Serie documentos de trabajo

DISPUTE SETTLEMENT AND THE CANADA-UNITED STATES FREE TRADE AGREEMENT

Michael Hart

DOCUMENTO DE TRABAJO

Núm. VI - 1988

Dispute Settlement and the Canada-United States Free Trade Agreement

Michael Hart *

If there is one theme that pervades the Canada-US free-trade agreement (FTA) it is that of dispute settlement. Throughout the text the two governments enter into a variety of notification, consultation, fact-finding, advisory and conciliation obligations aimed at managing the agreement and at avoiding or settling disputes, disputes between the two governments and disputes occasioned by commercial rivalries in the integrated market.

These dispute settlement provisions follow the simple philosophy of international trade agreements from time immemorial and summed up by Will Clayton, the head of the US delegation to the ill-fated Havana Conference: "The world will be a better place to live in if nations, instead of taking unilateral action, without regard to the interests of others, will adopt and follow common principles and enter into consultation when interests come into conflict." [1]

But what a difference has emerged between the application of that principle in the days of Will Clayton and his Canadian colleague, Dana Wilgress, and the days of Simon Reisman and Peter Murphy, the two main

---

* The author is an officer of the Canadian Department of External Affairs and a former member of the Canadian team that negotiated the Canada-US FTA. He is currently on leave from the Government as a Visiting Professor at the Norman Paterson School of International Affairs at Carleton University and as a Senior Research Fellow at the Institute for Research on Public Policy. The views expressed are those of Mr. Hart and do not reflect the views of the Government of Canada.

1 Foreword to Clair Wilcox, *A Charter for World Trade* (New York: MacMillan, 1949), pp. ix-x.

protagonists in the Canada-US negotiations. Clayton and Wilgress would not have understood the preoccupation of the popular press in Canada in 1987 with the need for a binding dispute settlement mechanism; they would have been bewildered by the political rhetoric asserting that such a mechanism was central to the negotiations; and they would have dismissed as negotiating hype the claim of the negotiator that without such a mechanism, the agreement was not worth the powder to blow it to hell.

Even discounting the rhetoric, dispute settlement was a central theme of the negotiations. Protracted and difficult issues revolved around it. Indeed, the resolution of other trade policy issues in the end became a matter of determining appropriate and mutually acceptable mechanisms for joint decision-making. The dispute settlement issue can thus be used as a prism through which to view the negotiations as a whole as well as to examine the principal preoccupations in international trade relations today.

The Issue

Not all conflicts between governments, of course, can be classified as disputes and the dispute settlement provisions of the Canada-US FTA are only aimed at a small fraction of the trade and investment issues that may arise between the two governments on a day-to-day basis. Most of those issues are routinely addressed through regular diplomatic and technical contacts. To ensure that such issues do not escalate into disputes, the agreement contains a variety of notification and consultation requirements. While the provisions for managing the FTA and for avoiding disputes are important, this paper is concerned with the more formal dispute settlement provisions in the FTA and in international trade relations more generally.

Richard Bilder has defined a dispute as "a specific disagreement concerning a matter of fact, law or policy in which a claim or assertion of one party is met with a refusal, counterclaim or denial by another." He goes on to suggest that such a disagreement "has become defined, controverted and serious in contrast to other more amorphous, less-focused, and less-serious types of frictions, concerns, grievances, complaints or differences."[2] It is the mechanisms to deal with such issues that are the concern of this paper.

2 Richard B. Bilder, *When Neighbours Quarrel: Canada-U.S. Dispute-Settlement Experience* (Madison, Wisconson: Institute for Legal Studies, 1987), p. 9.

Traditionally, dispute settlement provisions in international agreements have been divided into a number of techniques, ranging from notification and consultation obligations to formal adjudication by a third party. These techniques can be classified as follows:

- consultative (notification, consultation and negotiation): the obligation to inform the other party of any actions that may directly affect its interests or that of its citizens and consult about the matter. The purpose of such consultations often is to negotiate a solution to any conflict that may arise as a result of the action. Thus the obligation is largely preventative. Governments favour this model because they control the process throughout. Additionally, when they have resolved a dispute through negotiation, the two parties are most likely to be satisfied. But a negotiated solution is always based on compromise which in turn may be based on factors other than the merits of the case, particularly if such negotiations are conducted in secret and have been subjected to the pressures of special interests. Particularly contentious issues may also prove immune to a negotiated solution.

- objective support (third-party good offices, fact-finding and enquiry): a number of agreements require that where the two parties cannot resolve a dispute through consultation and negotiation, they call in a third party to provide objective support. Such a technique often works well where governments are not the real parties to the dispute but act as proxies for private interests. A neutral statement of the facts, for example, might then help to expedite a negotiated solution. While a more potent obligation than that of the purely consultative model, a solution is still likely to be based on compromise rather than principle, favouring the stronger party. Additionally, there are more likely to be unwelcome surprises. On the positive side, experience suggests that third parties can help to neutralize contentious issues and point to solutions. Finally, governments beset by the pressures of special interests may find it helpful to be able to point to the views of an impartial third party in explaining a final settlement.

- recommendatory (third-party mediation and conciliation): the GATT dispute settlement process, and that of many other trade agreements, involves the establishment of a panel whose function is not only to establish the facts but to work with the parties to effect a mutually satisfactory solution. In the case of the GATT, when

conciliation does not work, a panel can make a ruling as to the facts of the matter and recommend a solution to the contracting parties of the GATT acting collectively who may then make a final determination. Even at GATT, such third-party rulings stop short of being binding because decisions are taken by consensus and involve the parties to the dispute. Again, governments prefer to negotiate solutions and avoid the loss of control third-party conciliation may involve; but for smaller countries, especially, third-party conciliation may reduce disparities in power and lead to a decision based on rules and principles rather than power.

- binding (third-party arbitration and adjudication): among trade agreements, only the Treaty of Rome provides for mandatory third-party arbitration involving the supranational institutions of the Community. All other trade agreements that include arbitration provisions provide that these may only be triggered with the consent of the two parties, somewhat diluting their effectiveness. One of the main advantages of both third-party conciliation and arbitration is the stimulative effect it has on recalcitrant governments. This stimulative effect is particularly strong in the face of binding and compulsory arbitration. Most governments would rather solve an issue than be exposed to a possibly unwelcome third-party settlement. Once such a process starts, it is hard to turn it off. The results are likely to be conservative, based on rules and precedent and rule out a possibly better, more creative solution. Nevertheless, especially for smaller countries, the potential of a principled and impartial solution to a vexing problem may be more than enough to offset such disadvantages.

Over the years, these basic techniques have been developed and implemented in various bilateral and multilateral agreements. In negotiating new obligations today, therefore, governments have a wide variety of experiences upon which to base their choices. No technique is without a practical application or example. As we shall see below, the trend in international trade agreements has been to go beyond simple consultative or objective support models into recommendatory and even binding models. Because these are more difficult to negotiate, dispute settlement has assumed a more role in modern trade negotiations.

Where governments have been prepared to go further than consultative arrangements, they are more likely to do so on the basis of agreed substantive rules. Dispute resolution without such rules is a mug's game

because there is no agreed basis for conciliation, arbitration or adjudication. Conversely, rules without an effective mechanism to resolve disputes about their interpretation are less likely to inspire confidence and create a stable trading environment. The GATT experience in agriculture has demonstrated the problem of dispute resolution in the absence of rules or in the absence of consensus about the rules. Complaints have been many, but few of the parties have been satisfied, even with GATT's non-binding form of dispute settlement. Disputes cannot be resolved fairly and satisfactorily in the absence of agreed rules. Indeed, the more formal and binding the dispute settlement obligations, the more detailed and substantive the rules must be. Thus the role of dispute settlement in international trade negotiations is inextricably linked to developments in the substance of international trade rules. We turn now to this interrelationship in the context of the Canada-US bilateral trade negotiations.

Some Simple Explanations

The Canada-United States free-trade negotiations were the most public trade negotiations ever conducted. For three years they dominated the public policy agenda in Canada. At its simplest, therefore, dispute settlement assumed importance because it was an issue that politicians and journalists could readily understand, describe and explain. The public political process thrives on issues that can be summed up in simple terms. It is hard to encapsulate the benefits of tariff cuts into a media-grabbing fifteen-second television clip; but a binding dispute settlement mechanism can be so treated because it addresses the inequities that have already captured public attention -- it could, for example, be portrayed as giving Canada a square deal on lumber or as wiping out the infamy of a fish countervail determination.

Equally interesting is the fact that lawyers played a much more prominent role in the negotiations than ever before. For lawyers, dispute settlement is almost an end in itself. Lawyers, including through a committee jointly sponsored by the ABA and the CBA, have long advocated the establishment of new mechanisms to resolve trade and investment disputes between Canada and the United States.[3] Remarkably

3 See, for example, the March 20, 1979 Report and Recommendations of the American and Canadian Bar Association's Joint Working Group on the Settlement of International Disputes between Canada and the United States (adopted August 15, 1979 by the ABA and August 30, 1979 by the CBA). The

enough, until recently, trade negotiators were not lawyers. Indeed, there has long been a strong antipathy between the legal fraternity and trade negotiators. Trade negotiators prefer being their own lawyers. The free-trade negotiations, however, gave full rein not only to government lawyers but also to many practitioners in private practice brought in to give expert advice. The agreement reflects this fact -- for good or for ill. When lawyers were placed in charge of this aspect of the negotiations, they seized the moment to put into reality what they had long advocated.

Finally, dispute settlement was the issue on which the business establishment first lobbied the Canadian Government for a new and better trade relationship with the United States. The business community as a whole did not initially seek the elimination of tariffs (they liked Canada's tariff) or a more open market for trade in services (like many government officials, they weren't sure what the issues were). Rather, they advised the Government to negotiate a framework agreement containing two elements -- a program for negotiating reductions in barriers at some indefinite point in the future and agreed procedures for the speedy and amicable settlement of disputes immediately. Their primary concern was the increasing number of intractable trade and investment disputes souring relations between the countries. It was only gradually that Canada's business leaders warmed to a much more comprehensive view of an agreement and accepted the advantages of removing barriers sooner rather than later.[4]

Interesting as these factors may have been, they were in reality no more than symptoms of much deeper changes in the conduct of trade relations and the pursuit of international trade rules over the past fifty years, changes which explain why Canada was prepared to abandon its long and fond attachment to multilateral negotiations as the forum for negotiating with the United States and why binding dispute settlement became such a critical aspect of the negotiations.

---

report and its recommendations are discussed in Erik B. Wang, "Adjudication of Canada-United States Disputes," *The Canadian Yearbook of International Law*, vol. XIX, 1981.

4 The Business Council on National Issues, for example, first suggested that the government negotiate a framework agreement and then proposed a trade enhancement agreement. Both proposals emphasized dispute settlement provisions over more substantive rules dealing with particular trade barriers. See Jock Finlayson, "Canadian business and free trade," *International Perspectives*, March/April, 1985, pp. 29-31.

Roots

As an illustration of how things have changed in the past fifty years, it is instructive to look at the two bilateral agreements negotiated between Canada and the United States in 1935 and 1938.[5] These were landmark agreements, part of the Roosevelt Administration's Good Neighbour Policy and negotiated under the aegis of the Reciprocal Trade Agreements Program. That program marked a reversal in the long trend of ever-increasing US protectionism and in congressionally mandated and executed trade policy. For the first time, Congress delegated its responsibility for trade policy to the President and the President used that authority to open the US market to foreign goods on a reciprocal and negotiated basis. [6]

It also marked the first time since Canada became a nation that the two neighbours extended most-favoured-nation treatment to each other. Ever since the United States Congress abrogated the Elgin-Marcy Reciprocity Treaty in 1866, the United States and Canada had on various occasions sought to place their trade on a more advantageous footing but each effort had failed. As a result, the two countries treated each other's goods to the highest barriers. Canada and the United States, insofar as their bilateral trade was concerned, treated each other then as they treat Albania and North Korea today. [7]

But one looks in vain in those agreements for detailed dispute settlement or other institutional provisions. There are no rules providing for notification, consultation and conciliation. There is a general nullification and impairment clause [8] indicating that if either party feels aggrieved, it should enter into negotiation with the other and try to resolve the matter. On the whole, the substantive obligations in the agreement were considered clear enough. And perhaps they were. In 1935, a comprehensive trade agreement basically dealt with two issues: the tariff and quotas. Both are straightforward measures applied at the

5 Canada Treaty Series, No. 9 (1936) and No. 8 (1939).

6 A good exposition of the Reciprocal Trade Agreements Program and its relationship to post-war trade policy can be found in William A. Brown, *The United States and the Restoration of World Trade* (Washington: Brookings Institution, 1950).

7 For a Canadian participant's view of the conduct and importance of these negotiations, see Dana Wilgress, *Canada's Approach to Trade Negotiations* (Montreal: Private Planning Association of Canada, 1963).

8 Article XI in the 1935 agreement; Article XV in the 1938 agreement.

border. The major potential for dispute lay in the obligation to extend most-favoured-nation treatment, and it was judged an issue that could be addressed through established diplomatic channels. The whole of the 1935 agreement is 24 pages long. The text itself comprises 15 articles and requires 8 pages. The 1938 agreement extends this to 18 articles and 12 pages and adds 50 pages of annexes and schedules. The 1987 agreement, on the other hand, takes 151 articles, as many annexes and schedules and, with explanatory notes, was made public in three volumes totalling 2407 pages. Matters have changed. They have become more complex and deal with a much greater range of issues.

More Rules -- More Room for Dispute

The more detailed and complicated the rules, the more room there is for differences in interpretation and for dispute and the greater the need for mechanisms to avoid or resolve conflict. By extension, when there is greater potential for dispute, there is need for procedures that will remove disputes from the realm of high politics to that of technical discussion. A conflict every year or two can be dealt with through consultation and negotiation at the highest political level. A new dispute every month requires more complicated machinery and procedures that shield politicians from daily pressure and criticism. Thus the simple fact that agreements were becoming more complicated and detailed suggested that more formal and detailed institutional provisions might be desirable.

But the changes in international trade agreements are more than a matter of weight and length. The substance of trade policy has also changed and those changes have resulted in an increasing focus on institutional provisions. This is more than a matter between Canada and the United States. It is also a phenomenon evident in the GATT and in other bilateral trade agreements, although the bilateral Canada-United States negotiations showed it more clearly and in more detail than any previous bilateral trade negotiation, in part because it was the most comprehensive and ambitious trade negotiation ever pursued between two sovereign nations. In these negotiations the two governments sought to come to grips with the changing nature of trade relations and place their economic relationship on a more modern footing. In effect, their effort sought to replace an agreement negotiated forty years earlier, the GATT, an agreement that reflected the experience and policies of the 1930s and 1940s.

Growth in Role of Government

One of the basic changes that the Canada-US negotiations needed to take into account is the growth in government and in bureaucracies. Governments have become involved in a wide range of activities aimed at political, economic, cultural and social objectives, each of which raises the potential for conflict between nations. Tax incentives, adjustment assistance programs, domestic content requirements, government purchasing policies, minimum price and maximum production programs and research and development assistance have resulted in governments in industrialized countries assuming an increasingly more influential role in determining who produces what for whom. Pure private enterprise has become a fiction. The issue is no longer whether governments should interfere in the economy, but how and when and for whose benefit. This all-pervasive role of modern governments carries with it considerable potential for intergovernmental conflict.[9] The ongoing crisis in world trade in agriculture, for example, is no more than a dispute about the appropriate role of government in the economy.

With the growth in government activity has come the end of old boy networks. In the 1930s and 1940s, the leadership of the international trade policy community were a small group of men of similar age and background. They were graduates of half a dozen schools (Cambridge, Oxford, the LSE, Harvard, Yale and Princeton), had read the same books, and had a shared view of the world. Not only did they see each other at international conferences, but they became life-long friends, sent each other birthday and Christmas cards and even summered together. They did not need elaborate machinery to resolve disputes. They did not need a detailed construction of rules. At early GATT meetings, they aired their differences and Dana Wilgress, Canadian veteran of the negotiations and chairman of the first five annual sessions of the GATT, would appoint two or three to sit down with the disputants, work out the differences and report back to the whole meeting. Resolving a dispute was a matter of common sense, not of rules and procedures.[10]

---

9 An interesting analysis of the problems generated by the growing role of government in modern society is provided by Colin Campbell, *Governments Under Stress* (Toronto: University of Toronto Press, 1983).

10 Contemporary accounts of this informal, old-boy network approach to resolving trade disputes, particularly between Canada and the United States, can be found in the memoirs of Canadian trade and other senior officials, of which, fortunately, there are quite a number. See, for example, Arnold Heeney, *The things that are Caesar's: Memoirs of a Canadian public servant* (Toronto: University of Toronto

Today, there are few veterans. Each negotiation brings new faces. Shared assumptions and outlooks are matters of the past. At GATT meetings, the British delegate does not speak but defers to the spokesman for the Community, who could be a Greek or a Dane. The US delegate is more likely to be a graduate of Ohio State than of Harvard and to have studied micro-economics or climatology rather than liberal arts. Canada may be represented by a fisherman's son from Newfoundland rather than a scion of the Toronto or Montreal establishment. Even more remote in background and outlook are the representatives of Indonesia, Cote d'Ivoire and Peru. In such a changed atmosphere there is much to be said for finding refuge in agreed impartial and impersonal rules and procedures.

From MFN to National Treatment

Even more fundamental in the pursuit of agreed rules and procedures has been the change from the central importance of most-favoured-nation treatment (MFN) to an increasing emphasis on national treatment. These concepts are the two basic pillars of non-discrimination governing international trade relations. They are at the heart of the GATT and they underpin all modern trade agreements. But the relative importance of these two principles has changed. [11]

Press, 1972); Hugh L. Keenleyside, *Memoirs of Hugh L. Keenleyside*, vol. I: *Hammer the Golden Day* (Toronto: McClelland and Stewart, 1981); vol. II: *Bridge of Time* (Toronto: McClelland and Stewart, 1982); Lester B. Pearson, *Mike: The Memoirs of the Right Honourable Lester B. Pearson,* Volume I: 1897-1948 (Toronto: University of Toronto Press, 1972); Escott Reid, *Time of Fear and Hope: The Making of the North Atlantic Treaty 1947-1949* (Toronto: McClelland and Stewart, 1977); and Dana Wilgress, *Memoirs* (Toronto: Ryerson Press, 1967). The same theme is captured in Jack Granatstein, *A Man of Influence: Norman A. Robertson and Canadian Statecraft 1929-1968* (Ottawa: Deneau, 1981); *The Ottawa Men* (Toronto: Oxford, 1982) and, with Rober Cuff, *American Dollars, Canadian Prosperity: Canadian-American Economic Relations 1945-1950* (Toronto: Samuel-Stevens, 1978).

11 MFN addresses the issue of external discrimination while national treatment addresses the issue of internal discrimination. MFN impinges directly on the foreign policies of governments while national treatment affects their domestic policies. MFN means that countries will not discriminate among sources of imports or destinations of exports at the frontier, i.e., that the goods produced by country A will be treated no less favourably than country B in terms of tariffs, quotas, export taxes and other measures applied at the border. The treatment extended, of course, National treatment in GATT means that once goods have entered into the territory of a country, they will be treated no less favourably than goods of domestic origin as regards domestic taxes, laws, regulations and other requirements affecting their internal sale. National treatment does not mean that

When MFN was the main preoccupation, it was a question of agreeing to treat all foreigners the same while reserving the right to treat your own people better. While the principle may only be honoured in the breach today, it is no longer a matter of controversy.[12] But in the 1930s and 1940s Canadians found it an infringement of their sovereignty that an international agreement should dictate that they could not treat British goods better than American goods. Similarly, American legislators were only prepared to extend MFN on a conditional basis, i.e., only if they were satisfied that their generosity would be reciprocated on a bilateral basis. In effect, they were not prepared to extend MFN. Today, with the challenge having shifted to national treatment, Canadians are sensitive about an international agreement determining what kind of government assistance can be extended in the name of regional development while Americans are concerned about Canadians participating in a review of decisions by a US court. These are now the issues. This shift in sensitivity about the kinds of international obligations that may erode national sovereignty can be illustrated by examining some popular attitudes toward international transactions.

International agreements are made between governments, but they establish rules and standards of behaviour that largely govern transactions that take place between private parties. Most international trade disputes, therefore, are at root a conflict between private parties, even where they may involve government policies. It is not the United States Government that is concerned about Canadian subsidies, but rather US firms competing with Canadian firms that may have benefitted from such subsidies.

Most of us are quite relaxed about competitive quarrels between domestic firms. But let one of the firms be foreign, and a whole panoply of other factors enter into play. We would not tolerate a government helping Heinz ketchup maintain its market share by placing a production quota on Hunt's catsup. But that is in fact what we do tolerate for

---

foreign goods are treated in the domestic market as they would be in their country of origin. Such treatment would involve reciprocity.

12 In indicating that the issue is not controversial as a matter of trade policy, I am not suggesting that all countries routinely put into practice an obligation they all accept in principle. That is clearly not the case. Abuse of the MFN principle is rampant, for example, in voluntary export restraints and regional integration agreements, but these abuses in no way undermine the basic commitment of most industrialized countries to the principle of MFN.

domestic companies in trouble, when we allow governments to place quotas on imports. At heart we are all mercantilists! [13]

These differences are also reflected in attitudes to trade disputes. If Exxon has a complaint about the marketing practices of Texaco, it is free to bring a civil suit and press its claim in open court based on the facts it has assembled. Only if Texaco has engaged in criminal activity is the government brought into the case and then not on behalf of Exxon but on behalf of all citizens. But if General Motors or Ford is unhappy about the marketing practices of Hyundai, it can ask the government to help them do something about them, as they did recently in bringing a dumping suit in Canada. As long as the complaint is properly documented (a relatively simple challenge), government officials then become investigators, prosecutors and adjudicators of the complaint. Most of us accept this state of affairs with equanimity. There is no reason in logic, however, that we should. It may be a normal, nationalistic reflex -- but it is not a rational, economic response. [14]

There is a further complication. The fact that General Motors or Ford can turn to the US or Canadian government for help in resolving its competitive problems with Hyundai means that Hyundai will turn to the Government of Korea for help and thus private disputes become disputes between governments. To shield themselves somewhat from domestic critics and to make life more stable and predictable, governments have

---

13 Mercantilists believe that exports are good and imports are bad, and reject the notion that international trade based on comparative advantage and specialization is the route to economic growth. Most-favoured-nation and national treatment are alien to mercantilism. Modern mercantilists clothe their arguments in terms of reciprocity and seek to gain mutual and equal advantage or, often, to ensure that they have no disadvantage. The increasing resort to trade remedy laws as the principal instruments of protection constitutes a rejection of most-favoured-nation and national treatment and an effort to undermine the benefits of specialization and comparative advantage. The spread of "conditional" most-favoured-nation treatment in the GATT codes negotiated in the Tokyo Round lend help and comfort to the mercantilists, by establishing classes of MFN.

14 For an interesting exposition of the conflict between trade policy and competition policy, see a paper commissioned by the Canadian Department of Consumer and Corporate Affairs for consideration by the OECD Committee on Competition Policy by Rodney Grey, "Trade Policy and the System of Contingency Protection in the Perspective of Competition Policy," (OECD Document DAFFE/RBP/WP1/86.3). Another paper commissioned by CCA, Klaus Stegemann, "The Consideration of Consumer Interests in the Implementation of Anti-dumping Policy" was prepared for a 1984 OECD Symposium on the Consumer Policy and International Trade.

gradually negotiated more and more international rules to govern these situations and the increase in rules has created new conflicts requiring resolution. These rules have increasingly delved into matters that were once considered matters of purely domestic concern.

The trade rules of the past accepted that one could penalize foreign companies to the benefit of domestic companies. The trade rules of the future probably will not. That is what the move toward extending the reach of national treatment is all about. That is the direction in which trade negotiations are moving and the issue which proved the greatest challenge in the bilateral trade negotiations just completed. That same issue is also critical to the Uruguay Round of multilateral negotiations now under way. Today's agreements deal with issues of domestic law and treatment: subsidies, product standards, phytosanitary regulations, agricultural support payments and similar issues that may at first glance appear to be matters strictly of domestic concern, but which can have direct repercussions on the trade interests of foreign firms. If one adds rules about services and investment to this mix, both of which essentially involve rules about national treatment, it is not hard to understand why dispute resolution has become increasingly important. [15]

The fact that governments are moving in that direction makes the negotiation of trade rules much more delicate. As issues become more subtle and complicated and impinge more and more on what are perceived to be domestic matters, governments will increasingly need to rely on rules and procedures that ensure that decisions are not capricious and nationally motivated. Additionally, for federal states such as Canada and the United States, the extension of national treatment and the negotiation of rules dealing with domestic regulations may involve the jurisdiction of the sub-federal levels of government, a problem both of negotiation and of enforcement. Before the bilateral Canada-US negotiation, both governments had already experienced difficulties with this phenomenon, such as the trade restrictive effect of provincial liquor regulations or state health regulations.

15 The implications of the move from MFN to national treatment are explored in Michael Hart, "The Mercantilist's Lament: National Treatment and Modern Trade Negotiations," *Journal of World Trade law*, Vol. 21, no. 6 (December, 1987), pp. 37-61.

The single most important and delicate issue on today's agenda is the question of subsidies paid out by all levels of government.[16] It affords a good example of the difficulty of modern trade negotiations. Forty years ago, the architects of the GATT thought it was enough to outlaw what they called export subsidies, direct government assistance contingent on export performance, while permitting other kinds of subsidies;[17] members were allowed to take measures to offset the distorting effect of domestic subsidies, i.e, to impose countervailing duties if subsidized imports injured domestic production. Subsidization was not a big issue then, but it is a major issue now, in part as a result of changing expectations about the role of government in society. Nevertheless, GATT members have yet to come to an understanding of what constitutes a subsidy and what is injury. Until these questions are settled, members are free to set their own standards, a right the United States has pursued with increasing zeal through its countervailing duty statute. Such unilateralism, however, runs against the spirit of international agreement and has led and will continue to lead to contentious trade disputes.

In 1986, for example, Canadians were not amused when the US Department of Commerce reversed a 1983 ruling and decided that Canadian softwood stumpage practices constituted a countervailable subsidy. To Americans, its Government was helping out a major industry that was under direct competitive threat from unfairly subsidized

16 US commentators frequently suggest that subsidization is largely a foreign problem; see, for example, Gary Hufbauer and Joanna Shelton Erb, *Subsidies in International Trade* (Washington: Institute for International Economics, 1984). There is no shortage of public sources which demonstrate the opposite. Among the most important are various studies by the Congressional Research Service (e.g., *The Subsidization of Natural Resources in the United States,* February 5, 1985) and the Congressional Budget Office (e.g., *Federal Support of U.S. Business,* January, 1984). The main growth in US subsidies has been at the state level, for which see, for example, *Directory of Incentives for Business Investment and Development in the United States,* prepared by the National Association of State Development Agencies, 2nd edition (Washington: The Urban Institute Press, 1986). Equally, there are various sources of information on Canadian subsidy practices, such as J. Peter Johnson, *Government Financial Assistance Programs in Canada,* 3rd edition (Toronto: Price Waterhouse, 1985) and *Services and Subsidies to Business: Giving with Both Hands,* A Study Team Report to the Task Force on Program Review (The Neilsen Task Force)*(Ottawa: Supply and Services, 1986).*

17 The vagueness of GATT disciplines is underscored by the fact that forty years later members could still not agree on a definition of what constitutes an export subsidy and had to content themselves with an illustrative list in the 1979 GATT Subsidies Code.

imports. To Canadians, the United States was arbitrarily and unilaterally deciding how Canada should tax its resource industries. From their point of view, the Government was free to give trees away. Thus what was a subsidy to one was a sovereign right to control resources to the other and had nothing to do with trade.[18] Conflicts with such emotional overtones are not easily settled and would benefit from clear rules and procedures that would remove the issue from the political agenda.

A good deal of effort was expended in the bilateral negotiations to come to a common understanding on subsidies and other instruments of contingency protection (such as safeguards and dumping, about which more below). These efforts did not succeed. As a substitute, the two governments agreed on procedures to handle disputes involving these matters. While not ideal, it is a step forward. The lesson for those interested in dispute settlement is that domestic policy (i.e., measures whose impact is primarily internal to a country) is much more difficult to bring under the discipline of international trade rules than foreign policy (i.e., measures whose impact is primarily felt at the border) and that while procedural solutions are better than no solution, they are not a substitute for substantive results. If future disputes are to be avoided or settled quickly and equitably, there must be agreement on both the ground rules and the process by which such disputes will be defused. Both the rules and the process must inspire confidence -- the rules must be perceived to be clear and unequivocal and the process equitable, transparent and final.

Judicialization of Trade Relations

One of the reasons theCanada-US negotiations did not fully meet this goal was the difficulty of solving the trade remedy conundrum, the conflicts engendered by the judicialization or legalization of trade issues, a development in which the United States has taken the lead but in which most other major trading countries are participating.[19] US legislators

18 The lumber issue is discussed in Michael B. Percy and Christian Yoder, *The Softwood Lumber Dispute & Canada-U.S. Trade in Natural Resources* (Halifax: Institute for Research on Public Policy, 1987).

19 Rodney Grey has coined the phrase "contingency protection" to refer to the various devices available to governments to restrict trade on a contingent or administrative rather than regular basis. These devices include antidumping and countervailing duties, safeguard procedures and measures to deal with unfair trade. In all these cases, trade flows unless it can be proven that the goods are tainted by unfairness or injury calling for either exclusion orders or offsetting penalties. He has argued that this form of administered protection is inherently

discovered earlier in this century that they could satisfy their constituents' complaints about foreign competitors by giving the US courts the right to try cross-border trade disputes. Rather than addressing the individual complaints of various producers, they established classes of action and defined what was acceptable and what was not. In 1897 they decreed that foreign exporters could not evade the tariff by accepting an export subsidy and gave the executive the right to levy a countervailing duty. In 1921 they gave the executive the right to levy anti-dumping duties. Both these laws created private rights of action, i.e., mandatory procedures triggered by private complaints. Since then, every Congress has seen fit to add to these private rights of redress and to enshrine increasingly more complex tests into the trade legislation. Sparingly used before the 1970s, these private trade remedies have become the instrument of choice in the 1980s and as a result have altered the nature of intergovernmental trade relations. Rather than one government addressing the complaints of its citizens to another government on the basis of international treaty rights, citizens address their complaints directly to quasi-judicial domestic panels or the courts which will try the issues on the basis of domestic law.

As went the United States Congress, so went the United States' major trading partners, although not all adopted the highly legalistic US approach. The European Community, for example, opted for an administrative system allowing bureaucrats the flexibility to negotiate solutions with complainant and offender, often behind closed doors. Canada adopted procedures very similar to those in the United States.

It is one thing if private rights reinforce treaty rights and obligations, it is quite another if they unilaterally extend rights and obligations. In general, in extending these private rights, the US Congress has paid little heed to US international trade obligations. The basic framework of US trade remedy laws predated the GATT and was little affected by it. The many new wrinkles adopted since have filled vacuums in the GATT system or simply interpreted the GATT in new ways. Louis Sohn has noted that at present,

---

discriminatory and only suitable for larger countries capable of devoting the necessary investigative resources to make it work. See Rodney de C Grey, *United States Trade Policy Legislation: A Canadian View* (Montreal: The Institute for Research on Public Policy, 1982). A description of Canadian and US contingent protection laws can be found in Robert K. Paterson, *Canadian Regulation of International Trade and Investment* (Toronto: Carswell, 1986) and Eugene T. Rossides, *US Import Trade Regulation* (Washington: Bureau of National Affairs, 1986) respectively.

> in the gray areas where the [GATT] rules are unclear, both the rules and remedies are provided mostly by national legislation and national courts, to the great dissatisfaction of the other country which considers it below its dignity and a violation of the sovereign equality of states that the court of another country would judge the validity of its acts and would take steps against its nationals on the basis of its own legislature's interpretation of the applicable [international] rules.[20]

From the Kennedy Round on, trade negotiations have tried to come to grips with this judicialization of trade policy. The Tokyo Round codes were one answer -- establishing internationally agreed procedural standards for the pursuit of these judicial trade remedies. In the Canada-US negotiations sought to come to grips with more basic issues -- what in fact is unacceptable price discrimination in international trade and what constitutes a trade distorting subsidy. Much useful discussion took place but agreement remained elusive. These issues remain on the agenda.

The trend toward increasing judicialization of trade relations is not liable to be reversed. The United States Congress is unlikely to be convinced that it should begin to dismantle this system of private rights. The challenge to trade negotiators thus is two-fold: to develop better substantive international rules and standards governing the practices addressed by trade remedy laws such as price discrimination, subsidies and injury; and better procedures for resolving disputes about the interpretation of those rules, procedures that will lead to results that will be reflected in domestic decision-making.

Small-Country Search for Stability

It is the smaller countries especially that have found a need for agreed rules and procedures to address the judicialization of trade relations and the problems raised by the encroachment of trade negotiations on what used to be considered domestic issues. For a medium-sized power such as Canada, dependent on trade with a much larger world power, there are significant benefits to basing that relationship on a system of rules backed up by a formal, impartial dispute settlement process. Those benefits used to be supplied by the GATT. Many Canadians concluded in the 1980s that the protection of the GATT had become illusory. This is not a uniquely Canadian point of view.

---

20 Louis B. Sohn, "Dispute Resolution Under a North American Free Trade Agreement," *Canada-United States Law Journal*, vol. 12 (1987), pp. 323.

Observed one jaded Australian veteran of the Geneva of the late 1970s and early 1980s:

> If small and medium-size countries do not have confidence in GATT's dispute settlement procedures, especially where the major trading powers are concerned, it can hardly be any wonder if they do not have confidence in the GATT system as a whole. ... By the end of the 1960s divergence from GATT rules had become so widespread that most signatory countries had come to regard the GATT as no longer a legal framework for international trade but rather a set of principles more honoured in the breach than in the observance. [21]

The GATT of the early 1950s was not only homogeneous in the composition of its delegates, but also in its members who had a shared outlook and commitment to the substance of the rules. The United States may have dominated, but it did so on the basis of a commitment to making things work, while the rest were all smaller states dedicated to the protection afforded by the rules. Today, three giants dominate and there is no longer a shared view of the world. The European members are committed first to the consolidation of the new European Empire, a giant customs union supported by client states benefitting from various preferences, the whole structure at odds with the GATT principle of non-discrimination. Developing members are committed either to their alliance with the EC or to defending their special and differential status. Japan has yet to accept that one exports in order to import and maintains a market closed to a wide range of goods. The United States regrets its earlier generosity and seeks ways to address its declining competitiveness and "even the playing field. [22]

The Big Three have often demonstrated that they would prefer to work things out among themselves without the interference of the smaller members. They occasionally invite Canada to participate as the representative of the small and unimportant. Canadian officials sometimes have difficulty appreciating what is expected of them on these occasions. Periodic statements of rededication to the principles of GATT

---

21 C. F. Teese, "A View from the Dress Circle in the Theatre of Trade Disputes," *The World Economy*, vol. 5, number 1 (March, 1982), pp. 43 and 49.

22 On the problems facing the GATT, particularly the dispute settlement process, see Robert E. Hudec, *The GATT Legal System and World Trade Diplomacy* (New York: Praeger, 1975) and Adjudication *of International Trade Disputes* (London, Trade Policy Research Centre, 1978); Miriam Camps and William Diebold, Jr., *The New Multilateralism: Can the World Trading System be Saved* (New York: Council on Foreign Relations, 1983) and The Atlantic Council, *The Uruguay Round of Multilateral Trade Negotiations Under GATT: Policy Proposals on Trade and Services* (Washington, 1986).

notwithstanding, the Big Three have been in the forefront in watering down the practical effect of GATT disciplines. Said the Atlantic Council of the United States in a recently released study:

> The rhetorical declarations of support for freer trade and against protectionism which are repeated at almost every GATT and OECD Ministerial gathering and even at Economic Summit meetings do not constitute an adequate demonstration of political will and have lost their credibility. [23]

In these circumstances, it is little wonder that the smaller countries are insisting on more stable and predictable rules and procedures. In their view, they have seen GATT's dispute settlement process change from one dedicated to adjudication on the basis of rules and principles to one that smooths the way for diplomatic, negotiated solutions.[24] Canada especially has been preoccupied with strengthening the dispute settlement provisions and thus promoting stability and predictability. It raised the issue as an important item for the 1982 ministerial meeting and has repeatedly returned to the theme. It is central to its objectives for the Uruguay Round.

For Canada, the strength of multilateralism used to lie in the fact that its officials could build alliances with delegates from other, like-minded countries, and have an impact through group action -- although this may be more myth than fancy. Today, there are few with whom to build alliances; many of the smaller European countries have become part of the suffocating embrace of the Community; Australia and New Zealand share Canada's interest in resource trade but have an entirely different perspective on trade in manufactures and services. There are now few who share Canada's outlook. Indeed, it is the United States with which Canada has the most in common. Alliances now seem less important, as do negotiations, where Canada is a fringe player. If GATT continues to have a value, it is as a forum for dispute settlement, and that value has waned as the consensus about the rules has eroded.

---

23 The Atlantic Council, *The Uruguay Round of Multilateral Trade Negotiations Under GATT: Policy Proposals on Trade and Services* (Washington, 1986), p. 27.

24 See C. F. Teese, "A View from the Dress Circle in the Theatre of Trade Disputes," *The World Economy*, vol. 5, number 1 (March, 1982).

Dispute Settlement and Sovereignty

As agreements have become more complex and have dealt more and more with domestic issues and the search for more binding or stabilizing forms of dispute settlement has intensified, the potential conflict with sovereignty has increased. The desire for stability and predictability places a premium on objective, policy neutral solutions. But the greater the move towards judicial rather than political-type dispute settlement (i.e., from negotiation and conciliation to third-party arbitration and reliance on permanent joint institutions), the greater the potential erosion of sovereignty. The institutional provisions of an agreement, more than anything else, bring home how international negotiations can compromise national sovereignty. Politicians are loathe to admit this, but it is a fact that the whole purpose of international agreements is to tie the hands of governments. Bob Hudec has noted:

> The main reason for establishing an international regulatory structure is to create pressure that will influence governments to act in conformity with certain agreed objectives. The fact that governments are prepared to accept regulations indicates a shared perception of the need for mutual restraint and discipline. ... The prime objective of regulatory policy is to make this shared value a more effective influence on conduct by creating institutions that will augment its force.[25]

The challenge is to find that delicate balance between what is necessary to restrain the actions of other governments and what is acceptable to one's own. That is what negotiations are all about. Finding that balance has become increasingly delicate and difficult. [26]

While all agreements involve binding commitments, governments have tended to shy away from advance commitments to binding dispute settlement involving third parties. Marcel Cadieux, former Ambassador to the United States and veteran Canadian diplomat, noted "the almost overwhelming preference on the part of both Canada and the United States over the years to resolve their disputes through negotiations rather than through adopting a strictly legal approach."[27] Both governments

---

25 Robert Hudec, "GATT Dispute Settlement After the Tokyo Round: an Unfinished Business," *Cornell International Law Journal*, vol. 13 (1980), p. 145.

26 The Macdonald Commission Final Report includes a detailed and sensitive discussion of the relationship between sovereignty and international trade agreements.

27 Quoted in Erik B. Wang, "Adjudication of Canada-United States Disputes," *The Canadian Yearbook of International Law*, vol. XIX, 1981, p. 159.

have tended to fear that they will not have sufficient control over the outcome of more formal mechanisms, particularly if the third-party is a standing tribunal. They hold no such fear, of course, about domestic courts. The argument runs that what may be acceptable for the resolution of disputes between private parties is not acceptable for disputes between governments, even where these have their origin in private-party disputes.

Concerns about sovereignty and dispute settlement are not unrelated to the problem of enforceability. Unlike domestic law, international dispute settlement depends greatly on the will of the disputants to be governed by the settlement. This is not much of a problem in consultative or objective support models but becomes an issue once the parties have accepted third-party adjudication or have delegated authority to a permanent joint institution. Part of members' dissatisfaction with GATT dispute settlement, for example, arises out of the problem of enforcement. The only sanction available to GATT members is to withdraw concessions from the offending state, a penalty that can often harm the offended state more than the offending, especially if the latter is large and the former small. The only real sanction, therefore, is that failure to abide by decisions undermines confidence not only in the dispute settlement process but also in the integrity of the rules themselves. This is a sanction not always appreciated by governments beset by the pressures of special interests. Politicians and government officials, therefore, have tended to be skeptical about the benefits of third-party arbitration and joint institutions.

Additionally, government officials tend by nature to be conservative and traditionalist. They resist change because change may involve unknown complications. More importantly, institutional change could involve a dilution of powers and a new sharing of authority. In the absence of formal mechanisms to resolve disputes, responsibility rests within existing diplomatic and bureaucratic channels. More formal mechanisms at a minimum would dilute the powers of these channels and the officials that control them. Maxwell Cohen has noted:

> Inevitably, of course, professionals often are resistant to serious change if change cuts across the use of well-tried methods and skills and without promising superior results. Inevitably, too, since ego and power are happy partners, sharing authority is not a voluntary act of much attraction. [28]

28 Maxwell Cohen, "Canada and the US -- new approaches to undeadly quarrels," *International Perspectives*, March/April 1985, pp. 16-22.

But while government officials may be skeptical and resistant to new institutions and more binding procedures, scholars, lawyers in private practice and businessmen have become increasingly convinced of the value of these more coercive forms of dispute settlement. From their perspective, the confidential nature of government-to-government negotiations leaves too much room for extraneous issues to influence the outcome of a dispute. Especially if the issue arises out of a private sector conflict, they prefer that it be resolved more openly on the basis of previously agreed rules and involving a neutral third party. These calculations influenced the increasing calls in both Canada and the United States for the development of formal dispute resolution machinery to deal with cross-border disputes, particularly trade and investment disputes, even in the absence of agreed substantive rules on these issues. Among influential voices were:

- The Canadian Senate Committee on Foreign Affairs; [29]
- A Joint Committee of the American and Canadian Bar Associations;[30]
- The Macdonald Commission;[31] and
- The Business Council on National Issues.[32]

The Bilateral Negotiations

The attitudes and developments discussed above were critical in the preparation for and the conduct of the bilateral negotiations. Indeed, they formed the basis in Canada for seriously considering a move away from the perceived safety of multilateral negotiations to the danger of negotiating one-on-one with the United States. If Canada had to abandon its traditional strong reliance on multilateralism to achieve its trade agenda, the new agreement had at a minimum to contain strong rules and institutional provisions to overcome the much feared disparity in power

29 The Committee, under the chairmanship of Senator George vanRoggen, spent eight years studying Canada-US relations and issued its report *Canada-United States Relations,* in three volumes in 1976, 1978 and 1982. The first volume dealt with the institutional framework, the second with trade relations and the third with the issue of a free-trade agreement.

30 See footnote 3 above

31 *Royal Commission on the Economic Union and Development Prospects for Canada* (Ottawa: Supply and Services, 1985). The Commission was chaired by the Honourable Donald Macdonald. The section on trade relations can be found in volume one.

32 See footnote 4 above.

between Canada and the United States. In reality, that disparity may not be so great when it comes to individual issues, but this does not lessen the perception that strong dispute settlement procedures were essential to making the agreement acceptable to Canadians.

The Canada-United States trade and investment relationship is the largest in the world and even on a calm day, there are dozens of conflicts at issue. These, however, had become increasingly acrimonious in the 1980s and resistant to traditional techniques, including GATT. Two issues stood out. One was growing Canadian concern with judicialization. It had introduced a high degree of unilateralism into the relationship and had become a fertile field for trade frictions and need for dispute resolution. One trade policy veteran observed:

> Domestic legal and administrative systems which govern trade have now become so extensive and complex that only full-time specialists can understand them; they have become correspondingly open to manipulation by powerful, special interest groups and at times can operate with unpredictable results. The growing complexity of these domestic trade policy systems generates pressures for international rules to govern their use.[33]

To match this Canadian concern, American officials were convinced that in Canada, both federal and provincial governments had moved beyond the acceptable in their participation in the economy, distorting trade and investment patterns to the detriment of US interests. Of particular concern were the Foreign Investment Review Agency implemented in 1975, the National Energy Program introduced in 1980 and a continuing preoccupation with regional development assistance. Thus Canadian concerns with secure access to the United States market were countered by US concerns about trade distortion. As well, US desire to broaden the scope of the trade agreement into the areas of investment and services, added potentially explosive issues to the agenda.

Given these factors, it was no wonder that dispute settlement figured prominently in the negotiations. Ironically, however, Canada viewed strong dispute settlement provisions as a shield to protect its sovereignty and overcome the disparity in power between the two nations in an agreement that would contain far-reaching substantive provisions, while

33 Frank Stone, *Institutional Provisions and Form of the Proposed Canada-United States Trade Agreement,* (Ottawa: Institute for Research on Public Policy, mimeo, 1985).

the United States regarded the dispute settlement provisions themselves as potentially the greatest threat to its sovereignty.

The Canada-US FTA thus proved an experiment that sought to go beyond GATT by establishing binding dispute settlement without the supranational institutions which made this possible in the Treaty of Rome. This desire to go beyond GATT reflects the fact that the objectives of the two governments suggested that they were embarked on negotiating an agreement that would be more integrative than GATT but less so than the Treaty of Rome. The challenge for the architects, therefore, was to find that fine line between the economic virtues of stability and efficiency and the political demands of sovereignty.

Canadian officials stressed from the outset that satisfactory results on dispute settlement and trade remedy law were central to a successful outcome for the negotiations. Canada wanted binding dispute settlement and a wholly new regime to deal with the practices addressed by trade remedy law. US officials, on the other hand, countered that it would be very difficult if not impossible to accept binding dispute settlement, to establish any permanent institutional machinery or to negotiate a new trade remedy regime that would stretch disciplines beyond those enshrined in GATT. Thus the fears of some Canadians about a small country negotiating with a big country appeared to be well founded in US insensitivity to these central concerns. Canadians, on the other hand, were not sensitive to US concerns about the precedents the agreement would set for a major power with interests all over the world. Early on, therefore, it appeared clear that both sides had to show considerable ingenuity to come up with acceptable compromises on these key issues.

What is in the Agreement

The agreement required compromises -- comprises between domestic interests in both countries as well as between the United States and Canada. Thus in terms of the objectives set by the two governments at the outset of negotiations, there remain areas for improvement. Canada, for example, would like to see more progress in the trade remedy and government procurement areas while the United States would like to develop an intellectual property chapter as well as stronger obligations in the investment area. Much of the enthusiasm expressed at the beginning of the negotiations had to be tempered by the reality of domestic politics on both sides of the border. The result is a conventional trade agreement to which have been added a number of cautiously pioneering chapters.

This less ambitious result tempered the need for far-reaching dispute settlement provisions.

In general, the FTA provides a code of conduct for the two governments in their regulation of both private firm behaviour and their own economic policies. It covers trade in all goods and most services as well as many investment transactions and most business travel. The most extensive obligations cover trade in goods and include obligations regarding tariffs, rules of origin, quotas, customs procedures, safeguards, unfair trade remedies, government procurement, national treatment, technical barriers and exceptions. The rights and obligations in these chapters are based on GATT and are consistent with the rules set out in GATT Article XXIV. Four sectors are singled out for special treatment, in most cases in order to specify exceptions to the general obligations. In all these aspects, the FTA is very conventional in its approach, although there are fewer exceptions than in many other free-trade area agreements.

What makes the agreement pioneering is its coverage of services, investment and business travel. The obligations regarding services are limited to those traded services specified in an annex and the commitment is confined to maintaining the status quo or better, i.e., not to discriminate in favour of local suppliers any more than is already the case. Thus the obligation for traded services is much less than for trade in goods. For investment, there is a similar future oriented pledge not to introduce new forms of discrimination. The only rollback from current discrimination is in the Canadian regulation of direct and indirect takeovers where Canada has agreed to phase out review of the latter and to limit the review of direct takeovers to those involving Canadian assets in excess of $150 million. The third non-traditional area, business travel, sets up rules which will make it possible for Canadians and Americans to travel relatively freely between the two countries in order to carry on the activities covered by the rest of the agreement. Thus, while these three chapters may break new ground for a free-trade area agreement, they do so cautiously.

It is in the two chapters dealing with dispute settlement that an effort is made to build a basis for a more ambitious agreement for the future, particularly the chapter devoted to settling disputes involving trade remedies. It is here that the two governments sought to come to grips with the problem of judicialization.

The general dispute settlement chapter establishes a range of institutional obligations to avoid and settle all but disputes between the Parties related to trade remedies and financial services.[34] They include:

- mandatory notification of any measure;
- mandatory provision of information to the other party on any measure, whether or not it has been notified;
- consultations at the request of either party concerning any measure or any other matter which affects the operation of the Agreement, with a view to arriving at a mutually satisfactory resolution;
- referral to a Canada-United States Trade Commission, should resolution through consultations fail; and
- use of dispute settlement procedures should the Commission fail to arrive at a mutually satisfactory resolution. Procedures are:
  - compulsory arbitration, binding on both parties, for disputes arising from the interpretation and application of the safeguards provision;
  - binding arbitration in all other disputes where both parties agree; and
  - panel recommendations to the Commission, which, in turn, is mandated to agree on a resolution of the dispute.

Given the complexity and scope of the FTA, the economy of these provisions has surprised some commentators such as Bob Hudec, Bill Graham and Frank Stone.[35] They have all suggested that over time, the

34 The Financial Services chapter was almost wholly the product of discussions between finance officials rather than trade officials. They were conducted in parallel with the main negotiations and the results then grafted onto the agreement. Treasury and Finance officials were skeptical that the dispute settlement provisions in a trade agreement could be appropriate to an issue that fell within the competence of finance officials and insisted that they not apply to their chapter, thus proving the point made above by Maxwell Cohen about bureaucratic inertia and reluctance to share power.

35 See Robert Hudec, "Comments on Dispute Resolution Mechanism," in Jeffery J Schott and Murray G. Smith, editors, *The Canada-United States Free Trade*

institutional provision will need to be expanded. In particular, they have noted that the absence of a permanent commission or secretariat dedicated to fact-finding and enquiry will undermine the confidence business will have in the agreement. Hudec, in addition, believes that the failure to establish a permanent adjudicatory tribunal will further undermine confidence.

These shortcomings are not surprising and reflect the fact that not all the ambitions of the two governments were met. The agreement's substantive obligations in the most difficult areas, with one exception, are not very extensive. The chapters covering government procurement, services and investment do little more than bless the status quo. The most extensive obligations cover well ploughed ground and thus do not necessarily warrant more binding and substantive dispute settlement obligations. The exception is contingency protection, about which more below.

While the concept of national treatment permeates the agreement, in areas where it would bite and create potential conflict, the two governments were prepared to tolerate exceptions, such as in services (where the obligation is future oriented and limited to covered services), subsidies (where rules remain to be determined) and agriculture (where real progress will have to be made multilaterally). But the basis has been laid to expand rights and obligations and negotiations will undoubtedly progress into potentially more difficult areas, such as subsidies or phyto-sanitary regulations. More extensive dispute settlement obligations may then be required to keep the peace.

A possible basis for expansion of the dispute settlement provisions, not requiring negotiation, can be found in the provision in Chapter

---

Agreement: The Global Impact (Halifax: Institute for Research on Public Policy, 1988); Frank Stone, "Comments" on the Hudec paper in the same volume; and William Graham"The Role of the Commission in the Canada-U.S. Free Trade Agreement: A Canadian Perspective," in Proceedings of a conference sponsored by the American Bar Association on the United States/Canada Free Trade Agreement: The Economic and Legal Implications, Washington, January 28-29, 1988. A more sympathetic analysis of the dispute resolution is provided by Gary N. Horlick, Geoffrey D. Oliver and Debra P. Steger, "Dispute Resolution Mechanisms," in Schott and Smith, *The Canada-United States Free Trade Agreement: The Global Impact*.

Nineteen calling for a secretary to act as a repository for appeals.[36] This provision could eventually form the basis for a secretariat whose primary purpose would be to serve the agreement and ensure its proper functioning, as the GATT secretariat has done for the GATT for the past forty years.

One of the reasons Canada was prepared to settle for less ambitious dispute settlement provisions was the separate but temporary regime negotiated on the most difficult substantive issue, trade remedies. These provisions, therefore, must also be viewed as part of the dispute settlement package.

In the first place, the two governments agreed to continue to work toward a new regime, obviating the need for border remedies by the development of new rules on subsidy practices and by relying on domestic competition laws. They have given themselves seven years to achieve this goal. Failure to reach agreement at the end of seven years would bring the whole free-trade agreement into question.

In the meantime, the two governments have agreed to a unique mechanism to settle any disputes regarding the application of their respective antidumping and countervailing duty laws. Either government may seek a review of an antidumping or countervailing duty determination by a bilateral panel with binding powers. Producers in both countries will continue to have the right to seek redress from dumped or subsidized imports, but any relief granted will be subject to challenge and review by a binational panel which will determine whether existing laws were applied correctly and fairly. Such bilateral panels will take on the judicial review function of the Court of International Trade in the United States and the Federal Court in Canada. Canadian producers who have in the past complained that political pressures in the United States have disposed U.S. officials to side with complainants will now be able to appeal to a bilateral tribunal.

Findings by a panel will be binding on both governments. Should the panel determine that the law was properly applied, the matter is closed. If it finds that the administering authority (the Department of Commerce or the International Trade Commission in the United States or

36 This would be similar to what happened in GATT where three references to an Executive Secretary provided the basis for building a large and active secretariat over the years.

the Department of National Revenue or the Canadian Import Tribunal in Canada) erred on the basis of the same standards as would be applied by a domestic court, it can send the issue back to the administering authority to correct the error and make a new determination.

Finally, the two governments agreed that changes to existing anti-dumping and countervailing duty legislation will apply to each other only following consultation and if specifically provided for in the new legislation. Moreover, either government may ask a bilateral panel to review such changes in light of the object and purpose of the agreement and their rights and obligations under the GATT Anti-dumping and Subsidies Codes. Should a panel recommend modifications, the parties will consult to agree on such modifications. Failure to reach agreement gives the other party the right to take comparable legislative or equivalent executive action or terminate the agreement.

The two governments have also agreed to stringent standards for the application of emergency safeguards to bilateral trade. For the transition period only (i.e., until the end of 1998), either country may respond to serious injury to domestic producers resulting from the reduction of tariff barriers under the agreement with a suspension of the duty reductions for a limited period of time or a return to the most-favoured-nation tariff level. No measure can last more than three years or extend beyond December 31, 1998. Any such action will also be subject to compensation by the other country, for example, through accelerated duty elimination on another product.

Additionally, they have agreed to exempt each other from global actions under GATT Article XIX except where the other's producers are important contributors to the injury caused by a surge of imports from all countries. Should either government take global emergency action, however, companies in the other country will not be allowed to rush in and take advantage of the situation. Any surge in exports in those circumstances may lead to their inclusion in the global action. Should the other Party be included in a global action either initially or subsequently, its exports will be protected against reductions below the trend line of previous bilateral trade with allowance for growth. Again, any emergency measures applied between the two countries will be subject to compensation.

Any dispute as to whether the conditions for imposing a bilateral measure, for including the other Party in a global action or for

determining the adequacy of compensation will be subject to binding arbitration after the action has been taken. Failure to meet the requirements would result in removal of the measure and, if appropriate, compensation.

Conclusions

Both governments recognize that the provisions dealing with dispute settlement and trade remedy law required compromises. For trade remedy law, two-thirds of the job remains to be done, the more difficult two-thirds. Only the safeguard provisions are meant to be final. Despite their temporary character, however, the provisions addressing countervail and antidump are an important step in the right direction. The general dispute settlement provisions rely heavily on bilateral negotiation and do not include any permanent machinery, weaknesses which critics believe will place additional strains on the bilateral relationship. Nevertheless, there are important positive features.

The United States, despite a strong inclination to the contrary, has agreed that in a free-trade agreement there is a bilateral dimension to the application of its trade remedy laws. It therefore agreed to subject decisions by its domestic agencies to bilateral review rather than domestic judicial review and to make decisions by a bilateral panel final and binding. It also agreed that it cannot change its laws in this area without taking account of its new obligations to Canada and again, to let a bilateral panel determine whether it has faithfully discharged this obligation. In effect, the two governments replaced unilateral judicialization with bilateral judicialization. The practical impact of these obligations will become evident in the years to come and will be particularly important in defining how the general dispute settlement obligations will grow. The psychological impact, however, can be measured now. These obligations constitute a very major breakthrough and give room for optimism that the two governments will be able to develop new trade remedy rules and will rely on bilateral decision-making rather than unilateralism in settling disputes between them.