longer and lead to a common denominator result involving many more players underscored the need to go further and more quickly with Canada's most important economic partner. The United States shared this perception for reasons of its own. Both countries, however, made it clear that any bilateral agreement would, by definition, build upon the GATT, but go beyond. It turned out that the CUFTA, while solidly built on GATT foundations, also became an important precursor to what would become some of the core elements of the WTO Agreement. Canadian and US experience in addressing trade in services, intellectual property rights, technical barriers,

investment, dispute settlement, and other issues between them in the bilateral negotiations, informed their approach to the multilateral negotiations. For example, certain provisions on agriculture or intellectual property rights were not included in the CUFTA because the two governments agreed they would be addressed in the multilateral negotiations.

The extension of the CUFTA into the North American Free Trade Agreement provided an opportunity not only to include Mexico, but also to revisit some aspects of the CUFTA and strengthen them in light of experience and progress in the multilateral negotiations. When the CUFTA negotiations concluded at the end of 1987 neither the Canadian nor the US government anticipated that they would soon be engaged in trilateral negotiations. Canadian ministers and officials, in particular, were initially less than eager to engage in another round of difficult negotiations with the United States. It did not take long, however, for the geopolitical imperatives that had disposed the government of George H.W. Bush to respond positively to Mexican overtures to translate into similar Canadian imperatives, opening the way to the trilateral negotiations and the successful conclusion of the NAFTA in 1993.

The CUFTA negotiations began and largely ended before the Uruguay Round negotiations moved from their preparatory to their substantive phase. The NAFTA negotiations, on the other hand, were conducted in tandem with the multilateral negotiations, providing considerable scope for feedback from one to the other. The NAFTA agreement, therefore, reflected experience not only in implementing and applying the CUFTA, but also in negotiating the WTO agreements. As such, the implementation of these three agreements into domestic law and practice should be considered as three acts of a single drama, rather than as separate and distinct events.<sup>xxxiv</sup>

## **Implementing Free Trade**

*Summary: While Canada had gained considerable experience in implementing trade agreement obligations, and by the 1980s had developed sophisticated trade and trade-related domestic laws, regulations, and institutions, the three agreements implemented between 1989 and 1995 posed new challenges. The three agreements were part of the transition from a body of rules focused on negative prescriptions to one that contained an increasing range of positive rules. They also required Canada to address the challenge of multilevel rule-making flowing from complementary but not identical*

agreements negotiated at both the regional and multilateral levels. Such issues as intellectual property rights, public procurement, investment, sanitary and phytosanitary regulations, required implementation in domestic law not only as a result of the CUFTA and NAFTA, but also as a result of the WTO, sometimes in slightly different forms. Implementing all three agreements demanded a much more extensive effort at bringing a broad spectrum of domestic laws and regulations into line with the standards set out in the agreements.

**Box 1: Canada's Principal Trade Laws in Brief**

*The Customs Tariff* – One of Canada's oldest pieces of legislation, the Customs Tariff sets out the rates of duty for thousands of individual products and the manner in which duties are to be calculated and collected. As well, it lists those products for which imports are prohibited.

*The Customs Act* – This act provides the legal basis for the activities of Canada's customs agents. It involves a wide range of detailed rules prescribing the form and manner in which goods may be imported and what duties must be paid.

*The Export and Import Permits Act* – This act provides the authority for the government to prohibit certain goods from being imported or exported and to control what quantities of other goods may be imported or exported at any one time.

*The Special Import Measures Act* – The provisions of this act allow Canadian producers, harmed by dumped, subsidized, or other injurious imports, to seek temporary relief or protection from such imports by means of a special antidumping or countervailing duty.

*The Canadian International Trade Tribunal (CITT) Act* – This act establishes the CITT, a quasi-judicial body of enquiry whose primary function is to determine whether or not Canadian producers are injured by imports of dumped or subsidized goods. The act also specifies the conditions under which Canadian producers may obtain temporary relief from goods being imported in large quantities and at low prices so as to cause serious injury. The CITT also carries out other economic enquiries on behalf of the government, most related to import policy questions.

Source: Hart (1994:48).

Implementing the GATT had largely involved commitments related to the tariff and its administration, such as rules governing valuation and classification, and to other clearly trade-related instruments, such as antidumping and countervailing duties, quantitative restrictions, and similar measures. More generally, the GATT's rules required its members to refrain from applying their trade policies in ways that were contrary to the agreement's fundamental principles, particularly non-discrimination and transparency. The obligations did not require adherence to specific standards, nor did they impose rules and procedures for the detailed administration of trade policy. For example, there was no obligation to set maximum tariff rates; GATT members remained free to negotiate such rates and free to apply them at lower levels or not all. The basic national treatment obligation did not guarantee a standard of



treatment respecting the level of indirect taxes. Instead, it required that such taxes or other regulations affecting internal trade not be higher or more burdensome for imports than for products of domestic origin. In those instances where governments saw an advantage in discriminating in favour of domestic suppliers, such as in public procurement or domestic subsidy practices, appropriate exceptions were built into the GATT.

Similarly, the GATT did not require its members to apply countervailing or antidumping measures, marks of origin, quantitative restrictions on trade, or subsidies. Instead, it established disciplines on the use of such measures. The articles allowing exceptions – for example, for balance-of-payments reasons, tariff preferences, or import surges – were similarly encumbered with disciplines and in some cases surveillance, all intended to make their use difficult. While the articles on customs administration and valuation set out prescriptive rules and procedures, the need for such measures arose from the application of an import regime which the GATT did not substantively require.<sup>xxxv</sup> Common to all of these obligations was the general requirement of most favored nation treatment.

In the six rounds of multilateral trade negotiations, from the provisional entry into force of the GATT in 1948 to the completion of the Tokyo Round of negotiations in 1979, the fundamental structure of the rules did not change. The focus of each negotiation was the reduction of tariffs on industrial goods. While the Kennedy and Tokyo Rounds expanded negotiations beyond tariffs to the development of disciplines on export and internal subsidies, the application of countervailing and antidumping duties, and separate agreements on trade in civil aircraft and government procurement, the results were fully consistent with the architecture of the original GATT. As a general rule, commitments not to engage in certain practices or to refrain from introducing certain measures – i.e., negative prescriptions – do not require implementation. They amount to a good faith commitment, and problems only arise in the event of a breach of the obligation, leading to dispute settlement procedures.

Unlike the GATT, the negotiation and implementation of the CUFTA, NAFTA, and WTO agreements involved a significant shift in international rule-making from negative prescription to positive norms and obligations. All three involved not only an extension of earlier GATT rights and obligations, but also commitments to adopt and implement specific policies, practices, and procedures. These additional rules reached well behind national borders and engaged public policy issues that went beyond the traditional boundary between

national economies and the global economy. They extended the object and purpose of trade policy from trade liberalization through trade barrier reductions to positive rule-making aimed at ensuring the capacity of producers around the globe to fully contest the markets of member states from any other market. In order to implement the commitments set out in these agreements, the Canadian government needed to conduct a wholesale review of federal legislation governing not only exports and imports, but also domestic commerce more generally. As a result, each of the three agreements required major implementing legislation amending a wide range of earlier statutes.<sup>xxxvi</sup>

This change in the object and purpose of trade negotiations is well illustrated by an important innovation introduced during the negotiation of the CUFTA and continued in the negotiation of the NAFTA and WTO: the inclusion of legal advisors as an integral part of the negotiating team. In prior negotiations, Canadian practice had been to consult the government's lawyers at the conclusion of the negotiations and seek their advice on fine points of treaty making and domestic implementation. Trade officials – not just in Canada, but more widely – maintained that the inclusion of lawyers too early in the process might complicate efforts to reach satisfactory conclusions. In a similar vein, the GATT Secretariat did not establish a legal division staffed by officials formally trained in law until 1980.<sup>xxxvii</sup>

While lawyers in Canada's Department of Justice and Department of External Affairs had long been critical of this tradition, ministers and trade officials were satisfied that lawyers were not needed throughout the negotiating process. But with the negotiation of the CUFTA, the complexity of the negotiations and the range of issues that might affect domestic law and practice produced a change in attitude toward the usefulness of lawyers. The Trade Negotiations Office, which was set up in 1985 to conduct the CUFTA negotiations, included a senior official from the Justice Department who supervised a team of more than a dozen lawyers who oversaw the drafting of the agreement and subsequently advised the legislative drafting specialists.<sup>xxxviii</sup>

### **Implementing the Canada-US Free Trade Agreement**

In preparation for implementing the CUFTA, the negotiating team, in consultation with government officials, prepared detailed assessments of the anticipated legislative changes that might be needed to implement the provisions in each of the chapters. These assessments were discussed with Justice Department specialists who prepared the legislation for consideration

by cabinet before it was introduced in Parliament. To guide the parliamentarians, the Research Branch of the Library of Parliament prepared its own detailed memorandum outlining the necessary legislative changes. A good deal of the CUFTA could have been implemented on the basis of the government's existing discretionary authority, as provided in such legislation as the *Customs Tariff*, the *Customs Act*, the *Export and Import Permits Act*, and the *Special Import Measures Act*. Nevertheless, in order to ensure a process that paralleled that in the United States and provided for greater certainty, the government chose to introduce detailed legislation to implement many aspects of the CUFTA on a statutory rather than discretionary or policy basis. As noted earlier, the changing nature of trade obligations – from negative to positive prescription – helps to explain the appeal of a wholesale review and updating of Canada's trade legislation at this time.

The legislation was introduced at the end of May 1988 and passed by the House of Commons on August 31, 1988, following extensive discussion and scrutiny by a parliamentary committee. At the request of John Turner, leader of the Liberal opposition that enjoyed a majority in the upper chamber, the Senate threatened to hold up the legislation indefinitely. The prime minister solved this problem by calling an election.<sup>xxxix</sup> As a result, Canadians had an opportunity to debate the agreement and decide whether to re-elect the government or to support the opposition parties, each of which opposed the agreement. The government was returned with a strong mandate and immediately re-introduced the legislation implementing the agreement. This time it quickly passed both the House of Commons and the Senate and received royal assent on December 30, 1988. These moves cleared the way for the government to bring the agreement into force on January 1, 1989, concurrently with the United States.

***The 1988 Canada-United States Free Trade Agreement Act:***<sup>x1</sup>

- Approved the CUFTA and affirmed the authority of the federal government to fulfill Canada's obligations under the agreement;
- Provided for the appointment of Canada's representatives to meetings of the Canada-United States Trade Commission and any subsidiary bodies;
- Authorized the government to implement the wine and distilled spirits provisions in chapter 8 of the agreement;

- Established a Procurement Review Board to review the procurement practices of the federal government subject to the provisions of chapter 13 of the agreement;
- Amended the *Special Import Measures Act* to implement the provisions governing emergency safeguards (chapter 11) and to allow for the creation of binational panels to review decisions respecting the application of antidumping and countervailing duties on imports of goods from the United States, pursuant to chapter 19 of the agreement; and
- Amended some 26 other federal statutes to bring them into conformity with the agreement.

**Box 2: CUFTA Implementation**

The *Canada-United States Free Trade Agreement Act* made consequential changes to the following twenty-eight existing federal statutes:

<i>Bank Act</i>	<i>Broadcasting Act</i>
<i>Canadian Agricultural Product Standards Act</i>	<i>Canada Grains Act</i>
<i>Canadian and British Insurance Companies Act</i>	<i>Canadian Wheat Board Act</i>
<i>Canadian International Trade Tribunal Act</i>	<i>Copyright Act</i>
<i>Customs Act</i>	<i>Customs Tariff</i>
<i>Department of Agriculture Act</i>	<i>Excise Tax Act</i>
<i>Importation of Intoxicating Liquors Act</i>	<i>Export and Import Permits Act</i>
<i>Investment Canada Act</i>	<i>Income Tax Act</i>
<i>Loan Companies Act</i>	<i>Investment Companies Act</i>
<i>Meat Inspection Act</i>	<i>Meat Import Act</i>
<i>Seeds Act</i>	<i>National Energy Board Act</i>
<i>Standards Council of Canada Act</i>	<i>Special Import Measures Act</i>
<i>Textile and Clothing Board Act</i>	<i>Statistics Act</i>
<i>Western Grain Transportation Act</i>	<i>Trust Companies Act</i>

Additionally, a number of provinces enacted legislation implementing certain provisions into provincial law – particularly those in chapter 8 governing wine and spirits – largely to assert provincial rights in respect to some of the issues covered by the agreement. In recognition of this reality, the federal Act implementing the agreement included a provision indicating that to the extent that provincial legislation satisfied trade agreement obligations in areas of provincial responsibility, federal regulations would not apply.<sup>x11</sup>

A few examples of the legislative changes covered by the Act illustrate the more demanding nature of the CUFTA as compared to the GATT. The provisions of chapter 19 of the agreement governing the application of antidumping and countervailing duty procedures on goods imported from the United States or Canada required extensive revisions to the *Special Import Measures Act* as well as consequential amendments to the *Canadian*

*International Trade Tribunal Act*. Judicial review of agency decisions was provided for in both countries, but was traditionally invoked much more extensively in the United States than in Canada. Chapter 19 transferred this review function from domestic courts and tribunals to binational panels in cases involving Canadian or US goods. The Act itself provides for this authority, spells out the nature of this review and the ability of binational panels to make orders analogous to those of a domestic court, ensures roughly parallel treatment of both US and Canadian cases, and amends the two other statutes to the extent necessary to implement fully the provisions of chapter 19.

The GATT had originally exempted the procurement of goods by governments for their own use from the national treatment provisions of article III, which allowed governments to discriminate in favour of domestic suppliers.<sup>xlii</sup> During the Tokyo Round negotiations, developed country members of the GATT concluded a modest agreement opening a fraction of public procurement to competitive bidding. In implementing this agreement and to address the bidding process more generally, the United States federal government relied on much more transparent procedures than was the case in Canada. The CUFTA (chapter 13) required Canada to implement similar procedures, in addition to expanding coverage of the GATT Procurement Code for cross-border suppliers. To that end, part II of the Act granted the government authority to establish such procedures and set up a Procurement Review Board to provide bidders with an opportunity to gain quasi-judicial review of federal government procurement decisions.

CUFTA rules governing rules of origin, duty drawbacks, and other provisions in chapters 3 and 4, as well as provisions governing safeguards (chapter 11) and the special safeguard provisions for fresh fruits and vegetables (chapter 7), required amendments to the *Customs Act*, the *Customs Tariff*, the *Excise Act*, and the *Export and Import Permits Act*. Chapter 11 of the agreement requires Canada and the United States to treat both countries' imports separately in the application of emergency safeguard procedures. The Act made changes to the *Customs Act*, the *Special Import Measures Act*, and the *Canadian International Trade Tribunal Act* to implement this provision into law.

The Act needed to make substantial amendments to the *Investment Canada Act* in order to implement Canada's obligations under the investment provisions set out in chapter 16. Similarly, chapter 17 governing financial services required amendments to the ownership

and related restrictions in the *Bank Act*, the *Canadian and British Insurance Companies Act*, the *Investment Companies Act*, the *Loan Companies Act*, and the *Trust Companies Act*.

A good proportion of trade in agriculture is not covered by the CUFTA; the two parties had agreed that they would address many agricultural issues as part of the multilateral negotiations at the GATT in Geneva. Nevertheless, there were enough provisions in CUFTA's chapter 7 to require changes to seven acts dealing with trade in grains and meat as well as laws governing technical regulations and standards for agricultural, food, beverage, and related goods. Provisions addressing the non-discriminatory application of technical regulations affecting non-agricultural goods (chapter 6) required amendments to the *Standards Council of Canada Act*. The energy provisions in chapter 9 required changes to the *National Energy Board Act* in order to ensure that any orders issued by the National Energy Board affecting bilateral trade in energy goods would be consistent with the agreement.

Finally, while Canada took great pains to exempt the cultural industries of Canada from the CUFTA, in chapter 20 the United States succeeded in resolving a number of irritants in the cultural area that required major changes to the *Broadcasting Act*, the *Copyright Act*, and the *Income Tax Act*.

### **Institutional Provisions and Resource Implications**

From the outset, the Europeans had vested their customs union with a vast administrative infrastructure, whose principal features are an executive secretariat independent of member governments and exercising autonomous powers, a complex structure of ministerial councils and committees, a parliament, and a court. None of that was considered necessary or feasible in a North American context. As former Canadian ambassador to the United States Allan Gotlieb observes, "the world's largest bilateral economic relationship [is] managed without the assistance of bilateral institutions and procedures." (Gotlieb 2003) Rather than seeking to create structures where none were needed, the two governments focused on the functions that needed to be performed for the efficient implementation of the free-trade area. In this regard, they agreed to continue to rely on the vast body of informal networks through which Canadian and US officials cooperate and coordinate their joint activities.

The absence of formal structure results from a determined, and largely successful, effort to treat issues in the relationship vertically, rather than horizontally, and to build firewalls to prevent cross linkages. It derives, in part, from Canadian fears that as the smaller

partner, Canadian interests would be overwhelmed in any more formal relationship. As former WTO official Debra Steger points out, “Canadians ... are worried about invasion of our public policy autonomy by the Americans.” It also originates in the US system of governance that makes coherence and coordination in both foreign and domestic policies extraordinarily difficult to achieve on a sustained basis. As well, in Steger’s words, “Americans ... fear internationalism in all of its forms.” (Steger 2004: 80)

The institutional gap is filled by inspired *ad hocery*. The inter-connected nature of the Canadian and American economies virtually requires officials of the two countries to work closely together to manage and implement a vast array of similar but not identical regulatory regimes, from food safety to refugee determinations. Officials and sometimes ministers have developed a dense network of informal cooperative arrangements to share information, experience, data, and expertise with a view to improving regulatory outcomes, reducing costs, solving cross-border problems, implementing mutual recognition arrangements, establishing joint testing protocols, and more. Little of this activity, however, is coordinated or subject to a coherent overall view of priorities or strategic goals. Rather, it is the natural result of officials with similar responsibilities and shared outlooks seeking support and relationships to pursue them. The economic impact of the CUFTA greatly increased this North American habit of mind. As discussed below, the CUFTA may only have established two formal binational institutions, but the number and activity of informal bilateral networks increased rapidly as the agreement took hold (Mouffa, Morales and Heynen 2004).

In light of these considerations, it is not surprising that the CUFTA required the establishment of only two bilateral institutions and one domestic institution in Canada, and that the budgetary, staff, and other resource requirements for these institutions have proven to be modest. The three institutions are the following:

- A Canada-United States Trade Commission (article 1802) with responsibility for supervising the implementation of the CUFTA, resolving disputes about its interpretation and application, and overseeing its future elaboration. It would normally be headed by Cabinet-level officials responsible for international trade, with authority to delegate the detail of their work to lower level officials and to set up such committees and other subsidiary bodies as necessary. The commission is wholly

intergovernmental, and thus requires no permanent officials, budget, or headquarters. It is up to each party to determine how to staff and resource the commission.

- A Binational Secretariat (article 1909) with responsibility for servicing the requirements of the provisions set out in chapter 19 that review agency decisions arising from cross-border countervailing and antidumping duty cases. Again, each party is responsible for establishing its section of the secretariat, appointing its officials, and assuming its costs. While the two sections are required to work closely together and have some supra-national characteristics, the secretariat's binational character ensures that both parties will be able to keep a close eye on costs and operating procedures. Its costs to the Canadian taxpayers in its first five years of operation, before being replaced by the Trinational Secretariat, amounted to less than Cdn \$6.5 million.<sup>xliii</sup>
- A Procurement Review Board in Canada to consider procurement practices of the federal government departments, consistent with the requirements of chapter 13 of the agreement. The United States already had sufficient institutional capacity in place to discharge these responsibilities. The work of the board was modest and the government subsequently decided to fold its mandate into the broader mandate of the Canadian International Trade Tribunal.

Putting the agreement into effect required more resources than had been needed to implement Canada's rights and obligations under the GATT. While it is difficult to gauge the extent and costs of these resources, given the extent to which they form part of the broader growth in government resources and expenditures, it is possible to point to areas where costs increased. Canada's trade and foreign ministries, for example, saw no need for a trade law division for most of the postwar years. The increased involvement of trained legal specialists in the negotiation of the CUFTA, however, was continued with the establishment of such a division in the Department of Foreign Affairs and International Trade (DFAIT) in 1988. By the mid-1990s, the division was staffed by several dozen lawyers drawn from the Department of Justice and DFAIT's own cadre of international legal specialists. Similarly, human resources in the department's trade and US relations bureaus increased, as did those in allied domestic departments, such as Agriculture and Industry.



The full budgetary implications of these additional resources are difficult to separate from other activities. But growth in the number of people focused on trade policy and other trade-related activities grew considerably during the late 1980s and into the 1990s. The broader range of issues covered by the negotiations engaged officials from departments that had previously played at best a marginal role. For example, the interdepartmental committee on commercial policy during the Tokyo Round negotiations attracted regular participation from senior officials in the Departments of External, Finance, Industry, Trade and Commerce, and Agriculture. By the early 1990s, officials from 24 departments and agencies demanded a seat at this table.

### **Trade Agreements and Adjustment Assistance**

A major issue faced by the Canadian government in implementing the CUFTA was whether to introduce a CUFTA-specific labour-market trade adjustment program. The US Congress, in enacting the 1962 *Trade Expansion Act*, for the first time had added a trade adjustment feature to the US trade negotiations program. The idea that more open markets would lead to adjustments in domestic production patterns and labour markets is unexceptionable. As any economist would insist, trade agreements that do not lead to such adjustments are not of much value. The idea of tying adjustment assistance to the impact of a trade agreement, however, can raise significant problems. Isolating the economic impact of trade liberalization from other economic factors that may alter production and labour market patterns, from changes in consumer taste to technological developments, is fraught with difficulty. As US officials learned, the problem with a trade-specific adjustment assistance program is that every economic grievance and problem will be blamed on the trade agreement and merit adjustment assistance, creating an open-ended budgetary problem.

**Box 3: Typical Canadian Federal Adjustment Assistance Programs (1989)**

**A. Labour**

*Industrial Adjustment Service* – a cooperative forum that seeks to identify and resolve problems related to human resources, new technologies, productivity, relocations or layoffs.

*Skill Investment* – assists workers, including those recently laid off, to adapt to technological or market changes.

*Skill Shortages* – assists employers to train workers in areas of existing or anticipated skills shortages.

*Community Futures* – assists communities outside metropolitan areas in their efforts to identify, develop and undertake measures that support adjustment arising from structural and economic changes and to create permanent employment.

*Innovations* – a project-oriented program that encourages the development and testing of innovative solutions to labour market problems.

*Job Entry* – helps individuals who have difficulty in entering or re-entering the labour market, particularly young people and women.

*Job Development* – assists the long-term unemployed in finding permanent jobs.

*Canadian Rural Transition* – helps farm families in finding and adjusting to permanent alternative employment.

*Unemployment Insurance Program* – insurance program that helps Canadians between jobs with basic income support.

*Program for Older Worker Adjustment (POWA)* – provides assistance to workers involved in major permanent layoffs through income support.

*Labour Market Adjustment Services* – provides counseling and outreach services for workers and employers through, for example, Job Information Centres.

#### **B. Business**

*Federal-Provincial Adjustment Program for Grapes and Wine* – a cooperative program involving the BC, Ontario and federal governments aimed at easing the transition of grape growers to greater international competition.

*Economic and Regional Development Agreements* – includes a range of cooperative programs involving the federal and provincial governments.

*Atlantic Canada Opportunities Agency* – ACOA is responsible for a number of programs that seek the establishment and growth of small and medium-sized businesses in Atlantic Canada and help to diversify the region's employment base.

*Western Economic Diversification* – responsible for a number of programs that seek the establishment and growth of small and medium-sized businesses in Western Canada and help to diversify the employment base of the region.

*Federal Business Development Bank* – assists small and medium-sized businesses in financing domestic and foreign sales and in securing loans for expansion and restructuring.

*Industry Competitiveness Programs* – includes a range of programs administered by Industry, Science and Technology Canada such as the Defense Industry Productivity Program (DIPP), Strategic Technologies, Technology Outreach Program (TOP), Small Business Loan Program, and the Microelectronics and Systems Development Program (MSDP).

Source: Hart (1994: 9-10).

Despite the alarm bells raised by US experience with trade-related adjustment assistance, Prime Minister Brian Mulroney believed that the politics of the free-trade negotiations demanded a government sensitive to labour-market and related adjustment concerns. Therefore, he promised the provincial premiers and the general public that the

government would introduce extensive new adjustment assistance programs to address CUFTA-related problems in implementing the CUFTA. Officials in the Department of Finance, backed by their minister, Michael Wilson, made clear that this open-ended commitment spelled potential fiscal disaster and resisted all efforts to include adjustment assistance provisions in pending implementing legislation or budgets. They prevailed, convincing the prime minister that the wide array of existing, non-trade-specific adjustment-assistance programs (See Box 3) were more than sufficient to address any problems that might arise from the agreement's implementation. The prime minister reluctantly agreed and solved the political problem by appointing a blue-ribbon panel to assess the capacity of these programs to address CUFTA-induced labour-market adjustment.<sup>xliiv</sup> The panel produced an excellent report that clearly outlined the pros and cons of various approaches to adjustment assistance and recommended that the government strengthen a few existing programs to ensure that they could meet any additional demand.<sup>xlv</sup>

One specific adjustment assistance program, however, escaped the veto of Finance officials: the Federal-Provincial Adjustment Program for Grapes and Wine. Gaining provincial and industry support to resolve the long-standing dispute with the United States – as well as the European Communities – over the protection extended to Canada's wine industry required a commitment on the part of the federal government to help fund adjustment programs to buy out farmers invested in the Labrusca grape varieties common to Eastern North America and help them make the transition to vinifera varieties more suited to the making of quality wines. It proved a remarkably successful program; weaning Canadian growers off protection and helping wineries make the transition to quality wines that could compete on price and quality. (Hart 2005)

The lesson learned from the CUFTA implementation experience was reinforced during the implementation of the NAFTA and the WTO. Despite grumbling from organized labour and its political supporters, there was no further serious discussion about trade-specific adjustment programs.

### **Implementing the North American Free Trade Agreement**

From the outset of the NAFTA negotiations, Canada insisted that the new agreement enhance the CUFTA and in no way erode the benefits Canada had already realized as a result of either the GATT or the CUFTA. This proved possible, and at the same time there was opportunity to

make such improvements as the three governments deemed desirable. Their ability to transform the CUFTA into a more comprehensive trilateral agreement, open to signature by other countries, had obvious implications for the continuing application of the CUFTA. When negotiating the CUFTA, Canada and the United States had decided that the combination of overlapping and duplicating rights and obligations in the CUFTA and the GATT could best be addressed by means of a precedence clause. This clause provided that in the event of conflict between the CUFTA and the GATT, the CUFTA would prevail unless specifically provided otherwise.

The degree of overlap between the CUFTA and the NAFTA is more extensive and more complicated because much of the language was adjusted to make it more suitable for accession by other parties.<sup>xlv<sup>i</sup></sup> Canada and the United States agreed to address this overlap by using the same procedure they had used in 1947, when the multilateral GATT replaced the 1938 Canada-US Reciprocal Trade Agreement. To that end, Canada and the United States agreed that the NAFTA, with all of its improvements, would supersede the CUFTA. The NAFTA either incorporates by reference, replaces with trilaterally agreed improvements, or makes generic all the CUFTA obligations between Canada and the United States. As a result, the two governments were able to agree to suspend the CUFTA as long as they are both parties to the NAFTA. Essentially, the rights and obligations set out in the CUFTA remain in effect, but in an updated and improved agreement.

The improvements incorporated in the NAFTA were extensive and included the following:

- New rules on duty drawback allowed Canadian manufacturers greater flexibility in using input from non-NAFTA sources when these are incorporated into exports of manufactured products to other NAFTA countries.
- Better disciplines on customs administration set out clear rules on how the agreement should be interpreted and administered by the customs authorities, with clear procedures for the redress of grievances.
- Reworked rules of origin made their application more transparent and certain, narrowing the scope for disputes resulting from differences in interpretation and application. North American content rules were raised to 62.5 percent for cars, light trucks, and major components, and 60 percent for other automotive products.

- Constrained by slow progress on trade in agricultural products in the Uruguay Round, the three countries succeeded in putting together a series of bilateral arrangements. The CUFTA agriculture provisions were carried forward into the NAFTA, while Canada and the United States each negotiated separate arrangements regarding market access with Mexico.
- New standards provisions built on the extensive progress made in the Uruguay Round set out clear rules to reduce the scope for using standards as a disguised barrier to trade while preserving the right of governments to regulate within their own borders and promote such important goals as protecting the environment.
- In provisions on land transport, the agreement provides that truckers can carry cargo from one country to the other, but reserves local cargoes to truckers based in that country.
- The extension of covered cross border services include aerial surveys, mapping, remote sensing, and similar activities.
- The investment chapter covers a broader range of operations and business activities than the CUFTA, including important provisions for resolving certain types of disputes between governments and investors from other NAFTA countries.
- A new chapter on intellectual property provisions was added; similar to those included in the GATT Uruguay Round results.
- The financial services chapter was recast on the basis of tighter rules of general application and subject to the dispute-settlement provisions of the agreement.
- Chapter 19 of the CUFTA, providing for binding bilateral review of antidumping and countervailing duties, was made a permanent feature of the NAFTA.
- The institutional provisions were recast to include greater emphasis on mediation and conciliation, improvements to the panel selection process, and specialized provisions for certain issues (for example, financial services).
- Two side agreements to address environmental and labour-market issues were added. The environmental agreement affirms the right of governments to protect the environment, even when protection measures conflict with their trade obligations,

provided such steps do not involve unnecessary discrimination or introduce disguised restrictions on trade. It establishes that the trade-related obligations in certain international environmental agreements can override obligations in the NAFTA. Any panel established to address an environmental issue may call on the help of a board of scientific experts.

- The labour side agreement affirms the three governments' commitment to the rigorous enforcement of workers' rights and provides procedures to address any complaints regarding the failure of any government to enforce labour laws.

The extensive improvements as well as the inclusion of Mexico required the government to pursue new legislation updating the *Canada-United States Free Trade Implementation Act*. A complicating feature was that the NAFTA negotiations had concluded at the end of the mandate of President George H.W. Bush, but its legislative consideration took place under the administration of President Bill Clinton. The addition of the environment and labour side agreements, concluded by the Clinton administration, were critical to gaining sufficient support among Democrats to ensure congressional approval. Even then, the US House of Representatives approved US implementing legislation by the narrowest of margins.

The delay in approval occasioned by the US political calendar did not allow Canada's Conservative government, which had been elected in the free trade election of 1988, to conclude its own NAFTA implementing legislation. Parliament passed the implementing legislation, but the government delayed royal assent pending an election. In the subsequent election, Canadians indicated that they had grown tired of the Conservatives and opted instead for a new Liberal government and an opposition dominated by three smaller parties. The Conservatives were reduced to two seats. The party that had opposed the CUFTA and expressed concern about the NAFTA would have to decide whether or not to proceed.

The new prime minister, Jean Chrétien, to the relief of senior civil servants, business leaders, and the US and Mexican governments, adopted a pragmatic stance. He accepted that the changes wrought in the Canadian economy as a result of the CUFTA could not be undone and the inclusion of Mexico and an accession clause in the NAFTA were consistent with Liberal instincts, namely that Canada should not focus exclusively on trade with the United States. By 1993, the most difficult adjustments flowing from the CUFTA had been weathered. It was time for the federal government to focus on new priorities. The imminent conclusion of

the Uruguay Round and its extensive improvements to the multilateral regime along lines consistent with the CUFTA and NAFTA further underlined that it would not make sense to turn back the clock. As a result, Chrétien appointed a committed free trader, Roy MacLaren, as his trade minister with instructions to seek some cosmetic changes to the NAFTA to demonstrate that there was a new government in charge, and then to proceed with ratification. The US and Mexican governments quickly agreed to an understanding regarding subsidies, dumping, and water, and on January 1, 1994 Canada was in a position to proclaim the *NAFTA Implementation Act* and ratify the Agreement.

**Box 4: NAFTA Implementation**

The *North American Free Trade Agreement Implementation Act*<sup>xlvii</sup> made consequential changes to the following twenty-nine existing federal statutes:

- |                                                     |                                        |
|-----------------------------------------------------|----------------------------------------|
| <i>Canada Mortgage and Housing Corporations Act</i> | <i>Bank Act</i>                        |
| <i>Canadian Agricultural Product Standards Act</i>  | <i>Canadian Wheat Board Act</i>        |
| <i>Canadian International Trade Tribunal Act</i>    | <i>Commercial Arbitration Act</i>      |
| <i>Cooperative Credit Association Act</i>           | <i>Copyright Act</i>                   |
| <i>Customs Act</i>                                  | <i>Customs Tariff</i>                  |
| <i>Export and Import Permits Act</i>                | <i>Fertilizer Act</i>                  |
| <i>Food and Drugs Act</i>                           | <i>Industrial Design Act</i>           |
| <i>Importation of Intoxicating Liquors Act</i>      | <i>Insurance Companies</i>             |
| <i>Investment Canada Act</i>                        | <i>Investment Companies Act</i>        |
| <i>Canada Land Surveys Act</i>                      | <i>Meat Import Act</i>                 |
| <i>Meat Inspection Act</i>                          | <i>National Energy Board Act</i>       |
| <i>Patent Act</i>                                   | <i>Pest Control Products Act</i>       |
| <i>Special Import Measures Act</i>                  | <i>Standards Council of Canada Act</i> |
| <i>Textile and Clothing Board Act</i>               | <i>Trade-marks Act</i>                 |
| <i>Trust and Loan Companies Act</i>                 |                                        |

The NAFTA Act followed the general contours of the CUFTA Act, adding Mexico as appropriate and updating the legislation to reflect improvements that had been agreed. The inclusion of a NAFTA chapter on intellectual property rights required changes to some additional statutes, such as the *Copyright Act*, the *Patent Act*, the *Food and Drugs Act*, the *Trade-marks Act*, and the *Industrial Design Act*. The new arbitration procedures in the investment chapter required changes in the *Commercial Arbitration Act*. The revised chapter on financial services required some changes in the *Canada Mortgage and Housing Corporations Act*. The inclusion of aerial services is reflected in amendments to the *Canada Land Surveys Act*.

A new wrinkle, inspired by US practice, was added in implementing the NAFTA. Pursuant to the US fast-track procedures, the administration is required to table a statement on implementation when it sends legislation to implement a new trade agreement to Congress. The statement serves not only as a guide to the agreement and its implementing legislation for both legislators and engaged publics, but also as an official statement of how the US government intends to interpret and apply the agreement. In dispute settlement cases, the US government relies on such documents as part of the *travaux publiques* to guide a panel in interpreting an agreement. Largely as a defensive measure, Canadian officials decided it would be beneficial to place their government's interpretation of the agreement on a similar footing, and at the same time provide attentive public and regulatory officials with an authoritative guide to the agreement. The Canadian statement included not only a guide to the agreement, but also to its implementing legislation. It was published in the *Canada Gazette* at the time that the NAFTA was brought into force.<sup>xlviii</sup>

### **NAFTA Institutional Provisions and Resource Implications**

Similar to the CUFTA, the NAFTA provides for a North American Trade Commission staffed by the most senior political official responsible for trade in each of the three member governments. It also provides for a permanent trilateral secretariat to replace the CUFTA's binational secretariat, responsible for facilitating the administration of chapter 19. As with the CUFTA, these two central institutions rely on each of the three governments for staff and resources. The budgetary implications for Canada of the Trade Commission are difficult to work out but are not onerous. The Canadian section of the trilateral secretariat has, to date, cost the Canadian government a little over C\$31 million, an average of about C\$2 million per year.

The NAFTA also established two trilateral commissions, one for the environment and one for labour. Canada agreed to provide the environmental commission with a headquarters in Montreal and an annual grant of US\$3,000,000, for a total of US\$42,000,000 to date. The United States and Mexico also contribute \$3 million annually. The environmental commission has investigated various complaints from citizen groups and provided the three governments with advice on trilateral environmental issues. The labour commission was originally located in Dallas, but due to lack of activity, was relocated to Washington to reduce budgetary costs for the US government. The three member governments contribute half a million dollars a



year to its work, but based on its last annual report (2002), the commission boasts considerable cash and resources in hand since its operating costs and activities have been modest. (Commission for Labor Cooperation 2002)

Finally, given the perceived gap between Canadian and US institutional capacity to apply the NAFTA and that of Mexico, the agreement provides for a more formalized approach to the work of the vast network of informal contacts that had developed between Canada and the United States. Virtually every chapter of the agreement provides for committees and working parties to facilitate discussion and review of the implementation of the agreement (see Box 5). Some of these groups have been more active than others, but their structures and mandates are sufficiently flexible to allow officials in the three governments to determine how often they need to meet and what issues they need to pursue. As a result, it is difficult to measure the resource implications of these bodies except to note that they have added to the general perception that the number of Canadian officials engaged on trade and trade-related files has grown considerably.

**Box 5: NAFTA Committees/Working Groups:**

- Committee on Trade in Goods (Chapter Three, Article 316)
- Working Group on Textiles & Apparel (WGTA)
- Committee on Trade in Worn Clothing (Chapter Three, Annex 300-B, Section 9.1)
- Working Group on Rules of Origin (Chapter Five, Article 513)
- Customs Subgroup (Chapter Five, Article 513.6)
- Committee on Agricultural Trade (Chapter 7, Article 706)
- Working Group on Agricultural Grading and Marketing Standards
- Working Group on Tariff Rate Quota Administration (1999 NAFTA Commission)
- Working Group on Agricultural Subsidies (Chapter 7, Article 705.6)
- Advisory Committee on Private Commercial Disputes Regarding Agricultural Goods (Chapter 7, Article 707)
- Committee on Sanitary and Phytosanitary Measures (Chapter 7, Article 722 and includes CUFTA Article 708 Working Groups)
- Technical Working Groups on Sanitary and Phytosanitary Measures (Chapter 7, Article 722)
- Working Group on Emergency Action
- Committee on Standards Related Measures (Chapter Nine, Article 913)
- Land Transportation Standards Sub-Committee and its various working groups (Chapter Nine, Article 913.5 (a) (I), Annex 913.4a-1). Last meetings/reports to Commission in 2001.
- Telecommunications Standards Sub-Committee (Chapter Nine, Article 913.5 (a) (ii), Annex 913.5.a-2)
- Automotive Standards Council (Chapter Nine, Article 913.5(a)(iii), Annex 913.5.a-3)
- Sub-Committee on Labelling of Textile and Apparel Goods (Chapter Nine, Article 913.5(a)(iv) Annex 913.5.a-4)
- Sub-Committee on Labelling of Packaging and Food Standards
- Working Group on Government Procurement and Committee on Small Business (Chapter Ten, Article 1021)
- Investment Experts Group (IEG) (Chapter 11)
- Working Group on Services (Chapter 12)
- Financial Services Committee (Chapter 14, Article 1412, Annex 1412.1)
- Ad-Hoc Committee of Experts on Trade and Competition Policy (Chapter 15, Article 1504)
- Temporary Entry Working Group (Chapter 16, Article 1605)
- Chapter 19 Operational Working Group (Chapter 19, Article 1907.1)
- Advisory Committee on Private Commercial Disputes (Chapter 20, Article 2022)

## **Implementing the World Trade Organization Agreement**

The NAFTA was brought into force a few weeks after the successful conclusion of the Uruguay Round of multilateral trade negotiations on December 15, 1993. By the end of April, 1994, ministers had gathered in Marrakech, Morocco, to formally adopt the results and commit governments to bringing the agreement into force at the beginning of 1995. The successful conclusion of the Uruguay Round considerably expanded and broadened international trade and investment rules. The NAFTA and the new WTO agreements cover much of the same ground, and the two sets of rules are largely complementary and mutually reinforcing. In many respects, the NAFTA built on progress that had been made in the

Uruguay Round while the round profited from the experience of Canada, the United States, and Mexico in negotiating first the CUFTA, and then the NAFTA. Nevertheless, there are areas in which the final results of the Uruguay Round amplified or modified provisions of the NAFTA. It was again necessary for the government to introduce implementing legislation and prepare an explanatory statement.

The Marrakech Agreement involved some 30 separate agreements and 27 decisions and declarations, collectively amounting to the largest commercial agreement ever negotiated on such a broad basis. In order to provide an integrated set of obligations, and at the same time remove the institutional ambiguity that had hampered GATT, the centre-piece of the new trade regime is the World Trade Organization. It provides the organizational framework within which members will pursue rights and obligations set out in three main agreements: an amended General Agreement on Tariffs and Trade dubbed the GATT 1994, a new General Agreement on Trade in Services (GATS) and a new Agreement on Trade-Related Intellectual Property Rights (TRIPs). A series of codes flesh out the rights and obligations contained in the revised GATT. Most are revised versions of the Tokyo Round codes, in some cases radically revised, as in the case of subsidies, and decisions and understandings on a range of important matters including dispute settlement, the trade policy review mechanism and the interpretation of various GATT articles. Detailed schedules are appended to the revised GATT and new GATS that specifically set out the market-access commitments of individual members. The schedules appended to the GATT 1994 contain not only traditional tariff bindings, but also commitments on other product-specific border measures.

Bill C-57, *An Act to Implement the Agreement Establishing the World Trade Organization*, introduced by the government in the House of Commons on October 25, 1994, entered into force on January 1, 1995. Similar to the CUFTA and NAFTA implementation Acts, it did all that was necessary by way of legislation to ensure that Canada's obligations under the WTO agreement can be met and that Canada can exercise all its rights.

Article XVI of the agreement required Canada to amend some statutes in order to bring them into conformity with the obligations set out in the constituent agreements of the WTO. Clause 3 of the Act clearly states that such is the Act's purpose. Clauses 10, 11 and 12 of the Act serve to fulfill the administrative aspect of Canadian WTO membership. Finally, in order to eliminate the problem of 'free riders', sub-clause 13 (2) of the *WTO Act* gives the

Governor-in-Council the power to issue the necessary orders to suspend concessions made by Canada under the agreement with respect to non-WTO members. This time, the Act set out amendments to some 23 federal statutes, as per Box 6.

**Box 6: WTO Implementation**

The *World Trade Organization Agreement Implementation Act*<sup>xlix</sup> made consequential changes in the following twenty-three existing federal statutes:

<i>Bank Act</i>	<i>Canadian International Trade Tribunal Act</i>
<i>Canadian Wheat Board Act</i>	<i>Cooperative Credit Association Act</i>
<i>Copyright Act</i>	<i>Customs Act</i>
<i>Customs Tariff</i>	<i>Export and Import Permits Act</i>
<i>Fertilizers Act</i>	<i>Financial Administration Act</i>
<i>Food and Drugs Act</i>	<i>Industrial Design Act</i>
<i>Insurance Companies Act</i>	<i>Integrated Circuit Topography Act</i>
<i>Investment Canada Act</i>	<i>Investment Companies Act</i>
<i>Meat Import Act</i>	<i>Patent Act</i>
<i>Pest Control Products Act</i>	<i>Special Import Measures Act</i>
<i>Trade-marks Act</i>	<i>Trust and Loan Companies Act</i>
<i>Western Grain Transportation Act</i>	

## **WTO Institutional Provisions and Resource Implications**

In translating their GATT experience into the new WTO agreement, governments were determined to preserve the extensive involvement of their own officials in the day-to-day operation of the new organization and to pursue decisions on the basis of consensus. More than in any other international organization, participating governments assumed “ownership” of GATT’s daily operation and relied on a handful of permanent officials to provide them with advice, support, and institutional memory. The WTO institutionalizes these arrangements and adds ministerial oversight of them. The agreement establishing the WTO provides for governance by a Ministerial Conference and a General Council and notes that “the WTO shall continue the practice of decision-making by consensus followed under GATT 1947.” To underline this point, no provision is made for voting in the WTO’s subsidiary bodies.

As a result of members’ commitment to “owning” the WTO, a typical week at the WTO’s headquarters may see as many as three or four dozen meetings, ranging from the General Council or the Dispute Settlement Body, the Trade Policy Review Body, or the Trade Negotiations Committee, to accession working parties, dispute settlement panels, standing committees (e.g., Trade and Development or Trade and the Environment) and some two

dozen committees dealing with oversight responsibilities for the individual agreements that operate under the aegis of the WTO. Each of these meetings will be staffed by a mix of officials from capitals and permanent missions of member governments, chaired by an official from one of the member governments, and supported by secretariat officials. The resources available to the WTO to perform its mandate, therefore, are not just those of the secretariat, but also those of the 175 permanent missions of members and observers accredited to the WTO, and the officials in capitals who support them. (Blackhurst 1998).

In addition to the formal meetings organized by the secretariat, member governments pursue a busy schedule of informal meetings in conference rooms in their permanent missions, over lunch, at cocktails, and throughout the Geneva area doing what WTO diplomats do best: gathering information, sharing intelligence, assessing issues, analyzing problems, and building consensus on pending decisions. Their aim is to not only to meet the specific goals and interests of their own governments, but also to satisfy the more general objective of ensuring the continued viability and integrity of the multilateral trading system.

The participation of member governments in this constant round of diplomatic and technical activity varies according to the resources individual governments are prepared to devote to it, the interests governments believe can be advanced or need to be defended at the WTO, and the talents of individual diplomats active in WTO affairs. Leading members, such as the United States, the EU, Canada, Japan, Brazil, and India maintain large missions in Geneva staffed by specialists and diplomats. Their work is closely integrated into and monitored by officials and their political masters in capitals. Such an investment in resources ensures a high degree of involvement in every aspect of the WTO's work and exerts a major influence on its evolution. Smaller members, on the other hand, find it difficult to muster such resources. At best, they must often rely on one or two officials with experience in trade and economic affairs or, more often, on officials with broad diplomatic experience rather than specific trade or economic expertise. Some members do not even maintain a permanent office in Geneva, depending instead on diplomatic representation in Brussels, Paris, or some other European capital to keep an eye on WTO affairs. Resource considerations thus have an important bearing on the approach members take to the challenges of participation and policy development at the WTO.

Credible and effective participation in the work of the WTO and its many subsidiary bodies requires not only the skills expected of any accomplished diplomat, but also technical expertise in the minutiae of the WTO's 30 agreements and the myriad of trade-related subjects they cover. Technical expertise involves not only knowledge of the rules and their application, but also an appreciation of the political economy of those rules in affected countries. Few individuals can master all these agreements, as well as possess the skills of a negotiator and diplomat. As a result, the leading members of the WTO rely on delegations of specialists in both the subject matter and the requisite analytical, diplomatic, and negotiating skills.

The Canadian mission in Geneva plays an active role in WTO affairs. In addition to a senior ambassador concentrating on economic institutions, it also boasts up to eight other officers conversant in trade policy matters and equipped to handle various WTO issues. Canada has also succeeded in placing more of its nationals into influential secretariat positions. Canada gets good mileage out of this representation in Geneva in the day-to-day affairs of councils and committees, in the informal diplomacy that is key to resolving delicate negotiating issues, and in the building of coalitions and alliances. With the support of a much enlarged headquarters staff, Canada gets consistently good marks for the quality of its representation and the ideas it brings to the table.

### **Gaining Full Trade Agreement Benefits**

*Summary: So far, this discussion has focused on Canadian experience in implementing trade agreements into domestic law. Gaining the full benefits of trade agreements, however, also involves ensuring that Canadian-based firms are able to take full advantage of the market-access commitments made by the other parties to the agreements. Two aspects of public policy are key to implementing this dimension: assisting and facilitating exports and defending market access. This section surveys Canadian experience in developing the requisite programs to promote exports and enhancing the country's capacity to address trade- and investment-based disputes using the procedures laid out in the three agreements.*

The market access gained through trade negotiations can be enhanced by supportive export marketing efforts. This can cover a range of activities such as foreign market intelligence, recruitment of sales agents, and developing technology partnerships. Given the diverse

range of countries to which Canadian firms export, a wide variety of programs have been deployed over the years to meet their needs. They share the following three broad objectives:

- enhancing export awareness among Canadian producers of competitive goods and services;
- maintaining an inventory of strategic information about potential exporters and customers; and
- assisting smaller Canadian enterprises in their market development activities.

In some markets where government-to-government contacts are an essential part of marketing, government trade and investment promotion efforts can make the difference between a potential and an actual sale. In other markets, where decisions are basically market driven, government efforts can build useful bridges between Canadian firms and potential customers, distributors and investors, particularly for first-time exporters and investors. Small and medium-sized enterprises (SMEs) unaffiliated with larger groups represent the majority of the Canadian exporting community, although in volume terms exports are highly concentrated among a small group of global companies. Nevertheless, SMEs represent a large potential, either for expanding their export horizons or receiving an introduction to the benefits of exporting. In the competitive global market of today, however, such companies with their limited financial resources and specialist skills face special obstacles in doing business abroad. They often cannot afford to build the technology and investment linkages that are frequently required for successful export marketing strategies. For this reason, SMEs have become the main focus of a wide range of government trade development assistance programs.

### **Box 7: Canada's Principal Trade Development Programs in 1989<sup>1</sup>**

*Program for Export Market Development (PEMD)* – the primary trade promotion tool (\$29 million dollars annually in the late 1980s, more in the 1990s) assists Canadian marketing activities abroad. When sales result, industry-initiated activities are repayable, while costs are shared for government initiatives.

*Technology Inflow Program (TIP)* – facilitates technology acquisition with emphasis on small and medium-sized firms with limited means; priority given to space, biotechnology and advanced industrial materials technology sectors in Europe, US and Japan.

*Investment Development* – Specialists at 8 posts in Europe, the USA and Asia facilitate foreign investment that brings jobs, entrepreneurial expertise and new technology to Canada.

*International Financial Services and Capital Projects* – assists Canadian firms to increase their share of the annual US \$31 billion market of projects funded by international institutions, such as the World Bank; supports exporters through special financing with the Export Development Corporation or Canada Account; and assists with participation in export consortia for large projects.

*Trade Information Systems* – facilitates information flow about markets abroad and Canadian export potential by maintaining a data base of exporters, products and contacts abroad (WIN Export) available to the provinces and the exporting public.

*Trade Centres and Export Education* – 14 International Trade Centres across Canada provide assistance to exporters and coordinate with provincial trade ministries; assistance is also provided to Centres for International Business Studies at 8 Canadian universities.

*Geographic and Sectoral Marketing Expertise* – Regional and sectoral trade development specialists provide advice on opportunities and local conditions at more than 100 posts abroad, in five regional branches covering the globe, and in four sectoral divisions that cooperate closely with trade specialists in other government departments, in the provinces and industry associations to provide accurate product information and marketing advice for companies in individual sectors.

*Tourism* – In association with Tourism Canada, 66 commercial officers at Canadian embassies and consulates abroad support tourism promotion activities within a budget of \$4 million annually.

*Canadian International Trade Month (CITM)* – Every October, External Affairs and International Trade Canada mounts a series of programs and events, including its annual export awards, to promote export awareness and proficiency among Canadians.

Source: Hart (1994: 54).

The federal government also promotes export development through the programs of the Export Development Corporation (EDC), including insurance and financing services for the export of Canadian goods and services and investment guarantees to Canadian companies with overseas operations. The EDC is able to raise capital at highly competitive rates for its corporate account, which it operates on a commercial basis. As a result, the credit-worthiness of the purchasing country and the inherent risk of each particular transaction will determine what services EDC is prepared to provide. The corporate account provides short-, medium- or long-term credit facilities. In circumstances where the EDC is not prepared to offer the



services of its corporate account it can draw on the Canada account for both concessional and non-concessional financing, insurance, and investment guarantees.

New trade development techniques must be evaluated continuously. There is also a need for government-wide consistency to avoid duplication and to ensure that export promotion programs meet the needs of Canadian producers. Greater cooperation between the government and private sector ensures that programs respond to technological change and market developments. The government developed a number of new programs specifically to promote CUFTA and NAFTA, including a program designed to help new exporters to the United States and Mexico. The government also expanded its trade development resources in both countries.

The provinces also became active in promoting their trade, tourism, and investment interests in foreign markets. Most maintain offices abroad, some of them co-located with federal representatives, others in separate locations. Their activities complement federal programs or are pursued jointly.

## **Conflict Management**

In addition to export assistance programs, the federal government defends access gained through trade negotiations. Much of this effort is focused on solving small problems before they become larger and more intractable. Ultimately, however, the efficacy of this effort depends on the willingness of the government to pursue trade litigation and changes in the rules, where necessary.

For both Canada and the United States, but particularly for Canada, binding dispute settlement procedures are a critically important dimension of managing relations between the two countries. Considerable energy and negotiating coin were used by Canada in the CUFTA, NAFTA, and WTO negotiations to strengthen dispute settlement procedures, such as making access more automatic, ensuring the independence of panelists, making panel rulings more binding, providing the process with greater institutional support, and otherwise establishing rules and procedures that would help to reduce the disparity in power between Canada and its major trading partner. Not surprisingly, Canada has made extensive use of these procedures, but so has the United States, sometimes to the regret of Canadian interests. On balance, however, despite discomfort on individual issues on both sides of the border, the dispute

settlement procedures in the three agreements have greatly enhanced the rule of law in relations between Canada and the United States.

For Canada, the NAFTA and the WTO are not alternative but complementary means to a common end. They are parts of a single body of rules and procedures to govern trade and investment relations with the United States. These rules have steadily, but not uniformly, improved as a result of negotiation, implementation, and litigation. Consequently, for individual policy problems, governments must choose the forum they wish to use with care. The complementarity of the rules in the NAFTA and WTO is further underscored by the fact that some issues can only be litigated in one forum, while others can be pursued in either. Issues raised by the application of the laws in a particular subsidy/countervailing duty case, for example, can be litigated in both forums, but the issues that can be raised are not the same. NAFTA chapter 19 involves the interpretation and application of domestic law; NAFTA chapter 20 and the WTO's Dispute Settlement Understanding (DSU) involve the interpretation and application of the rules in each respective agreement. The difference is important and should not be confused. Chapter 19 allows parties to the case to appeal determinations made by domestic decision-making bodies on the basis of the same standard of review as a domestic court would use in that country for such a case; in effect, chapter 19 litigation replaces domestic litigation. Litigation under NAFTA chapter 20 (chapter 18 of the original CUFTA) or the WTO-DSU, on the other hand, allows governments to settle disputes arising as a result of differing interpretations of the rights and obligations set out in the NAFTA and WTO respectively.

Canada and the United States have both made extensive use of the full range of available dispute settlement procedures (See Boxes 8-10).<sup>11</sup> The result has been a marked reduction in the number of festering issues and an increase in the number of issues resolved on the basis of agreed upon rules. In the more than 40 years between the entry into force of the GATT and the entry into force of the FTA, Canada and the United States had made sparing use – 12 times in 41 years – of the dispute settlement provisions of the GATT, in large part because Canadian governments had more confidence in their capacity to settle on the basis of consultation than litigation. As a result, however, some issues were never settled. Since 1989, Canada and the United States have used the general litigation procedures of the GATT/WTO and NAFTA chapters 18 and 20 frequently, suggesting a very high level of

mutual confidence, even if some cases end up creating temporary political discomfort and other cases, such as softwood lumber, prove too difficult to resolve.

<b>Box 8: US and Canadian Resort to CUFTA/NAFTA Chapter 19, 1989-2008</b>		
	Reviews of US Determinations	Reviews of Cdn determinations
<i>CUFTA 1989-93</i>		
Antidumping	8	4
Subsidies/Countervail	6	-
Injury	5	7
Extraordinary challenge procedures	3	-
<i>NAFTA 1994-2008</i>		
Antidumping	25	9
Subsidies/Countervail	14	-
Injury	11	2
Extraordinary challenge procedures	2	-
Source: <a href="http://www.nafta-sec-alena.org/english/index.htm">www.nafta-sec-alena.org/english/index.htm</a>		

Over the course of the CUFTA's five years, Canadian and US parties invoked chapter 19 proceedings 33 times. Canada and the United States were generally pleased with the way these proceedings operated.<sup>1ii</sup> As a result, the NAFTA made them a permanent feature of the agreement and extended them to Mexico. Since NAFTA's entry into force, the pace has slowed somewhat, as have the number of new bilateral antidumping and countervailing duty cases. Nevertheless, NAFTA chapter 19 procedures were invoked by the two parties a total of 63 times up to the end of 2008, most of them to review US agency decisions (see Box 8). Over the course of now 20 years, panels have sustained some decisions by administrative tribunals and remanded others, seeking either clarification or stronger justification for the decision rendered or, in the absence of justification, determining that the decision be vacated. Experts reviewing the reasoning in such cases have generally agreed that three- or five-person panels, familiar with the economic and legal concepts, have performed their tasks ably and professionally and often more thoroughly than had been the case with domestic courts. The US challenges of a total of five panel determinations under the extraordinary challenge procedures, all of which were dismissed, illustrate the political difficulty faced by US authorities in rejecting an available channel of appeal. In the United States, as long as litigants

are unhappy and a channel of appeal exists, an appeal is likely unless it has been clearly demonstrated that the chances of success are marginal at best.

From a Canadian perspective, US use of the challenge procedures has proved beneficial because the three-judge panels in all five cases ended up setting a very high standard that appellants must satisfy. The decisions have confirmed what for Canada had been the purpose of the procedure: a safety valve in cases of aberrant decisions or tainted panels; they are not meant to be used as a routine form of appeal. For Canada, this has been a highly satisfactory result in ensuring that dispute settlement procedures play their role in depoliticizing the management and resolution of conflict, an objective the US shares in the abstract but has difficulty applying in specific instances.

By any measure, the process has demonstrated a very high level of professionalism and lack of bias. With the exception of a small number of high-profile cases, it has succeeded in resolving disputes on a more principled, less political basis. For the smaller, less powerful partner, this is a highly desirable outcome.

One unanticipated development is also worth noting. On cross-border trade, new antidumping and countervailing duty investigations have become increasingly rare. The extent of intra-corporate trade and other structural forms of commercial integration, and, no doubt the disciplines imposed by chapter 19, have virtually eliminated the practice in which firms in the manufacturing and industrial sectors resort to trade remedies. Most of the chapter 19 cases involving Canada and the United States have arisen from reviews of earlier cases, rather than from new ones. In cross-border terms, the principal trade remedy problem remaining is the role of government in resource management, including pricing.

Chapter 18 of the CUFTA (replaced by chapter 20 in the NAFTA) provides the general dispute settlement provisions of the agreement. Modeled on procedures developed under the GATT, but with a number of important innovations aimed at making the procedures more certain and credible, chapter 18/20 provides the basis for resolving complaints arising from conflicting interpretations in the implementation and application of the agreement. Canada and the United States used the CUFTA procedures five times over the course of the five years that it was in force: three times by Canada and twice by the United States. In all five cases, the procedures succeeded in settling the dispute (see Box 9). In addition, Canada

and the United States used the CUFTA's consultation provisions to resolve a number of other issues on a basis that obviated the need for formal panel proceedings.

Following entry into force of the NAFTA, Canada and the United States have used the revised provisions of chapter 20 only once. The United States complained that Canadian tariffication of import quotas on supply-managed dairy and poultry products implemented pursuant to the WTO Agreement on Agriculture was inconsistent with Canada's NAFTA obligations. The complaint was dismissed by a panel of five law school professors. The United States expressed deep disappointment but accepted the verdict.

**Box 9: Canada-United States Trade Dispute Settlement Cases – 1989-2009**

1989	CUFTA	US complaint regarding salmon and herring landing requirements.
—	CUFTA	Canadian complaint regarding US lobster size restrictions.
—	GATT	Canadian complaint concerning the imposition of countervailing duties by the United States on imports of fresh, chilled, and frozen pork from Canada.
1990	GATT	US complaint regarding the import, distribution, and sale of certain alcoholic drinks by provincial marketing agencies.
1991	CUFTA	Canadian complaint regarding US application of automotive rules of origin (non-mortgage interest rate).
—	GATT	Canadian complaint regarding measures affecting the distribution and sale of alcoholic and malt beverages in the United States.
—	GATT	US complaint about a Canadian countervailing duty case involving grain corn.
—	GATT	Canadian complaint regarding US initiation of a countervailing duty proceeding involving imports of softwood lumber from Canada.
1992	CUFTA	US complaint regarding Canadian subsidies on exports of wheat (pricing and other practices of the Canadian Wheat Board).
—	CUFTA	Canadian complaint regarding Puerto Rican standards affecting imports of UHT milk from Canada.
—	GATT	US complaint regarding antidumping duties on beer imported into British Columbia.
1995	NAFTA	US complaint that Canadian tariffication of supply managed commodities (dairy and poultry products) was not required by the WTO Agriculture Agreement and was inconsistent with Canada's NAFTA obligations.
1996	WTO	US complaint regarding Canadian measures affecting the importation and distribution of split-run periodicals.
1997	WTO	US complaint regarding measures affecting the importation of milk and the exportation of dairy products.
1998	WTO	Canadian complaint regarding state measures (South Dakota and others) affecting the importation and shipment of cattle, swine, and grains.
1999	WTO	US complaint regarding the term of patent protection in Canada.
—	WTO	Canadian complaint regarding the initiation of countervailing duty proceedings by the United States against live cattle.
—	WTO	Canadian complaint regarding US support program for sugar and syrups.
2000	WTO	Canadian complaint of US practice of treating an export restraint as a subsidy.
2001	WTO	Canadian complaint that section 129 of the Uruguay Round Implementation Act was inconsistent with the WTO.
—	WTO	Canadian complaint that US AD and CVD offset arrangements were inconsistent with the WTO.
2001	WTO	US complaint that Canadian wheat marketing practices constituted state trading practices inconsistent with the WTO.
—	WTO	First of six Canadian complaints filed in pursuit of US AD and CVD practices affecting Canadian softwood lumber exports to the United States. Four more were filed in 2002 and a sixth in 2004.
2004	WTO	Canadian complaint about US import restrictions on spring wheat.

- |      |                                                                                                            |
|------|------------------------------------------------------------------------------------------------------------|
| 2006 | WTO US complaint regarding a Canadian AD/CVD case on corn from the United States.                          |
| 2007 | WTO Canadian complaint regarding subsidies to US corn producers.                                           |
| 2009 | WTO Canadian complaint regarding US country-of-origin labeling (COOL) requirements affecting meat imports. |

Sources: [www.wto.org/wto/dispute/bulletin.htm](http://www.wto.org/wto/dispute/bulletin.htm) and [www.nafta-sec-alena.org/english/index.htm](http://www.nafta-sec-alena.org/english/index.htm)

Similar to the experience with chapter 19, panels under chapter 18/20 have proven highly professional. Both governments have carefully chosen qualified, able, and experienced individuals to serve on panels and have provided them with sufficient resources to hire staff to support their efforts. The issues in most of the cases raised difficult points of law and policy and required a sophisticated understanding of both, as well as a capacity to develop reasoning that would ensure acceptance of the decisions rendered. The use of experienced former officials and law school professors has invested the process with a high degree of credibility. The decisions rendered, however, have not been without controversy. Canada was deeply disappointed in the lobster decision, for example, convinced that it had a good case. Similarly, US officials were confident that they would prevail in the dairy and poultry supply management case. In both instances, however, governments accepted the decision of the panel, clearly signaling their determination to live with the results of the process.

Despite the entry into force of the CUFTA in 1989, both Canada and the United States continued to exercise their GATT rights. Before the GATT was subsumed into the WTO in 1995, each had used the GATT complaints procedures three times following the CUFTA's entry into force. The CUFTA specified that for issues that are covered by both the CUFTA and the GATT, the complaining party has the option of choosing the forum in which it wants to pursue the issue. Once a forum has been chosen, however, the complaining party cannot change its mind and take the issue to the other forum.

With the entry into force of the WTO's binding dispute settlement provisions, both Canada and the United States have shown a marked preference for these procedures to settle general trade disputes between them, as well as with other parties. Similar to the CUFTA, NAFTA chapter 20 provides that the complaining party has the right to choose the forum for issues that are covered by both agreements. By the middle of 2009, Canada had formally invoked WTO procedures 15 times and the United States had used them five times to address bilateral issues. Again, some of the cases litigated proved difficult and controversial. Eight

reined in excesses in the increasingly protectionist US trade remedy system and helped to keep two highly politicized industries – pork and softwood lumber – in check. Two cases involving alcoholic beverages were part of a prolonged saga of ensuring compliance with trade agreement obligations by sub-federal authorities. To date, Canada has proved more willing or able to exercise its responsibility under the federal state clauses of the GATT/WTO and CUFTA/NAFTA, but each case has established important precedents for the principle that the rule of law in trade relations extends beyond national governments. The periodicals and supply management cases, arguably the most politically difficult trade cases faced by Canada in the 1990s, were each resolved as a result of panel determinations, one under NAFTA, the other under the WTO.

Like the CUFTA/NAFTA panels, GATT/WTO panels have proven highly competent and professional. While the Appellate Body has shown a penchant for amending panel determinations, it has done so on the basis of relatively esoteric points of law and treaty interpretation, often adding nuances aimed at strengthening the role of precedent and ensuring more uniform interpretations. The existence of a permanent body of officials with legal training to assist panels and the Appellate Body has added to the quality of panel decisions and made them increasingly judicial in tone.

The overall impression of this record of litigation between the two countries over the past two decades under both the CUFTA/NAFTA and the GATT/WTO is one of commitment to the rule of law. Both sides have used the procedures roughly equally. Both have succeeded and failed in pressing their complaints. Both have generally accepted the results of panel proceedings and implemented the required changes in law and policy, although not always with enthusiasm and grace. On occasion, some additional pressure is required to resolve the issues. On other occasions, the resolution of one dimension of an issue has led to a flare up of a related issue. In general, however, the two governments have been prepared to make full use of the system and to live by its results.

Chapter 11 of the NAFTA, which sets out the three countries' rights and obligations related to foreign direct investment, also includes an innovative set of provisions to address disputes between foreign investors and the host government. Unlike the state-to-state provisions of chapters 19 and 20, chapter 11 provides for mandatory arbitration between a complaining investor and the responding government. After a slow start, investors have begun



to make increasing use of these provisions, particularly to challenge regulatory policies that they believe were having discriminatory and negative impacts on investor interests. By the end of 1999, only one arbitral panel — between a US investor and Mexico — had concluded its work and made an award. Not surprisingly, the pace, costs, and uncertain outcome have disposed investors to begin to take a more cautious approach to chapter 11.

By the middle of 2009, 13 Canadian investors had filed cases against the United States, while 23 US investors had filed cases against Canada.(See Box 10) Of those filed against the United States, five have been dismissed as without merit, three softwood lumber cases have been consolidated into a single case that remains active, and five other complaints remain active. Of those filed against Canada, three have been withdrawn, five are inactive, four were successfully arbitrated (three in favour of the complainants and one in favour of the government of Canada), and 12 cases are active. Many of the latter have been filed relatively recently and are in the early stages. As with earlier cases, most are likely to become inactive or will be withdrawn. Some of the early cases involved the issue of “regulatory takings.” Complainants launched procedures when they believed government regulatory action had been tantamount to an expropriation or forced divestiture of their assets in that jurisdiction. Some of the US complaints against Canada have raised the issue of standing, given the lack of clear evidence of direct investment in Canada. A number of the Canadian complaints have revolved around court rulings rather than governmental measures. All the cases, therefore, raise complex issues regarding the intent of the governments in establishing the investor-state provisions which the arbitral panels needed to sort out.

**Box 10: Canada-United States Investment Arbitration Cases – 1989-2008**

**Cases filed against Canada by US investors**

- |      |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
|------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1996 | Ethyl Corporation complained regarding Canadian restrictions on imports of the gasoline additive MMT. The issue was settled on the basis of proceedings under the Canadian Internal Trade Agreement, without formal resort to arbitration under the NAFTA. The Canadian government amended the offending regulations and offered the corporation a financial settlement.                                                                                                                                                                                                                                                                                                                                                      |
| 1998 | S.D. Myers, a US company from Ohio, complained regarding a Canadian ban on the export of hazardous wastes. The ban was subsequently withdrawn, but arbitration procedures continued to settle the claim for damages. The tribunal released its award on liability on November 13, 2000, ruling that Canada’s actions had breached two of the four obligations under chapter 11 that were subject to the claim. Canada filed an application with the Federal Court of Canada seeking review of the tribunal's decision on the grounds that elements of the decision exceeded the tribunal's jurisdiction and were made in conflict with Canada's public policy. On January 13, 2004, the court dismissed Canada’s application. |

- Sun Belt Water Inc. (US — California) complained regarding the conduct of the government of British Columbia in a court case arising out of its withdrawal of permission to export bulk shipments of water. Its Vancouver joint venture partner, Snowcap Waters Ltd. of Vancouver, was compensated by the BC government; Sun Belt claims it was not. No formal claim was ever filed.
- Pope and Talbot (US — Washington) filed a claim against Canada for damages arising as a result of a bilateral softwood lumber agreement. The tribunal released its decision on May 31, 2002 which, overall, found that Canada had not violated the NAFTA in its implementation of the Softwood Lumber Agreement. The only violation arose from an administrative audit undertaken to verify Pope & Talbot's quota.
- 2000 United Parcel Services of America, Inc. ( UPS ) filed a claim against Canada alleging that Canada Post Corporation engaged in anti-competitive practices by providing its courier products with advantages that were not provided to UPS Canada and that the Canada Border Services Agency provided treatment less favourable to UPS Canada than to Canada Post's courier services. The arbitration tribunal released its decision to the Parties on June 11, 2007, rejecting the claims of UPS.
- Ketcham Investments, Inc. and Tysa Investments, Inc. filed a claim against Canada, but subsequently advised that they would not be pursuing it.
- 2001 Chemtura Corp., formerly Crompton Corporation, a United States company, served Canada with a Notice of Intent to Submit a Claim to Arbitration in November 2001. Chemtura filed its most recent Notice of Arbitration on Feb. 10, 2005.
- Trammel Crow, a US Corporation, filed a claim against Canada, but subsequently advised that it would not be pursuing its claim.
- 2004 Albert Connolly, a US citizen, served Canada with a Notice of Intent to Submit a Claim to Arbitration. No valid claim has been filed.
- Contractual Obligation Productions, a US company, and Charles Robert Underwood and Carl Paolino, US citizens, served Canada with a 'Notice of Intent to Submit a Claim to Arbitration. No valid claim has been filed.
- 2005 Peter Nikola Pesic, a US citizen, served Canada with a Notice of Intent to Submit a Claim to Arbitration but subsequently withdrew his notice.
- 2006 Merrill & Ring Forestry L.P. served Canada with a Notice of Intent.
- V.G. Gallo, a US investor, served Canada with a Notice of Arbitration on October 12, 2006. Subsequently, on March 30, 2007, Canada was served with a Notice of Arbitration.
- GL Farms LLC, a US company, and Carl Adams, served Canada with a Notice of Arbitration.
- 2007 The Gottlieb Investors Group, US investors, served Canada with a Notice of Intent.
- Mobil Investments Canada Inc. served Canada with a Notice of Intent on August 3, 2007.
- 2008 Melvin Howard, a US citizen, on behalf of Centurion Health Corporation, served Canada with a Notice of Intent alleging that a proposed project, the Regent Hills Health Care Centre, was treated in a manner that contravened Canada's NAFTA chapter 11 obligations..
- Members of the Clayton family and a corporation they control, Bilcon, served Canada with a Notice of Intent.
- David Bishop, a US citizen, served Canada with a Notice of Intent alleging that Destinations Saumon Gaspésie Inc. was treated in a manner that contravened Canada's NAFTA chapter 11 obligations.
- William Jay Greiner, a US citizen, and Malbaie River Outfitters Inc. served Canada with a Notice of Intent alleging that Malbaie River Outfitters Inc. was treated in a manner that contravened Canada's NAFTA chapter 11 obligations.
- Dow AgroSciences LLC, a US corporation, served a Notice of Intent to Submit a Claim to Arbitration for losses allegedly caused by a Quebec ban on the sale and certain uses of lawn pesticides containing the active ingredient 2,4-D.

----- Georgia Basin L.P., a limited partnership based in Washington State which owns timber lands in British Columbia, alleges that Canada's export controls on logs harvested from land in British Columbia under federal jurisdiction violate Canada's obligations under NAFTA chapter 11.

----- Janet Marie Broussard Shiell, William Shiell IV, and William Shiell V have served the Government of Canada with a "Notice of Intent" alleging that one of their companies, Brokerwood Products International (Canada), was treated in a manner that contravened Canada's NAFTA chapter 11 obligations.

#### **Cases filed against the United States by Canadian investors**

1998 The Loewen Group, Inc., a Canadian corporation, and Raymond L. Loewen, its chairman and CEO at the time of the events at issue, filed a claim alleging that the conduct of a civil case in Mississippi and the reduction of a bond required for leave to appeal breached US obligations under NAFTA chapter 11. On June 26, 2003, the Loewen Tribunal issued an award dismissing all claims against the United States.

1999 Methanex Corporation, a Canadian marketer and distributor of methanol, submitted a claim alleging that the US is in breach of its obligations under chapter 11 through California's enactment of a ban on the use or sale in California of the gasoline additive MTBE. On August 9, 2005, the Methanex Tribunal issued an award dismissing all claims against the United States.

----- Mondev International Ltd., a Canadian corporation, submitted a claim alleging that a decision by the Supreme Judicial Court of Massachusetts breached US obligations under NAFTA chapter 11. On October 11, 2002, the Mondev Tribunal issued an award dismissing all claims against the United States.

2000 ADF Group Inc., a Canadian corporation, filed a claim on its own behalf and on behalf of ADF International Inc., its Florida subsidiary, alleging that the federal *Surface Transportation Assistance Act* of 1982 and the Department of Transportation's implementing regulations, which require that federally-funded state highway projects use only domestically produced steel, breach US obligations under chapter 11. On January 9, 2003, the ADF Tribunal issued an award dismissing all claims against the United States.

2002 Kenex Ltd., a Canadian company, submitted a Notice of Arbitration alleging that the United States Drug Enforcement Agency and the Office of National Drug Control Policy implementation of a ban prohibiting the trade of industrial hemp products breached US obligations under chapter 11.

2002 Canfor Corporation, a Canadian company, filed a Notice of Arbitration alleging that certain antidumping, countervailing duty and material injury determinations the United States had levied on softwood lumber imports breached obligations under chapter 11 of the North American Free Trade Agreement. The matter was consolidated with Tembec and Terminal into a single case in 2005.

2003 Tembec Incorporated, a Canadian company, filed a Notice of Arbitration alleging that certain antidumping, countervailing duty and material injury determinations the United States had levied on softwood lumber imports breached obligations under NAFTA chapter 11. The matter was consolidated with Terminal and Canfor into a single case in 2005.

2003 Glamis Gold Ltd., a Canadian corporation, submitted a claim to arbitration on behalf of its enterprises Glamis Gold, Inc. and Glamis Imperial Corporation for alleged injuries relating to a proposed gold mine in Imperial County, California.

2004 Terminal Forest Products Ltd., a Canadian company, filed a Notice of Arbitration alleging that certain antidumping, countervailing duty and material injury determinations the United States had levied on softwood lumber imports breached their obligations under chapter 11. This matter was consolidated with Tembec and Canfor into a single case in 2005.

2004 Grand River Enterprises Six Nations, Ltd., a Canadian corporation, along with Jerry Montour, Kenneth Hill and Arthur Montour, filed a Notice of Arbitration alleging that a 1998 settlement agreement between various US state attorneys general and the major tobacco companies, as well as certain state legislation that partially implemented the settlement, breached US obligations under chapter 11.

2005 Members of the Canadian Cattlemen for Fair Trade filed numerous Notices of Arbitration alleging that the United States had violated its NAFTA chapter 11 obligations by closing the border to the

importation of Canadian cattle after the discovery in 2003 of a case of bovine spongiform encephalopathy (BSE or mad cow disease) in a cow in Alberta.

- 2007 Domtar Inc., a Canadian corporation, filed a Notice of Arbitration against the United States under the UNCITRAL Arbitration Rules, on behalf of itself and its subsidiaries, Domtar Enterprises Inc. and Domtar Industries Inc., for losses allegedly suffered as a result of (i) certain US antidumping, countervailing duty and material injury determinations on Canadian softwood lumber; (ii) the Continued Dumping and Subsidy Offset Act of 2000; and (iii) the 2006 Softwood Lumber Agreement between the United States and Canada.
- 2008 Apotex Inc., a Canadian corporation, alleged that US courts had committed errors in interpreting federal law, and that such errors are in violation of NAFTA article 1102 (national treatment) and article 1105 (minimum standard of treatment under international law). Apotex also alleges that the challenged US court decisions expropriated Apotex's investments under NAFTA Article 1110.

Source: <http://www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/usa.aspx?lang=en>.

To the extent that governments have used available rules and procedures, it is clear that the new, more binding procedures – whether to appeal trade remedy decisions, treaty interpretation, or investor-state disputes – have helped the management of Canada-US relations. The existence of international agreements does not mean the end of conflicts, only that there is a better basis for resolving them. They make it possible to bring conflicts to a mutually acceptable conclusion and to resolve contentious issues.

A profound misreading of the CUFTA and the NAFTA led to complaints among the Canadian general public about the rash of Canada-US trade disputes in the late 1980s and early 1990s. The existence of rules and procedures does not end disputes and, in fact, may increase the number of issues that need to be resolved. Canadians have benefited from this process, as the rules have become clearer, trade and investment conditions have become more stable and predictable, and the capacity of governments to favour local producers has become more constrained.

## **Economic Impacts**

In the year 2000, after almost a dozen years of free trade with the United States, the value of Canada's annual two-way trade with the United States surpassed C\$700 billion.<sup>1iii</sup> Since 1985, the value of trade and foreign direct investment in both the Canadian and US economies had grown rapidly, from some 50 percent of GDP to nearly 90 percent in the case of Canada, and from less than 20 percent to over 30 percent for the United States. The leading sectors of both economies were now those most engaged in international exchange, and in both countries, the basis of prosperity was more and more knowledge-based production. The response of the two economies to the challenges posed by freer bilateral trade and investment

had been both remarkable and positive. Trade growth slowed or even stagnated after 2000 for reasons that are largely unrelated to free trade, including the impact of tighter security measures at the border after September 11, 2001 and of macro-economic developments. The discussion below, therefore, analyzes the period up to 2000 only.

Over time, the impact of a single policy change is difficult to disentangle from other influences on the economy. Nevertheless, studies by various economists suggest that the CUFTA and the NAFTA had exactly the kind of impact originally sought: a more secure and more open border encouraging more rational investment decisions, leading to both more cross-border trade and investment and to a more efficient allocation of resources. A study prepared by the Royal Bank of Canada, which examined the first decade of bilateral free trade, concluded that implementation of the CUFTA had resulted in:

- a substantial increase in bilateral trade and a boost in the productivity performance of the Canadian manufacturing sector;
- a substantial increase in two-way foreign direct investment flows;
- a combination of both transitional job losses and export-based job creation; and
- improvement in settling trade disputes. (Royal Bank 1999)

The numbers on which these rather cautious conclusions are based are impressive. As indicated in table 1, the value of two-way trade between Canada and the United States, which had stagnated during the decade ending in 1989, exploded over the course of the next decade. Merchandise exports to the United States almost doubled as a share of Canadian GDP (from 15 to 28.4 percent or from \$101.6 in 1989 to \$271.5 billion in 1998), led by the manufacturing sector. Import growth was equally impressive, increasing from \$88.1 to \$203.3 billion. Two-way trade in services grew at a similar prodigious rate, almost doubling over the course of the decade, from \$30.4 to \$58.9 billion. That pace was maintained over the course of the next two years as two-way trade in goods and services reached \$703 billion in 2000, with total exports to the United States representing nearly 40 percent of total Canadian production.

<b>Table 1: Two-way Trade, Canada and the United States, 1990-2008</b>						
Goods	Value (millions of current dollars)			Annual growth (%)		
	Services	G & S	Goods	Services	G & S	G & S
1990-1999 (avg)	356,181	48,703	404,895	10.5	8.5	10.4
1997	454,140	57,923	512,063	12.8	8.0	12.3
1998	503,293	63,248	566,541	10.8	9.2	10.6
1999	558,722	67,982	626,704	11.0	7.5	10.6
2000	627,426	75,424	702,849	12.3	10.9	12.1
2001	605,936	73,644	679,580	- 3.5	- 2.4	- 3.4
2002	602,715	74,953	677,670	- .5	1.8	- .3
2003	569,340	79,174	648,514	- 5.9	5.6	- 4.3
2004	600,615	82,213	682,828	5.5	3.8	5.3
2005	627,612	84,652	712,264	4.5	3.0	4.3
2006	626,462	83,211	709,673	- .2	- 1.7	- .4
2007	625,572	--	--	- .2	--	--
2008	650,664	--	--	4.0	--	--

Source: Statistics Canada, CANSIM, Matrix no. 2361: Canadian Balance of International Payments — United States; author's calculations.

An econometric analysis of the data by Shenje Chen and Prakash Sharma of the Trade and Economic Analysis Division of Canada's Department of Foreign Affairs and International Trade (Chen and Sharma 1997) concluded that two fundamental factors were responsible for the extraordinary performance of Canadian exports: first, economic growth in Canada's major trading partner, the United States; and second, trade liberalization of goods and services under the CUFTA, NAFTA, and WTO. Chen and Sharma also point to the fact that trade grew in both directions, suggesting that monetary policy and currency fluctuations played only a minor part in the story and that trade liberalization – bilateral, trilateral, and multilateral – played a major part in the growth of trade and investment in the Canadian economy in the 1990s. This conclusion is strongly supported by the work of Daniel Schwanen who, in a series of three studies of the CUFTA/NAFTA impact, demonstrated that the strongest growth was recorded in sectors liberalized by the agreement. (Schwanen 1992, 1993 & 1997) He concluded that "the pattern of trade between the two countries has shifted roughly in the direction of pre-CUFTA expectations, and the competitive position of Canadian and US producers in each other's markets has improved relative to those in third countries in many sectors that were liberalized under free trade." (Schwanen 1997)

On a global basis as well, growth has been most impressive and enduring in sectors liberalized by recent trade negotiations. There was a further shift in the value-added composition of Canadian trade, as Canada became less reliant on exports of raw materials at relatively low stages of processing. Finally, the growth in trade was shared widely across the country as each province and territory experienced substantial growth and as the US share of that trade grew more rapidly than trade with the rest of the world.

Policy matters, as does corporate strategy. Much of the growth in trade was concentrated in intra-industry and intra-corporate transactions, as the manufacturing sector rationalized production in the face of declining barriers and enhanced opportunities. This led to higher productivity in sectors benefiting from increasing competition and opportunity, despite pressures in the opposite direction from non-trade-related factors. (Trefler and Sawchuk 2002) Investment data also suggests deepening integration of the two economies (see table 2) over the course of the 1990s, as both Canadian and US firms participated in cross-border positioning through mergers and acquisitions to strengthen their competitive positions in a more integrated North America and globalizing world economy. Additionally, Canadian firms became more active players in the global economy through foreign direct investment. In 1996 Canada for the first time became a net exporter of capital. Interestingly, Canadian investment in the rest of the world grew even more rapidly than Canadian investment in the United States, despite the relatively low value of the Canadian dollar.

Year	Outward Canadian FDI (FDI Stocks, millions of \$ Cdn)		Inward Canadian FDI	
	USA	World	USA	World
1990	60,049	98,402	84,089	130,932
1992	64,502	111,691	88,161	139,918
1994	77,987	146,315	102,629	154,594
1996	93,939	181,238	121,943	182,126
1998	133,267	262,909	146,893	219,389
2000	193,651	356,506	177,900	319,116
2002	199,092	435,494	231,566	356,819
2004	198,460	448,546	243,328	379,450
2006	229,737	524,749	271,125	438,648
2008	310,708	637,281	293,608	504,864

Source: Statistics Canada Catalogue 67-202 XBP (September 2009)

Economic analysis confirms what most economists and other analysts of trade and economic policy have long known: freer trade is a necessary but not a sufficient condition for sustained economic growth for smaller, trade-dependent economies. The CUFTA, and the complementary impact of the NAFTA and WTO, provided a much improved trade policy environment for investors in Canadian-based production, which is evident in its impact and results.

While the focus of most analyses of the CUFTA has been its impact on trade and investment, a further important dimension has been its impact on the movement of people. Easing restrictions on temporary business travel was not on the original 1985 negotiating agenda of either Canada or the US. It was added at the behest of Canadian business advisors, particularly in the financial services sector, who pointed out that the full benefits of reducing trade and investment barriers would not be realized without addressing the excessive regulatory structure that hampered business travel between the two countries. Chapter 16 of the CUFTA (17 in the NAFTA) turned out to be a very pleasant surprise, borne out by the growth in Canadian business travelers to the United States.

Border crossings over the first decade of bilateral free trade peaked in 1991, at the height of the cross-border shopping phenomenon stimulated by the high value of the Canadian



dollar. This traffic steadily declined for the rest of the decade, in step with the declining value of the Canadian dollar. More detailed analysis reveals some interesting trends. Truck traffic increased from an average of 20,000 vehicles per day in the period 1986 to 1991, to an average of 30,000 vehicles by 1996. In response, governments moved to increase border infrastructure. The tonnage of goods moved by rail increased by similar magnitudes, again concentrated in the period since 1990. Air traffic increased even more dramatically, carrying both passengers and goods, particularly after the entry into force of the Open Skies agreement and the development of cross-border commercial alliances between Canadian and American carriers. Business travel, which takes place largely by air, increased steadily. Finally, the number of Canadians and Americans taking advantage of the ability to reside temporarily in the other country to pursue trade and investment opportunities rose steadily. Until 1989, the number of Canadians residing temporarily in the United States as students or workers held steady at about 17,000 per year. By 1998, that number had risen to 98,000, of which more than 75,000 were taking advantage of the TN visa program, which allows Canadian professionals to work temporarily in the United States. (Iqbal, 1999)

Much of the combined impact of the massive increases in this movement of people, goods, and services took place at a few popular border crossings – the top ten border crossing points are responsible for more than 80 percent of surface traffic and the top five Canadian airports carry the preponderance of cross-border air traffic. This concentration placed increasing strains on customs and immigration facilities and procedures. Infrastructure improvements to address the growing volumes of traffic helped. More fundamentally, however, the success of the CUFTA pointed to the need to tackle the broader issue of the extent to which border restrictions and procedures themselves can be eased and even eliminated. (Hart and Dymond 2007)

Finally, any assessment of the impact of freer cross-border trade would be incomplete without a nod toward the pleasant surprises provided by NAFTA's two side agreements covering labour and environmental issues. Sometimes policy initiatives have unintended consequences. The reason for the side agreements was to neutralize the impact of US environmental and labour critics of Mexican policies. This they succeeded in doing. Canada agreed, but worked hard to ensure that neither agreement could be used by US interests to sideswipe Canada. This was also achieved. Additionally, however, the two agreements have

demonstrated the benefits of strengthening the institutional basis for intergovernmental cooperation and of transparency. The secretariats established to administer the two agreements have worked hard to make the transparency and consultation provisions of the two agreements work, to the benefit of all three countries. While environmental and labour critics of trade liberalization are unlikely to cheer these results, they demonstrate to more impartial observers that attaching labour and environmental provisions to trade agreements has merit.

## **Conclusions**

Canadian officials may not initially have considered a free-trade agreement with the United States as central to Canada's economic future. But it soon became symbolic for a whole series of reforms. Implementing Canada's commitment to freer trade led to wholesale changes in domestic law and released the economic forces needed to place Canada's further economic development on a more sustainable footing. Complementary steps in the late 1980s and into the 1990s to curb spending, reduce regulatory burdens, privatize crown corporations, reform the tax regime, reduce business subsidies, eliminate the National Energy Program, and refocus the Foreign Investment Review Agency, ensured that Canada would enter the 21<sup>st</sup> century in better shape than many other industrialized countries. Implementing free trade, while not a sufficient condition, had certainly proven to be a necessary condition to strengthening Canada's economic performance.

For many developing countries, facing for the first time the onerous task of implementing trade obligations into domestic law and practice, Canada offers an attractive example of what can be accomplished. While the task of implementing free trade entailed many difficult political decisions and required a serious commitment of resources, time has demonstrated that these resources were well spent.

A bilateral free trade agreement with a major economy can prove a critically important vehicle for overcoming the blind alley represented by the perverse doctrine of special and differential treatment for developing countries embedded in the multilateral trade regime. Special and differential status has succeeded in permeating the GATT/WTO. Lax enforcement, pro forma consultations, and indifferent notification, coupled with the ease with which industrialized countries are able to practice reverse discrimination, have further conditioned developing countries to consider their obligations to be unrelated to domestic policy formulation and implementation. In effect, there are few obligations that bite and, therefore,

little tradition in developing countries of domestic economic law and practice shaped by external obligations.

The globalization of production and markets has fundamentally changed how developing countries must produce and market their goods and services as well as the parameters within which governments act to influence domestic and international patterns of production and distribution. By the 1990s, developing countries were accepting that they had to adjust to the demands and realities of a rapidly globalizing economy if they were to maintain, let alone increase, their standard of living. While many recognized that these changes might threaten the socio-political foundations of their societies, they also accepted that these changes promised unprecedented opportunities to resolve their long-standing socio-economic problems.

Free trade agreements provide an opportunity to consolidate these advances in mutually reinforcing international and domestic law. They offer a politically attractive vehicle for confronting powerful domestic interests that have benefited from earlier regimes but that now stand in the way of much-needed reform. Gaining the full benefits of free trade requires a willingness to confront these interests not only during the negotiation of free trade, but even more importantly, during its implementation. It is a lesson that Canada learned over the decade 1986-95 and one which many developing countries need to learn now. Failure to learn this lesson will erode the benefits of free trade and doom much-needed domestic reform efforts.

## Endnotes

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- i Professor and Simon Reisman Chair in Trade Policy in the Norman Paterson School of International Affairs at Carleton University in Ottawa, Canada, and a distinguished fellow of its Centre for Trade Policy and Law. Hart is a former official in the government of Canada and participated in negotiating and implementing the three agreements discussed in this paper. Much of the analysis in this paper is based on that experience.
- ii For a more detailed discussion of SDT and its perverse impact on economic development, see Hart and Dymond (2003), Michalopoulos (2002), and Keck and Low (2005).
- iii To be sure, efforts have been made to develop such underpinnings, only to be found wanting by more thorough economic analysis. Irwin (1996 and 2002) provides the most up-to-date, thorough, and elegant analysis of the many unsuccessful efforts over the years to dispute the theories underpinning the impact of free trade and open economies on economic development and poverty alleviation.
- iv For a more complete discussion of mercantilist bargaining and the theory underpinning the trade negotiations that led to the GATT, see Hart and Dymond (2008), pp. 4-7.
- v Even more perversely, special and differential treatment contributed to corruption. Many developing countries traditionally relied on the provisions in GATT Article XVIII permitting protection to safeguard the balance of payments for development purposes. Most developing countries maintain non-convertible currencies with exchange rates fixed at inappropriate levels, leading to chronic balance-of-payments problems. The instrument of choice often used to conserve scarce foreign exchange is licensing of both exports and imports, much of it applied on a discretionary basis. Nothing corrupts more quickly and thoroughly than a discretionary licensing scheme administered by underpaid officials. Thus, in many developing countries, reliance on GATT Article XVIII to shelter domestic economic actors from international competition has not only had the expected negative effects of closed economies, but has also had the even more depressing corollary effect of fostering thoroughly corrupt and corrupting trade regimes.
- vi The US position, of course, reflects the arrogance of power. The idea that the United States may not have fully implemented its own obligations is not one that US officials find easy to entertain, e.g., its long-standing failure to implement the trucking obligations set out in the NAFTA.
- vii In Canadian legislative practice, statutes provide the government with broad authority to carry out Parliament's will, including implementing trade agreements. Such statutes often provide the government with sufficient authority to make regulations to apply the laws in an efficient and effective manner, including the authority to fine tune regulations and allocate resources as circumstances warrant without the need to go back to the legislature.
- viii International labour negotiations offer a case in point. Canada has participated in negotiating many of the international labour conventions at the International Labour Organization, but has ratified few of them due to the difficulty of gaining the approval of all ten provinces. The NAFTA labour side agreement, on the other hand, was incidental to the agreement as a whole and thus did not require formal approval of all ten provinces to bring it into force. Some of the provinces, however, did implement its provisions into provincial law.
- ix For example, in the extension of the Reciprocal Trade Agreements Act in 1951, Congress declared that "The enactment of sections 1352 (a), (c), 1354, and 1360 to 1367 of this title, and section 624 (f) of title 7, shall not be construed to determine or indicate the approval or disapproval of the Congress of the Executive Agreement known as the General Agreement on Tariffs and Trade." Tariff Act of 1930 (19 USC §§1303-1677h), §1366, enacted June 16, 1951.
- x The 1934 *Reciprocal Trade Agreements Act* first established the basis for modern, delegated trade negotiating authority. It was periodically extended and provided the basis for the bilateral negotiations of the 1930s and the multilateral negotiations from 1947-61. New authorities were set out in the 1962 *Trade Expansion Act*, the 1974 *Trade Act* (which included the first full iteration of the "fast-track" procedures specifically designed for the Tokyo Round negotiations), the 1979 *Trade Agreements Act*, the 1984 *Trade and Tariff Act* (which extended the fast-track authority to bilateral negotiations), the 1988 *Omnibus Trade Act*, and the 2002 *Trade Promotion Authority Act*. After the conclusion of the Uruguay Round, President Clinton did not succeed in gaining new negotiating authority. Trade promotion authority lapsed in 2007, and President Obama has yet to indicate what kind of authority he will seek.

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- x<sup>i</sup> For a detailed discussion of the role of trade and trade agreements in Canada's economic and political development, see Hart (2002).
- x<sup>ii</sup> The National Policy brought together three policy streams: an import substitution industrialization strategy based on high tariffs on manufactures in order to nurture a larger domestic economy; open immigration policies in order to increase the population and grow the economy; and an east-west trans-continental railroad to knit together the far-flung parts of the country more closely.
- x<sup>iii</sup> Trade Agreement Between Canada and the United States of America, Canada Treaty Series, 1936, No. 9, in force May 14, 1936 and Trade Agreement Between Canada and the United States of America, Canada Treaty Series, 1939, No. 8, in force June 19, 1939.
- x<sup>iv</sup> In Canadian parliamentary practice, a ways and means motion can be used to make changes in rates of taxation or the manner in which taxes are collected or administered. Since the tariff is a tax, ways and means motions are traditionally the way by which Canadian governments effect changes in tariff rates, whether in order to implement a trade agreement or for any other purpose.
- x<sup>v</sup> While the government was not required to seek parliamentary approval of the agreement, it did schedule a debate in the House of Commons at the conclusion of the negotiations in October, 1947 and indicated its intent to bring the agreement into force on January 1, 1948. Interestingly, there is no record of a parliamentary debate on the subsequent Havana Charter for an International Trade Organization, successfully concluded in March 1948, but never brought into force.
- x<sup>vi</sup> The US delegation suggested the PPA as a way of addressing the problem created by its limited negotiating authority. Congress had authorized the president to negotiate reciprocal tariff reductions in the 1934 Reciprocal Trade Agreements Act and its periodic extensions; it had not authorized negotiation of changes in domestic legislation. By dividing the GATT into three parts, two of which fell fully within the president's authority, it was possible to ratify the agreement as an executive agreement on the basis of the PPA. Other delegations, saddled with their own political problems, found this proposal attractive. The US delegation indicated to other delegations that it would work with Congress to ensure that future legislation would conform to GATT's requirements, a commitment that proved easier to make than to carry out. The fact that the GATT was perceived as an interim agreement made this sleight-of-hand credible; its temporary nature, however, stretched on for 46 years, requiring some institutional adjustments to make up for GATT's constitutional defects.
- x<sup>vii</sup> The *Antidumping Act* of 1968, which replaced previous provisions in the *Customs Act*, was introduced to bring Canadian practice into line with the Kennedy Round Code on Antidumping Practices.
- x<sup>viii</sup> The 1984 *Special Import Measures Act* (SIMA) followed four years of consultation and discussion and allowed Canada to fully implement both its rights and its obligations governing subsidies and countervailing and antidumping duties consequent to the conclusion of the Tokyo Round Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the GATT (Subsidies and Countervailing Measures Agreement) and the Agreement on Implementation of Article VI of the GATT (Antidumping Agreement).
- x<sup>ix</sup> Amendments to the *Customs Act* brought into force together with the SIMA, consequent to the conclusion of the Tokyo Round Agreement on Implementation of Article VII of the GATT.
- x<sup>x</sup> By means of the *Trade Agreements Act* of 1979 implementing the results of the Tokyo Round of GATT Negotiations.
- x<sup>xi</sup> Many of these clever programs had been introduced in the 1920s and 1930s to increase the protective effect of the tariff. Valuation uplifts, for example, provided the minister with the authority to "advance" value for duty purposes if the declared value was considered too low and did not reflect domestic values. The made/not-made provision applied the tariff only to goods that could be demonstrated to compete with Canadian-made goods, allowing the government to claim that the average tariff on machinery was considerably lower than the effective rate of protection. Similarly, the machinery program allowed manufacturers to avoid the tariff on machinery if they could demonstrate that no reasonable alternative was available from Canadian sources.
- x<sup>xii</sup> In negotiating more complex trade agreements, governments also learned to anticipate potential political problems by including exceptions to the general provisions of the agreement. Canadian political sensitivities in the agricultural and cultural sectors, for example, were often addressed by negotiating necessary exceptions to rules of general application. Similarly, trade agreement provisions dealing with public

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- procurement practices are often finely calibrated to allow governments to continue to discriminate in ways that are considered politically important enough to offset the economic advantages of adhering to the general rules of non-discrimination. Such exceptions are important to the political management of trade negotiations and facilitate the implementation of trade agreement obligations more generally.
- xxiii Agreement Concerning Automotive Products Between the Government of Canada and the Government of the United States of America, Canada Treaty Series 1966, No. 14, entered into force definitively September 16, 1966.
- xxiv In addition to the transparency requirements laid out in Article X and the consultation provisions of Article XXII – both aimed more at dispute avoidance than dispute settlement – Article XXIII sets out procedures giving parties the right to complain and seek redress when others fail to live up to their obligations. Over the years, GATT members had experimented with varying techniques to make these provisions operative and by the 1970s these had settled into an accepted pattern of customary practice. These procedures worked reasonably well except that they were based more on convention than on agreed obligations and required consensus at every decision point. See Hudec (1979 & 1990).
- xxv In 1962, the United States successfully complained of a questionable extra duty Canada had imposed on potatoes imported from the United States and in 1976, a working party looked into the Canadian resort to article XI quotas on eggs and recommended that Canada make some adjustments. The most prominent complaint to which Canada was a party was the 1976 tax practices case involving the United States Domestic International Sales Corporation (DISC) program and Belgian, Dutch, and French border tax adjustment practices.
- xxvi For a more detailed treatment of the considerations that led to the negotiation of the CUFTA, as well as of the negotiations and their results, see Hart, Dymond and Robertson (1994).
- xxvii (Canada 1985). The commission report totalled 1,767 pages in three volumes. Its supporting research was published in seventy-one volumes, of which at least a dozen volumes were devoted to various aspects of bilateral free trade. In the interest of full disclosure, the author was part of the staff of the Commission and contributed to its research and discussion and to the writing of its *Final Report*.
- xxviii See Canada (1983a & b). Again, in the interest of full disclosure, the author was one of the principals involved in this project.
- xxix See Hart, Dymond and Robertson 1994). Other accounts include Doern and Tomlin 1991 and Ritchie 1997.
- xxx At the beginning of the negotiations, Canada was prepared to put all federal procurement on the table and to work with the provinces in an effort to extend the agreement to most provincial procurement. US reluctance to contemplate a large agreement, however, soured the provinces on the benefits of participating and led to a small procurement agreement. Since that time, US officials have intimated that lack of provincial coverage is the basis of their own reluctance to extend the agreement further. As discussions in 2009 have made clear, an open US federal procurement market will prove sufficient to bring the provinces on board, even in the absence of full state participation.
- xxxi For a discussion of some of the remaining challenges, see Hart (2007) and Hart and Dymond (2008).
- xxxii Expressions of these objectives can be found in various contemporary documents, a number of which the government collected and published in Canada (1986). They also reflect the recommendations of the 1985 Macdonald Commission (Canada 1985).
- xxxiii The best and most detailed analysis of the agreement and its antecedents can be found in Johnson and Schachter (1988). See also its sequel, Johnson (1994).
- xxxiv More detail on the negotiations and their implementation can be found in: Doern and Tomlin (1991); Hart, Dymond, and Robertson (1994); Cameron and Tomlin (2000); Mayer (1998); and Hart (2002).
- xxxv Article X on the publication and administration of trade regulations is an exception to this paradigm of negative prescription. It should be added, however, that the existence of a body of norms (rather than requirements), did lead to a gradual convergence in the trade policies of the core GATT members, the industrialized countries clustered around the North Atlantic.
- xxxvi While the emphasis here is on legislative changes, it is important to keep in mind that legislative changes often extend to rule-making authority. In Canada, most statutes include provisions allowing the responsible minister(s) to translate the broad intent of Parliament as expressed in the statute into much more detailed

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regulations and policies. The statutory amendments that flowed from the CUFTA, NAFTA, and WTO establishing positive norms thus also opened the way to extensive changes in regulations and policies. See Doern and Johnson (2006).

xxxvii The GATT Secretariat had long maintained a position of “legal advisor,” a position occupied, for example, by Jean Rey and Åke Linden in the 1960s and 1970s. But Hans-Ulrich Petersmann was the first official hired to perform this function who had benefited from formal training in international law.

xxxviii In the interest of full disclosure, the author served as the principal Canadian draftsman of the CUFTA text, working closely with the legal team, but without benefit of formal legal training.

xxxix In Canada, senators are appointed by the prime minister and now serve until they reach age 75. Due to the longevity of previous Liberal governments, the upper chamber was still dominated by Liberal appointees in 1988. The leader of the opposition, unable to defeat the government in the House of Commons, prevailed upon his Liberal colleagues in the Senate to uphold the legislation. Liberal senators still enjoyed a majority in December following the election, but accepted that the will of the newly elected House could not be thwarted by an unelected group of senators.

xi *Canada-United States Free Trade Agreement Implementation Act*, 1988, c. 65, C-10.6 [Assented to December 30th, 1988].

xii See, for example, *International Trade and Investment Agreements Implementation Act*, R.S.A. 2000 in Alberta, and *An Act respecting the implementation of international trade agreements*, R.S.Q. c. M-35.2, for Quebec. In the 1920s, the federal government had, in response to the temperance movement, delegated responsibility for regulating the importation of wine and spirits to the provinces. The provinces, in turn, had used this delegated authority to establish provincial monopolies on the importation and distribution of wine and spirits. Some of these monopolies had developed a number of discriminatory practices that the federal government had agreed would be phased out as part of the CUFTA (chapter 8). To implement this commitment, the provinces were required to change their practices. The Free Trade Agreement Act provided the federal government with the authority to regulate provincial practices to the extent that the provinces failed to implement the obligations in chapter 8 with their own legislation. In addition, the CUFTA required amendments to the *Importation of Intoxicating Liquors Act* in order to give Canadian distillers the ability to import distilled spirits in bulk from the United States for purposes other than blending or flavoring, i.e., for bottling and sale in Canada under their own labels.

xlii GATT Article III:8(a) states: “The provisions of this Article shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale.”

xliii \$1,029,562 in 1989, \$1,101,534 in 1990, \$1,067,306 in 1991, \$1,563,896 in 1992, and \$1,673,646 in 1993.

xliv The prime minister’s willingness to be convinced was related to the attitude of organized labour. From the beginning of the CUFTA negotiations and through the NAFTA and WTO negotiations, organized labour and its political allies maintained that the Canadian economy was already too open and would only prosper with heavy doses of industrial policy and other *dirigiste* nostrums. In these circumstances, it became clear that adjustment programs alone would not be sufficient to gain their support.

xlvi The panel, chaired by former CEO of Bell Canada Enterprises, Jean de Grandpré, produced the report *Adjusting to Win* in March 1989. Its signature recommendation was that the government in its labour market policies should focus less on “safety net” programs and more on “trampoline” programs, i.e., programs that would not only catch people hurt by changing labour-market conditions, but also prepare them for rapid re-entry with renewed or increased skills.

xlvii Canada convinced the United States and Mexico that more generic language and an accession clause would make it easier to deal with future expressions of interest by other countries for bilateral free-trade agreements, particularly in the Americas. In the event, however, the United States and Mexico preferred to strike bilateral arrangements, an approach that Canada also followed in subsequent years. The NAFTA has thus served as a model for other agreements struck by all three countries, and the accession clause has remained as little more than a curiosity.

xlviii *North American Free Trade Agreement Implementation Act 1993*, c. 44 N-23.8 [Assented to June 23rd, 1993].

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- xlviii In the interest of full disclosure, the author was the principal compiler and editor of both the NAFTA and WTO Statements on Implementation.
- xliv *World Trade Organization Agreement Implementation Act 1994*, c. 47, W-11.8 [Assented to December 15th, 1994].
- i Given the number of such programs and the nature of politics, these programs have evolved since then. For the purpose of this discussion, the programs in place in 1989 are the ones that are pertinent to understanding what was involved in implementing the CUFTA.
- ii This inventory is limited to cases that reached the stage of panel proceedings. Consultations pursuant to these provisions, but which did not lead to panel proceedings, are not included. The availability of panel proceedings often has a salutary effect on such consultations, helping them to come to mutually satisfactory conclusions.
- iii The complete record of Canada-US dispute settlement under the CUFTA was examined by Davey (1996). He concludes that “the dispute settlement mechanisms of the [CUFTA] have worked reasonably well, particularly the binational panel review process. The basic goal of trade dispute settlement ... is to enforce the agreed-upon rules. By and large, these dispute settlement mechanisms have done that.” (288-9)
- iiii Disentangling the influence of one economic factor from all the others can be a mug’s game, particularly with the passage of time. The assessment in this paper is limited to the first decade and relies on a few of the studies done in the late 1990s. This section, as well as the section that follows on dispute settlement, is largely focused on Canada-US cross-border trade. The addition of Mexico, while a major achievement, was largely a matter for that country and the United States. To be frank, the NAFTA governs two critical trade and investment relationships: between Canada and the United States and between Mexico and the United States. Despite high expectations, a Canada-Mexico trade and investment relationship largely remains an aspiration.



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