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## A Proposed Legal Framework for a Comprehensive Free Trade and Investment Agreement Between Canada and the United States

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# A Proposed Legal Framework for a Comprehensive Free Trade and Investment Agreement Between Canada and the United States

Saul Aronson

## **Abstract**

This Article examines some of the more recent problems involving Canadian-United States trade, and proposes a legal framework within which to formulate a comprehensive trade and investment agreement.

# A PROPOSED LEGAL FRAMEWORK FOR A COMPREHENSIVE FREE TRADE AND INVESTMENT AGREEMENT BETWEEN CANADA AND THE UNITED STATES

*Saul Aronson\**

## INTRODUCTION

Canada and the United States are each other's largest commercial partners. Bilateral trade between the two countries, which amounted to well over 110 billion dollars worth of goods and services in 1984, is greater than the United States' combined bilateral trade with both Japan and the European Community.<sup>1</sup> Furthermore, they are each other's greatest source of foreign investment. The United States has over 52 billion dollars invested in Canada,<sup>2</sup> while Canada has approximately 9 billion dollars in direct and portfolio investment in the United States.<sup>3</sup>

As a result of these trade and investment activities, the economic and fiscal policies of each country have a strong effect in the other.<sup>4</sup> Despite this, Canada and the United States have not entered into a legally enforceable, comprehensive, investment or trade agreement. This has left both sides virtually powerless to take remedial action in the face of growing trade and investment disputes. This Article examines some of the more recent problems involving Canadian-United States trade, and proposes a legal framework within which to formulate a comprehensive trade and investment agreement.

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1. Address by Thomas d'Aquino, President of the Business Council on National Issues, International Business Council MidAmerica (Feb. 8, 1984).

2. Boyd, *Canada-United States Transnational Business Activities: Current Tax and Other Developments - Introductory Remarks*, 4 CAN.-U.S. L.J. 90, 90 (1981).

3. *Id.*

4. *Id.*

I. *EXISTING BARRIERS TO THE FLOW OF TRADE AND  
INVESTMENT BETWEEN CANADA AND THE  
UNITED STATES*

Both Canada and the United States have expressed serious concern over each others' growing protectionist actions regarding trade and investment. Recently, disputes have arisen over such areas as nontariff trade barriers and restrictive investment practices. The following is a survey of current trade and investment problems.

A. *United States Concerns*

1. Investment Barriers

The United States is particularly concerned about Canada's efforts to gain greater Canadian equity ownership and to ensure that significant manufacturing operations take place in Canada.<sup>5</sup> Two areas which have been a particular source of irritation to the United States are the Foreign Investment Review Agency<sup>6</sup> (FIRA) and the National Energy Plan<sup>7</sup> (NEP).<sup>8</sup>

Under the Foreign Investment Review Act<sup>9</sup> (Act), those

5. King, *The Changing Context for the Foreign Investor in Canada: Introductory Remarks*, in SYMPOSIUM: PRIVATE INVESTORS ABROAD—PROBLEMS AND SOLUTIONS 235, 238 (1982).

6. The Foreign Investment Review Agency was established by the Foreign Investment Review Act, ch. 46, § 7, 1973-1974 Can. Stat. 619. It became effective in 1974 with respect to acquisition of Canadian companies, and in 1975 with respect to new investments. Macdonald, *Canadian Industrial Policy Objectives and Article III of GATT: National Ambitions and International Obligations*, 6 CAN. BUS. L.J. 385, 393-94 (1982).

7. CAN. DEP'T OF ENERGY, MINES AND RESOURCES, *THE NATIONAL ENERGY PROGRAM 1980* (Report No. EP80/4E) (1981). The National Energy Program is an energy package that includes pricing regimes, fiscal measures, expenditure programs, and direct federal action to achieve the goals of energy security, opportunity and fairness. The specific elements of the National Energy Program . . . will re-structure Canada's energy system to balance domestic oil supplies with domestic demand by 1990, achieve an equitable sharing of energy benefits and burdens among Canadians, lead to a high level of Canadian ownership and control of the energy sector, expand the role of the public sector in oil and gas, and ensure greater industrial benefits from energy development.

*Id.*

8. King, *supra* note 5, at 239.

9. Foreign Investment Review Act, ch. 46, 1973-1974 Can. Stat. 619. The Act provides for the "review and assessment of acquisitions of control of Canadian business enterprises by certain persons and of the establishment of new businesses in Canada by certain persons." *Id.* preamble.

who are not citizens or permanent residents of Canada, and corporations controlled directly or indirectly by such persons,<sup>10</sup> must apply to FIRA for permission to acquire control over a Canadian enterprise, or to make a new investment in Canada in an area where such investment is unrelated to that previously carried out by such person in Canada.<sup>11</sup> The general criterion for allowing a takeover or investment is that it be of significant benefit to Canada.<sup>12</sup> FIRA's decisions also consider these specific criteria: 1) the effect of the acquisition;<sup>13</sup> 2) the nature and level of the applicant's economic activity in Canada;<sup>14</sup> 3) whether there is significant Canadian participation in the business;<sup>15</sup> 4) the effect of the acquisition on industrial efficiency, productivity,<sup>16</sup> and competition in Canada;<sup>17</sup> and, 5) whether the business is compatible with enunciated policy objectives of all levels of government.<sup>18</sup>

FIRA has, in practice, often negotiated with the applicant "to win" specific "pro-Canada" employment of Canadian citizens,<sup>19</sup> use of Canadian goods and services,<sup>20</sup> and greater Canadian equity participation.<sup>21</sup> Because nonapprovals sometimes result for political reasons,<sup>22</sup> FIRA is viewed by the

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10. For a definitional discussion of the entities affected, see Scace, *U.S. Investment in Canada: The Foreign Investment Review Act (FIRA) and Provincial Incentives*, 4 CAN.-U.S. L.J. 100, 100-01 (1981).

11. Foreign Investment Review Act, ch. 46, §§ 8-13, 1973-1974 Can. Stat. 619; see Macdonald, *supra* note 6, at 394.

12. Foreign Investment Review Act, ch. 46, § 2, 1973-1974 Can. Stat. 619; see Macdonald, *supra* note 6, at 394; Scace, *supra* note 10, at 101.

13. Foreign Investment Review Act, ch. 46, § 2(a), 1973-1974 Can. Stat. 619; see Macdonald, *supra* note 6, at 394; Scace, *supra* note 10, at 101.

14. Foreign Investment Review Act, ch. 46, § 2(a), 1973-1974 Can. Stat. 619; see Macdonald, *supra* note 6, at 394; Scace, *supra* note 10, at 101.

15. Foreign Investment Review Act, ch. 46, § 2(b), 1973-1974 Can. Stat. 619; see Macdonald, *supra* note 6, at 394; Scace, *supra* note 10, at 101.

16. Foreign Investment Review Act, ch. 46, § 2(c), 1973-1974 Can. Stat. 619; see Macdonald, *supra* note 6, at 394; Scace, *supra* note 10, at 101.

17. Foreign Investment Review Act, ch. 46, § 2(d), 1973-1974 Can. Stat. 619; see Macdonald, *supra* note 6, at 394; Scace, *supra* note 10, at 101.

18. Foreign Investment Review Act, ch. 46, § 2(e), 1973-1974 Can. Stat. 619; see Macdonald, *supra* note 6, at 394; Scace, *supra* note 10, at 101.

19. Macdonald, *supra* note 6, at 395.

20. *Id.* A General Agreement on Tariff and Trade (GATT) tribunal recently held that Canada's legal sourcing requirements are inconsistent with GATT national treatment principles. Decision of GATT Panel on Canada's Administration of the Foreign Investment Review Act, L/5504 (1984).

21. Macdonald, *supra* note 6, at 395.

22. See Rugman, *Canada: FIRA Update*, 17 J. WORLD TRADE L. 352, 354-55

United States Government and by the United States financial and business community as a substantial barrier to foreign direct investment in Canada.<sup>23</sup> The number of unsuccessful FIRA applicants doubled from 14% in 1978 to 29% in 1981.<sup>24</sup> Although the current approval rate is roughly 95%,<sup>25</sup> there is no guarantee that approvals will continue.<sup>26</sup> This causes Canada to be a costly and unattractive investment environment for multinational enterprises.<sup>27</sup>

"Canadianization" is also the rationale behind the National Energy Plan. The creation of the NEP resulted from the Canadian Government's belief that foreign energy firms, which controlled 62.7% of the oil and gas sector and 38.3% of mining,<sup>28</sup> were not reinvesting enough of their profits from Canadian energy production into energy development.<sup>29</sup> With the NEP, Canada hopes to direct energy profits into the development of Canadian businesses and natural resources and to ensure its future energy self-sufficiency.<sup>30</sup> The program requires foreign firms to be at least 50% Canadian owned and calls for at least 50% Canadian ownership of oil and gas production by 1990.<sup>31</sup> It also includes a retroactively applied "back-in" provision, which gives 25% of oil and gas discoveries in Canadian

(1983). The implication is that "FIRA can turn from a paper tiger to an angry Canadian bear, depending on the political views of the government and minister responsible." *Id.* at 352.

23. *Id.* at 354.

24. *See id.* at 353. FIRA approved 87% of new business investments in 1978, but only 71% in 1981. *Id.*

25. Interview with G.H. Dewhirst, Director General of the Foreign Investment Review Agency, in Ottawa, Canada (Feb. 20, 1984).

26. *See Rugman, supra* note 22, at 354. The FIRA has been marked with uncertainty, and if it continues "to bend with the political winds it may eventually blow away foreign investment altogether. . . . The very uncertainty surrounding FIRA makes it a substantial barrier to foreign direct investment." *Id.*

27. *Id.* at 354-55. A multinational enterprise has been defined as "the embodiment of foreign direct investment by a single business enterprise which straddles several economies (a minimum for four or five) and divides its global activities between different countries with a view to realizing over-all corporate objectives." GOV'T OF CAN., *FOREIGN DIRECT INVESTMENT IN CANADA* 51 (1972).

28. King, *supra* note 5, at 238. The figures quoted are in terms of assets. *Id.* n.2.

29. *Id.* at 237.

30. *Id.*

31. Canada Oil and Gas Act, ch. 81, § 19, 1980-1982 Can. Stat. 2655; *see Lacasse, Legal Issues Relating to the Canadian National Energy Program*, 16 *VAND. J. TRANS-NAT'L L.* 301, 305, 334 (1983).

lands to a government-owned corporation.<sup>32</sup> Canadian firms are given preference when applying for production licenses and exploration incentive grants.<sup>33</sup>

The United States takes the position that the NEP, by discriminating against United States owned or controlled interests, conflicts with the principle of national treatment<sup>34</sup> expressed in the General Agreement on Tariffs and Trade<sup>35</sup> (GATT) and the Organization for Economic Control and Development Guidelines on International Investment and Multinational Enterprises<sup>36</sup> (OECD Guidelines). Furthermore, the United States believes that the 25% retroactively applied "back-in" provision is expropriatory in nature.<sup>37</sup> It rejects the payments made to United States interests to compensate for the "back-in" arrangement because such payments may not "take full account of the true commercial assets involved."<sup>38</sup>

32. Canada Oil and Gas Act, ch. 81, § 19, 1980-1982 Can. Stat. 2655; *see King, supra* note 5, at 237.

33. Canada Oil and Gas Act, ch. 81, § 27, 1980-1982 Can. Stat. 2655; *see Lacasse, supra* note 31, at 332.

34. Lacasse, *supra* note 31, at 335 (citing Letter from William E. Brock, United States Trade Representative, to Herb Gray, Canadian Industry Minister (Mar. 11, 1981)). The United States views the NEP as unjust discrimination, even taking into account the Canadian interpretive statement on national treatment at the time of 1976 Organization of Economic Cooperation and Development declaration on national treatment. *Id.* at 336.

35. *Opened for signature* Oct. 30, 1947, 61 Stat. A3, T.I.A.S. No. 1700, 55 U.N.T.S. 194 [hereinafter cited as GATT]. GATT is the principal forum through which the over 80 signatories work to "reduce tariffs, eliminate nontariff measures, and remove other trade obstacles." 4 U.S. DEP'T OF COM., TECHNICAL BARRIERS TO TRADE iii (The Tokyo Round Agreements Sept. 1981). The GATT provision on national treatment provides that "the products . . . of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale . . . purchase . . . or use." GATT, *supra*, art. III(2).

36. Org. of Econ. Cooperation and Dev., International Investment and Multinational Enterprises (1976) [hereinafter cited as OECD Guidelines]. These guidelines provide:

that member countries should, consistent with their needs to maintain public order, to protect their essential security interests and to fulfill commitments relating to international peace and security, accord to . . . [Foreign Controlled Enterprises] treatment under their laws . . . consistent with international law and no less favourable than that accorded in like situations to domestic enterprises.

*Id.* art. 2(1).

37. Lacasse, *supra* note 31, 346-48.

38. *Id.* at 346 (quoting Letter from William E. Brock, United States Trade Rep-

## 2. Trade Barriers

Canadian trade policy is another cause for concern in the United States.<sup>39</sup> The United States objects to Canada's proposed import policy, which would add to existing Canadian antidumping legislation a "basic price" system for use in complex and emergency situations.<sup>40</sup> This system would be more restrictive than current United States antidumping legislation.<sup>41</sup> The United States Government fears that, as a result, internal pressures will mount to make United States antidumping legislation more protectionist.<sup>42</sup>

A closely related issue is the proposed antidumping and countervail systems. These proposals, according to one author, fail to meet the Tokyo Round<sup>43</sup> requirements because the impact of dumping or subsidization on domestic producers is not regarded simultaneously.<sup>44</sup> The United States believes Canada should adopt a technique similar to its own preliminary pricing system, which would tend to make Canada's antidumping and countervail systems less threatening.<sup>45</sup>

Still another area of concern to the United States is trade in services.<sup>46</sup> A good example of this is the border broadcasting dispute, which began in 1976 when Canada eliminated tax deductions for approximately Can.\$15 million in advertising costs spent by Canadian firms for broadcast time on United States radio stations.<sup>47</sup> Attempts in Congress to retaliate

representative, to Peter M. Towe, Canadian Ambassador to the United States (June 1, 1981)).

39. R. GREY, *TRADE POLICY IN THE 1980'S: AN AGENDA FOR CANADIAN-U.S. RELATIONS* 68 (1981).

40. *Id.* at 72.

41. *Id.* The Canadian "basic price" system would be more restrictive than the United States "trigger price" system in that under the United States system "sale at less than the trigger price may trigger an anti-dumping investigation but not the automatic levying of an anti-dumping duty." *Id.*

42. *Id.*

43. Tokyo Round refers to the most recent multilateral trade negotiations conducted pursuant to GATT, which were held in Geneva from 1973 to 1979. See generally Graham, *Results of the Tokyo Round*, 9 GA. J. INT'L & COMP. L. 153 (1979).

44. R. GREY, *supra* note 39, at 73-74.

45. *Id.* at 74.

46. *Id.* at 74-75.

47. Westell, *Poison Pinpricks*, Foreign Pol'y, Winter 1980-1981, at 101; see Morrissy, *Industrial Policies of North American and Their Implications for U.S Trade and Investment Relations*, 7 N.C. J. INT'L L. & COM. REG. 331, 345 (1982).



against Canada have been unsuccessful.<sup>48</sup> Other Canadian restrictions of trade in service are likely to receive increased attention in the United States. These include banking, insurance, engineering consulting, data processing, air transport, and marine transport.<sup>49</sup>

Finally, the United States would like to see liberalization of Canadian Government procurement regulations.<sup>50</sup> The Canadian Treasury Board ensures that "government purchases for goods and services over \$2 million and construction over \$10 million meet government objectives."<sup>51</sup> Although Canada is a signatory to the GATT procurement code,<sup>52</sup> significant areas of purchasing by federal, provincial, and local government and Crown Corporations are not covered by the code.<sup>53</sup>

## B. Canadian Concerns

### 1. Investment Barriers

In a recent report, Canada's Foreign Investment Review Agency stated that, contrary to assertions made by the United States, foreign investment is in fact controlled by the United States.<sup>54</sup> Foreign investment in power production, for exam-

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48. See Morrissy, *supra* note 47, at 345. These failed attempts "illustrate how difficult it is to define and impose appropriate retaliation, especially cross-product retaliation. Often an industry is reluctant to accept, at some cost to itself, trade restrictions that are designed as a mode of retaliation to benefit another sector." *Id.*

49. R. GREY, *supra* note 39, at 74.

50. Morrissy, *supra* note 47, at 346-47.

51. *Id.*

52. *Id.*

53. *Id.*

54. FOREIGN INV. REV. AGENCY, BARRIERS TO FOREIGN INVESTMENT IN THE UNITED STATES 71 (1982) [hereinafter cited as FOREIGN INVESTMENT BARRIERS]. The report stated, in pertinent part:

The United States Government, like any other, has on a number of occasions passed legislation to control foreign investment in order to protect its own interests. Statements on the open nature of the American economy are simply not borne out of American practice. What we find in place of a visible regulatory authority is a web of laws, regulations, public hearings, programs and ordinances, at both the state and federal level, which can effectively prevent, or at least delay, a foreign investment transaction at the discretion of almost anyone with the knowledge and resources to selectively apply the procedures.

*Id.* at 2. It further asserts that "[s]teps have been taken to prohibit or restrict foreign investment in many areas including shipping, aviation, aeronautics, communications, nuclear and hydroelectric power, banking, insurance, real estate, mining, maritime

ple, is virtually prohibited in the United States. Under the Atomic Energy Act of 1954,<sup>55</sup> aliens, foreign governments, foreign corporations, or foreign-controlled enterprises cannot be issued licenses for the operation of atomic energy utilization-of-production facilities in the United States.<sup>56</sup> In addition, licenses for hydroelectric facilities are not available to foreign-controlled enterprises,<sup>57</sup> and leases for the development of geothermal steam and associated resources may be issued only to United States citizens and corporations organized under federal or state law.<sup>58</sup> In addition,

foreign-controlled enterprises may not acquire rights of way for oil pipelines, or acquire any interest therein, or acquire leases or interests therein for mining coal, oil, or certain other minerals, on federal lands other than the outer continental shelf. However, a foreign-controlled corporation may hold such an interest if its home country grants reciprocal rights to U.S. corporations . . . .<sup>59</sup>

This reciprocity provision was applied to Royal Dutch Shell, a Netherlands corporation in the 1920's, and to the United Kingdom with regard to coal when it nationalized its coal industry in 1948.<sup>60</sup> Recently, the United States Department of Interior reviewed Canada's reciprocal status under the Act.<sup>61</sup> After months of delay, then Secretary of the Interior James Watt declared that Canada was still a reciprocal country in that

activities, and defense (which itself covers many areas). Special measures are applied to foreign-controlled companies." *Id.* at 71. The report adds that "the absence of clear authority and well-defined restrictions leaves the system open to abuse. Decisions by regulatory agencies frequently appear arbitrary and unfair. Pressure from interest groups can lead to 'adjusted' interpretations of the law." *Id.*

55. 42 U.S.C. § 2011 (1976).

56. *Id.* § 2133(d); see *FOREIGN INVESTMENT BARRIERS*, *supra* note 54, at 8.

57. Federal Power Act, 16 U.S.C. § 791 (1976); see *FOREIGN INVESTMENT BARRIERS*, *supra* note 54, at 8.

58. Geothermal Steam Act, 30 U.S.C. § 1001 (1976); see *FOREIGN INVESTMENT BARRIERS*, *supra* note 54, at 9.

59. *FOREIGN INVESTMENT BARRIERS*, *supra* note 54, at 11. This prohibition is codified by the Mineral Lands Leasing Act of 1920, 30 U.S.C. § 181 (1976).

60. See *The Adequacy of the Federal Response to Foreign Investment in the United States, Twentieth Report by the Committee on Government Operations*, 96th Cong., 2nd Sess. 137 (1980); *FOREIGN INVESTMENT BARRIERS*, *supra* note 54, at 11.

61. *FOREIGN INVESTMENT BARRIERS*, *supra* note 54, at 12. "It has been made public that Canada could be declared wholly or partly non-reciprocal, in which case Canadian firms could be banned wholly or partly from mineral leases on U.S. federal lands." *Id.*

its laws and regulations do not deny Americans "the privilege of stock ownership in corporations which have an interest in Canadian mineral resources."<sup>62</sup>

The United States also controls foreign investment indirectly through selective application of securities, antitrust and defense laws, congressional lobbying and hearings, and governmental monitoring and review.<sup>63</sup> One agency in particular is the Committee on Foreign Investment in the United States<sup>64</sup> (CFIUS), whose primary responsibility is to monitor the impact of, and coordinate United States policy on, foreign investment in the United States.<sup>65</sup> Its functions include reviewing "investments in the United States which, in the judgment of CFIUS, might have major implications for United States national interest."<sup>66</sup> Upon a finding that an investment would have major implications for the national interest, the chairman contacts the Economic Policy Group and the National Security Council, requesting their concurrence in notifying the foreign government involved.<sup>67</sup> They, in turn, make a request to that government to either refrain or modify the investment so that it is acceptable to the United States Government.<sup>68</sup> Although CFIUS does not have the legal power to block investments, it is confident that diplomatic representation would suffice in the case of investments by foreign governments or by a private foreign investor.<sup>69</sup>

Recent activities of CFIUS demonstrate its restrictive prac-

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62. *Id.*

63. *Id.* at 71.

64. *Id.* at 56. Created by an Executive Order on May 7, 1975, the committee is chaired by the Treasury Department and includes representatives of the Departments of State, Defense, and Commerce, the Office of the United States Trade Representative, and the Council of Economic Advisors. Exec. Order No. 11,858, 3 C.F.R. 990 (1975). It has the primary responsibility for monitoring the impact of, and coordinating policy for, foreign investment in the United States. See FOREIGN INVESTMENT BARRIERS, *supra* note 54, at 56.

65. FOREIGN INVESTMENT BARRIERS, *supra* note 54, at 56.

66. *Id.* at 57. It also has the function of providing "guidance on arrangements with foreign governments for advance consultations on prospective major foreign governmental investments in the United States . . . ." *Id.* at 56.

67. *Id.* at 58.

68. *Id.*

69. *Id.* The committee has stated that it is unlikely that a foreign government would persist in investing in the United States over the strong objections of the United States Government. Even if it were insensitive to the implications of such actions, the fear of retaliation would be preventive. *Id.*

tices. For instance, CFIUS requested a deferral of the proposed acquisition and transfer of Texasgulf's Canadian assets to the Canadian Development Corporation, a Crown Corporation, on the ground that it would have an adverse effect on the availability of sulphur and phosphate fertilizers in the United States.<sup>70</sup> In July, 1981, CFIUS asked French-owned Société Nationale Elf Aquitaine to hold back on its merger with Texasgulf in order to give the committee time to assess the implications of the proposed merger.<sup>71</sup> The committee has also looked at actions leading to the acquisition of 25,000 shares of Conoco by the Montreal-based Seagram Co.,<sup>72</sup> as well as several dealings involving the Kuwait Petroleum Corporation, a proposed joint-venture with Pacific Resources and AZL Resources, and a proposed merger with Santa Fe International.<sup>73</sup>

There are indications that CFIUS' role in reviewing foreign investment will become greater. Congress has criticized CFIUS as being "seriously deficient" in protecting United States national interests<sup>74</sup> and thus may want to extend its authority and increase its powers. There are also indications that the Reagan Administration is willing to respond to the possible dangers of foreign investment, particularly investments made by alien governments that are not consistent with the energy independence goals of the United States.<sup>75</sup>

In summarizing barriers to foreign investment in the United States, a FIRA report stated that the foreign investor "encounters not a single central agency, but a highly diffuse set of laws and regulations which may leave him confused and perhaps suspicious that the very ambiguity of his situation is no accident."<sup>76</sup>

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70. *Id.* at 61 (quoting *U.S. vs. Canada: Ominous Developments for Foreign Investors*, *Bus. Int'l*, July 24, 1981, at 237).

71. FOREIGN INVESTMENT BARRIERS, *supra* note 54, at 60 (quoting *Elf Wraps up Deal of Texasgulf*, *The Gazette* (Montreal) July 20, 1981, at 49).

72. FOREIGN INVESTMENT BARRIERS, *supra* note 54, at 60 (quoting King, *Tougher Line is Sought in U.S. to Monitor Foreign Investment*, *Globe and Mail*, Aug. 10, 1981, at 12).

73. FOREIGN INVESTMENT BARRIERS, *supra* note 54, at 61 (quoting *Federal Response to OPEC Country Investments in the United States: Hearings Before the House Subcomm. of the Comm. on Gov't Operations*, 97 Cong., 1st Sess. 258-60 (1981)).

74. See FOREIGN INVESTMENT BARRIERS, *supra* note 54, at 59.

75. *Id.* at 60.

76. *Id.* at 71.

## 2. Trade Barriers

The United States Congress, in response to organized labor's concerns about increasing unemployment, businessmen's frustrations over "unfair" trade practices of major trading partners, and the general unease of the United States public, is moving increasingly towards protectionist trade policies.<sup>77</sup> Unfortunately, Canada is often inadvertently affected by United States legislation aimed at other countries.<sup>78</sup> A fear that this may debilitate the Canadian economy has led to rising Canadian concern over United States nontariff barriers in several areas, including countervailing duties, procurement, and United States safeguard actions applied inadvertently against Canadian exports.<sup>79</sup>

### a. Countervailing duties

With respect to countervailing duties, the GATT agreement fails to meet Canada's needs regarding its trade relations with the United States.<sup>80</sup> For example, the Canadian government has noted that "although the U. S. government [under GATT] must now establish injury before imposing countervail duties, the new U.S. procedure makes it easier for U.S. companies to lodge complaints and for the authorities to find 'injury.'"<sup>81</sup>

The GATT agreement, furthermore, does not always clarify what constitutes a subsidy for countervail purposes.<sup>82</sup> Should the United States vigorously apply its countervail system, it could have a greater impact on the effectiveness of Ca-

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77. Address by Allan E. Gotlieb, Canadian Ambassador to the United States, C.V. Starr Center for Applied Economics, New York University (Apr. 15, 1983).

78. *Id.* "In many cases, the object of U.S. frustration is not Canada at all, but [it] often [gets] hit by legislation aimed at other trading partners." *Id.*

79. STANDING SENATE COMM. ON FOREIGN AFF., CANADA-UNITED STATES RELATIONS, vol. 3, CANADA'S TRADE RELATIONS WITH THE UNITED STATES 11-12 (1982) [hereinafter cited as STANDING COMMITTEE REPORT]. "In the context of Canada-U.S. trade, as distinct from multilateral trade, the impact of non-tariff barriers is increasing both relatively and absolutely. This reflects both the diminishing importance of tariffs and the growing recourse to non-tariff barriers as a form of protection." *Id.* at 11.

80. *See id.* at 12.

81. *Id.* A bill before Congress would make it even easier for all industries to file countervailing duty suits. Westell, *U.S. Trade Lobbies Fed by Opportunism*, *Globe and Mail*, Jan. 28, 1984, at B1, col. 1.

82. *Standing Committee Report, supra* note 79, at 12.

nadian industrial development policies than would any parallel countervail action that Canada could take against the United States.<sup>83</sup>

#### b. Procurement

Procurement, including products purchased by governments and their agencies, is the most pressing nontariff barrier problem between Canada and the United States.<sup>84</sup> Without a domestic mass market base, the survival of Canadian industries such as telecommunications equipment, electricity generating and transmitting equipment, urban mass transit equipment, aircraft and aircraft parts and avionics, depends on sales to foreign procurement markets in the United States.<sup>85</sup> The difficulty is that not only does the GATT procurement code not apply to these areas, but that there is a marked increase in United States procurement protection by Congress and at the state level.<sup>86</sup> Of the fifty states, thirty-seven have adopted "Buy American" restrictions<sup>87</sup> to several federal appropriations laws such as the Public Works Employment Act<sup>88</sup> and the Clean Water Act.<sup>89</sup> These legislative actions have hurt some Canadian producers badly. In one case, for example, steel bridge exports to New York State alone fell from Can.\$20 million in 1978 to Can.\$1 million in 1979.<sup>90</sup>

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83. *Id.* The report states that:

This is because such a relatively large percentage of Canadian production is exported while in the United States the major portion of production is for the internal market. Any subsidization of Canadian industry could be seen as involving an encouragement of production for export purposes and would accordingly run the risk of U.S. countervail. By contrast, subsidization of a firm in the United States would be directed mainly toward encouraging production for the U.S. domestic market and would only involve the risk of Canadian countervail for the very small percent of products which it might export.

*Id.*

84. *Id.* at 13.

85. *Id.*

86. *Id.*

87. *Id.* These restrictions require that 50% of the content be American and final assembly take place in the United States. *Id.*

88. 40 U.S.C. § 270a (Supp. IV 1980).

89. 33 U.S.C. § 1251 (1976).

90. STANDING COMMITTEE REPORT, *supra* note 79, at 13. As a result, the company "decided it had no alternative but to establish facilities within the United States if it wanted to circumvent state Buy American barriers to municipal markets." *Id.* at

14. A car manufacturer, in another case, warned if the 50% requirement for basic

### c. United States Safeguard Actions

Canadian exports are also vulnerable to United States safeguard or emergency actions.<sup>91</sup> In times of economic downturn, business persons are likely to seek protection from emergency import action.<sup>92</sup> In January, 1984, Canada's daily national newspaper reported that several United States industries recently launched initiatives to reduce imports in such areas as fish processors, copper and steel producers, and manufacturers of autos, footwear and flatware.<sup>93</sup> It is believed that the wine, canned tuna, uranium, and machine tool industries are likely to urge protectionist moves as well.<sup>94</sup>

To comply with GATT, however, safeguard measures such as tariffs or quotas must not be discriminatory or single out imports from a particular country: They must apply to imports across the board.<sup>95</sup> As a result, Canadian imports may suffer if the United States takes action against intolerable imports from other countries.<sup>96</sup>

### C. Summary

Both Canada and the United States are greatly concerned about each other's trade and investment policies. The negative consequences of such policies appear to be greater for Canada, as evidenced by its shrinking share of world trade in manufactured goods as well as its declining trade performance with the United States.<sup>97</sup> Furthermore, the current uncertainty surrounding Canada's FIRA may force multinational enterprises to seek more secure investment environments else-

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United States content were to be raised to 75%, "it would lead to complete manufacture of his company's urban transport cars in the United States." *Id.*

91. *Id.* at 16.

92. *Id.*

93. Westell, *U.S. Trade Lobbies Fed by Opportunism*, *Globe and Mail*, Jan. 28, 1984, at B1, col. 1.

94. *Id.*

95. LeMay, *Bilateral Pact Aids Canada's Viewpoint*, *Globe and Mail*, Feb. 27, 1984, at B1, col. 1.

96. STANDING COMMITTEE REPORT, *supra* note 79, at 16. "Examples of past U.S. punitive action hitting Canada inadvertently are U.S. safeguard measures against specialty steel and fasteners in 1974 and 1978." *Id.*

97. *Id.* at 18. The Canadian Standing Senate Committee on Foreign Affairs, for example, fears Canada is in danger of being pushed out of world markets altogether. *Id.*

where.<sup>98</sup> The NEP, with its provisions for "Canadianization" of the oil and gas industries, has provoked a massive withdrawal of United States investment capital, thereby vastly increasing Canada's dependence on new sources of foreign funds.<sup>99</sup> The Canadian Government is also concerned that its industrial policies will cause Canada to become a target for additional retaliatory measures from the United States Government and influential segments of the private business sector.<sup>100</sup>

Because United States domestic production is primarily for its own huge internal market, the consequences for the United States are not quite so apparent.<sup>101</sup> The following section examines the effectiveness of multilateral and bilateral agreements used by Canada and the United States to conduct trade and investment relations.

## II. *THE EFFECTIVENESS OF CURRENT MULTILATERAL AND BILATERAL AGREEMENTS*

### A. *Multilateral Agreements*

At the multilateral level, both Canada and the United States are signatories of the GATT<sup>102</sup> and OECD declarations.<sup>103</sup> Each of these instruments has its limitations.

GATT, for example, is aimed almost exclusively at reducing or eliminating import tariffs and has limited application to nontariff barriers.<sup>104</sup> It is not a comprehensive free trade agreement.<sup>105</sup> Free trade, if it occurs at all, may not be fully

98. Rugman, *supra* note 22, at 354. "Multinational enterprises have the flexibility to go elsewhere when the costs of investing in one host nation become too high, as when there are changes in environmental parameters, such as FIRA." *Id.*

99. Beigie & Stewart, *New Pressures, Old Constraints: Canada-United States Relations in the 1980s*, in 40 *BEHIND THE HEADLINES* No. 6, at 17 (1983).

100. *STANDING COMMITTEE REPORT*, *supra* note 79, at 20. "Bilateral trade confrontations seem bound to increase and Congress, in particular, may retaliate in quite unrelated areas as it has done in the past. The Canadian economy could end up in a very much worse situation than would have occurred without some of these Canadian government's industrial development measures." *Id.*

101. *Id.* at 12.

102. GATT, *supra* note 35, preamble.

103. Convention on the Organisation for Economic Co-operation and Development, *opened for signature* Dec. 14, 1960, 12 U.S.T. 1728, T.I.A.S. No. 4891, 888 U.N.T.S. 179.

104. GATT, *supra* note 35, arts. II(2), III(1).

105. *See id.* art. II. For example, GATT allows states to maintain current preferential policies and establish countervailing duties. *See id.*



realized until the 1990's.<sup>106</sup> Another difficulty is that GATT is strictly limited to commercial policy; it does not deal with issues of investment or foreign ownership.<sup>107</sup> The OECD Guidelines provide for national and most-favored-nation treatment for investments made in member states.<sup>108</sup> However, failure to comply with its terms does not entitle other member states to legal remedies.<sup>109</sup> It is a political, not a legal, instrument.<sup>110</sup> Moreover, Canada has filed a reservation taking exception to the national treatment principle<sup>111</sup> under article III, section 1 of the OECD Guidelines.<sup>112</sup> In effect, there is no legally enforceable investment agreement between Canada and the United States.

Both countries, however, have expressed interest in expanding trade and investment negotiations within a multilateral framework.<sup>113</sup> The current United States Administration, for instance, would like to expand GATT to include trade in services,<sup>114</sup> and hopes eventually, for an agreement similar to GATT in the area of investments.<sup>115</sup> A United States proposal for GATT expansion to trade in services suggests that a "trade only" framework is not adequate.<sup>116</sup> Canadian officials are receptive to trade discussions at the multilateral level as well, preferring such arrangements to a bilateral "elephant-mouse" relationship with the United States.<sup>117</sup> As for investment, Canada is satisfied with the present status quo and expresses no

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106. STANDING COMMITTEE REPORT, *supra* note 79, at 23.

107. Macdonald, *supra* note 6, at 403.

108. OECD Guidelines, *supra* notes 36, art. 2. For the principle provision, see *supra* note 36.

109. Macdonald, *supra* note 6, at 399.

110. *Id.*

111. This principle calls for equal treatment in the taxation of foreign and domestic products. See *id.*; see also GATT, *supra* note 35, art. III.

112. Macdonald, *supra* note 6, at 398-99. Under Canada's reservation, it "retains its right to take measures affecting foreign investors which it considers to be necessary in its particular circumstances." Can. Dep't of External Aff., Statement by the Honourable Flora MacDonald at the OECD Ministerial Meeting (June 13, 1979).

113. See *infra* notes 114-18 and accompanying text.

114. R. GREY, *supra* note 39, at 74.

115. Interview with D.J. Klock, Financial Attache of the Embassy of the United States of America, in Ottawa, Canada (Feb. 21, 1984). According to one United States embassy official in Ottawa, investment and trade are inseparable. *Id.*

116. *Id.*

117. Interview with G.H. Dewhirst, Director General of the Foreign Investment Review Agency, in Ottawa, Canada (Feb. 20, 1984).

interest in concluding an investment agreement at either the bilateral or multilateral level with the United States.<sup>118</sup>

### B. *Bilateral Agreements*

While Canada and the United States do not have plans to discuss an overall investment agreement,<sup>119</sup> both sides have negotiated and are engaged in negotiations involving limited free trade on a sectoral basis.<sup>120</sup> Although the United States would prefer a master design for a comprehensive economic arrangement, Canada favors an incremental and sectoral scheme under which the accord would be slowly implemented with a high degree of interim safeguard provisions.<sup>121</sup>

There is, however, considerable debate as to whether sectoral arrangements should be extended to all industrial sectors.<sup>122</sup> Critics voice several observations. First, both sides perceive sectoral agreements differently: to the United States, sectoral agreements are limited free trade agreements;<sup>123</sup> to Canada, they are fair share arrangements.<sup>124</sup> The United States, in its antipathy for market sharing agreements, does not look favorably on Canadian safeguard provisions.<sup>125</sup> Another problem is the incapacity of the United States Administration to negotiate with major interest groups on trade policy.<sup>126</sup> Further, the growing demand for protectionism in the United States raises the question of whether a formalized bilateral economic arrangement is feasible.<sup>127</sup> Finally, sectoral free trade

118. Interview with D. Waddell, Canadian Director of United States Trade and Economic Relations, in Ottawa, Canada (Feb. 20, 1984).

119. *Id.*

120. Anderson, *Sectoral Free-Trade Pacts Offer Mutual Advantages*, *Globe and Mail*, Feb. 28, 1984, at B2, col. 5.

121. Beigie & Stewart, *supra* note 99, at 21. One example of sectoral free trade is the area of automobile products, where an integrated Canadian-United States market was created by promoting trade in new automobiles and parts on a duty free basis. Morrissy, *supra* note 47, at 350.

122. Morrissy, *supra* note 47, at 350.

123. *Id.* at 351. This means that the United States views them as a compromise to full free trade with Canada. *See id.* at 350-51.

124. *Id.* at 351. Fair share arrangements mean that the arrangements are used to protect key Canadian trade sectors which would otherwise be vulnerable to unrestricted competition from the United States. *See id.* at 350-51.

125. Beigie & Stewart, *supra* note 99, at 21.

126. *Id.* at 21-22. "The increasing role of a fractious congress in trade policy . . . leads to serious doubt about the bilateral negotiating process." *Id.* at 22.

127. *Id.* at 22.

fails to create the institutional network necessary to "link" the two countries.<sup>128</sup>

While most Canadian economists would probably favor a general free trade arrangement with the United States, the Canadian Government's opinion is that Canadians are not ready for such a move. There is a fear that free trade would lead to Canada's political subordination to the United States.<sup>129</sup> Sectoral arrangements avoid the political problems raised by a comprehensive agreement while being consistent with a policy of gradually moving toward free trade.<sup>130</sup> Presently, a bilateral study group is studying prospects for liberalizing trade in steel, agricultural equipment, computer and information services, and government procurement relating particularly to mass transit vehicles.<sup>131</sup>

### III. ALTERNATIVES AND PROPOSALS

#### A. *Why Free Trade and Open Access Investment?*

In view of the current obstacles to trade and investment between Canada and the United States, both countries have studied the idea of creating a mutually acceptable framework to conduct either trade or investment relations. The Canadian Standing Senate Committee on Foreign Affairs suggested in a March, 1982 report that Canadian economic development would be advanced through the conclusion of a comprehensive free trade agreement between the two countries.<sup>132</sup> This subject has also been raised by the United States, most notably in the United States Trade Agreements Act of 1979,<sup>133</sup> which re-

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128. Morrissy, *supra* note 47, at 353. "[T]here is a conspicuous absence of a mutually accepted perception of the relationships among the North American countries. The old 'special' relationships between the United States and each of its neighbors no longer provides policy guidance and support to bilateral consultations." *Id.*

129. Anderson, *Sectoral Free-Trade Pacts Offer Mutual Advantages*, *Globe and Mail*, Feb. 28, 1984, at B2, col. 5. One Canadian business leader stated that while "sectoral arrangements are the second-best solution to Canada's trade problems . . . it is more practical than a general free-trade approach." *Id.*

130. *Id.*

131. *Id.*

132. See STANDING COMMITTEE REPORT, *supra* note 79, at 22. "The Committee believes that if Canada is to retain its current standard of living and its present productive capacity into the 1990's, the piecemeal approach to trade liberalization and the reliance on a series of supportive measures must give way to the forthright adoption of this broad policy initiative." *Id.*

133. 19 U.S.C. § 2501 (1982). This Act is designed to "approve and implement

quired the President to report to Congress by mid-1981 on the possibility of free trade agreements with countries of the northern portion of the Western Hemisphere.<sup>134</sup> While Canada does not share the United States' desire to conclude a bilateral or multilateral investment agreement,<sup>135</sup> Canadian policy makers acknowledge the need to create national policies that will address United States interests and sensitivities.<sup>136</sup>

Most opposition to a bilateral free trade agreement between Canada and the United States comes from Canada.<sup>137</sup> Canadian opponents argue that adjustment costs would outweigh any short-term advantage, and that longer term gains for Canada forecast by international trade theory would not be realized in a Canadian-United States context.<sup>138</sup> They offer the following reasons: 1) Canadian manufacturing industries enjoy few comparative advantages vis-a-vis the United States;<sup>139</sup> 2) Heavy United States ownership in Canadian industry would tend to result in Canadian production being relocated in the United States even where Canadian production costs were lower;<sup>140</sup> 3) The exchange rate cannot be relied upon to regulate the relative competitiveness and location advantages between Canada and the United States in the manufacturing sector;<sup>141</sup> and 4) The structure of the Canadian economy following free trade would be less conducive to its future development.<sup>142</sup> In addition to these factors, many Canadians fear

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the trade agreements negotiated under the Trade Act of 1974," 19 U.S.C. § 2101. *Id.* § 2502.

134. *Id.* § 2511; see CAN. DEP'T OF EXTERNAL AFF., CANADIAN TRADE POLICY FOR THE 1980'S: A DISCUSSION PAPER 42 (1983) [hereinafter cited as CANADIAN TRADE POLICY].

135. Interview with D. Waddell, Canadian Director of United States Trade and Economic Relations, in Ottawa, Canada (Feb. 20, 1984).

136. See CANADIAN TRADE POLICY, *supra* note 134, at 42.

137. *Id.* at 43.

138. *Id.*

139. *Id.* "Consequently, the removal of tariffs would simply lead to the replacement . . . of Canadian manufacturing production by Americans. Canadian labour . . . would be drawn into the resources and services sector, would seek to emigrate or, most probably, would swell the ranks of the unemployed." *Id.*

140. *Id.*

141. *Id.*

142. *Id.* "A strengthening of the resource sector at the expense of manufacturing might yield high income but would stultify efforts to foster the indigenous technology and [research and development] capability necessary for Canada's longer term success as an industrial society." *Id.*

that a Canadian-United States free trade agreement would, over time, erode Canada's political sovereignty.<sup>143</sup> Free trade, they assert, would inevitably lead to the formation of common institutions, and, given relative economic weight, the United States would tend to dominate these institutions.<sup>144</sup>

However, proponents of bilateral free trade in Canada note that the Canadian economy is already closely integrated with that of the United States.<sup>145</sup> Interdependence, they argue, is likely to increase in the future and may result in Canada's economy becoming even more vulnerable to policies of the United States.<sup>146</sup> They believe that a free trade agreement is necessary to reduce this danger and cite the following advantages: 1) Much of Canadian manufacturing industry is not competitive internationally, having developed behind a protective tariff;<sup>147</sup> 2) The United States is Canada's natural market for manufactured goods;<sup>148</sup> and 3) The dislocation costs of free trade would be reduced by phasing in tariff reductions over an extended period.<sup>149</sup>

There are persuasive reasons for a United States interest in a bilateral free trade agreement with Canada as well. First, an administration study, authorized by the United States Trade Agreement Act of 1974,<sup>150</sup> found that the United States would benefit from reciprocal trade liberalization with its North American neighbors.<sup>151</sup> Second, a convincing argument can

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143. *Id.* at 43-44

144. *Id.* The Canadian Department of External Affairs concluded that there is no convincing need to pursue a free trade agreement. *Id.* at 44.

145. *Id.*

146. *Id.*

147. *Id.* at 43. "Greater efficiency can be achieved through rationalization but the domestic market alone is too small to allow for such rationalization and the realization of available economies of scale." *Id.*

148. *Id.* It is also a natural market for many resources and agricultural items. "Free trade between Canada and United States would provide a large enough market and a necessary competitive stimulus for Canadian industry . . . ."

149. *Id.* "It may not be necessary to include agricultural items in a free trade arrangement. The floating exchange rate would tend to cushion the adverse short-term impact of free trade on the Canadian manufacturing sector and to reduce the risk of a major bilateral balance of payments deficit for Canada." *Id.*

150. 19 U.S.C. § 2101 (1982).

151. STANDING COMMITTEE REPORT, *supra* note 79, at 39.

The report itself spoke of the 'clear economic arguments [favoring] regional integration. It stated that U.S. industries might have 'fewer reservations about trade liberalization with Canada due to a more comparable level of

be made that the current trade "status quo" will only worsen unless positive action is taken to promote effective and harmonious bilateral trade relations.<sup>152</sup> Without the stabilizing factor of ongoing multilateral trade negotiations to provide a forum for dialogue, trade disputes between the two nations will tend to erupt more easily.<sup>153</sup> Third, there are commercial incentives for the United States to enter into such an agreement: guaranteed access to what is currently the most important single market for United States firms;<sup>154</sup> benefits to industry in emerging businesses and intra-industry trade;<sup>155</sup> advantage over sectoral arrangements insofar as broader negotiations permit trade-offs among sectors and among problems;<sup>156</sup> and advancing the regional interests of both states.<sup>157</sup> Finally, because Canada is the United States' major trading partner, it is in the interest of the United States that Canada have a strong economy.<sup>158</sup>

Despite Canada's satisfaction with investment "status-quo,"<sup>159</sup> compelling arguments exist for liberalization of investment restrictions as well. In a recent statement prepared by the Senior Interdepartmental Group on International Eco-

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economic development' than with Mexico which could be seen as threatening jobs and markets with cheaper goods. . . . [G]iven the Reagan Administration's known advocacy of freer trade . . . any proposal for bilateral free trade by Canada would likely be given fair hearing in Washington.

*Id.*

152. *Id.*

153. *Id.* at 40.

154. S. Weintraub, U.S.-Canada Free Trade: What's in it for the United States? 21 (Sept. 7, 1983) (unpublished paper prepared for delivery at the Biennial Conference of the Association for Canadian Studies in the United States, Rockport, Maine, Sept. 29 to Oct. 1, 1983).

155. *Id.* at 21-22.

156. *Id.* at 22.

157. *Id.* at 23.

158. STANDING COMMITTEE REPORT, *supra* note 79, at 41. The Committee explained that:

The motive for the United States being willing to negotiate away some of the problems is the motive to which we have often appealed in the United States; that is their interest in Canada having a strong economy. . . . [T]hey understand that they are not going to better themselves by weakening us since we are their principal customer. Senior American policy-makers do adjust their policy in the light of that requirement.

*Id.*

159. See Interview with D. Waddell, Canadian Director of United States Trade and Economic Relations, in Ottawa, Canada (Feb. 20, 1984).

conomic Policy, President Reagan stated that in order to achieve more efficient international production, "foreign investment flows must respond to private market forces."<sup>160</sup> According to the policy statement, direct private foreign investment plays a vital role in the United States and world economies because it "can act as a catalyst for growth, introduce new technology and management skills, expand employment and improve productivity. Foreign direct investment can be an important source of capital and can stimulate international trade. Both home and host country economies benefit from an open international investment system."<sup>161</sup>

In view of growing intervention by both developing and developed nations attempting to regulate international direct investment, the United States is advocating free, unimpeded international investment at both the multilateral and bilateral levels.<sup>162</sup> Should the United States conclude a comprehensive bilateral agreement with Canada, it would probably emphasize the free flow of investment.<sup>163</sup>

### B. *A Proposed Legal Framework*

This section explores both the nature of a free trade and open access investment agreement and the types of provisions likely to be included in such an agreement.

#### 1. Proposed Trade Section to a Bilateral Agreement

##### a. A Bilateral Agreement and GATT

Any free trade agreement between Canada and the United States must stay within the legal framework of the GATT articles.<sup>164</sup> The basic principle behind the GATT is nondiscrimination, i.e., members shall extend to all other members, on a nondiscriminatory basis, any concessions negotiated on both tariff and nontariff barriers to trade.<sup>165</sup> Article XXIV of GATT,

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160. International Investment Policy, Statement by President, 19 WEEKLY COMP. PRES. DOC. 1214, 1214 (Sept. 9, 1983).

161. *Id.* at 1217.

162. *Id.* at 1216-19.

163. STANDING COMMITTEE REPORT, *supra* note 79, at 45.

164. *Id.* at 30. "Any other course would be likely to invite retaliation from third countries, an outcome which the United States, as well as Canada, would seek to avoid." *Id.*

165. *Id.*

however, permits signatories to negotiate preferential free trade agreements so long as certain conditions are met.<sup>166</sup> Realistically, there are two possible avenues Canada and the United States could pursue to negotiate a free trade arrangement within the legal framework of article XXIV of GATT: either a declaratory approach or conclusion of an interim agreement.

Under a declaratory approach, article XXIV requires that all barriers to trade be eliminated on substantially all trade of goods between the countries concluding a preferential agreement.<sup>167</sup> If such a requirement is met, Canada and the United States would issue a bilateral declaration of free trade as existing between the two countries.<sup>168</sup> From there they would be free to liberalize trade for further products as they see fit.<sup>169</sup> However, although the declaratory approach would clear the way for duty free trade in the remaining fifteen or twenty percent of protected industries, its main deficiency is that it ignores the problem of nontariff barriers.<sup>170</sup>

The second possibility within article XXIV is a Canadian-United States interim agreement leading to the formation of a free trade area. Under this alternative, the countries involved submit a plan and schedule for the achievement of a free trade area within a reasonable length of time to GATT signatories, as well as adequate information to allow them to make recommendations.<sup>171</sup> The central advantage to this approach is that it provides a mechanism for negotiating the mutual reduction of nontariff barriers.<sup>172</sup> Canada and the United States, regard-

166. GATT, *supra* note 35, art. XXIV; see STANDING COMMITTEE REPORT, *supra* note 79, at 30.

167. GATT, *supra* note 35, art. XXIV.

168. STANDING COMMITTEE REPORT, *supra* note 79, at 32.

169. *Id.* The Canadian Senate Standing Committee concluded that "by 1987 a *de facto* free trade area between Canada and the United States could be deemed to exist in respect to tariffs." *Id.* at 33.

170. *Id.* These include the valuation of countervailing duties, customs and antidumping procedures. *Id.*

171. *Id.* at 34.

172. *Id.* The Senate Committee, in recommending this approach, states: The main advantage of the "interim agreement" procedure is the opportunity it offers, before initial negotiations have been completed, to ascertain the degree of commitment on the part of the United States to reduce . . . some of its non-tariff barriers. . . .In effect . . . each side could test the other's position before ratifying a treaty. . . .



less of the approach, could, in all likelihood, conclude a free trade agreement within the legal parameters of GATT.

b. General Considerations Regarding the Nature of a Free Trade Agreement

In its report on Canadian-United States Trade Relations, the Canadian Standing Senate Committee on Foreign Affairs concluded that the only successful approach under an interim agreement would be a comprehensive across-the-board trade arrangement.<sup>173</sup> It further concluded that such an accord should set out a schedule of tariff reductions over a given transition period, with particularly sensitive items negotiated as exclusions, rather than excluding everything unless specifically negotiated.<sup>174</sup> The committee did not attempt to specify in detail provisions that should be included in a Canadian-United States free trade agreement, because it believed that such a task was better left to negotiation.<sup>175</sup> The committee did outline some general observations on the terms such an agreement should contain.

i. Timing and Scope

The committee recommended that nontariff barriers be eliminated immediately, and tariffs be eliminated over a transition period of eight to ten years. Further, it recommended an increased rate of elimination of United States tariffs to enable a major reorganization of Canadian industry.<sup>176</sup> This is not the case for United States industry, because United States barriers are less extensive to begin with.<sup>177</sup>

ii. Rules of Origin

A free trade area between Canada and the United States raised the problem of "trade deflection."<sup>178</sup> This occurs when products from third countries enter the free trade area by way

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*Id.* at 35.

173. *Id.* at 36.

174. *Id.*

175. *Id.* at 89.

176. *Id.* at 90.

177. *Id.*

178. *Id.* at 91.

of the country with the lowest tariff on that particular good.<sup>179</sup> The product is then reexported to the other member of the free trade area at a zero tariff rate, thereby providing an unfair benefit to the country with the lower external tariff. For this reason, a free trade agreement must establish "rules of origin" for intramember trade.<sup>180</sup> The committee concluded that rules of origin should be liberal enough for Canadian manufacturers to continue to receive less costly imports.<sup>181</sup>

### iii. Exceptions and Safeguards

The committee concluded that agricultural products would be the most important exception in a Canadian-United States agreement. It believed that each country should retain sovereignty over matters relating to customs administration and to the imposition of their individual tariffs against third party states.<sup>182</sup> Furthermore, it found that escape clauses could be used by member states faced with disruptions in particular sectors, resulting from tariff cuts designed to impose quantitative limitations, provided that rigid standards are met.<sup>183</sup> In addition, it might be politically necessary to include guarantees for Canadian employment so long as they are subject to a rigid, short-term transitional time period.<sup>184</sup>

### iv. Adjustment Assistance

The committee also found that most of the burden of adjustment resulting from a Canadian-United States free trade agreement would fall on Canada.<sup>185</sup> This is because the impact of United States competition on Canadian industry would be much greater than the impact of Canadian competition on United States industry.<sup>186</sup> The committee, therefore, was of the opinion that a well planned program of adjustment assistance to affected industries would be an essential aspect of a

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179. *Id.*

180. *Id.*

181. *Id.* at 93.

182. *Id.*

183. *Id.*

184. *Id.*

185. *Id.* at 94.

186. *Id.*

Canadian-United States free trade agreement.<sup>187</sup>

#### v. Subsidies

The committee recommended that a free trade agreement between Canada and the United States include an explicit understanding of "a balance of mutually tolerable subsidy programs."<sup>188</sup> These would meet each state's needs without unduly frustrating the objectives of the agreement itself.<sup>189</sup>

#### vi. Competition Policy

Rationalization through mergers of small Canadian producers, as well as the rationalization of United States firms with Canadian subsidiaries, should be encouraged.<sup>190</sup> In order to enhance such a process, the committee suggested that a free trade agreement provide that United States and Canadian competition laws be relaxed during the transition period.<sup>191</sup>

#### vii. The Institutional Structure

Finally, the committee found that a permanent joint mechanism to monitor the performance of a bilateral free trade agreement would be required.<sup>192</sup> In addition, it would be important to create an appeal tribunal to rule on complaints and violations under the free trade agreement.<sup>193</sup>

### C. *The Australia-New Zealand Closer Economic Relations-Trade Agreement as a Model*

This section examines the Australia-New Zealand Closer Economic Relations-Trade Agreement<sup>194</sup> (Australia New Zea-

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187. *Id.* at 96.

188. *Id.* at 98.

189. *Id.*

190. *Id.*

191. *Id.* at 99.

192. *Id.*

193. *Id.* at 106.

194. Mar. 28, 1982, Australia-New Zealand, 22 I.L.M. 945 (1983) [hereinafter cited as Australia-New Zealand Agreement]. The objectives of the treaty are:

- (a) to strengthen the broader relationship between Australia and New Zealand;
- (b) to develop closer economic relations between the Member States through a mutually beneficial expansion of free trade between New Zealand and Australia;

land Trade Agreement) as a possible model for a bilateral free trade agreement between Canada and the United States. The desirability of this model is twofold. First, the relationship between Australia and New Zealand is remarkably similar to the one between Canada and the United States.<sup>195</sup> Second, the provisions of the Australian New Zealand Trade Agreement seem to fit squarely within the recommendations of the Standing Senate Committee and the needs of Canada and the United States in their trade relationship.<sup>196</sup>

### 1. Parallels

The economic relationship between Australia and New Zealand parallels the Canadian-United States situation.<sup>197</sup> Like Canada and the United States, Australia and New Zealand have developed a close economic relationship, and their citizens tend to think of themselves as part of the same culture. Not only do they share a common language, historical origin and geography, but they are also each other's major trading and investment partners.<sup>198</sup> Moreover, New Zealand, with a population one-fifth the size of Australia's, expressed the same reluctance Canada now expresses about entering into a free trade agreement with its larger neighbor.<sup>199</sup> New Zealand feared such a move would diminish its ability to safeguard long sheltered industries.<sup>200</sup> Both nations recognized that the New Zealand Australia Free Trade Agreement,<sup>201</sup> a product-by-product free trade approach similar in concept to sectoral free trade between Canada and the United States, was far too re-

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- (c) to eliminate barriers to trade between Australia and New Zealand in a gradual and progressive manner under an agreed timetable and with minimum of disruption; and
  - (d) to develop trade between New Zealand and Australia under conditions of fair competition.

*Id.* art. 1.

195. Interview with T.H. Gross, Commercial Counsellor, Australian High Commission, in Ottawa, Canada (Feb. 20, 1984); *see infra* notes 197-206 and accompanying text.

196. *See supra* notes 173-93 and accompanying text.

197. Interview with T.H. Gross, Commercial Counsellor, Australian High Commission, in Ottawa, Canada (Feb. 20, 1984).

198. *Id.*

199. *Id.*

200. *Id.*

201. Aug. 31, 1965, Australia-New Zealand, 5 I.L.M. 305 (1966).

strictive.<sup>202</sup> In an effort to develop closer economic relations, eliminate barriers to trade between the two countries in a gradual and progressive manner, and conduct trade under conditions of fair competition, the Australia-New Zealand Closer Economic Relations-Trade Agreement was concluded.<sup>203</sup> The agreement, which complies with article XXIV of GATT,<sup>204</sup> is a comprehensive free trade arrangement that takes into account relevant regional factors.<sup>205</sup> New Zealand, for example, is given special treatment in some industry sectors that it believes are still vulnerable and require continued protection.<sup>206</sup> Clearly, this similarity appears to make the Australia New Zealand Trade Agreement an appropriate model for Canadian-United States trade relations.

## 2. Relevant Provisions

The Australia New Zealand Trade Agreement is comprehensive and includes types of provisions recommended by the Standing Senate Committee. Among areas directly recommended by the committee that the agreement covers are: tariffs,<sup>207</sup> nontariff barriers, such as antidumping action,<sup>208</sup> countervailing action,<sup>209</sup> safeguard measures during the transition period,<sup>210</sup> and government purchasing.<sup>211</sup> It also covers export subsidies and incentives,<sup>212</sup> rules of origin,<sup>213</sup> agricultural stabilization and support,<sup>214</sup> and consultation and review.<sup>215</sup>

Other provisions in the agreement would also be suitable

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202. Interview with T.H. Gross, Commercial Counsellor, Australian High Commission, in Ottawa, Canada (Feb. 20, 1984).

203. Australia-New Zealand Agreement, *supra* note 194, art. 1.

204. GATT, *supra* note 35, art. XXIV

205. See Interview with T.H. Gross, Commercial Counsellor, Australian High Commission, in Ottawa, Canada (Feb. 20, 1984).

206. See Australia-New Zealand Agreement, *supra* note 194, annex. C.

207. See *id.* art. 4.

208. See *id.* art. 15.

209. See *id.* art. 16.

210. See *id.* art. 17.

211. See *id.* art. 11.

212. See *id.* art. 9.

213. See *id.* art. 3.

214. See *id.* art. 10.

215. See *id.* art. 22. This article calls for annual meetings between ministers of member states, and meetings at the written request of either nation when one state believes that an obligation has not been fulfilled, a benefit conferred upon it by the agreement is being denied, the achievement of any objective of the agreement is

for a Canadian-United States agreement. Article 12, for instance, covers "Other Trade Distorting Factors" and provides that member states shall "examine the scope for taking action to harmonise requirements relating to such matters as standards, technical specifications and testing procedures, domestic labelling and restrictive trade practices."<sup>216</sup> Such a stipulation in a Canadian-United States context would be of tremendous help to United States manufacturers who must comply with Canadian federal legislation requiring product labelling in both French and English.<sup>217</sup> The agreement, furthermore, provides for harmonization of customs policies and procedures in particular cases by requiring each member state to consult at the written request of the other.<sup>218</sup> Article 18 contains a list of exceptions that cover areas such as general health, morals, and welfare,<sup>219</sup> while article 6 and annexes C, E, and F refer to those sectors in which the agreement has modified application, such as agricultural and other food products (e.g. tobacco, plastics, textiles, wood, and certain iron and steel products).<sup>220</sup>

### 3. Proposed Investment Section to a Bilateral Agreement

An open access investment agreement between Canada and the United States must be based on principles of national

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being frustrated, or "a case of difficulty has arisen or may arise." *Id.* A general review of the operation of the agreement will occur in 1988, based on such factors as:

- (a) whether the agreement is bringing benefits to Australia and New Zealand on a reasonably equitable basis having regard to factors such as the impact on trade . . .
- (b) the need for additional measures . . .
- (c) the need for changes in Government economic policies and practices . . .
- (d) such modification of the operation of this Agreement as may be necessary to ensure that quantitative import restrictions and tariff quotas . . . are eliminated by 30 June, 1995; and . . .
- (e) any other matter relating to this Agreement.

*Id.*

216. *Id.* art. 12.

217. *See, e.g.*, Consumer Packaging and Labelling Act, ch. 41, 1970-1972 Can. Stat. 831; Textile Labelling Act, CAN. REV. STAT. ch. 46 (1st Supp. 1970); Food and Drugs Act, CAN. REV. STAT. ch. F-27 (1970); Canada Agricultural Products Standards Act, CAN. REV. STAT. ch. A-8 (1970); Fish Inspection Act, CAN. REV. STAT. ch. F-12 (1970); Meat Inspection Act, CAN. REV. STAT. ch. M-7 (1970); Hazardous Products Act, ch. 42, 1968-1969 Can. Stat. 997.

218. Australia-New Zealand Agreement, *supra* note 194, art. 21.

219. *Id.* art. 18.

220. *Id.* art. 6, annexes C, E & F.

treatment, most-favored-nation and right of establishment.<sup>221</sup> For this reason, the terms of Canada's FIRA must be faced.<sup>222</sup> One proposal would permit the screening agency to continue through the transition period in order to protect small, dislocated Canadian firms dependent on the Canadian domestic market and faced with the need to restructure.<sup>223</sup> Once Canadian industry sufficiently rationalizes to be competitive, FIRA's importance as a screening agency would decline.<sup>224</sup> Such an alternative would make an investment treaty with Canada politically more feasible.<sup>225</sup> However, it is clear that, from a United States perspective, any agreement must eventually lead to full, free, and open access to investment between the two states.<sup>226</sup> The following are the types of provisions such an agreement would be likely to include.

#### a. National Treatment and the Right of Establishment

Foreign investors should be able to make the same kinds of investments, under the same conditions, as nationals of the host state.<sup>227</sup> Exceptions should be limited to areas of legitimate national security or related interests.<sup>228</sup> In such instances, investments should be treated in accordance with the most-favored-nation principle.<sup>229</sup> In addition, there should be no unreasonable or discriminatory barriers to establishment.<sup>230</sup>

#### b. Compensation for Expropriation

The Treaty Concerning the Reciprocal Encouragement and Protection of Investments,<sup>231</sup> between the United States

221. See International Investment Policy, Statement by the President, 19 WEEKLY COMP. PRES. DOC. 1214, 1216-17 (Sept. 9, 1983).

222. STANDING COMMITTEE REPORT, *supra* note 79, at 85.

223. *Id.*

224. *Id.*

225. Interview with D.H. Wright, Senior Associate, Business Council on National Issues, in Ottawa, Canada (Feb. 20, 1984).

226. See International Investment Policy, Statement by President, 19 WEEKLY COMP. PRES. DOC. 1214, 1216 (Sept. 9, 1983).

227. *Id.* at 1216.

228. *Id.*

229. *Id.*

230. *Id.* at 1216-17.

231. Sept. 29, 1982, Egypt-United States, art. 3, 21 I.L.M. 927 (1982) [hereinafter cited as Egypt Treaty]. This treaty was opposed by Egypt, partly because the

and Egypt, provides an appropriate model for an expropriation compensation provision in the Canadian-United States context. Such a provision should provide that no investment may be expropriated unless the taking is done for a public purpose; is accomplished under due process of law; is not discriminatory; is accompanied by prompt and adequate compensation; and does not violate any agreement regarding contractual stability or expropriation.<sup>232</sup> Compensation must equal the fair market value of the expropriated investment on the date of expropriation.<sup>233</sup> Such compensation must be calculated not to reflect any reduction in fair market value due to either prior public notice or the occurrence of the events that constituted or resulted in the expropriatory action.<sup>234</sup>

### c. Consultation and Exchange of Information

The parties should, on written request of either one, hold prompt consultations to discuss the interpretation or application of the agreement or to resolve any disputes in connection with it.<sup>235</sup>

### d. Proposed Dispute Resolution Mechanism

In order to resolve disputes arising under a free trade and investment agreement between Canada and the United States, some type of legally enforceable dispute resolution mechanism is required. Canada is not a signatory to the Treaty on the Settlement of Investment Disputes Between States and Nation-

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expropriation provisions conflicted with third world views, and is being renegotiated. Note, *An Examination of Compensation Terms in the United States-Egypt Bilateral Investment Treaty*, 16 CASE W. RES. J. INT'L L. 287, 301 (1984).

232. Egypt Treaty, *supra* note 231, art. 3.

233. *Id.*

234. *Id.* The United States Egyptian treaty provides that "such compensation shall include payments for delay as may be considered appropriate under international law, and shall be freely transferable at the prevailing rate of exchange for current transactions on the date of the expropriatory action." *Id.*

A new series of United States investment treaties, such as the Egypt Treaty under consideration here, has changed the customary prompt, adequate and effective compensation standard the above definition. Compare *id.* with Treaty of Amity, Economic Relations and Consular Rights, Aug. 15, 1955, United States-Iran, art. IV(2), 8 U.S.T. 899, 903, T.I.A.S. No. 3853. These new terms appear to require fair market value compensation and clear up possible ambiguities associated with the traditional terms. See Note, *supra* note 231, at 292.

235. See Note, *supra* note 231, at 300.



als of Other States.<sup>236</sup> Thus, arbitration, the traditional treaty dispute resolution mechanism, does not exist as a readily available alternative. Diplomacy remains as the only procedure to resolve disputes. For this reason, both Canada and the United States should adopt procedures recommended by a joint working group of the American Bar Association and Canadian Bar Association for a system of third-party settlement of legal disputes.<sup>237</sup> The draft treaty, which is designed for the legal backgrounds of Canada and the United States, is composed of a mechanism to which both countries could submit disputes arising out of "any question of interpretation, application or operation of a treaty in force between them."<sup>238</sup> When a dispute arises, it would be submitted to a three member arbitral tribunal, one from each member state with the third selected by agreement of the two states.<sup>239</sup> Where nations are unable to agree on the choice of a third arbitrator within 120 days, the matter would be referred to a special chamber of the International Court of Justice.<sup>240</sup> Compulsory arbitration would be available if all efforts at negotiation failed.<sup>241</sup> In January, 1984, a similar dispute resolution mechanism was introduced by Senator Mitchell into the United States Senate.<sup>242</sup>

#### IV. OUTLOOK AND SUMMARY

In a recent article, Canada's national newspaper reported that Canada is now pursuing a policy of free trade with the United States.<sup>243</sup> According to the report, some high-ranking Canadian officials even favor full bilateral free trade with the United States.

Sylvia Ostry, deputy minister of international trade, places

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236. *Opened for signature* Aug. 27, 1965, 17 U.S.T. 1270, T.I.A.S. No. 6090, 575 U.N.T.S. 160.

237. Am. Bar Ass'n & Can. Bar Ass'n, *Draft Treaty on a Third-Party Settlement of Disputes*, in SETTLEMENT OF INTERNATIONAL DISPUTES BETWEEN CANADA AND THE U.S.A. xxi (1979).

238. *Id.* art. 1.

239. *Id.* art. 3.

240. *Id.*

241. *Id.* art. 1.

242. S. 2228, 98th Cong., 2d Sess. § 62 (1984).

243. *Free Trade Backers Predict Economics of Scale*, *Globe and Mail*, Mar. 16, 1984, at 1, col. 3.

great store in free-trade arrangements. She does not think free trade would impinge on national sovereignty.

"Look at Europe," she insists. "The countries are as nationalistic as ever. Look at Canada. Ask yourself: is Canada now more linked to the U.S. economically than it was in 1950? The answer is yes. But has that diminished Canada's sense as a nation? The answer is no."<sup>244</sup>

Prominent members of Canada's business community appear to be in agreement.<sup>245</sup> Pierre Lortie, president of the Montreal Stock Exchange, is quoted as saying "[we] should aim at total integration. . . . Our governments may lose some of their discretionary powers but Canada as a whole will gain. The time has come to seriously consider the North American option."<sup>246</sup> The Reagan Administration welcomes Canada's overture to liberalize trade.<sup>247</sup> According to one official, the United States is "essentially following the Canadian Government's lead."<sup>248</sup>

Investment, unlike trade, is not an area Canada is seeking to liberalize.<sup>249</sup> One official in the United States State Department noted that overall the Canadian-United States relationship is "in good shape,"<sup>250</sup> and that Canadian administration of FIRA has improved.<sup>251</sup>

### CONCLUSION

Although Canada and the United States are each others' major trading partners, they have not concluded a comprehensive trade agreement to resolve disputes or protect trade between the two nations. A comprehensive, bilateral, free trade, open access investment agreement between Canada and the United States, similar to the Australia-New Zealand Closer Economic Relations Trade Agreement, would facilitate trade

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244. *Id.* at 14, col. 2.

245. *Id.* col. 6.

246. *Id.*

247. King, *Reagan Aide Welcomes Overture*, *Globe and Mail*, Mar. 16, 1984, at 14, col. 3.

248. *Id.* col. 4.

249. Interview with D. Waddell, Canadian Director of United States Trade and Economic Relations, in Ottawa, Canada (Feb. 20, 1984).

250. Martin, *U.S. Awaits Overtures on Free Trade Pacts*, *Globe and Mail*, Mar. 20, 1984, at 4, col. 5.

251. *Id.* col. 6. This is demonstrated by increased satisfaction on the part of United States companies with how their proposals are handled. *Id.*

and investment between the United States and Canada, while providing adequate protection to those industries that may be threatened by foreign competition.